

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

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM APRIL 1, 2001 TO DECEMBER 31,
2001

COMMISSION FILE NUMBER 000-28275

[PFSWEB, INC. LOGO]
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)
500 NORTH CENTRAL EXPRESSWAY, PLANO, TEXAS
(Address of principal executive offices)

75-2837058
(I.R.S. Employer
Identification Number)
75074
(Zip code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE:
972-881-2900

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
COMMON STOCK, PAR VALUE \$.001 PER SHARE

Indicate by a 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 a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 28, 2002 (based on the closing price as reported by the National Association of Securities Dealers Automated Quotation System) was \$15,429,859.

As of February 28, 2002, there were 18,149,496 shares of the registrant's Common Stock, \$.001 par value, outstanding, excluding 86,300 shares of common stock in treasury.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Annual Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of stockholders to be held in June 2002, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Annual Report relates.

INDEX

PAGE ---- PART I Item 1.

Business.....	2	Item
2. Properties.....	27	
Item 3. Legal Proceedings.....		
27	Item 4. Submission of Matters to a Vote of Security	
27	Item 5. Market for Registrant's Common	
	Equity and Related Stockholder	
Matters.....	28	Item 6. Selected
Consolidated Financial Data.....	28	Item 7.
Management's Discussion and Analysis of Financial Condition and		
Results of Operations.....	30	Item 7a.
Quantitative and Qualitative Disclosures about Market		
Risk.....	43	Item
8. Consolidated Financial Statements and Supplementary Data....	44	
Item 9. Changes in and Disagreements with Accountants on Accounting		
and Financial Disclosure.....	87	PART
III	Item 10. Directors and Executive Officers of the	
Registrant.....	87	Item 11. Executive
Compensation.....	87	Item 12.
Security Ownership of Certain Beneficial Owners and		
Management.....	87	Item
13. Certain Relationships and Related Transactions.....	87	
PART IV	Item 14. Exhibits, Consolidated Financial Statement	
Schedules, and Reports on Form 8-		
K.....	87	
Signatures.....		
	92	

Unless otherwise indicated, all references to "PFSweb," "the Company," "we," "us" and "our" refer to PFSweb, Inc., a Delaware corporation, and its subsidiaries. All references to "Daisytek" refer to our former parent corporation, Daisytek International Corporation, a Delaware corporation, and its subsidiaries. Reference in this Report to the Company's fiscal year means the 12 month period ending on March 31 of such year. In June 2001, the Company elected to change its fiscal year end date from March 31 to December 31. Consequently the Company's most recently completed fiscal period is a nine month period ended December 31, 2001.

PART I

ITEM 1. BUSINESS

GENERAL

PFSweb serves as the "brand behind the brand" for companies seeking to increase their supply chain efficiencies. As a business process outsourcer, offering scalable, cost effective, multi-channel infrastructure solutions for manufacturers, distributors and retailers, we are able to provide our clients with seamless and transparent solutions to support their business strategies. Utilizing our technology and infrastructure expertise, we enable our clients to develop and deploy new products and new business strategies rapidly through our solutions. Our clients engage us as both a consultant to assist them in the design of a business solution, as well as the virtual and physical infrastructure needed to build and operate that solution.

We help our clients define new ways to do business, allowing them the ability to quickly and dramatically change how they 'go-to-market.' Each client has unique specifications that require highly customized solutions. Clients turn to us to help address such business issues as customer satisfaction, production capacity requirements, vendor integration, supply chain compression, and international expansion, among others. We also act as an agent of change providing clients the ability to alter the distribution channel, establish direct relationships with key clients, and reduce the time and costs associated with existing distribution channel strategies. Our clients are seeking solutions that will provide them substantial supply chain and channel marketing efficiencies, while simultaneously creating a world-class customer service experience.

Our technology and business infrastructure are adaptable, changeable and reliable. This flexibility allows us to design custom, variable cost solutions to fit the business requirements of our client's strategies. Our revenue is primarily earned from service fees charged to process individual business transactions on our client's behalf through our technology and infrastructure capabilities. These business transactions may include the answering of a phone call or an e-mail, the design and hosting of a client web-site, the processing of an electronic credit card authorization, the receipt and storage of our client's inventory, the assembly of a kit of products to meet our customers specifications, the shipping of products to our client's customer, the management of a complex set of electronic data transactions designed to keep our client's suppliers and customers accounting records in balance, or the processing of a returned package.

Our capabilities are quite expansive. In an ongoing quest to offer the most necessary and resourceful products to our clients, we are continually developing capabilities to meet the most pressing business issues in the marketplace. Our business objective is to focus on "Leading the Evolution of Outsourcing." As our tagline suggests, we will continue to evolve our service offerings to meet the needs of the marketplace and the demands of the unique client requirement. We are most successful when we develop a new capability to enable a client to pursue a new initiative and we are then able to leverage that revolutionary development across other client or prospect solutions as it becomes "best practice" in the marketplace. Our team of experts design and build diverse solutions for Fortune 1000, Global 2000 and brand name clients around a flexible core of technology and physical infrastructure that includes:

- Technology collaboration provided by our suite of software products, called the Entente Suite(SM), that are e-commerce and collaboration tools that enable buyers and suppliers to fully automate their business transactions within their supply chain. Entente supports industry standard collaboration techniques including XML based protocols such as Biztalk and RosettaNet, real-time application interfaces, text file exchanges via secured FTP, and traditional electronic data interchange ("EDI");
- Managed Web hosting and Web development, including web site design, creation, integration and ongoing maintenance, support and enhancement of web site;
- Order Management, including order processing from any source of entry, back order processing and future order processing, tracking and tracing, credit management, all with multiple currency and language options;

- Customer Relationship Management ("CRM"), including interactive voice response ("IVR") technology and web-enabled customer contact services through world-class call centers utilizing voice, e-mail, voice over Internet protocol ("VOIP") and Internet chat communications that are fully integrated with real-time systems and historical data archives to provide complete customer lifecycle management;
- International fulfillment and distribution services, including warehouse management, inventory management, product warehousing, order picking and packing, transportation management and reverse logistics;
- Kitting and assembly services, including light assembly, procurement services, Supplier Relationship Management, specialized kitting, and supplier consigned inventory hubbing in PFSweb's distribution facilities or co-located in other facilities;
- Information management, including real-time data interfaces, data exchange services and data mining;
- Financial services, including secure on-line credit card processing, fraud protection, invoicing, credit management and collection, and working capital solutions; and
- Professional consulting services, including a consultative team of experts that customize solutions to each client and consistently seek out ways to increase efficiencies and produce benefits for the client.

We are headquartered in Plano, Texas where our executive and administrative offices are located as well as our primary technology laboratories and hosting facilities. We operate state-of-the-art call centers from our U.S. facilities located in Plano, Texas, and Memphis, Tennessee, and from our international facilities located in Toronto, Ontario and Liege, Belgium. We have more than one million square feet of warehouse floor space located across our facilities in Memphis, Toronto and Liege allowing us to provide global distribution solutions. These distribution facilities are highly automated and contain state of the art material handling and communications equipment. We provide solutions to clients that are often regarded as market leaders in a variety of different industries. Those industries include technology manufacturing, telecommunications, computer consumables, direct marketing, apparel, retailing, collectibles, consumer goods, personal care/cosmetics, pharmaceuticals, housewares and consumer electronics, among others.

Prior to December 1999, we were a wholly-owned subsidiary of Daisytek International Corporation ("Daisytek"), one of the world's largest wholesale distributors of computer supplies, office products, and film and tape media. Our business unit was formed in 1991 to leverage Daisytek's core competencies in customer service, order management, product fulfillment and distribution. From 1996 to 1999, the operations of our business unit were primarily focused in several Daisytek subsidiaries operating collectively as Priority Fulfillment Services, Inc. ("PFS"). In June 1999, Daisytek created a separate wholly owned subsidiary named PFSweb, Inc., a Delaware corporation, to become a holding company for PFS in contemplation of an initial public offering (the "Offering") of PFSweb. In December 1999, we sold 3,565,000 shares of common stock in the Offering and Daisytek contributed to us all the assets, liabilities and equity comprising PFS. PFSweb and Daisytek completed their separation on July 6, 2000 through a pro rata distribution to Daisytek's common stockholders of all of the shares of our common stock which Daisytek then held (the "spin-off").

Upon completion of the Offering, we entered into a number of agreements with Daisytek relating to our business and our proposed spin-off from Daisytek. See "Spin-off of PFSweb from Daisytek." In May 2001, certain of these agreements were terminated as part of a transaction in which we sold to Daisytek certain assets used to provide transaction management services to Daisytek. As part of this sale transaction, we also entered into a short term transition services agreement with Daisytek which expired in November 2001.

Although we continue to be party to certain agreements with Daisytek relating to the spin-off, we do not currently generate any revenues or incur any expenses related to services for Daisytek.

INDUSTRY OVERVIEW

Business activities in the public and private sectors operate in an environment of rapid technological advancement, increasing competition and continuous pressure to improve operating and supply chain efficiency. In response to these developments, several significant trends have emerged. For example:

- Manufacturers are looking to restructure their supply chains to maximize efficiency and reduce costs in both business-to-business and business-to-consumer markets and to create a variable-cost supply chain that is able to support the multiple unique needs of each of their initiatives, including traditional and electronic commerce.
- Government agencies are focusing on improved citizen usability and interaction, as well as the need to manage government initiatives from an efficiency perspective.
- Companies in a variety of industries are using outsourcing as a method to address one or more business functions that are either not within their core business competencies, or to improve the speed or cost of implementation.

SUPPLY CHAIN MANAGEMENT TREND

As companies continue to focus on improving their businesses and balance sheet financial ratios, significant efforts and investments are being contemplated and made to identify ways to maximize supply chain efficiency. Working capital financing, vendor managed inventory, supply chain visibility software solutions, distribution channel skipping, direct to consumer e-commerce sales initiatives, and complex upstream supply chain collaborative technology are products that manufacturers seek to help them achieve greater supply chain efficiency. AMR Research predicts that the Supply Chain Management Market, which we believe includes the type of products described above, will increase from \$6.7 billion in 2001 to nearly \$21.1 billion by 2005.

A key business challenge facing many manufacturers and retailers as they evaluate their supply chain efficiency is in determining how the trend for consumers to shop via the Internet in an electronic commerce fashion will affect their traditional commerce business model. AMR Research predicts that between January 2002 and January 2003, companies will continue to increase spending associated with eBusiness by 7%. While many leading industry experts have tempered their e-commerce growth trend estimates downward over the past year, we believe that companies will still need to continue to strategically plan for the impact that e-commerce and other new technology advancements will have on their traditional commerce business models and their existing technology and infrastructure capabilities. eMarketer predicts that by 2004, business-to-business e-commerce worldwide will reach \$2.367 trillion up from \$474 billion in 2001. While the majority of online transactions currently occur in the United States and North America, in the coming years we believe that certain Asian and European nations will experience significant growth in e-commerce transactions as well.

Manufacturers, as buyers of materials, are also imposing new business practices and policies on their supplier partners in order to shift the normal supply chain costs and risk associated with inventory ownership away from their own balance sheets. Through techniques like Vendor Managed Inventory ("VMI") or Consigned Inventory Programs ("CIP") manufacturers are asking their suppliers, as a part of the supplier selection process, to provide capabilities where the manufacturer need not own, or even possess, inventory prior to the exact moment that unit of inventory is required as a raw material component or for shipping to a customer. In order to be successful for all parties, business models such as these often require a sophisticated collection of technological capabilities that allow for complete integration and collaboration of the information technology environments of both the buyer and supplier. For example, in order for an inventory unit to arrive at the precise required moment in the manufacturing facility, it is necessary for the Manufacturing Resource Planning ("MRP") systems of the manufacturer to integrate with the CRM systems of the supplier. When hundreds of supplier partners are involved, this process can become quite complex and technologically challenging. Buyers and suppliers are seeking solutions that utilize XML based protocols like Biztalk, RosettaNet and other traditional EDI standards in order to insure an open systems platform that promotes easier technology integration in these collaborative solutions.

GOVERNMENT OUTSOURCING TREND

The United States government has increased its focus on streamlining work efforts and reducing overall governmental costs, which has led to further evaluation of outsourcing as a possible avenue to achieve these goals. The federal government has formulated an E-Government strategy, which was created to support multi-agency projects that improve citizen services and yield performance gains. Also, recent revisions to government mandate A-76 state that Government agencies must conduct thorough audits to determine the lowest cost and most efficient option, and to outsource to the public sector when in-house operations are unable to compete.

With more than 60% of all Internet users coming into contact with government websites, the necessity to transform business into a more citizen-friendly environment is even more prevalent. As stated in the February 2002 E-Government Strategy document developed by the U.S. Office of Management and Budget (OMB) E-Government task force, the primary goals for this initiative are to:

- Make it easy for citizens to obtain service and interact with the federal government;
- Improve government efficiency and effectiveness; and
- Improve the government's responsiveness to citizens.

Based on the U.S. federal budget, federal information technology (IT) spending in the United States will exceed \$48 billion in 2002 and \$52 billion in 2003. This level of IT spending provides enormous opportunities for the government to transform itself into a citizen-centered E-Government and provides additional opportunities for the government to work with the public sector to develop more user friendly methods of interaction. A significant portion of current federal IT spending is devoted to Internet initiatives, yielding more than 35 million web pages online at more than 22,000 web sites. Past agency-centered IT approaches have limited the government's productivity gains and ability to serve citizens. With this initiative, the federal government is poised to transform the way it does business with citizens through the use of E-Government.

The 2002 E-Government Strategy document goes on to state, "E-Government provides many opportunities to improve the quality service to citizens. Citizens should be able to get service or information in minutes or hours, versus today's standard of days or weeks. Citizens, businesses and state and local governments should be able to file required reports without having to hire accountants and lawyers. Government employees should be able to do their work as easily, efficiently and effectively as their counterparts in the commercial world. Effective execution of this strategy are targeted to:

- Simplify delivery of services to citizens;
- Eliminate layers of government management;
- Make it possible for citizens, businesses, other levels of government and federal employees to easily find information and get service from the federal government;
- Simplify agencies' business processes and reducing costs through integrating and eliminating redundant systems;
- Enable achievement of the other elements of the President's Management Agenda; and
- Streamline government operations to guarantee rapid response to citizen needs."

E-Government Strategy activities are centered on four citizen-centered groups, including:

- Individuals/Citizens: Government-to-Citizens(G2C);
- Businesses: Government-to-Business(G2B);
- Intergovernmental: Government-to-Government(G2G);
- Intra-governmental: Internal Efficiency and Effectiveness(IEE);

Through the new Government E-Strategy, Government agencies are currently faced with pressure to upgrade technology capabilities and to better interface with their audiences. Combined with the A-76 initiative that directs Government agencies to pursue the most cost-effective method of doing business, current federal strategy now enforces government's need to better understand public alternatives, submit to extensive requests for proposals to an array of government and non-government providers, and to perform complex evaluations of existing operations and functions. These initiatives will drive government usage of outside sources.

OUTSOURCING TREND

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

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

As a result, the market for outsourcing services and external services has experienced significant growth. Gartner Dataquest predicts that the U.S. external services market will reach \$276 billion in 2002, an 8% increase over the \$254 billion spent in 2001. By 2005, they expect the industry to surpass \$395 billion. Gartner Dataquest defines external services to include consulting, application development and integration, management services and outsourcing, business process management, transaction processing, hardware and software support, and education and training. Gartner Dataquest foresees the Business Process and Transaction Management (BPTM) services to have a strong growth rate as enterprises attempt to reduce the cost of transaction processing in noncore areas by turning to external suppliers. Worldwide BPTM services are expected to total \$145.2 billion in 2005, as compared to \$74.8 billion in 2000.

Typically, outsourcing service providers are focused on a single function, such as information technology, call center management, credit card processing, warehousing or package delivery. This focus creates several challenges for companies looking to outsource more than one of these functions, including the need to manage multiple outsourcing service providers, to share information with service providers and to integrate that information into their internal systems. Additionally, the delivery of these multiple services must be transparent to the customer and enable the client to maintain brand recognition and customer loyalty.

Furthermore, traditional commerce outsourcers are frequently providers of domestic-only services versus international solutions. As a result, companies requiring global solutions must establish additional relationships with other outsourcing parties.

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

THE PFSWEB SOLUTION

PFSweb serves as the "brand behind the brand" for companies seeking to increase the efficiencies of all aspects of their supply chain.

Our value proposition is to become an extension of our clients' businesses by delivering a superior experience that increases and enhances sales and market growth, customer satisfaction and customer retention. We act as both a virtual and a physical infrastructure for our clients' businesses. By utilizing our services, our clients are able to:

Quickly Capitalize on Market Opportunities. Our solutions empower clients to rapidly implement their supply chain and e-commerce strategies and to take advantage of opportunities without lengthy integration and implementation efforts. We have ready built technology and physical infrastructure that is flexible in its design, which facilitates quick integration and implementation. Currently, PFSweb operates with substantial capacity in its call center, technology and distribution areas further aiding our clients' speed to market. The PFSweb solution is designed to allow our clients to deliver consistent quality service as transaction volumes grow and also to handle daily and seasonal peak periods. Through our international locations, our clients can use the broad reach of the Internet and e-commerce to sell their products almost anywhere in the world..

Improve the Customer Experience. We enable our clients to provide their customers with a positive buying experience thereby maintaining and promoting brand loyalty. Through our use of advanced technology, we can respond directly to customer inquiries by e-mail, voice or data communication and assist them with on-line ordering and product information. We offer our clients a "world class" level of service, including 24-hour, seven-day-a-week, Web-enabled customer care service centers, detailed CRM and exceptional order accuracy. We have significant experience in the development of Internet web sites that allows us to recommend features and functions that are easily navigated and understood by our client's customers. Our technology platform is designed to ensure high levels of reliability and fast response times for our clients' customers. Because our technology is "world-class" our clients benefit from being able to offer the latest in customer communication and response conveniences to their customers.

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

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

THE PFSWEB STRATEGY

Our objective is to grow by being an international provider of integrated business process outsourcing solutions. As this evolution of our business model continues, we remain focused today on the following fundamentals:

Focus on quality performance for our existing clients. By providing our existing clients with superior operating results, we believe we can expand relationships within these existing client accounts to service additional product categories and business segments and to provide other additional services. Our objective is to integrate ourselves to the point that we become our clients' operations and technology departments. Based upon our clients' needs, we will continue to introduce new services and products. We also intend to continue our commitment to invest in state-of-the-art technology, equipment and systems to provide new, high-quality, innovative solutions to our existing clients and to attract new clients.

Engaging clients with founded business strategies and financial stability. We intend to expand our business by targeting major brand name companies with proven and founded business models that are seeking to adjust their supply chain strategy or introduce new products or business programs into their existing business. We believe these companies will be the leaders in the evolving marketplace, and this focus will provide us with opportunities to grow along with our clients' strategic initiatives.

Hiring, retaining and training high quality professionals. Our team of people and their experience are crucial elements in the expansion of our business because of the uniqueness of analyzing and developing successful solutions to each individual client's business case. Hiring and retaining high quality individuals who can design expert business solutions for our prospective clients will allow PFSweb to continue to extend its expertise, knowledge, and strategy to potential clients.

Inventing new technology and operational capabilities. We intend to aggressively expand our market potential by inventing new technology and operational capabilities that will continue to clearly differentiate PFSweb from its competitors. We believe that companies are looking for new efficiencies that they can utilize to reduce costs and save time. Based upon our clients' and prospective clients' needs we will continue to evolve and develop solutions that can produce the most positive changes within their organizations.

Controlling overhead costs while focusing on reducing our own excess infrastructure. We intend to continue our focus on controlling overhead costs in order to maintain our strong financial position. Our objective is to seek new business to absorb current excess capacity and to reduce our overhead costs as a percent of revenue. Through the successful execution of this strategy, it is our objective to create a strong springboard towards achieving sustainable profitability.

Seeking strategic opportunities, including acquisitions, that may further our growth objectives. We intend to examine all possible avenues for business growth, including acquisitions and strategic alliances. These alliances may include relationships with consultants, software companies and other providers of technology related services to assist in developing relationships with major brand names that are reevaluating their current infrastructure. We may also consider acquisitions of, or mergers with, synergistic businesses in order to further expand our solution offering and client base, as well as to enhance shareholder value.

To execute these strategies we may, among other things, continue to incur significant operating and marketing expenses, invest in additional technology infrastructure and continue to maintain certain excess capacity. The successful balance of the execution of these strategies over the next year, we believe, should result in the formation of a solid strategic and financial foundation for PFSweb and provide PFSweb a sustainable and profitable business model for the future.

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

PFSWEB SERVICES

We offer a comprehensive and integrated set of business infrastructure solutions that are tailored to our clients' specific needs and enable them to quickly and efficiently implement their supply chain strategies. Our services include:

Technology Collaboration. Specifically for e-commerce initiatives, PFSweb has created the Entente Suite(SM), which alludes to the level of electronic cooperation that is possible when we construct solutions with our clients using this technology. This set of software solutions enables everything from order processing and inventory reporting to total e-commerce design and implementation. The Entente Suite comprises four key components -- EntenteDirect(SM), EntenteMessage(SM), EntenteWeb(SM) and EntenteReport(SM).

EntenteDirect provides customers with a real-time, user-friendly interface between their system and PFSweb order processing and related functions. Using real-time or batch processes, EntenteMessage is a file delivery solution for clients using warehousing and distribution facilities. EntenteWeb is a one-stop shop for the entire e-commerce process, particularly for companies with unusual needs or specific requests that can't be met by the typical e-commerce development packages. EntenteWeb is particularly focused to enable global commerce strategies with its extensive currency and language functionality. EntenteReport is a real-time, user-friendly data mining tool particularly suited to companies that need to put key e-commerce data into the hands of business users, but do not have the IT resources to facilitate the necessary data extraction, manipulation and presentation. EntenteReport is web browser-based and simplifies even the most complex data for extraction and analysis.

The Entente Suite operates in an open systems environment and features the use of industry-standard XML, enabling customized e-commerce solutions with minimal changes to a client's or our Enterprise Resource Planning ("ERP") systems, speeding the implementation process. Additionally, by using XML, the Entente Suite offers companies a more robust electronic information transfer option than text file FTP or EDI.

Managed Web Hosting and Web Development. We offer a highly available and secure managed web hosting solution that encompasses complete creation and maintenance of client web sites. Operating with an in-house creative staff, we customize commerce enabled client sites to their exact specifications and requirements. As with all major brand name companies, consistency within the brand image is vital; therefore, our design engineers create sites that seamlessly integrate and mirror the exact brand image of our clients. By operating on IBM enterprise systems and utilizing our state of the art Entente Suite technology along with Microsoft .Net technologies, we can maintain a robust hosting environment where client sites reside, maintain and update all necessary infrastructure.

Specifically through the EntenteWeb package, clients can build an e-commerce initiative with relatively low investment and in a time efficient manner. EntenteWeb is a complete front-to-back e-commerce solution which incorporates components ranging from the look of the user interface to specific business purchasing, warehousing and shipping needs, enabling companies to define in exact terms their desired e-commerce site functionality.

Order Management. Our order management solutions provide clients with interfaces that allow for real-time information retrieval, including information on product orders, shipment, delivery and customer history. These solutions are seamlessly integrated with our Web-enabled customer contact centers, allowing for the processing of orders through shopping cart, phone, fax, mail, email, Web chat, and other order receipt methods. As the information backbone for our total supply chain solution, order management services can be used on a stand alone basis or in conjunction with our other business infrastructure offerings, including customer contact, financial or distribution services. In addition, for the business-to-business market, our technology platform provides a variety of order receipt methods that facilitate commerce within various stages of the supply chain. Our systems provide the ability for both our clients' and their customers to track the status of orders at any time. Our services are transparent to our clients' customers and are seamlessly integrated with

our clients' internal systems platforms and Web sites. By synchronizing these activities, we can capture and provide critical customer information, including:

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

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

An important feature of evolving commerce remains the ability for the customer to speak with a live customer service representative. Our experience has been that a majority of consumers tell us that they visited the Web location for information, but only a fraction of those consumers chose to place their order online. Our customer care services utilize features that integrate voice, e-mail, data and Internet chat communications to respond to and handle customer inquiries. Our customer care representatives answer various questions, acting as virtual representatives of our client's organization, regarding order status, shipping, billing, returns and product information as well as a variety of other questions. Our Web-enabled customer care technology identifies each customer contact automatically and routes it to the available customer care representative who is individually certified in the client's business and products. Our web-enabled customer care centers are designed so that our customer care representatives can handle many different clients and products in a shared environment, thereby creating economy of scale benefits for our clients as well as highly customized dedicated support models that provide the ultimate customer experience and brand reinforcement. Our advanced technology also enables our representatives to up-sell, cross-sell and inform customers of other products and sales opportunities. The Web-enabled customer care center is fully integrated into the data management and order processing system, allowing full visibility into customer history and customer trends. Through this fully integrated system we are able to provide a complete CRM solution.

With the need for efficiency and cost optimization for many of our clients, we have integrated IVR as another option for customer contacts. IVR creates an "electronic workforce" with virtual agents that can assist customers with vital information at any time of the day or night. IVR allows for our clients' customers to deal interactively with our system to handle basic customer inquiries, such as account balance, order status, shipment status, catalog requests, product and price inquiries, and routine order entry for established customers. The inclusion of IVR to our service offering allows us to offer a cost effective way to handle high volume, low complexity calls.

International Fulfillment and Distribution Services. An integral part of our business process outsourcing solutions is the warehousing and distribution of inventory owned by our clients. We currently have more than one million square feet of warehouse space domestically and internationally to store and process our clients' inventory. We receive client inventory in our distribution centers, verify shipment accuracy, unpack, inspect for damage and stock for sale the same day. On behalf of our clients, we pick, pack and ship their customer

orders and can provide customized packaging, inserts and promotional literature for distribution with customer orders. Based upon our clients' needs, we are able to take advantage of a variety of shipping and delivery options, including next day service. Our facility is equipped with multi-carrier functionality, allowing us to integrate with all major shipping carriers and provide a comprehensive transportation management offering. In addition, an increasingly important function that we provide for our clients is reverse logistics management. We offer a wide array of product return services for our clients, including issuing return authorizations, receipt of product, crediting customer accounts, and disposition of returned product.

Our distribution facilities contain computerized sorting equipment, powered material handling equipment, scanning and bar-coding systems and automated conveyors, in-line scales, x-ray equipment and digital cameras to photograph shipment contents for automatic accuracy checking. Our international distribution complexes include several advanced technology enhancements, such as radio frequency technology in product receiving processing to ensure accuracy, an automated package routing system and a "pick to light" paperless order picking system. Our advanced distribution systems provide us with the capability to currently warehouse an extensive number of stock keeping units (SKUs) for our clients ranging from high-end laser printers to cosmetic compacts. Our facilities are flexibly configured to process business-to-business and single pick business-to-consumer orders from the same central location.

During 2001, we warehoused, managed and fulfilled approximately \$1 billion in client merchandise and transactions. This does not represent our revenue, but rather the revenue of our clients' transactions for whom we provided e-business infrastructure solutions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Kitting and Assembly Services. Our expanded kitting and assembly services reduce the time and costs associated with managing multiple suppliers, warehousing hubs, and light manufacturing partners. As a single source provider, we provide clients with the advantage of convenience, accountability and speed. Our comprehensive kitting and assembly services provide a quality one-stop resource for any international channel. PFSweb's kitting and assembly service includes light assembly, specialized kitting and supplier-consigned inventory hubbing either in our distribution facilities or co-located elsewhere. We also offer customized light manufacturing and Supplier Relationship Management ("SRM") for Fortune 1000 and Global 2000 manufacturers.

Combining our assembly services with our supplier-owned inventory hub services allows our clients to reduce cycle times, to compress their supply chains and to consolidate their operations and supplier management functions. We have supplier inventory management, assembly and fulfillment services all in one place, providing greater flexibility in product line utilization, as well as rapid response to change orders or packaging development. Our standard capabilities include: build-to-order, build-to-stock, expedited orders, passive and active electrostatic discharge ("ESD") controls, product labeling, serial number generation, marking and/or capture, lot number generation, marking, and capture, asset tagging, bill of materials ("BOM") or computer automated design ("CAD") engineering change processing, SKU-level pricing and billing, manufacturing and metrics reporting, first article approval processes, and comprehensive quality controls.

Our kitting and assembly service also includes procurement. We work directly with client suppliers to make Just-in-Time ("JIT") inventory orders for each component in client packages, thereby ensuring the appropriate inventory quantities at just the right time to PFSweb then turned around JIT to customers.

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

Information Management. We have the ability to communicate with and transfer information to and from our clients through a wide variety of technologies, including real-time data interfaces, file transferring

and electronic data interchange. Our systems are designed to capture, store and electronically forward to our clients critical information regarding customer inquiries and orders, product shipments, inventory levels, product returns and other information. We maintain for our clients detailed product master files that can be seamlessly integrated with their Web sites. Our systems are capable of providing our clients with customer and order information for use in analyzing sales and marketing trends and introducing new products. We also offer customized reports or data analyses based upon specific client needs to assist them in their budgeting and business decision process.

Financial Services. Our financial services are divided into two major areas: 1) billing and collection services for business-to-business and business-to-consumer clients and 2) working capital solutions. Through our client financial services, we act as a virtual and physical financial management department for all potential client needs.

We offer secure credit and collections services for both business-to-business and business-to-consumer business. Specifically, for business-to-consumer clients, we offer secure, real-time credit card processing for orders made via a client Web site or through our customer contact center. Additionally, we calculate sales tax, if applicable, for numerous taxing authorities and on a variety of products. Using third-party leading-edge fraud protection services and risk management systems, we can assure the highest level of security and the lowest level of risk for client transactions.

For business-to-business clients, we offer full-service accounts receivable management and collection capabilities, including the ability to generate customized computer-generated invoices in our clients' names. We assist clients in reducing accounts receivable and days sales outstanding, while minimizing costs associated with maintaining an in-house collections staff. In addition, we offer electronic credit services in the format of EDI X.12 and XML communications direct from our clients to their vendors, suppliers and retailers.

PFSweb's affiliate, Supplies Distributors, Inc. provides working capital solutions, which enables manufacturers to remove inventory and receivables from their balance sheets through the use of third party financing. This service offering is available to clients operating in North America and Europe.

While the majority of our clients maintain ownership of their own inventory, we work with Supplies Distributors to create and implement client inventory solutions as well. PFSweb has years of experience in dealing with the issues related to inventory ownership, secure inventory management, replenishment and product distribution. PFSweb and Supplies Distributors can offer prospective clients a management solution for the entire customer relationship, including ownership of inventory and receivables. Through CIP, we utilize technology resources to time the replenishment purchase of inventory with the simultaneous sale of product to the end user. All interfaces are done electronically and all processes regarding the financial transactions are automated, creating significant supply chain advantages.

PFSweb is experienced in the complex legal, accounting and governmental control issues that can be hurdles in the successful implementation of working capital financing programs. Our knowledge and experience help clients achieve supply chain benefits while reducing inventory carrying costs. Substantial benefits and improvement to a company's balance sheet can be achieved through these working capital solutions.

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

Comprised of industry experts from top-tier consulting firms and industry market leaders, our team of professional consultants provides client service focus and logistics and distribution expertise. They have built solutions for Fortune 1000 and Global 2000 market leaders in a wide range of industries, including apparel, computer-related products, telecommunications, cosmetics, housewares, high-value collectibles, sporting goods, pharmaceuticals and several more. Focusing on the evolving infrastructure needs of major corporations

and their business initiatives, our team has a solid track record providing consulting services in the areas of supply chain management, distribution and fulfillment, technology interfacing, logistics and customer support.

CLIENTS AND MARKETING

Our target clients include brand name manufacturers looking to quickly and efficiently implement business initiatives, to adapt their go-to-market strategies, or to introduce new products or programs, without the burden of modifying or expanding their order processing and distribution infrastructure. We also target retailers and direct marketers seeking to expand their sales through new channels as well as government agencies trying to reduce costs and/or increase efficiency, expectations and responsiveness. Our services are available for a multitude of industries and company types, including such clients as:

International Business Machines ("IBM") (printer supplies in several geographic areas), Adaptec (computer accessories), a U.S. Federal Government Unit (as a sub-contractor to IBM Global Services), Avaya Communication, Dell (a computer manufacturer), Emtec Magnetics (a manufacturer of BASF-branded data media and audio visual products), Lancome (a cosmetics division of L'Oreal International), Xerox (printers and printer supplies), Thomson multimedia (RCA branded televisions and consumer electronics), Mary Kay Cosmetics (cosmetics), Pharmacia/Upjohn (pharmaceuticals), Nokia USA.com (cell phone accessories), Roots Canada (apparel), and Hewlett-Packard (printers and computer networking equipment).

We target clients through a direct sales force dedicated to acquiring new business to fuel our growth; through direct marketing to key vertical industry segments where we feel that we are able to provide significant service differentiation; trade shows and industry conferences, trade journal advertising, and our Web site. We also pursue strategic marketing alliances with consultants and other professional firms to generate referrals and customer leads.

Our direct sales force is comprised of dedicated sales professionals whose compensation is tied to their ability to expand our relationships with existing clients and attract new clients. We also employ highly trained implementation managers whose responsibilities include the oversight and supervision of client projects and maintaining high levels of client satisfaction.

TECHNOLOGY

We maintain advanced management information systems and have automated key business functions using on-line, real-time systems. These systems enable us to provide our clients information concerning sales, inventory levels, customer payments and other operations that are essential for our clients to efficiently manage their electronic commerce and supply chain business programs. Our systems are designed to scale rapidly in order to handle the transaction processing demands of our clients.

We employ technology from a selected group of partners, many of which are also our clients. For example, we deploy IBM e-servers and network printers in appropriate models to run Web site functions as well as order management and distribution functions. We utilize Avaya Communication for telephone switch and call center management functions. We also employ Avaya Communication for our Web-enabled customer care center to interact with customers via voice, e-mail or chat. Avaya Communication technology also allows us to share Web pages between customers and our service representatives. We have the ability to transmit and receive voice, data and video simultaneously on a single network connection to a customer to more effectively serve that customer for our client. Clients' interest in using this technology stems from its ability to allow shoppers to consult with known experts in a way that the customer chooses prior to purchasing. Our sophisticated computer-telephony integration has been accomplished by combining systems software from IBM and Avaya Communication together with our own application development. We use AT&T for our private enterprise network and long distance carrier. We use J.D. Edwards as the software provider for the primary ERP applications that we use in our operational areas and financial areas. We use Siemens Dematic/ Rapistan Materials Handling Automation for our automated order selection, automated conveyor and "pick-to-light" (inventory retrieval) systems, and Symbol Technologies/Telxon for our warehouse radio

frequency applications. Our Warehouse Management System ("WMS") is a highly customized J.D. Edwards' system.

Many internal infrastructures are not sufficient to support the explosive growth in e-business, e-marketplaces, supply chain compression, distribution channel realignment and the corresponding demand for real-time information necessary for strategic decision-making and product fulfillment. To address this need, we have created the Entente Suite which is a comprehensive software solution, with supporting services and hardware, that enables companies with little or no e-commerce infrastructure to speed their time to market and minimize resource investment and risk, and allows all companies involved to improve the efficiency of their supply chain. The Entente Suite is comprised of four distinct offerings -- EntenteDirect, EntenteMessage, EntenteWeb, and EntenteReport -- which can stand alone or be combined for a fully customized e-commerce solution depending on the level of direct involvement a company wants to maintain in their e-commerce initiative.

The components of the Entente Suite provide the open platform infrastructure that allows us to create complete e-commerce solutions with our customers. Using the various components of the Entente Suite, we can assist our clients in easily integrating their Web sites or ERP systems to our systems for real-time transaction processing without regard for their hardware platform or operating system. This high-level of systems integration allows our clients to automatically process orders, customer data and other e-commerce information. We also can track information sent to us by the client as it moves through our systems in the same manner a carrier would track a package throughout the delivery process. Our systems enable us to track, at a detailed level, information received, transmission timing, any errors or special processing required and information sent back to the client. The transactional and management information contained within our systems is made available to the client quickly and easily through the Entente Suite.

The Entente Suite serves as a transparent interface to our back-office productivity suite which is a customized JD Edwards order management and fulfillment application that runs on IBM e-Servers. It also is designed to integrate with marketplace technologies offered by major marketplace software companies.

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

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

Our information technology operations and infrastructure are built on the premise of reliability and scalability. We maintain diesel generators and uninterruptible power supply equipment to provide constant availability to computer rooms, call centers and warehouses. Multiple Internet service providers and redundant Web servers provide for a high degree of availability to Web sites that interface with our systems. Capacity planning and upgrading is performed regularly to allow for quick implementation of new clients and avoid time-consuming infrastructure upgrades that could slow growth rates. We also have a disaster recovery plan for our information systems and maintain a "hot site" under contract with a major provider.

COMPETITION

Many companies offer, on an individual basis, one or more of the same services we do, and we face competition from many different sources depending upon the type and range of services requested by a potential client. Our competitors include vertical outsourcers, which are companies that offer a single function, such as call centers, public warehouses or credit card processors. Many of these companies have greater capabilities than we do for the function they provide. We also compete against transportation logistics

providers who offer product management functions as an ancillary service to their primary transportation services. In many instances, our competition is the in-house operations of our potential clients themselves. The in-house operations departments of potential clients often believe that they can perform the same services we do, while others are reluctant to outsource business functions which involve direct customer contact. We cannot be certain that we will be able to compete successfully against these or other competitors in the future.

Although many of our competitors can offer one or more of our services, we believe our primary competitive advantage is our ability to offer a wide array of services that cover a broad spectrum of business processes, including web site design and hosting, kitting and assembly, order processing and shipment, credit card payment and customer service, thereby eliminating any need for our clients to coordinate these services from many different providers. We believe we are unique in offering our clients a very broad range of business process services that addresses, in many cases, the entire business transaction, from demand to delivery.

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

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

We believe that we presently compete favorably with respect to each of these factors. However, the market for our services is becoming more competitive and still evolving, and we may not be able to compete successfully against current and future competitors.

EMPLOYEES

As of December 31, 2001, we had 575 full-time employees and 45 part-time employees, of which 498 were located in the United States. We are not a party to any collective bargaining agreements, and we have never suffered an interruption of business as a result of a labor dispute. We consider our relationship with our employees to be good.

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

REGULATION

Our business may be affected by current and future governmental regulation, both foreign and domestic. For example, the Internet Tax Freedom Act bars state and local governments from imposing taxes on Internet access or that would subject buyers and sellers of electronic commerce to taxation in multiple states. This act is in effect through November 1, 2003. If legislation to extend this act or similar legislation is not enacted, Internet access and sales across the Internet may be subject to additional taxation by state and local governments, thereby discouraging purchases over the Internet and adversely affecting the market for our services.

SPIN-OFF OF PFSWEB FROM DAISYTEK

HISTORY

The PFSweb business unit was formed in 1991 as a subsidiary of Daisytek named "Working Capital of America" whose purpose was to provide inventory management, direct shipping to end-users, and accounts receivable collections for Daisytek customers and other third parties. Until 1996, this business unit was comprised of operations both at Working Capital of America and at Daisytek. As the business gradually developed, this business unit recognized an opportunity to expand its business and capitalize on Daisytek's strengths in customer service, order management, product fulfillment and distribution, and provide these services on an outsourcing basis. Since 1996, the operations of this business unit have been primarily focused in PFS. PFSweb was formed in 1999 to be a holding company for PFS and to facilitate the Offering and spin-off from Daisytek. In December 1999, we completed the Offering and entered into various agreements with Daisytek relating to the spin-off. Under these agreements, the spin-off was conditioned upon, among other things, the receipt of a ruling by the Internal Revenue Service ("IRS") that, among certain other tax consequences of the transaction, the spin-off qualify as a tax-free distribution for U.S. federal income tax purposes and not result in the recognition of taxable gain or loss for U.S. federal income tax purposes to Daisytek or its shareholders (the "IRS Ruling"). On June 8, 2000, Daisytek received the IRS Ruling and the Daisytek board of directors approved the spin-off and authorized the distribution of 14,305,000 shares of PFSweb common stock to the holders of Daisytek common stock. The distribution was made at the close of business on July 6, 2000 to Daisytek stockholders of record as of June 19, 2000.

PFSWEB'S RELATIONSHIP WITH DAISYTEK

At the time of the Offering, PFSweb and Daisytek entered into various agreements providing for the separation of their respective business operations. These agreements governed various interim and ongoing relationships between the companies, including the transaction management services that PFSweb provided for Daisytek, the transitional services that Daisytek provided to PFSweb and a tax indemnification and allocation agreement which governs the allocation of tax liabilities and sets forth provisions with respect to other tax matters.

All of the agreements between PFSweb and Daisytek were made in the context of a parent-subsidary relationship and were negotiated in the overall context of the spin-off. Although we generally believe that the terms of these agreements are consistent with fair market values, there can be no assurance that the prices charged to or by each company under these agreements are not higher or lower than the prices that may be charged by, or to, unaffiliated third parties for similar services.

Although we continue to be party to certain agreements with Daisytek, such as the Master Separation Agreement, the Tax Indemnification and Allocation Agreement and the Initial Public Offering and Distribution Agreement, we do not currently generate any revenues or incur any expenses related to services for Daisytek.

MASTER SEPARATION AGREEMENT

The Master Separation Agreement sets forth the agreements between PFSweb and Daisytek with respect to the principal corporate transactions required to effect the transfers of assets and assumptions of liabilities necessary to separate the PFSweb business unit from Daisytek and certain other agreements governing this relationship thereafter.

Transfer of Assets and Liabilities. Following completion of the Offering, Daisytek transferred to PFSweb all of the fixed assets in Daisytek's Memphis distribution facility as well as certain assets associated with providing information technology services and the stock of several subsidiaries of Daisytek representing the business operations of PFSweb, and PFSweb transferred to Daisytek approximately \$5 million in cash and assumed approximately \$0.3 million of capital lease obligations, as well as the operating lease obligations related to these assets. PFSweb also repaid to Daisytek, from the net proceeds of the Offering, the aggregate

sum of approximately \$27 million, representing the outstanding balance of PFSweb's intercompany payable to Daisytek.

Indemnification. PFSweb agreed to indemnify Daisytek against any losses, claims, damages or liabilities arising from the liabilities transferred to PFSweb and the conduct of the PFSweb business after the completion of the Offering. Daisytek agreed to retain, and indemnify PFSweb against, any losses, claims, damages or liabilities arising from the conduct of the PFSweb business prior to the completion of the Offering.

INITIAL PUBLIC OFFERING AND DISTRIBUTION AGREEMENT

General. PFSweb and Daisytek entered into an Initial Public Offering and Distribution Agreement which governs their respective rights and duties with respect to the Offering and the spin-off, and sets forth certain covenants to which they are bound for various periods following the Offering and the spin-off.

Preservation of the Tax-free Status of the Spin-off. Daisytek has received a private letter ruling from the Internal Revenue Service to the effect that the spin-off qualifies as a tax-free distribution under Section 355 of the Internal Revenue Code to Daisytek and its stockholders. In connection with obtaining such ruling, certain representations and warranties were made regarding Daisytek, PFSweb and their respective businesses. PFSweb has also agreed to certain covenants that are intended to preserve the tax-free status of the spin-off. These covenants include:

Certain Acquisition Transactions. Until two years after the completion of the spin-off, PFSweb has agreed not to enter into or permit any transaction or series of transactions that would result in a person or persons acquiring or having the right to acquire shares of its capital stock that would comprise 50% or more of either the value of all outstanding shares of its capital stock or the total combined voting power of its outstanding voting stock.

Continuation of Active Trade or Business. Until two years after the completion of the spin-off, PFSweb has agreed to continue to conduct its active trade or business (within the meaning of Section 355 of the Code) as it was conducted immediately prior to the completion of the spin-off. During such time, PFSweb has agreed not to:

- liquidate, dispose of or otherwise discontinue the conduct of any substantial portion of its active trade or business; or
- dispose of any business or assets that would cause it to be operated in a manner inconsistent in any material respect with the business purposes for the spin-off as described in the representations made in connection with Daisytek's request for the IRS Ruling.

Continuity of Business. Until two years after the completion of the spin-off, PFSweb has agreed that it will not voluntarily dissolve or liquidate; and, except in the ordinary course of business, neither it nor any of its direct or indirect subsidiaries will sell, transfer, or otherwise dispose of or agree to dispose of assets (including any shares of capital stock of its subsidiaries) that, in the aggregate, constitute more than 60% of its assets.

Intracompany Debt. Until two years after the completion of the spin-off, PFSweb will not be able to have any indebtedness to Daisytek, other than payables arising in the ordinary course of business.

These covenants will not prohibit PFSweb from implementing or complying with any transaction permitted by an IRS ruling or a tax opinion.

Other Covenants Regarding Tax Treatment of the Transactions. The transfer of assets and liabilities from Daisytek to PFSweb as provided by the master separation agreement (the "Contribution") were intended to qualify as a reorganization under Section 368(a)(1)(D) of the Code (a "D Reorganization"). Until two years after the completion of the spin-off, PFSweb has agreed not to take, or permit any of our subsidiaries to take, any actions or enter into any transaction or series of transactions that would be reasonably likely to jeopardize the tax-free status of the spin-off or the qualification of the Contribution as a D Reorganization, including any action or transaction that would be reasonably likely to be inconsistent with

any representation made in connection with Daisytek's request for the IRS Ruling. PFSweb has also agreed to take any reasonable actions necessary for the Contribution and the spin-off to qualify as a D Reorganization.

Cooperation on Tax Matters. PFSweb and Daisytek have agreed to various procedures with respect to the tax-related covenants described above, and PFSweb is required to notify Daisytek if it desires to take any action prohibited by these covenants. Upon such notification, if Daisytek determines that such action might jeopardize the tax-free status of the spin-off or the qualification of the Contribution as a D Reorganization, Daisytek will either use all commercially reasonable efforts to obtain a private letter ruling from the IRS or a tax opinion that would permit PFSweb to take the desired action or provide all reasonable cooperation to PFSweb in connection with PFSweb obtaining such an IRS ruling or tax opinion. In either case, Daisytek has agreed to bear the reasonable costs and expenses of obtaining the IRS ruling or tax opinion, unless it is determined that PFSweb's proposed action will jeopardize the tax-free status of the spin-off or the qualification of the Contribution as a D Reorganization, in which event PFSweb will be responsible for such costs and expenses.

Indemnification for Tax Liabilities. PFSweb has generally agreed to indemnify Daisytek and its affiliates against any and all tax-related losses incurred by Daisytek in connection with any proposed tax assessment or tax controversy with respect to the spin-off or the Contribution to the extent caused by any breach by it of any of its representations, warranties or covenants. If PFSweb causes the spin-off to not qualify as a tax-free distribution, Daisytek would incur federal income tax (which currently would be imposed at a 35% rate) and possibly state income taxes on the gain inherent in the shares distributed, which would be based upon the market value of the shares of PFSweb at the time of the spin-off. This indemnification does not apply to actions that Daisytek permits PFSweb to take as a result of a determination under the tax-related covenants as described above. Similarly, Daisytek has agreed to indemnify PFSweb and its affiliates against any and all tax-related losses incurred by it in connection with any proposed tax assessment or tax controversy with respect to the spin-off or the Contribution to the extent caused by any breach by Daisytek of any of its representations, warranties or covenants.

Other Indemnification. PFSweb has generally agreed to indemnify Daisytek and its affiliates against all liabilities arising out of any material untrue statements and omissions in PFSweb's prospectus and the registration statement of which it is a part and in any and all registration statements, information statements and/or other documents filed with the SEC in connection with the spin-off or otherwise. However, PFSweb's indemnification of Daisytek does not apply to information relating to Daisytek. Daisytek has agreed to indemnify PFSweb for this information.

Expenses. In general, PFSweb agreed to pay substantially all costs and expenses relating to the Offering, including the underwriting discounts and commissions, and Daisytek agreed to pay substantially all costs and expenses relating to the spin-off.

TAX MATTERS

Daisytek and PFSweb have entered into a Tax Indemnification and Allocation Agreement to govern the allocation of tax liabilities and to set forth agreements with respect to certain other tax matters.

Under the Code, PFSweb ceased to be a member of the Daisytek consolidated group upon the completion of the spin-off.

Daisytek generally will pay all taxes attributable to PFSweb and its subsidiaries for tax periods or portions thereof ending on or before the effective date of the Offering, except to the extent of any accruals thereof on the books and records of PFSweb or its subsidiaries for such taxes under generally accepted accounting principles. Thereafter, for tax periods or portions thereof during which PFSweb was a member of the Daisytek consolidated, combined or unitary group, PFSweb was apportioned its share of the group's income tax liability based on its taxable income determined separately from Daisytek's taxable income, and PFSweb paid its calculated taxes to Daisytek, which will then file a consolidated, combined or unitary return with the appropriate tax authorities. There may be certain U.S. state or local jurisdictions in which PFSweb will file separate income tax returns, not combined or consolidated with Daisytek, for such tax periods. In that

circumstance, PFSweb would file a tax return with the appropriate tax authorities, and pay all taxes directly to the tax authority. PFSweb will be compensated for tax benefits generated by it before tax deconsolidation and used by the Daisytek consolidated group. PFSweb will prepare and file all tax returns, and pay all income taxes due with respect to all tax returns required to be filed by it for all tax periods after it ceased to be a member of the Daisytek consolidated, combined or unitary group.

Daisytek is responsible for most U.S. tax adjustments related to PFSweb for all periods or portions thereof ending on or before the effective date of the Offering. In addition, PFSweb and Daisytek have agreed to cooperate in any tax audits, litigation or appeals that involve, directly or indirectly, periods prior to the time that PFSweb ceased to be a member of the Daisytek consolidated group. PFSweb and Daisytek have agreed to indemnify each other for tax liabilities resulting from the failure to cooperate in such audits, litigation or appeals, and for any tax liability resulting from the failure to maintain adequate records.

Notwithstanding the tax allocation agreement, for all periods in which Daisytek owned 80% or more of PFSweb's capital stock, PFSweb will be included in Daisytek's consolidated group for federal income tax purposes. If Daisytek or other members of the consolidated group fail to make any federal income tax payments, PFSweb will be liable for the shortfall since each member of a consolidated group is liable for the group's entire tax obligation.

Under the Tax Indemnification and Allocation Agreement, Daisytek has agreed to indemnify PFSweb against any taxes resulting from the failure of the spin-off to qualify for tax-free treatment, except that PFSweb will be liable for, and will indemnify Daisytek against, any taxes resulting from the failure of the spin-off to qualify for tax-free treatment if it is the result of PFSweb engaging in a "Prohibited Action" or the occurrence of a "Disqualifying Event." Neither PFSweb nor Daisytek have the option to rescind the spin-off if a tax liability results.

A "Prohibited Action" is defined as:

- if PFSweb takes any action which is inconsistent with the tax treatment of the spin-off as contemplated in the IRS Ruling; or
- if, prior to the spin-off, PFSweb issued shares of stock or took any other action that would result in it not being controlled by Daisytek within the meaning of Section 368(c) of the Code.

A "Disqualifying Event" includes any event involving the direct or indirect acquisition of the shares of PFSweb's capital stock after the spin-off which has the effect of disqualifying the spin-off from tax-free treatment, whether or not the event is the result of our direct action or within PFSweb's control.

TRANSACTION MANAGEMENT SERVICES AGREEMENT

PFSweb and Daisytek entered into a transaction management services agreement which set forth the transaction management services that PFSweb provided for Daisytek. Under this agreement, PFSweb provided a wide range of transaction management services, including information management, order fulfillment and distribution, product warehousing, inbound call center services, product return administration and other services.

As described in "Sale of Assets to Daisytek," effective May 2001, Daisytek and PFSweb terminated the transaction management services agreement.

TRANSITION SERVICES AGREEMENT

Upon completion of the Offering, Daisytek and PFSweb entered into a transition services agreement. Under this agreement, Daisytek provided PFSweb with various services relating to employee payroll and benefits, use of facilities, and other administrative services. Daisytek is no longer providing services to PFSweb under this transition services agreement.

SUBSTITUTE STOCK OPTIONS

In connection with the completion of the spin-off, all outstanding Daisytek stock options were replaced with substitute stock options as described below:

Options held by Daisytek employees who were transferred to PFSweb were replaced (at the option holder's election) with either options to acquire shares of PFSweb common stock or options to acquire shares of both Daisytek common stock and PFSweb common stock (which may be exercised separately) (the "Unstapled Options"). Options held by Daisytek employees who remained with Daisytek were replaced (at the option holder's election) with either options to acquire shares of Daisytek common stock or Unstapled Options.

In general, the adjustments to the outstanding Daisytek options were established pursuant to a formula designed to ensure that: (1) the aggregate "intrinsic value" (i.e. the difference between the exercise price of the option and the market price of the common stock underlying the option) of the substitute options did not exceed the aggregate intrinsic value of the outstanding Daisytek stock option which was replaced by such substitute option immediately prior to the spin-off, and (2) the ratio of the exercise price of each option to the market value of the underlying stock immediately before and after the spin-off was preserved.

Substantially all of the other terms and conditions of each substitute stock option, including the time or times when, and the manner in which, each option will be exercisable, the duration of the exercise period, the permitted method of exercise, settlement and payment, the rules that will apply in the event of the termination of employment of the employee, the events, if any, that may give rise to an employee's right to accelerate the vesting or the time or exercise thereof and the vesting provisions, are the same as those of the replaced Daisytek stock option, except that option holders who are employed by one company will be permitted to exercise, and will be subject to all of the terms and provisions of, options to acquire shares in the other company as if such holder was an employee of such other company.

No adjustment or replacement was made to outstanding PFSweb stock options as a result of the spin-off.

On May 29, 2001, PFSweb repriced and fully vested all PFSweb options then held by Daisytek officers, directors and employees.

BUSINESS SUPPLIES DISTRIBUTORS

PFSweb, Business Supplies Distributors, (a Daisytek subsidiary -- "BSD"), Daisytek and IBM were parties to various Master Distributor Agreements which expired on various dates through September 2001. Under these agreements, BSD acted as a master distributor of various IBM products, Daisytek provided financing and credit support to BSD and PFSweb provided transaction management and fulfillment services to BSD. In July 2001, PFSweb and Inventory Financing Partners, LLC ("IFP") formed Business Supplies Distributors Holdings, LLC ("Holdings"), and Holdings formed a wholly-owned subsidiary, Supplies Distributors. Supplies Distributors, PFSweb and IBM entered into new Master Distributor Agreements to replace the prior agreements. Under these new agreements, Supplies Distributors and its subsidiaries act as master distributors of various IBM products and, pursuant to a transaction management services agreement between PFSweb and Supplies Distributors, PFSweb provides transaction management and fulfillment services to Supplies Distributors. See "Supplies Distributors".

SALE OF ASSETS TO DAISYTEK

In May 2001, we sold to Daisytek certain of our assets used to provide transaction management services to Daisytek and its subsidiaries for a purchase price of \$11 million (\$10 million of which was paid at closing and \$1 million was paid over a six month period ending in November 2001). As part of this transaction, Daisytek and PFSweb terminated the transaction management services agreement described above. As part of this transaction, we entered into a six-month transition services agreement with Daisytek under which we provided certain information technology transition services for a monthly service fee through November 2001.

RISK FACTORS

Our business, financial condition and operating results could be adversely affected by any of the following factors, in which event the trading price of our common stock could decline, and you could lose part or all of your investment. The risks and uncertainties described below are not the only ones that we face. Additional risks and uncertainties not presently known to us, or that we currently think are immaterial, may also impair our business operations.

RISKS RELATED TO OUR BUSINESS

OUR FINANCIAL INFORMATION FOR PERIODS PRIOR TO FISCAL YEAR 2001 MAY NOT BE REPRESENTATIVE OF OUR RESULTS AS A SEPARATE COMPANY.

The financial information for periods prior to fiscal year 2001 included in this Form 10-K may not reflect what our results of operations, financial position and cash flows would have been had we been a separate, stand-alone entity during the periods presented or what our results of operations, financial position and cash flows will be in the future. This is because:

- we made certain adjustments and allocations since Daisytek did not account for us as, and we were not operated as, a single stand-alone business for the periods presented; and
- the information does not reflect many significant changes that occurred in our funding and operations as a result of our new agreements with IBM and our separation from Daisytek.

We cannot assure you that the adjustments and allocations we made in preparing our historical consolidated financial statements appropriately reflect our operations during such periods as if we had, in fact, operated as a stand-alone entity or what the actual effect of our separation from Daisytek would have been. Accordingly, we cannot assure you that our historical results of operations are indicative of our future operating or financial performance.

WE HAVE EXCESS CAPACITY AND NEED MORE REVENUE TO ACHIEVE SUSTAINABLE PROFITABILITY.

We currently have unused space in our call centers and distribution centers and excess capacity in our systems infrastructure. As a result, we are currently incurring losses from operations. In order to properly service our existing clients and attract new clients, it may be difficult or impractical to substantially reduce many of the fixed costs associated with our unused space and excess capacity. Consequently, we may continue to incur losses from operations until we have sufficiently increased our revenue to cover our fixed and variable costs. While we believe that as we add revenue we will be able to cover our existing infrastructure costs, there can be no assurance that we will increase our revenue or achieve sustainable profitability.

OUR REVENUE IS DEPENDENT UPON OUR CLIENTS' BUSINESS AND TRANSACTION VOLUMES; ALL OF OUR CLIENT AGREEMENTS ARE TERMINABLE BY THE CLIENT AT WILL.

Our revenue is primarily transaction based and will fluctuate with the volume of transactions or level of sales of the products by our clients for which we provide transaction management services. If we are unable to retain existing clients or attract new clients or if we dedicate significant resources to clients whose business does not generate substantial transactions or whose products do not generate substantial customer sales, our business may be materially adversely affected. In addition, generally all of our agreements with our clients are terminable by the client at will. Therefore, we cannot assure you that any of our clients will continue to use our services for any period of time.

WE ANTICIPATE INCURRING SIGNIFICANT EXPENSES IN THE FORESEEABLE FUTURE, WHICH MAY REDUCE OUR ABILITY TO ACHIEVE PROFITABILITY.

In order to reach our business growth objectives, we expect to incur significant operating and marketing expenses, as well as capital expenditures, during the next several years. In order to offset these expenses, we will need to generate significant additional profitable business. If our revenue grows more slowly than either we

anticipate or our clients' projections indicate, or if our operating and marketing expenses exceed our expectations, we may not generate sufficient revenue to be profitable or be able to sustain or increase profitability on a quarterly or an annual basis in the future. Additionally, if our revenue grows more slowly than either we anticipate or our clients' projections indicate, we may incur unnecessary or redundant costs and our operating results could be adversely affected.

OUR OPERATING RESULTS COULD BE MATERIALLY IMPACTED BY OUR CLIENT MIX AND THE SEASONALITY OF THEIR BUSINESS.

Our business could be materially impacted by our client mix and the seasonality of their business. Based upon our current client mix, we anticipate our revenue to be most affected by seasonality during the first and second quarters of the fiscal year. We are unable to predict how the seasonality of future clients' business may affect our quarterly revenue.

OUR SYSTEMS MAY NOT ACCOMMODATE SIGNIFICANT GROWTH IN OUR NUMBER OF CLIENTS.

Our success depends on our ability to handle a large number of transactions for many different clients in various product categories. We expect that the volume of transactions will increase significantly as we expand our operations. If this occurs, additional stress will be placed upon the network hardware and software that manages our operations. We cannot assure you of our ability to efficiently manage a large number of transactions. If we are not able to maintain an appropriate level of operating performance, we may develop a negative reputation and our business would be materially adversely affected.

WE MAY NOT BE ABLE TO RECOVER ALL OR A PORTION OF OUR START-UP COSTS ASSOCIATED WITH ONE OR MORE OF OUR CLIENTS.

We generally incur start-up costs in connection with the planning and implementation of business process solutions for our clients. Although we generally recover these costs from the client in the early stages of the client relationship, there is a risk that the client contract may not fully cover the start-up costs. To the extent start-up costs exceed the start-up fees received, excess costs will be expensed as incurred. Additionally, in connection with new client contracts we generally incur capital expenditures associated with assets whose primary use is related to the client solution. There is a risk that the contract may end before expected and we may not recover the full amount of our capital costs.

OUR MARGINS MAY BE MATERIALLY IMPACTED BY CLIENT TRANSACTION VOLUMES WHICH DIFFER FROM CLIENT PROJECTIONS AND BUSINESS ASSUMPTIONS.

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

OUR BUSINESS IS SUBJECT TO THE RISK OF CUSTOMER CONCENTRATION.

For the nine month period ended December 31, 2001, excluding Daisytek, a U.S. Federal Government Unit, via a subcontract agreement with IBM, and Xerox Corporation represented approximately 29% and 14%, respectively, of our total revenue for such period. The loss of any one or more of such clients would have a material adverse effect upon our business.

WE HAVE GUARANTEED ALL OF THE INDEBTEDNESS OF OUR AFFILIATE, SUPPLIES DISTRIBUTORS, WHICH AS OF MARCH 2002 WAS APPROXIMATELY \$48.5 MILLION; WE ARE REQUIRED TO MAINTAIN A MINIMUM LEVEL OF SUBORDINATED LOANS TO SUPPLIES DISTRIBUTORS; AND WE ARE OBLIGATED TO REPAY ANY OVER-ADVANCE MADE TO SUPPLIES DISTRIBUTORS BY ITS LENDERS.

We have guaranteed all of the indebtedness of our affiliate, Supplies Distributors, which as of March 2002 was approximately \$48.5 million, which guaranty is secured by a pledge of substantially all of our assets. We currently have \$11.7 million of indebtedness owed to us from Supplies Distributors which is subordinated to the approximately \$48.5 million of Supplies Distributors' senior indebtedness. We are required to maintain \$6.5 million of subordinated loans to Supplies Distributors. Any default by Supplies Distributors under any such indebtedness would have a material adverse impact upon our business and financial condition. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors by its lenders.

WE FACE COMPETITION FROM MANY SOURCES THAT COULD ADVERSELY AFFECT OUR BUSINESS.

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

OUR SALES AND IMPLEMENTATION CYCLES ARE HIGHLY VARIABLE AND OUR ABILITY TO FINALIZE PENDING CONTRACTS MAY CAUSE OUR OPERATING RESULTS TO VARY WIDELY.

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

WE ARE DEPENDENT ON OUR KEY PERSONNEL, AND WE NEED TO HIRE AND RETAIN SKILLED PERSONNEL TO SUSTAIN OUR BUSINESS.

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

WE ARE SUBJECT TO RISKS ASSOCIATED WITH OUR INTERNATIONAL OPERATIONS.

A significant component of our business strategy is to continue to operate and expand internationally. We currently operate a 150,000 square foot distribution center in Liege, Belgium and a 33,000 square foot distribution center in Richmond Hill, Canada, near Toronto. We cannot assure you that we will be successful in expanding into additional international markets. In addition to the uncertainty regarding our ability to generate revenue from foreign operations and expand our international presence, there are risks inherent in doing business internationally, including:

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

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

WE ARE UNCERTAIN ABOUT OUR NEED FOR AND THE AVAILABILITY OF ADDITIONAL FUNDS.

Our future capital needs are difficult to predict. We may require additional capital in order to take advantage of unanticipated opportunities, including strategic alliances and acquisitions, or to respond to changing business conditions and unanticipated competitive pressures. In addition, we may require additional funds to finance our operating losses. Should these circumstances arise, we may need to raise additional funds either by borrowing money or issuing additional equity. We cannot assure you that we will be able to raise such funds on favorable terms or at all. If we were successful in completing an equity financing, this could result in dilution to our stockholders. We currently do not have any credit facility in place under which we can borrow funds when needed. If we are unable to obtain additional funds, we may be unable to take advantage of new opportunities or take other actions that otherwise might be important to our business.

WE MAY ENGAGE IN FUTURE STRATEGIC ALLIANCES OR ACQUISITIONS THAT COULD DILUTE OUR EXISTING STOCKHOLDERS, CAUSE US TO INCUR SIGNIFICANT EXPENSES OR HARM OUR BUSINESS.

We may review strategic alliance or acquisition opportunities that would complement our current business or enhance our technological capabilities. Integrating any newly acquired businesses, technologies or services may be expensive and time-consuming. To finance any acquisitions, it may be necessary for us to raise additional funds through public or private financings. Additional funds may not be available on terms that are favorable to us and, in the case of equity financings, may result in dilution to our stockholders. In addition, we have limited ability to issue capital stock during the two-year period following the spin-off. We may not be able to operate any acquired businesses profitably or otherwise implement our growth strategy successfully. If we are unable to integrate any newly acquired entities or technologies effectively, our operating results could suffer. Future acquisitions by us could also result in incremental expenses and the incurrence of debt and contingent liabilities, or amortization of expenses related to goodwill and other intangibles, any of which could harm our operating results.

OUR BUSINESS COULD BE ADVERSELY AFFECTED BY A SYSTEMS OR EQUIPMENT FAILURE, WHETHER OUR OWN OR OF OUR CLIENTS.

Our operations are dependent upon our ability to protect our distribution facilities, customer service centers, computer and telecommunications equipment and software systems against damage and failures. Damage or failures could result from fire, power loss, equipment malfunctions, system failures, natural disasters and other causes. Although we believe we have sufficient property and business interruption

insurance, if our business is interrupted either from accidents or the intentional acts of others, our business could be materially adversely affected. In addition, in the event of widespread damage or failures at our facilities, our short-term disaster recovery and contingency plans and insurance coverage may not be sufficient.

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

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

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

A BREACH OF OUR E-COMMERCE SECURITY MEASURES COULD REDUCE DEMAND FOR OUR SERVICES.

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

We may be required to expend significant capital and other resources to protect against security breaches or to address any problem they may cause. Because our activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage our reputation, cause us to lose clients, impact our ability to attract new clients and we could be exposed to litigation and possible liability. Our security measures may not prevent security breaches, and failure to prevent security breaches may disrupt our operations.

WE MAY BE A PARTY TO LITIGATION INVOLVING OUR E-COMMERCE INTELLECTUAL PROPERTY RIGHTS.

In recent years, there has been significant litigation in the United States involving patent and other intellectual property rights. We may be a party to intellectual property litigation in the future to protect our trade secrets or know-how. United States patent applications are confidential until a patent is issued and most technologies are developed in secret. Accordingly, we are not, and cannot be, aware of all patents or other intellectual property rights of which our services may pose a risk of infringement. Others asserting rights against us could force us to defend ourselves or our customers against alleged infringement of intellectual property rights. We could incur substantial costs to prosecute or defend any such litigation.

RISKS RELATED TO DAISYTEK

WE HAVE POTENTIAL LIABILITY TO DAISYTEK FOR TAX INDEMNIFICATION OBLIGATIONS.

Under the terms of our tax indemnification and allocation agreement with Daisytek, we will indemnify Daisytek for any tax liability it suffers arising out of our actions, or certain actions to which we are a party that may exist, before or after the spin-off that would cause the spin-off to lose its qualification as a tax-free distribution for federal income tax purposes. These actions include any event involving the acquisition of the shares of our capital stock after the spin-off which has the effect of disqualifying the spin-off from tax-free treatment, whether or not the event is the result of our direct action or within our control. If we cause the spin-off to not qualify as a tax-free distribution, Daisytek would incur federal income tax (which currently would be imposed at a 35% rate), and possibly state income taxes on the gain inherent in the shares distributed, which would be based upon the market value of the PFSweb shares at the time of the spin-off. In the event that we are required to indemnify Daisytek in respect of this liability, it would have a material adverse effect on our cash flow and business operations.

WE HAVE POTENTIAL LIABILITY FOR DAISYTEK'S TAX OBLIGATIONS.

For all periods in which Daisytek owned 80% or more of our capital stock, we are included in Daisytek's consolidated group for federal income tax purposes. If Daisytek or other members of the consolidated group fail to make any federal income tax payments, we would be liable for the shortfall since each member of a consolidated group is liable for the group's entire tax obligation.

WE HAVE LIMITED ABILITY TO ISSUE COMMON STOCK AFTER THE SPIN-OFF.

In order for the spin-off to be tax-free to Daisytek and Daisytek's stockholders, we agreed to certain limitations upon our issuance of capital stock during the two-year period after the spin-off, such as issuing an additional amount of our capital stock in a single transaction or series of transactions related to the spin-off which, when combined with the common stock issued in the Offering, could cause a 50% or greater change in the vote or value of our outstanding capital stock. These restrictions may impede our ability to complete transactions using our capital stock or to attract qualified persons to become officers or directors.

RISKS RELATED TO OUR INDUSTRY

IF THE TREND TOWARD OUTSOURCING DOES NOT CONTINUE, OUR BUSINESS WILL BE ADVERSELY AFFECTED.

Our business could be materially adversely affected if the trend toward outsourcing declines or reverses, or if corporations bring previously outsourced functions back in-house. Particularly during general economic downturns, businesses may bring in-house previously outsourced functions in order to avoid or delay layoffs. The continued threat of terrorism within the United States and abroad and the potential for sustained military action may cause disruption to commerce and economic conditions, both domestic and foreign, which could have a material adverse effect upon our business and new client prospects.

OUR MARKET IS SUBJECT TO RAPID TECHNOLOGICAL CHANGE AND TO COMPETE WE MUST CONTINUALLY ENHANCE OUR SYSTEMS TO COMPLY WITH EVOLVING STANDARDS.

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

RISKS RELATED TO OUR STOCK

OUR COMMON STOCK IS SUBJECT TO POSSIBLE DELISTING FROM THE NASDAQ NATIONAL MARKET SYSTEM.

Under current NASDAQ National Market System ("NMS") listing rules, listed companies are required to maintain a \$1.00 minimum share price. As of February 14, 2002, our common stock share price had closed under \$1.00 for 30 consecutive trading days. As a result, and in accordance with NASDAQ NMS regulations, we have until May 15, 2002 to regain compliance with this rule. If the bid price of our common stock closes at \$1.00 or more for a minimum of ten days prior to May 15, 2002, under current NASDAQ NMS rules, we would be in compliance with the minimum share price requirement. Conversely, if the share price does not meet this ten day requirement, our common stock would then be subject to a delisting determination from NASDAQ. Upon receipt of such determination, we may either (1) appeal the determination to the

NASDAQ Listing Qualifications Panel (which appeal would postpone the delisting until the appeal is decided) or (2) transfer our listing to the NASDAQ SmallCap Market. The delisting of our common stock could have a material adverse effect on the market price of, and the efficiency of the trading market for, our common stock.

OUR CERTIFICATE OF INCORPORATION, OUR BYLAWS, OUR SHAREHOLDER RIGHTS PLAN AND DELAWARE LAW MAKE IT DIFFICULT FOR A THIRD PARTY TO ACQUIRE US, DESPITE THE POSSIBLE BENEFIT TO OUR STOCKHOLDERS.

Provisions of our certificate of incorporation, our bylaws, our shareholder rights plan and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. For example, our certificate of incorporation provides for a classified board of directors, meaning that only approximately one-third of our directors will be subject to re-election at each annual stockholder meeting. Our certificate of incorporation also permits our Board of Directors to issue one or more series of preferred stock which may have rights and preferences superior to those of the common stock. The ability to issue preferred stock could have the effect of delaying or preventing a third party from acquiring us. We have also adopted a shareholder rights plan. These provisions could discourage takeover attempts and could materially adversely affect the price of our stock.

ITEM 2. PROPERTIES

Our PFSweb business is headquartered in a central office facility located in Plano, Texas, a Dallas suburb.

In the U.S., we operate an approximately eight hundred thousand square foot central distribution complex in Memphis, Tennessee. This complex is located approximately four miles from the Memphis International Airport, where both Federal Express and United Parcel Service operate large hub facilities.

We also operate a 150,000 square foot distribution center in Liege, Belgium, which contains advanced distribution systems and equipment. We also operate a 33,000 square foot distribution center in Richmond Hill, Canada, near Toronto. We operate customer service centers in Memphis, Tennessee; Plano, Texas; Richmond Hill, Canada; and Liege, Belgium. Our call center technology permits the automatic routing of calls to available customer service representatives in several of our call centers.

All of our facilities are leased and the material lease agreements contain one or more renewal options.

ITEM 3. LEGAL PROCEEDINGS

None.

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

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is listed and currently trades on the Nasdaq Stock Market under the symbol "PFSW." The following table sets forth for the period indicated the high and low sale price for the common stock as reported by the Nasdaq National Market:

PRICE -----	HIGH	LOW	-----	Fiscal
	Year 2001			
	First			
Quarter.....	\$17.13	\$3.88	Second	
Quarter.....	\$ 5.00	\$1.92	Third	
Quarter.....	\$ 2.69	\$0.53	Fourth	
Quarter.....	\$ 1.59	\$0.66	Nine Months Ended December 31, 2001	
			First	
Quarter.....	\$ 1.45	\$0.69	Second	
Quarter.....	\$ 1.06	\$0.35	Third	
Quarter.....	\$ 1.00	\$0.67		

As of March 15, 2002, there were approximately 7,100 shareholders of which 119 were record holders of the common stock.

We have never declared or paid cash dividends on our common stock and do not anticipate the payment of cash dividends on our common stock in the foreseeable future. We currently intend to retain all earnings to finance the further development of our business. The payment of any future cash dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, operations, capital requirements, the general financial condition of the Company and general business conditions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

HISTORICAL PRESENTATION

In June 2001, we announced a change in our fiscal year end from March 31 to December 31. Consequently, our most recent fiscal period is a nine month transition period ended December 31, 2001.

The selected consolidated historical statement of operations data for each of the fiscal years ended March 31, 2000 and 2001 and the nine months ended December 31, 2001, and the selected consolidated balance sheet data as of March 31, 2001 and December 31, 2001 have been derived from our audited consolidated financial statements, and should be read in conjunction with those statements and notes, which are included in this Form 10-K. The selected consolidated statement of operations data for the fiscal years ended March 31, 1998 and 1999 and the selected consolidated balance sheet data as of March 31, 1998, 1999 and 2000 have been derived from our audited consolidated financial statements, and should be read in conjunction with those statements, which are not included in this Form 10-K. The selected consolidated statement of operations data for the nine months ended December 31, 2000, and the selected consolidated balance sheet data as of December 31, 2000 have been derived from our unaudited interim condensed consolidated financial statements, and should be read in conjunction with these statements, which are not included in this Form 10-K. The financial information for periods prior to fiscal year 2001 herein may not necessarily reflect our results of operations, financial position and cash flows in the future or what our results of operations, financial position and cash flows would have been had we been a separate, stand-alone entity during the periods presented. The selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto which are included elsewhere in this Form 10-K.

HISTORICAL SELECTED CONSOLIDATED FINANCIAL DATA
(IN THOUSANDS, EXCEPT PER SHARE DATA)

NINE MONTHS ENDED FISCAL YEARS
ENDED MARCH 31, DECEMBER 31, ----

----- 1998
1999 2000 2001 2000 2001(B) -----

----- (UNAUDITED)
CONSOLIDATED STATEMENT OF
OPERATIONS DATA: Revenues:

Product revenue.....
\$46,404 \$ 94,768 \$57,044 \$ -- \$ -
- \$ -- Service fee
revenue..... 3,539 7,547
30,829 48,258 37,017 26,569
Service fee revenue-
affiliate..... -- -- --
-- 1,384 Other
revenue..... -- -- --
- 2,097 1,700 100 -----

- Total revenues.....
49,943 102,315 87,873 50,355
38,717 28,053 ----- --

Costs of revenues: Cost of
product revenue..... 43,992
89,401 53,905 -- -- -- Cost of
service fee revenue.... 2,208
5,323 23,475 34,261 26,670 17,984
Cost of other revenue..... -
- -- -- 2,470 2,411 (627) -----

----- Total costs of
revenues..... 46,200 94,724
77,380 36,731 29,081 17,357 -----

----- Gross
profit.....
3,743 7,591 10,493 13,624 9,636
10,696 Percent of
revenues..... 7.5% 7.4%
11.9% 27.1% 24.9% 38.1% Selling,
general and administrative
expenses..... 3,705 6,711
17,764 25,446 19,044 17,117
Other.....
-- -- -- -- (5,141) -----

----- Income (loss) from
operations..... 38 880 (7,271)
(11,822) (9,408) (1,280) Percent
of revenues..... 0.1%
0.9% (8.3)% (23.5)% (24.3)%
(4.6)% Interest expense (income),
net.... 143 374 459 (1,091) (880)
(496) ----- --

----- Income
(loss) before income
taxes.....
(105) 506 (7,730) (10,731)
(8,528) (784) Income tax expense
(benefit)..... (30) 214 (1,791)
25 36 (219) ----- --

----- Net
income (loss)..... \$
(75) \$ 292 \$(5,939) \$(10,756)
\$(8,564) \$ (565) =====
=====

PER SHARE DATA: Net income (loss)
per share: Basic and
diluted(a)..... \$ (0.01) \$
0.02 \$ (0.38) \$ (0.60) \$ (0.48) \$
(0.03) =====
===== Weighted
average number of shares

outstanding: Basic and
 diluted(a)..... 14,305
 14,305 15,479 17,879 17,870
 18,036

AS OF MARCH 31, AS OF DECEMBER
 31, -----

 --- 1998 1999 2000 2001 2000
 2001(B) -----
 - -----

(UNAUDITED) CONSOLIDATED
 BALANCE SHEET DATA: Working
 capital.....
 \$ 1,344 \$14,636 \$27,974
 \$19,941 \$21,055 \$11,154 Total
 assets.....
 20,911 69,057 60,405 59,089
 58,789 51,593 Long-term
 obligations.....
 1,827 29,029 2,407 4,353 4,100
 5,873 Shareholders' equity
 (deficit)..... (155) 581
 47,650 37,001 39,010 36,605

 (a) Prior to the Offering, which was consummated in fiscal year 2000, basic and
 diluted net income (loss) per share was determined based on net income
 (loss) divided by the 14,305,000 shares outstanding. There

were no potentially dilutive securities outstanding prior to the Offering. For fiscal year 2000 and 2001, and the nine month periods ended December 31, 2000 and 2001, outstanding options to purchase common shares of PFSweb were anti-dilutive and have been excluded from the weighted average share computation.

- (b) In June 2001, the Company elected to change its fiscal year end from March 31 to December 31. Consequently the Company's most recently completed fiscal period is a nine month period ended December 31, 2001.

ITEM 7. 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 consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-K.

FORWARD-LOOKING INFORMATION

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

- Our ability to retain and expand relationships with existing clients and attract 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 client mix and the seasonality of their business;
- our ability to finalize pending contracts;
- the impact of strategic alliances and acquisitions;
- trends in the market for our services;
- trends in e-commerce;
- whether we can continue and manage growth;
- changes in the trend toward outsourcing;
- increased competition;
- our ability to generate more revenue and achieve sustainable profitability;
- effects of changes in profit margins;
- the customer concentration of our business;
- the unknown effects of possible system failures and rapid changes in technology;
- trends in government regulation both foreign and domestic;
- foreign currency risks and other risks of operating in foreign countries;
- potential litigation involving our e-commerce intellectual property rights;
- our dependency on key personnel;

- our ability to raise additional capital;
- our relationship with and our guarantees of the working capital indebtedness of our affiliate, Supplies Distributors;
- the continued listing of our common stock on the NASDAQ; and
- our relationship with and separation from Daisytek, our former parent corporation.

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

OVERVIEW

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

Our service fee revenue is typically charged on a percent of shipped revenue basis or a per-transaction basis, such as a per-minute basis for Web-enabled customer contact center services and a per-item basis for fulfillment services. Additional fees are billed for other services. We price our services based on a variety of factors, including the depth and complexity of the services provided, the amount of capital expenditures or systems customization required, the length of contract and other factors. Many of our contracts with our clients involve third-party vendors who provide additional services such as package delivery. The costs we are charged by these third-party vendors for these services are passed on to our clients (and, in many cases, our clients' customers) and are not reflected in our revenue or expense. Historically, our services have also included purchasing and reselling client product inventory. In these arrangements, our product revenue was recognized at the time product was shipped. During the quarter ended September 30, 1999, our primary client agreement under which we previously purchased and sold inventory was restructured to provide transaction management services only on a service fee basis.

Our expenses are comprised of:

- prior to September 30, 1999, cost of product revenue, which consisted of the price of product sold and freight costs;
- cost of service fee revenue, which consists primarily of compensation and related expenses for our Web-enabled customer contact center services, international fulfillment and distribution services and professional consulting services, and other fixed and variable expenses directly related to providing services under the terms of fee based contracts, including certain occupancy and information

technology costs and depreciation and amortization expenses; and selling, general and administrative expenses, which consist primarily of compensation and related expenses for sales and marketing staff, executive, management and administrative personnel and other overhead costs, including certain occupancy and information technology costs and depreciation and amortization expenses. In addition, for the periods prior to September 30, 1999, certain direct contract costs related to our IBM master distributor agreements were reflected as selling and administrative expenses.

HISTORICAL FINANCIAL PRESENTATION

We believe our historical financial statements for the periods prior to fiscal year 2001 may not provide a meaningful comparison to our current and future financial performance for the reasons described below.

In 1996, we entered into an agreement with the printer supplies division of IBM. Under this agreement, we provided IBM with various transaction management services, such as call center services and order fulfillment and distribution. We also served as an IBM master distributor of printer supply products. Under this master distributor arrangement, we purchased the printer supply products from IBM and resold them to IBM customers. Following our initial agreement with the printer supplies division, we entered into several similar agreements with other divisions of IBM, both in the U.S. and Europe, and expanded our then existing agreements to include more product lines.

During the quarter ended September 30, 1999, we, Daisytek and IBM entered into new agreements to conform to our current business model. Under these new agreements, Daisytek acted as the master distributor of the IBM products and we provided various transaction management services. As part of this restructuring, we transferred to Daisytek the IBM product inventory, which we held as the master distributor, together with our customer accounts receivable and our accounts payable owing to IBM in respect of the product inventory. The purpose of the restructuring was to separate the master distributor and transaction management responsibilities between ourselves and Daisytek so that each could focus on its core competencies.

As a result of the restructuring of the IBM agreements, our historical financial statements for the periods prior to fiscal year 2001 may not provide a meaningful comparison to our current and future financial statements. This is because, as a master distributor under our prior agreements, we recorded revenue as product revenue as we sold the product to IBM customers. Similarly, our gross profit was based upon the difference between our revenue from product sales and the cost of purchasing the product from IBM.

As a result of this restructuring of our IBM agreements, our total revenues arising under our new IBM agreements have been reduced, as compared to the total revenues arising under the prior IBM agreements. However, our gross profit margin as a percent of service fee revenue under the new IBM agreements is higher as compared to our gross profit margin as a percent of product revenue under the prior IBM agreements.

In September 2001, Daisytek sold its subsidiaries that had been conducting the IBM business to a subsidiary of our affiliate, Business Supplies Distributors Holdings, LLC. In conjunction with this transaction, we entered into a new service fee contract with this affiliate. See "Supplies Distributors."

In addition, upon completion of the Offering on December 2, 1999, we entered into a transaction management services agreement with Daisytek. Under this agreement, we received service fee revenue based upon a percentage of Daisytek's shipped product revenue. Consequently, our historical financial statements reflect the service fee revenue we received from Daisytek under this new agreement for the twelve months ended March 31, 2001, but for only four months in the fiscal year ended March 31, 2000. Effective May 2001, our transaction management services agreement with Daisytek was terminated. Concurrently, we also entered into a six-month transitional and information technology services agreement with Daisytek, which terminated in November 2001.

RESULTS OF OPERATIONS

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

FISCAL YEARS ENDED NINE MONTHS ENDED MARCH 31,		DECEMBER 31, -----			
---	2000	2001	2000	2001	-----
-- (UNAUDITED) Product					
revenue.....	64.9%				
--% --% --% Service fee					
revenue.....	35.1	95.8			
95.6 94.7 Service fee revenue --					
affiliate.....	4.9				
Other					
revenue.....	4.2	4.4	0.4		
----- Total					
revenues.....	100.0	100.0			
100.0 100.0 ----- Cost of					
product revenue (as % of product					
revenue).....					
94.5	--	--	--	--	
Cost of service fee revenue (as %					
of service fee					
revenue).....					
76.1	71.0	72.0	64.3		
Cost of other revenue (as %					
of total revenues).... -- 4.9 6.2 (2.2) -----					
----- Total costs of					
revenues.....	88.1	72.9	75.1	61.9	---
----- Gross					
profit.....	11.9				
27.1 24.9 38.1 Selling, general and					
administrative expenses..... 20.2 50.5 49.2 61.0					
Other.....					
--	--	--	(18.3)		
----- Loss from					
operations..... (8.3)					
(23.4)	(24.3)	(4.6)			
Interest expense (income),					
net.....	0.5	(2.0)	(2.3)	(1.8)	---
----- Loss before income					
taxes..... (8.8) (21.4)					
(22.0) (2.8) Income tax expense					
(benefit).....	(2.0)	--	0.1		
(0.8) ----- Net					
loss.....					
(6.8)%	(21.4)%	(22.1)%	(2.0)%	=====	=====
=====					

NINE MONTHS ENDED DECEMBER 31, 2001 COMPARED TO NINE MONTHS ENDED DECEMBER 31, 2000

Service Fee Revenue (including service fee revenue -- affiliate). Service fee revenue was \$28.0 million for the nine months ended December 31, 2001 as compared to \$37.0 million for the nine months ended December 31, 2000, a decrease of \$9.0 million or 24.5%. The decrease in service fee revenue over the prior period was due to the impact of certain contract terminations, primarily the Daisytek contract, as well as certain other lower margin producing contracts. This reduction was partially offset by the impact of new service contract relationships and growth in existing client relationships. In conjunction with the \$10.9 million sale of a distribution facility to Daisytek in May 2001 (discussed below in "Liquidity and Capital Resources"), we terminated certain of our transaction management services agreements entered into between us and Daisytek and a Daisytek subsidiary. Concurrently with the closing of the facility sale, we entered into a six-month transition services agreement to provide Daisytek with certain transitional and information technology services, under which we earned \$2.6 million. The net impact of the changes in our services provided to Daisytek was a reduction in revenue of \$10.6 million for the nine months ended December 31, 2001. The reduction in revenue attributed to the termination of lower margin producing contracts was \$8.2 million for the nine months ended December 31, 2001. For the nine months ended December 31, 2001, the increase in revenue attributed to new client contract relationships was \$7.2 million. For the nine months ended December 31, 2001, the increase in revenue from existing contracts was \$2.6 million. We believe this increase was negatively impacted by the recent slowdown in the U.S. economy.

Pursuant to the terms of the Company's transaction management services agreement with Supplies Distributors, the Company earned service fees, which are reported as service fee revenue -- affiliate in the accompanying consolidated financial statements, of approximately \$1.4 million for the nine months ended

December 31, 2001. For the nine months ended December 31, 2001, PFSweb fees earned from BSD (the Daisytek subsidiary and predecessor to Supplies Distributors) were \$3.6 million. For the nine months ended December 31, 2000, prior to becoming a related party, service fees earned by PFSweb from BSD, associated with the same business activities, were \$4.6 million. For the nine months ended December 31, 2001, our revenue was negatively impacted by lower than anticipated IBM related activity due to the transition to Supplies Distributors from Daisytek but was benefited by approximately \$0.8 million of service fee adjustments resulting from the termination of the Daisytek transaction management service agreements. Service fee revenue earned from the IBM business for the nine months ended December 31, 2000 were reduced by \$1.3 million foreign currency transaction losses applicable to the devaluation of the Euro that were required, under the terms of the arrangements between us and BSD, to be included as part of the service fee billings.

Other Revenue. Other revenue of \$0.1 million for the nine months ended December 31, 2001 and \$1.7 million for the nine months December 31, 2000, respectively, represents the fees charged to clients in conjunction with early contract terminations.

Cost of Service Fee Revenue. Cost of service fee revenue was \$18.0 million for the nine months ended December 31, 2001, as compared to \$26.7 million during the nine months ended December 31, 2000, a decrease of \$8.7 million or 32.6%. The resulting service fee gross profit was \$10.0 million or 35.7% of service fee revenue, during the nine months ended December 31, 2001 as compared to \$10.3 million, or 28.0% of service fee revenue for the nine months ended December 31, 2000. For the nine months ended December 31, 2000, the service fee gross profit was negatively impacted by a \$1.3 million reduction in revenue applicable to foreign currency transaction losses discussed above, for which there was no reduction in costs. In addition, the gross profit earned on certain contracts terminated during the nine months ended December 31, 2000 was lower than other contracts we continue to operate. Additionally, by leveraging our existing infrastructure and by reducing the direct operating costs associated with the terminated contracts, such as personnel costs, warehousing and distribution costs, lower depreciation costs resulting from the sale of assets, and other expenses, we were able to reduce our operating costs and increase our gross profit percentage. For the nine months ended December 31, 2001, our gross profit margin was negatively impacted by lower than anticipated IBM related activity due to the transition to Supplies Distributors from Daisytek but was benefited by approximately \$0.8 million of service fees adjustments resulting from the termination of the Daisytek transaction management services agreements for which the related service activities were performed in earlier periods. Furthermore, the revenue generated by our transition services agreement with Daisytek, under which we provided certain transitional and information technology services, primarily utilized infrastructure, which existed in the prior periods and will continue to exist in future periods.

Cost of Other Revenue. Cost of other revenue for the nine months ended December 31, 2001 reflect the reversal of \$0.6 million of accruals made in the prior year for estimated client termination costs that were determined this period to be in excess of the actual costs. Cost of other revenue for the nine months ended December 31, 2000 includes costs from certain terminated contracts and are primarily comprised of approximately \$0.4 million of employee severance costs, approximately \$0.5 million of asset impairments from fixed assets which were specific to terminated contracts and produced no further value to PFSweb, and approximately \$1.6 million of certain uncollectible amounts receivable from, and accrued expenses applicable to, clients who terminated contracts.

Selling, General and Administrative Expenses. SG&A expenses were \$17.1 million for the nine months ended December 31, 2001, or 61.0% of revenues, as compared to \$19.0 million, or 49.2% of revenues, for the nine months ended December 31, 2000. The decrease in SG&A expenses are due to costs incurred in the prior nine month periods for which there are no or lower comparable costs incurred in the current year periods. These relate to approximately \$1.4 million of incremental costs primarily applicable to provisions for doubtful accounts, a \$0.5 million foreign currency transaction loss, due to a devaluation of the Euro, and the \$0.3 million favorable resolution of accounts and Value Added Tax ("VAT") receivables in the quarter ended September 30, 2001, offset by an increase in stand alone public company expenses, consisting primarily of taxes and insurance, incremental professional services fees for audit and tax services associated with the change in our fiscal year end and increases in personnel compensation and sales and marketing costs.

Other. Other primarily reflects the sale of a distribution facility previously used by PFSweb to provide outsourcing services to Daisytek. For the nine months ended December 31, 2001, cash proceeds of \$10.9 million, net of approximately \$0.6 million of closing costs, were received for assets with an approximately \$4.5 million net book value with a resulting \$5.8 million gain. The net gain was offset by a \$0.7 million non-cash stock compensation charge associated with our modification of certain PFSweb stock options held by employees of our former parent company Daisytek.

Interest Income. Interest income was \$0.5 million for the nine months ended December 31, 2001 as compared to interest income of \$0.9 million for the nine months ended December 31, 2000. The reduction in interest income is attributable to lower interest rates earned by our cash and cash equivalents and higher interest expense due to an increase in our long-term debt and capital lease obligations partially offset by the impact of higher interest rates charged on our subordinated loan to Supplies Distributors.

Income Taxes. For the nine months ended December 31, 2001, we recorded an income tax benefit of \$0.2 million which primarily relates to a pre-tax loss from our Canadian operations that can be carried back to prior tax years. For the nine months ended December 31, 2001, we did not record an income tax benefit associated with our net loss in our U.S. or European operations. Since we have not established a sufficient history of earnings for our U.S. and European operations, a valuation allowance has been provided for our net deferred tax assets as of December 31, 2001, which are primarily related to our net operating loss carryforwards. Although we had a pre-tax loss for the nine months ended December 31, 2000, we recorded an income tax provision associated with a pre-tax income from our Canadian operations.

FISCAL YEAR ENDED MARCH 31, 2001 COMPARED TO FISCAL YEAR ENDED MARCH 31, 2000

We believe our historical financial statements for the periods prior to fiscal 2001 may not provide a meaningful comparison to our current and future financial performance for the reasons described above in "Historical Financial Presentation."

Product Revenue. Product revenue was zero for fiscal 2001 as compared to \$57.0 million for fiscal 2000. As stated above, during the quarter ended September 30, 1999, we, Daisytek and IBM entered into new agreements applicable to all of our IBM relationships. As a result of these new agreements, the activities performed under these contracts since that date were accounted for as service fee revenue as opposed to product revenue.

Service Fee Revenue. Service fee revenue was \$48.3 million for fiscal 2001 as compared to \$30.8 million during fiscal 2000, an increase of \$17.5 million or 56.5%. Changes in service fee revenues over prior periods were due to the further expansion of existing contracts, the restructuring of all the IBM contracts, new service contract relationships, our transaction management services agreement with Daisytek which commenced on the completion of the Offering in December 1999 and the impact of certain contract terminations. Service fee revenue from existing contracts increased \$13.3 million and new service contract relationships added \$4.2 million for fiscal 2001. Service fee revenue for fiscal 2001 also includes approximately \$0.5 million of previously deferred revenue associated with terminated contracts. For fiscal 2001, service fee revenue totaling \$27.6 million included fees earned from Daisytek under our new transaction management services agreement, effective as of the Offering, our new IBM contracts that, prior to the September 1999 quarter, would have been reported as product revenue, and for certain subcontracted services. During fiscal 2001, we effected certain contract terminations with service fee revenues of approximately \$8 million and experienced a longer implementation cycle associated with new larger contracts.

Other Revenue. Other revenue of \$2.1 million for fiscal 2001 represents the fees charged to clients in conjunction with the early termination of certain contracts.

Cost of Product Revenue. Cost of product revenue was zero for fiscal 2001, as compared to \$53.9 million during fiscal 2000. Cost of product revenue as a percent of product revenue was zero during fiscal 2001 and 94.5% during fiscal 2000. The resulting gross profit margin was 5.5% for fiscal 2000.

Cost of Service Fee Revenue. Cost of service fee revenue was \$34.3 million for fiscal 2001, as compared to \$23.5 million during fiscal 2000, an increase of \$10.8 million or 45.9%. The resulting service fee gross profit

was \$14.0, million or 29.0% of service fee revenue, during fiscal 2001 as compared to \$7.4 million, or 23.9% of service fee revenue during fiscal 2000. The increase in gross profit margin for fiscal 2001 resulted primarily from the further expansion of existing contracts and new service contract relationships, including our transaction management services agreement with Daisytek, which commenced on the completion of the Offering in December 1999, and the termination of certain lower margin producing contracts. The gross profit margin also increased because cost of service fee revenue for fiscal 2000 included incremental costs related to a large number of new client implementations during that year. Fiscal 2001 gross profit increases were offset by approximately \$0.5 million of previously deferred costs associated with terminated contracts. In addition, certain excess infrastructure costs, incremental operating costs related to terminated contracts and costs associated with improving service quality had a negative impact on fiscal 2001 gross margin. As a percentage of total revenues, the gross profit margin for fiscal 2001 of 27.1% increased when compared to the 11.9% gross profit margin for fiscal 2000 due to the factors discussed above as well as the restructuring of all of the IBM contracts into service fee contracts, which typically have a higher gross profit margin as a percent of revenue as compared to the gross profit margin as a percent of revenue earned under the IBM master distributor agreements.

Cost of Other Revenue. Cost of other revenue for fiscal 2001 includes costs from certain terminated contracts and are primarily comprised of approximately \$0.4 million of employee severance costs, approximately \$0.5 million of asset impairments from fixed assets which were specific to terminated contracts and provided no further value to PFSweb, and approximately \$1.6 million of certain uncollectible amounts receivable from, and liabilities applicable to, clients who terminated contracts.

Selling, General and Administrative Expenses. SG&A expenses were \$25.4 million for fiscal 2001, or 50.5% of revenues, as compared to \$17.8 million, or 20.2% of revenues, for fiscal 2000. As a result of incremental costs, the restructuring of the IBM agreements and the related reduction in product revenue, SG&A expenses as a percentage of total revenue were higher in fiscal 2001 than in fiscal 2000. SG&A expenses increased as a result of costs incurred to support the higher sales volumes under both new and existing contracts, certain excess infrastructure costs, incremental investments in resources and technology to support our continued growth and public company costs.

Interest Expense (Income), Net. Interest income was \$1.1 million for fiscal 2001 as compared to interest expense of \$0.5 million for fiscal 2000. The weighted average interest rate was 6.7% during fiscal 2000. Our intercompany payable to Daisytek, on which we incurred interest expense during fiscal 2000, was repaid with a portion of the proceeds from our Offering. Subsequent to the Offering, the remaining proceeds have been utilized to fund working capital needs and capital expenditures and generate interest income.

Income Taxes. For fiscal 2001, we recorded income tax expense associated with our Canadian operations. Because of our limited operating history in Europe, it is uncertain whether it is "more likely than not" that we will be able to utilize our European losses in future periods and therefore we did not record an income tax benefit for the pre-tax losses. During fiscal 2001, we recorded an income tax benefit of \$0.1 million related to our ability to utilize our net operating losses to offset future taxes related to deferred tax liabilities. However, since we ceased to be included in Daisytek's consolidated return due to the completion of the spin-off and we have not established a sufficient history of earnings from our U.S. operations, on a stand-alone basis, a valuation allowance has been provided for the remaining net deferred tax asset as of March 31, 2001. For fiscal 2000, although we did not benefit our European losses, as a result of the inclusion of our U.S. operations in Daisytek's consolidated return prior to the spin-off, our income tax benefit as a percentage of pre-tax loss was 23.2%.

SUPPLIES DISTRIBUTORS

Business Supplies Distributors (a Daisytek subsidiary -- "BSD"), Daisytek and IBM and us were parties to various Master Distributor Agreements which had various scheduled expiration dates through September 2001. Under these agreements, BSD and its affiliates Business Supplies Distributors Europe B.V. ("BSD Europe"), a Daisytek subsidiary, and BSD (Canada) Inc., a Daisytek subsidiary ("BSD Canada" and together with BSD and BSD Europe, the "BSD Companies"), acted as master distributors of various IBM

products, Daisytek provided financing and credit support to the BSD Companies and we provided transaction management and fulfillment services to the BSD Companies. On June 8, 2001, Daisytek notified us and IBM that it did not intend to renew these agreements upon their scheduled expiration dates. In July 2001, we and Inventory Financing Partners, LLC ("IFP") formed Business Supplies Distributors Holdings, LLC ("Holdings"), and Holdings formed a wholly-owned subsidiary, Supplies Distributors ("Supplies Distributors"). Concurrently, Supplies Distributors formed its wholly-owned subsidiaries Supplies Distributors of Canada, Inc. ("SDC") and Supplies Distributors S.A. ("SDSA"), a Belgium corporation. Supplies Distributors, SDSA, IBM and PFSweb entered into new Master Distributor Agreements to replace the prior agreements. Under the new agreements, Supplies Distributors and SDSA act as master distributors of various IBM products and, pursuant to a transaction management services agreement between us and Supplies Distributors, we provide transaction management and fulfillment services to Supplies Distributors. We made an equity investment of \$0.75 million in Holdings for a 49% voting interest, and IFP made an equity investment of \$0.25 million in Holdings for a 51% voting interest. Certain officers and directors of PFSweb own, individually, a 9.8% non-voting interest, and, collectively, a 49% non-voting interest, in IFP. In addition to its equity investment in Holdings, we have also provided Supplies Distributors with a subordinated loan which, as of December 31, 2001, had an outstanding balance of \$11.7 million and accrued interest at approximately 10%. The balance can be decreased to \$6.5 million subject to Supplies Distributors' compliance with the covenants of its senior loan facilities, as amended.

On September 26, 2001, Supplies Distributors purchased all of the stock of the BSD Companies for a purchase price of \$923,000. In conjunction with the purchase, BSD and Supplies Distributors were merged with Supplies Distributors being the surviving corporation. Effective December 31, 2001, BSD Canada and SDC were amalgamated, with SDC being the surviving corporation. On September 27, 2001, Supplies Distributors entered into short-term credit facilities with IBM Credit Corporation ("IBM Credit") and IBM Belgium Financial Services S.A. ("IBM Belgium") for the purpose of financing its distribution of IBM products. The facilities, which at inception included \$40 million for the U.S. operations and 20 million Euros (approximately \$18 million) for the European operations, were subsequently increased to \$45 million and 27 million Euros (approximately \$24 million), respectively, and extended through March 25, 2002. The Company has provided a collateralized guaranty to secure the repayment of these credit facilities.

On March 29, 2002, Supplies Distributors entered into amended credit facilities with IBM Credit and SDSA and BSD Europe entered into amended credit facilities with IBM Belgium. The asset based credit facility with IBM Credit provides financing for purchasing IBM inventory up to \$32.5 million through June 30, 2002 and \$27.5 million from July 1, 2002 through its expiration on March 29, 2003. The asset based credit facility with IBM Belgium provides up to 27 million Euros (approximately \$24.3 million) in financing for purchasing IBM inventory through June 30, 2002 and 22 million Euros (approximately \$19.8 million) thereafter. The IBM Belgium facility remains in force until not less than 60 days written notice by any party, but no sooner than March 29, 2003. These credit facilities contain cross default provisions, various restrictions upon the ability of Holdings, Supplies Distributors, SDSA and BSD Europe to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors of no less than \$6.5 million, and shareholders' equity of at least \$25.0 million. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or SDSA under these facilities. An over-advance would arise in the event borrowings exceeded the maximum amount available under the eligible borrowing base, as defined.

Concurrent with these amended agreements, Supplies Distributors entered into a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to \$25 million of eligible accounts receivables in the U.S. and Canada. The Congress facility expires on the earlier of three years or the date on which the parties to the IBM Master Distributor Agreement shall no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such

agreement. Borrowings under the Congress facility accrue interest at prime rate plus 0.25% or Eurodollar rate plus 3.0% or on an adjusted basis, as defined. In Europe, SDSA entered into a two year factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 10 million Euros (approximately \$9 million) of eligible accounts receivables. Borrowings under this agreement accrue interest at 8.5%, or on an adjusted basis as defined. These credit facilities contain cross default provisions, various restrictions upon the ability of Holdings, Supplies Distributors and SDSA to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, we are required to maintain a subordinated loan of no less than \$6.5 million to Supplies Distributors and restricted cash of less than \$5.0 million, and are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors under the Congress facility. An over-advance would arise in the event borrowings exceeded the maximum amount available under the eligible borrowing base, as defined. PFS has also provided a guarantee of the obligations of Supplies Distributors and SDSA to IBM, excluding the trade payables that are financed by IBM credit.

Pursuant to the terms of our transaction management services agreement with Supplies Distributors, we earned service fees, which are reported as service fee revenue -- affiliate in the accompanying consolidated financial statements, of approximately \$1.4 million for the nine months ended December 31, 2001. For the nine months ended December 31, 2001, our fees earned from services provided under the IBM Master Distributor Agreements, including related party revenue, were \$5.0 million. For the nine months ended December 31, 2000, prior to becoming a related party, service fees earned by PFSweb from BSD, associated with the Master Distributor Agreements, were \$4.6 million. As of December 31, 2001, we had trade accounts receivables of \$0.9 million due from Supplies Distributors.

We record our interest in Holdings' net income, which is allocated and distributed to the owners pursuant to the terms of Holdings' operating agreement, under the modified equity method, which results in us recording our allocated earnings of Holdings or 100% of Holdings' losses. Pursuant to Holdings' operating agreement, Holdings allocates its earning and distributes its cash flow, as defined, in the following order of priority: first, to IFP until it has received a one-time amount equal to its capital contribution of \$0.25 million; second, to IFP until it has received an amount equal to a 35% cumulative annual return on its capital contribution; third, to PFSweb until it has received a one-time amount equal to its capital contribution of \$0.75 million; fourth, to PFSweb until it has received an amount equal to a 35% cumulative annual return on its capital contribution; and fifth, to PFSweb and IFP, pro rata, in accordance with their respective capital accounts. Notwithstanding the foregoing, no distribution may be made if, after giving effect thereto, the net worth of Holdings shall be less than \$1.0 million. Under terms of the credit agreements described above, Holdings is currently limited to annual cash dividends of \$0.6 million. We did not record any equity in the earnings of Holdings for the nine months ended December 31, 2001.

Summarized financial information for Holdings as of December 31, 2001 is as follows (in thousands):

Current assets.....	\$80,247
Total assets.....	\$81,554
Current liabilities.....	\$ 9,651
Credit facilities (guaranteed by PFSweb).....	\$59,038
Subordinated debt due to PFSweb.....	\$11,655
Members' capital.....	\$ 1,210

Summarized operating information for Holdings for the period from July 3, 2001 (Inception) through December 31, 2001 is as follows (in thousands):

Net revenues.....	\$75,444
Cost of goods sold.....	\$71,870
Income before taxes.....	\$ 673
Net income.....	\$ 401

LIQUIDITY AND CAPITAL RESOURCES

On May 25, 2001, we completed the sale of certain assets to Daisytek pursuant to an Asset Purchase Agreement (the "Purchase Agreement"). Under the Purchase Agreement, we transferred and sold to Daisytek certain distribution and fulfillment assets, including equipment and fixtures, that were previously used by us to provide outsourcing services to Daisytek. Daisytek also assumed certain related equipment leases and a warehouse lease and hired certain employees who were associated with the warehouse facility. The consideration payable under the Purchase Agreement of \$11.0 million included a termination by us and Daisytek of certain transaction management services agreements previously entered into between us and Daisytek and a Daisytek subsidiary. Proceeds of \$10.9 million were received for assets with an approximately \$4.5 million net book value with a resulting \$5.8 million gain, after closing costs of \$0.6 million. Concurrently with the closing of the asset sale, we and Daisytek also entered into a six-month transition services agreement, which terminated in November 2001, under which we provided Daisytek with certain transitional and information technology services.

Net cash used in operating activities was \$4.5 million for the nine months ended December 31, 2001, and primarily resulted from cash used to fund operating losses and the net impact of decreases in accounts payable and accrued expenses of \$9.1 million, partially offset by a decrease in prepaid expenses and other current assets of \$5.1 million. The decrease in accounts payable and accrued expenses is primarily attributable to the remittance of the VAT monies due to one of our clients and the reversal of client termination reserves, recorded as expense in prior year, and the reversal of deferrals applicable to the termination of the Daisytek transaction management services agreements, for which the related activities occurred in earlier periods. The decrease in other current assets primarily relates to the collection of a note receivable, a governmental grant and VAT receivables associated with our European operations. Net cash provided by operating activities was \$0.6 million for fiscal 2001, and primarily resulted from an increase in accounts payable and accrued expenses of \$8.2 million partially offset by cash used to fund operating losses and an increase to prepaid expenses and other current assets of \$5.4 million. The increase in other current assets primarily relates to receivables associated with our European operations including a \$1.1 million note receivable from a terminated client, a \$1.6 million receivable related to an asset based governmental grant and VAT receivables of \$2.3 million. The increase in accounts payable was primarily attributable to \$7.2 million of VAT collections that was due one of our clients. Cash flows provided by operating activities totaled \$10.6 million for fiscal 2000 and primarily relate to a reduction in accounts receivable of \$8.3 million and inventory of \$29.9 million, net of a reduction in accounts payable and accrued expenses of \$25.0 million. These reductions primarily related to the transfer of the IBM related working capital assets from us to Daisytek in conjunction with the new IBM agreements. The cash flow impact of these reductions was partially offset by cash used to fund operating losses.

Net cash used by investing activities for the nine months ended December 31, 2001 totaled \$8.1 million. The net proceeds of \$10.3 million from the sale of one of our distribution facilities to Daisytek were offset by capital expenditures of \$3.2 million, the establishment of a restricted cash balance of \$2.8 million to support our long-term debt and lease financing, and a subordinated loan of approximately \$11.7 million to Supplies Distributors and an equity investment of \$0.8 million in Holdings. Cash used in investing activities for fiscal 2001 totaled \$2.9 million. Capital expenditures were \$6.3 million for fiscal 2001. Partially offsetting the cash usage associated with these capital expenditures was the full collection of other receivables. Cash used in investing activities was \$10.2 million for fiscal 2000. During fiscal 2000, our capital expenditures totaled \$18.5 million and included the asset purchase from Daisytek at the completion of the Offering, our new Belgium distribution facility, and the expansion of U.S. sales and distribution facilities. Partially offsetting the

cash usage associated with these capital expenditures was the \$8.4 million collection of other receivables. Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, including our Internet-based customer tools, other methods of e-commerce and general expansion of our facilities, both domestic and foreign. We expect to incur capital expenditures in order to support new contracts and anticipated future growth opportunities. We anticipate that our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months will be approximately \$2 to \$4 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients. Some of these expenditures may be financed through operating or capital leases.

Net cash provided by financing activities was \$1.0 million for the nine months ended December 31, 2001, representing the proceeds from debt and from the issuance of common stock pursuant to our employee stock purchase plan offset by payments on our capital lease obligations and payments to acquire treasury stock. Net cash used in financing activities was \$0.2 million in fiscal 2001, representing payments on our capital lease obligations partially offset by the proceeds from issuance of common stock. Net cash provided by financing activities was \$24.0 million for fiscal 2000. In December 1999, we successfully completed our Offering and sold 3,565,000 shares of common stock, including the underwriters over-allotment, at \$17 per share. Net proceeds from the Offering aggregated approximately \$53.0 million. Proceeds were used to repay an intercompany payable to Daisytek of approximately \$27 million and to acquire from Daisytek all fixed assets in its Memphis distribution facility, as well as certain assets providing information technology services for approximately \$5 million, and we received the stock of several subsidiaries of Daisytek representing the business operations of PFSweb.

During the nine months ended December 31, 2001, our working capital decreased to \$11.2 million from \$19.9 million at March 31, 2001, primarily due to the establishment and capitalization of an affiliate, Supplies Distributors, and the funding of operations and capital expenditures offset by the proceeds from the sale of a distribution facility. In order to obtain additional financing in the future, in addition to our current cash position, we plan to evaluate alternatives including utilizing capital or operating leases, establishing our own credit facility, entering into asset based lending or factoring programs, or transferring a portion of our subordinated loan balances, due from Supplies Distributors, to third-parties. In conjunction with these alternatives we may be required to provide certain letters of credit to secure these arrangements. No assurances can be given that we will be successful in obtaining any additional financing or the terms thereof. We currently believe that our cash position and funds generated from operations will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements and our lease obligations, and additional subordinated loans to Supplies Distributors, if necessary, through April 2003.

The following is a schedule of our total contractual cash obligations, which is comprised of operating leases and long-term debt and capital leases (including interest), as of December 31, 2001 (in millions):

LONG-TERM DEBT AND CONTRACTUAL OPERATING CAPITAL			
TOTAL CASH LEASES LEASES OBLIGATIONS -----			
----- Fiscal Year Ended December			
31,			
2002.....	\$ 6,060	\$1,238	\$ 7,298
2003.....	5,985	1,248	7,233
2004.....	4,198	943	5,141
2005.....	2,782	786	3,568
2006.....	2,751	620	3,371
Thereafter.....	2,696	602	3,298
			----- Total
			contractual cash obligations..... \$24,472
	\$5,437	\$29,909	=====

In support of certain debt instruments and leases, as of December 31, 2001, we had \$2.8 million of cash restricted in the form of a letter of credit. The letter of credit expires at the termination of the underlying long-

term debt and lease obligations in July 2004. As described above, we have provided collateralized guarantees to secure the repayment of Supplies Distributors' credit facilities. As of December 31, 2001, the outstanding balance of the credit facilities guaranteed by PFSweb was approximately \$59.0 million. In association with the new credit facilities entered into in March 2002, the outstanding balance of the credit facilities guaranteed by PFSweb was approximately \$48.5 million. These guarantees expire concurrently with the expiration of the underlying credit agreements. To the extent Supplies Distributors or its subsidiaries fails to comply with its covenants, including its monthly financial covenant requirements, and the lenders accelerate the repayment of the credit facility obligations, Supplies Distributors or its subsidiaries would be required to repay all amounts outstanding thereunder. In such event, we would be obligated to perform under those guarantees and repay, to the extent Supplies Distributors or its subsidiaries was unable to, Supplies Distributors' or its subsidiaries credit facility obligations. Additionally, if we were unable to maintain our required level of stockholders' equity of \$25.0 million, we could also be obligated to perform under these guarantees. Any requirement to perform under our guarantees would have a material adverse impact on our financial condition and results of operations and no assurance can be given that we will have the financial ability to repay all of such guaranteed obligations. In addition, in the event Supplies Distributors or its subsidiaries is, or would be, in default of its obligations under its credit facilities, we are restricted from receiving any payment of our subordinated loans and such event would also have a material adverse impact upon our financial condition and results of operations. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries by its lenders. An over-advance would arise in the event borrowings exceeded the maximum amount available under the eligible borrowing base, as defined. The Company does not have any other material commercial commitments.

Currently, we believe that we are operating with and incurring costs applicable to excess capacity in both our North American and European operations. We believe that as we add revenue, we will be able to cover our existing infrastructure and public company costs and reach profitability. We currently estimate that the revenue needed to leverage our infrastructure and reach profitability is approximately \$14 million per quarter. No assurance can be given that we can achieve such operating levels, or that, if achieved, we will be profitable in any particular fiscal period.

In the future, we may attempt to acquire other businesses to expand our services or capabilities in connection with our efforts to grow our business. We currently have no binding agreements to acquire any such businesses. Should we be successful in acquiring other businesses, we may require additional financing. Acquisitions involve certain risks and uncertainties. Therefore, we can give no assurance with respect to whether we will be successful in identifying businesses to acquire, whether we will be able to obtain financing to complete an acquisition, or whether we will be successful in operating the acquired business.

INVENTORY MANAGEMENT

Prior to September 30, 1999, our agreements with IBM were structured as master distributor agreements. The transaction management services we provided for IBM under these agreements included purchasing and reselling IBM product inventory to IBM customers. During the quarter ended September 30, 1999, we restructured our agreements with IBM so that we no longer purchased or resold the IBM product inventory. In addition, we transferred to Daisytek the IBM-related customer accounts receivables, inventory and accounts payable. We do not currently own any product inventory.

SEASONALITY

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

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

INFLATION

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

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No.'s 141 and 142, "Business Combinations" and "Goodwill and Other Intangibles." SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. SFAS 142 requires that ratable amortization of goodwill be replaced with annual fair-value based tests of the goodwill's impairment, and that intangible assets other than goodwill be amortized over their useful lives. Additionally, under the provision of the new accounting standard, an acquired intangible asset should be separately recognized if the benefit of the intangible asset is obtained through contractual other legal rights, or if the intangible asset can be sold, transferred, licensed, rented, or exchanged, regardless of the acquirer's intent to do so. SFAS 141 is effective for all business combinations initiated after June 30, 2001 and for all business combinations accounted for by the purchase method for which the date of acquisition is after June 30, 2001. The adoption of SFAS 141 as of July 1, 2001 did not have a material impact on the Company's financial statements and related disclosures. The provisions of SFAS 142 will be effective for fiscal years beginning after December 15, 2001. The Company's adoption SFAS 142 on January 1, 2002 did not have a material impact on the Company's consolidated financial statements and related disclosures.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which addresses the accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company is currently assessing the impact on the consolidated financial statements and will adopt the provisions of this standard by the first quarter of 2003.

In October, 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which establishes a universal accounting model based on the framework established in SFAS 121 for the long-lived assets to be disposed of by sale. The Company's adoption of SFAS 144 on January 1, 2002 did not have a material impact on the Company's consolidated financial statements and related disclosures.

CRITICAL ACCOUNTING POLICIES

Our service fee revenues primarily relate to our (1) distribution services and (2) order management/customer care services.

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

Order management/customer care services relate primarily to taking customer orders for our client's products via various channels such as telephone call-center, electronic or facsimile. These services also entail addressing customer questions related to orders, as well as cross-selling/up-selling activities. Revenue is recognized as the services are rendered. Fees charged to the client are on a per transaction basis based on either (i) a pre-determined fee per order or fee per telephone minutes incurred, or (ii) are included in the product fulfillment service fees which are recognized on product shipment. Our cost of service fee revenue, representing the cost to provide the services described above, is recognized as incurred. Cost of service fee revenue also includes costs associated with technology collaboration and ongoing technology support which consist of creative website development and maintenance, web hosting, technology interfacing, and other ongoing programming activities. These activities are primarily performed to support the distribution and order management/customer care services and are recognized as incurred.

We also perform billing services and information management services for its clients. Billing services and information management services are typically not billed separately to clients because the activities are continually performed, and the costs are insignificant and are generally covered by other fees described above.

Therefore, any revenue attributable to these services is often included in the distribution or order management fees which are recognized as services are performed. The service fee revenue associated with these activities are currently not significant and are incidental to the above-mentioned services.

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

We primarily perform our services under two to three year contracts that can be terminated by either party. In conjunction with these long-term contracts we generally receive start-up fees to cover our implementation costs, including certain technology infrastructure and development costs. We defer the fees received, and the related costs, and amortize them over the life of the contract. The amortization of deferred revenue is included as a component of service fee revenue. The amortization of deferred implementation costs is included as a cost of service fee revenue. To the extent implementation costs exceed the fees received, excess costs are expensed as incurred.

A description of other significant accounting policies is included in footnote 2 to the accompanying consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

INTEREST RATE RISK

The carrying value of our financial instruments, which include cash and cash equivalents, accounts receivable, note receivable, accounts payable, long-term debt and capital lease obligations, approximate their fair values based on short terms to maturity or current market prices and rates. The impact of a 100 basis point change in interest rates would not have a material impact on the Company's results of operations or financial position.

FOREIGN EXCHANGE RISK

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

Effective April 1, 2001, in response to a change to the Euro for transaction activity previously conducted in the U.S. dollar by our largest European client, we adopted the Euro as our functional currency for our European operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND
FINANCIAL STATEMENT SCHEDULE

PAGE ---- PFSWEB, INC. AND SUBSIDIARIES Independent
Auditors' Report..... 45
 Report of Independent Public
Accountants..... 46 Consolidated Balance
Sheets..... 47 Consolidated
 Statements of Operations..... 48
Consolidated Statements of Shareholders' Equity and
 Comprehensive
 Loss..... 49
 Consolidated Statements of Cash
Flows..... 50 Notes to Consolidated
 Financial Statements..... 51 BUSINESS
SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES
 Independent Auditors'
Report..... 72 Consolidated
 Balance Sheet..... 73
 Consolidated Statement of
 Operations..... 74 Consolidated
 Statement of Members' Capital and Comprehensive
Income.....
 75 Consolidated Statement of Cash
 Flows..... 76 Notes to Consolidated
Financial Statements..... 77 SUPPLEMENTARY
 DATA Schedule II -- Valuation and Qualifying
 Accounts..... 91

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and
Shareholders of PFSweb, Inc.:

We have audited the accompanying consolidated balance sheets of PFSweb, Inc. and subsidiaries as of March 31, 2001 and December 31, 2001, and the related consolidated statements of operations, shareholders' equity and comprehensive loss and cash flows for the year ended March 31, 2001 and the nine-month period ended December 31, 2001. In connection with our audits of the consolidated financial statements, we also have audited the accompanying financial statement schedule as of March 31, 2001 and December 31, 2001 and for the year ended March 31, 2001 and the nine-month period ended December 31, 2001. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PFSweb, Inc. and subsidiaries as of March 31, 2001 and December 31, 2001, and the results of their operations and their cash flows for the year ended March 31, 2001 and the nine-month period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule as of March 31, 2001 and December 31, 2001 and for the year ended March 31, 2001 and the nine-month period ended December 31, 2001, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

Dallas, Texas
February 15, 2002, except for Note 7 and 9 to which the date is as of March 29,
2002

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of PFSweb, Inc.:

We have audited the accompanying consolidated statements of operations, shareholders' equity and cash flows of PFSweb, Inc. (a Delaware corporation) and subsidiaries (see Note 1) for the year ended March 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of PFSweb, Inc. and subsidiaries as of March 31, 2000, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Dallas, Texas,
May 4, 2000

PFSWEB, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

MARCH 31,	DECEMBER 31,	2001	2001	-----
ASSETS CURRENT ASSETS: Cash and cash				
equivalents.....		\$ 22,266	\$	
10,751 Accounts receivable, net of allowance for doubtful				
accounts of \$279 and \$254 at March 31, 2001 and December				
31, 2001, respectively (Note 7).....		7,294		
6,780 Other				
receivables.....				
4,972 92 Prepaid expenses and other current				
assets.....	3,144	2,646	-----	
Total current assets.....				37,676
20,269 -----	PROPERTY AND EQUIPMENT,			
net.....		20,875	15,329	NOTE
RECEIVABLE FROM AFFILIATE (Note 7).....				-
- 11,655 OTHER ASSETS (including \$2,757 of restricted				
cash as of December 31,				
2001).....		538	4,340	-
-----	Total			
assets.....		\$ 59,089	\$	
51,593 =====	LIABILITIES AND SHAREHOLDERS'			
EQUITY CURRENT LIABILITIES: Current portion of long-term				
obligations.....				\$
300 \$ 995 Trade accounts				
payable.....		11,403	2,820	
Accrued compensation				
payable.....	734	608	Accrued	
expenses.....		5,298		
4,692 -----	Total current			
liabilities.....		17,735	9,115	-----
- -----	LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS,			
less current				
portion.....				
2,139 3,663 -----	OTHER			
LIABILITIES.....				
2,214 2,210 -----	COMMITMENTS AND			
CONTINGENCIES (Notes 7 and 9) SHAREHOLDERS' EQUITY:				
Preferred stock, \$1.00 par value; 1,000,000 shares				
authorized; none issued and outstanding at March 31, 2001				
and December 31, 2001.....				-- --
Common stock, \$0.001 par value; 40,000,000 shares				
authorized; 17,907,378 and 18,143,409 shares issued at				
March 31, 2001 and December 31, 2001, respectively;				
17,907,378 and 18,057,109 outstanding at March 31 and				
December 31, 2001, respectively.....				
18 18 Additional paid-in				
capital.....		50,884	51,942	
Accumulated				
deficit.....		(13,592)		
(14,157) Accumulated other comprehensive				
loss.....	(309)	(1,113)	Treasury stock	
at cost, 86,300 shares at December 31,				
2001.....				-
- (85) -----	Total shareholders'			
equity.....		37,001	36,605	-----
-----	Total liabilities and shareholders' equity.....			
\$ 59,089 \$ 51,593 =====				=====

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

PFSWEB, INC. AND SUBSIDIARIES

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

FISCAL YEARS ENDED MARCH 31, -----		NINE MONTHS ENDED 2000 2001 DECEMBER 31, 2001 -----	
----- REVENUES (Note 5):			
Product			
revenue.....	\$57,044	\$ --	\$ --
	Service fee		
revenue.....		30,829	
48,258	26,569	Service fee revenue, affiliate (Note 7)..... -- -- 1,384	
revenue.....			--
	2,097	100	----- Total
revenues.....			87,873
50,355	28,053	----- COSTS OF REVENUES: Cost of product	
revenue.....		53,905	-- --
	Cost of service fee		
revenue.....		23,475	34,261
	17,984	Cost of other	
revenue.....		--	2,470
(627)	----- Total costs of		
revenues.....		77,380	36,731
	17,357	----- Gross	
profit.....			10,493
13,624	10,696	SELLING, GENERAL AND ADMINISTRATIVE EXPENSES..... 17,764 25,446 17,117 OTHER (Note 5)..... -- -- (5,141) ----- Loss from operations..... (7,271) (11,822) (1,280) INTEREST EXPENSE (INCOME), net..... 459 (1,091) (496) --- ----- Loss before income taxes..... (7,730) (10,731) (784) INCOME TAX EXPENSE (BENEFIT)..... (1,791) 25 (219) ----- NET	
LOSS.....			
\$ (5,939)	\$ (10,756)	\$ (565)	=====
NET LOSS PER SHARE: Basic and diluted..... \$ (0.38) \$ (0.60) \$ (0.03) =====			
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING: Basic and diluted..... 15,479 17,879 18,036 =====			

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

PFSWEB, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE LOSS

(IN THOUSANDS, EXCEPT SHARE DATA)

ACCUMULATED COMMON STOCK			
ADDITIONAL DAISYTEK'S OTHER -----			
----- PAID-IN			
ACCUMULATED NET EQUITY			
COMPREHENSIVE SHARES AMOUNT			
CAPITAL DEFICIT INVESTMENT LOSS			

- Balance, March 31,			
1999.....	-- \$--	\$ --	\$ --
-- \$ 712	\$ (131)	Net loss prior	
to initial public			
offering.....	-- --	-- (3,103)	--
Contribution of Daisytek's net			
equity			
investment.....	-- --		
(2,391)	-- 2,391	-- Net loss	
subsequent to initial public			
offering.....	-- --		
-- (2,836)	-- --	Issuance of	
common stock to			
Daisytek.....			
14,305,000	14 6	-- --	Initial
public offering, net of issuance			
costs.....			
3,565,000	4 53,010	-- --	
Stock based compensation			
expense... -- --	48	-- --	
Other comprehensive loss --			
foreign currency translation			
adjustment.....	-- --	-- (74)	-----

--- Comprehensive			
loss.....	Balance,		
March 31, 2000.....			
17,870,000	\$18 \$50,673	\$ (2,836)	
\$ --	\$ (205)	Net	
loss.....			
-- --	-- (10,756)	-- --	
Reduction in costs of initial			
public			
offering.....	-- --		
148	-- --	Stock based	
compensation expense... -- --	38		
-- --	-- Employee stock purchase		
plan.....	37,378	-- 25	-- --
- Other comprehensive loss --			
foreign currency translation			
adjustment.....	-- --	-- (104)	-----

---- Comprehensive			
loss.....	Balance,		
March 31, 2001.....			
17,907,378	\$18 \$50,884	\$(13,592)	
\$ --	\$ (309)	Net	
loss.....			
-- --	-- (565)	-- --	
Reduction			
in costs of initial public			
offering.....	-- --		
175	-- --	Purchases of	
treasury stock.....	-- --		
-- --	--	Stock based	
compensation expense... -- --			
704	-- --	Tax benefit from	
exercise of Daisytek stock			
options.....	-- --	26	-- --
- --	--	Employee stock purchase	
plan.....	236,031	-- 153	-- --
--	--	Other comprehensive loss --	
foreign currency translation			
adjustment.....			

```

-- -- -- -- (804) -----
-----
---- Comprehensive
loss..... Balance,
December 31, 2001.....
18,143,409 $18 $51,942 $(14,157)
$ -- $(1,113) =====
=====
TREASURE STOCK TOTAL -----
----- SHAREHOLDERS'
COMPREHENSIVE SHARES AMOUNT
EQUITY LOSS -----
----- Balance,
March 31, 1999..... -- $
-- $ 581 Net loss prior to
initial public
offering.....
-- -- (3,103) $ (3,103)
Contribution of Daisytek's net
equity
investment..... -- --
-- Net loss subsequent to
initial public
offering..... -- --
(2,836) (2,836) Issuance of
common stock to
Daisytek.....
-- -- 20 Initial public
offering, net of issuance
costs..... -- --
53,014 Stock based compensation
expense... -- -- 48 Other
comprehensive loss -- foreign
currency translation
adjustment.....
-- -- (74) (74) -----
----- Comprehensive
loss..... $ (6,013)
===== Balance, March 31,
2000..... -- $ -- $
47,650 Net
loss.....
-- -- (10,756) $(10,756)
Reduction in costs of initial
public
offering..... -- --
148 Stock based compensation
expense... -- -- 38 Employee
stock purchase plan..... -- --
25 Other comprehensive loss --
foreign currency translation
adjustment.....
-- -- (104) (104) -----
----- Comprehensive
loss..... $(10,860)
===== Balance, March 31,
2001..... -- $ -- $
37,001 Net
loss.....
-- -- (565) $ (565) Reduction in
costs of initial public
offering..... -- --
175 Purchases of treasury
stock..... 86,300 (85) (85)
Stock based compensation
expense... -- -- 704 Tax benefit
from exercise of Daisytek stock
options..... -- -- 26
Employee stock purchase
plan..... -- -- 153 Other
comprehensive loss -- foreign
currency translation
adjustment.....
-- -- (804) (804) -----
----- Comprehensive
loss..... $ (1,369)
===== Balance, December 31,
2001..... 86,300 $(85) $
36,605 =====

```

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

PFSWEB, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

FISCAL YEARS NINE MONTHS ENDED MARCH 31, ENDED -----	-----	-----	-----
----- DECEMBER 31, 2000 2001 2001 -----	-----	-----	-----
----- CASH FLOWS FROM OPERATING			
ACTIVITIES: Net			
loss.....			
\$ (5,939) \$(10,756) \$ (565)	Adjustments to reconcile		
net loss to net cash provided by (used in) operating			
activities: Depreciation and			
amortization.....	2,373	6,803	
4,605	Provision for doubtful		
accounts.....	458	2,203	17
income taxes.....	453	109	
-- Non-cash compensation			
expense.....	48	38	704
Gain on			
sale of distribution facility.....	--	--	--
(5,837)	Changes in operating assets and liabilities:		
Accounts receivables.....			
8,324	(607)	524	Inventories,
net.....	29,856	--	--
Prepaid expenses and other current assets.....			
(55)	(5,423)	5,152	Accounts payable and accrued
expenses.....	(24,954)	8,223	(9,061)
--	-----	-----	-----
Net cash provided by (used in)			
operating activities... 10,564	590	(4,461)	-----
----- CASH FLOWS FROM INVESTING			
ACTIVITIES: Purchases of property and			
equipment.....	(18,521)	(6,309)	
(3,237)	(Increase) decrease in other		
assets.....	8,358	3,417	(2,757)
Equity investment in			
affiliate.....	--	--	(750)
Proceeds from sale of distribution facility,			
net.....	--	--	10,298
Loan to			
affiliate.....	--	--	
--	(11,655)	-----	-----
Net cash used			
in investing activities.....	(10,163)		
(2,892)	(8,101)	-----	-----
----- CASH FLOWS			
FROM FINANCING ACTIVITIES: Issuance of common stock			
to Daisytek.....	20	--	--
Net			
proceeds from initial public offering of common			
stock.....	53,014	--	--
Net proceeds from issuance of common			
stock.....	--	25	153
Payment on capital			
lease obligations.....	(15)	(242)	
(558)	Proceeds from		
debt.....	--	--	
1,529	Purchases of treasury		
stock.....	--	--	(85)
Decrease in payable to			
Daisytek.....	(29,029)	--	--
-----	-----	-----	-----
Net cash provided by (used			
in) financing activities... 23,990	(217)	1,039	-----
--	-----	-----	-----
EFFECT OF EXCHANGE RATES ON			
CASH.....	(82)	(111)	8
-----	-----	-----	-----
NET INCREASE (DECREASE) IN			
CASH.....	24,309	(2,630)	
(11,515)	CASH AND CASH EQUIVALENTS, beginning of		
period.....	587	24,896	22,266
-----	-----	-----	-----
CASH AND CASH EQUIVALENTS, end of			
period.....	\$ 24,896	\$ 22,266	\$ 10,751
=====	=====	=====	=====
SUPPLEMENTAL CASH FLOW			
INFORMATION Non-cash investing and financing			
activities: Fixed assets acquired under capital			
leases.....	\$ 2,696	\$ --	\$ 2,777
=====	=====	=====	=====
Governmental grant receivable for			
capital expenditures (Note			
2).....	\$ --	\$ --	\$ --
\$ 1,564	\$ --	=====	=====

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

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. OVERVIEW AND BASIS OF PRESENTATION

In June 1999, Daisytek International Corporation ("Daisytek") created a separate wholly-owned subsidiary named PFSweb, Inc. (the "Company" or "PFSweb"), a Delaware corporation, to become a holding company for certain of Daisytek's wholly-owned subsidiaries ("PFS") in contemplation of an initial public offering of PFSweb. Daisytek contributed \$20,000 for 14,305,000 shares of common stock of PFSweb. In December 1999, PFSweb sold 3,565,000 shares of common stock at a price of \$17 per share (the "Offering"). Net proceeds from the Offering aggregated approximately \$53.0 million and were used to repay the Company's payable to Daisytek and to acquire from Daisytek all fixed assets in its Memphis distribution facility as well as certain assets providing information technology services for approximately \$5 million (see Note 5). Simultaneous with the completion of the Offering, Daisytek contributed to PFSweb all the assets, liabilities and equity comprising PFS.

On June 8, 2000, the Daisytek Board of Directors approved the separation of PFSweb from Daisytek by means of a tax-free dividend of Daisytek's remaining ownership of PFSweb after receiving a favorable ruling from the IRS to the effect that the distribution by Daisytek of its shares of PFSweb stock would be tax-free to Daisytek and to Daisytek's shareholders for U.S. federal income tax purposes. The distribution of Daisytek's 14,305,000 shares of PFSweb (the "Spin-off") occurred at the close of business on July 6, 2000, to Daisytek shareholders of record as of June 19, 2000.

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

For all periods prior to the Spin-off, the accompanying consolidated financial statements are presented on a carve-out basis and reflect the consolidated historical results of operations, financial position and cash flows of the Company. For all periods prior to the nine month period ended December 31, 2001, certain expenses reflected in the consolidated financial statements include an allocation of certain Daisytek corporate expenses and infrastructure costs (see Note 5). Management believes that the methods used to allocate expenses are reasonable, although the cost of services could be higher if obtained from other sources. In addition, certain service fee revenue and cost of service fee revenue have been reflected by PFSweb for services subcontracted to PFSweb by Daisytek. The service fee revenue, cost of service fee revenue and allocated expenses have been reflected on bases that Daisytek and PFSweb consider to be a reasonable reflection of the services provided and revenue earned by PFSweb and the utilization of services provided by Daisytek and the benefit received by PFSweb. The financial information included herein may not reflect the consolidated financial position, operating results, shareholders' equity and cash flows of PFSweb in the future or what it would have been had PFSweb been a separate, stand-alone entity during the periods presented.

In June 2001, the Company changed its fiscal year from March 31 to December 31. Consequently, the most recent fiscal period is a nine month transition period ended December 31, 2001.

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

Prior to the Offering, the financial position, results of operations and cash flows of PFS were referred to as the combined financial statements of PFSweb. Subsequent to the Offering and for all periods presented herein, the financial position, results of operations and cash flows of the Company are referred to as the consolidated

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

financial statements of PFSweb, Inc. and subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

INVESTMENT IN AFFILIATE

During the nine month period ended December 31, 2001, the Company made a 49% investment in Business Supplies Distributors Holdings, LLC, ("Holdings") an affiliate (see Note 7). The Company records its interest in Holdings' net income, which is allocated and distributed to the owners pursuant to the terms of Holdings' operating agreement, under the modified equity method, which results in the Company recording its allocated earnings of Holdings or 100% of Holdings' losses.

In addition to the equity investment, the Company loaned a subsidiary of this affiliate \$11.7 million in the form of a Subordinated Demand Note (the "Note"). The Note can be decreased to \$6.5 million subject to Holdings' compliance with the covenants of its senior loan facilities, as amended. Management believes that the Note, which is due on demand, will not be repaid in its entirety within the upcoming year and has therefore classified the entire balance as long-term.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. The allocation of certain expenses and the determination of costs applicable to client terminations (see Notes 1 and 5) in these consolidated financial statements also required management estimates and assumptions. Actual results could differ from those estimates.

REVENUE AND COST RECOGNITION

For fiscal 2000, the Company recognized product revenue and cost of product revenue upon shipment of product to customers and provided for estimated returns and allowances. The Company's service fee revenues primarily relate to its (1) distribution services and (2) order management/customer care services.

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

Order management/customer care services relate primarily to taking customer orders for our client's products via various channels such as telephone call-center, electronic or facsimile. These services also entail addressing customer questions related to orders, as well as cross-selling/up-selling activities. Revenue is recognized as the services are rendered. Fees charged to the client are on a per transaction basis based on either (i) a pre-determined fee per order or fee per telephone minutes incurred, or (ii) are included in the product fulfillment service fees which are recognized on product shipment. The Company's cost of service fee revenue, representing the cost to provide the services described above, is recognized as incurred. Cost of service fee revenue also includes costs associated with technology collaboration and ongoing technology support which consist of creative website development and maintenance, web hosting, technology interfacing, and other ongoing programming activities. These activities are primarily performed to support the distribution and order management/customer care services and are recognized as incurred.

The Company also performs billing services and information management services for its clients. Billing services and information management services are typically not billed separately to clients because the activities are continually performed, and the costs are insignificant and are generally covered by other fees described above. Therefore, any revenue attributable to these services is often included in the distribution or

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

order management fees which are recognized as services are performed. The service fee revenue associated with these activities are currently not significant and are incidental to the above-mentioned services.

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

Other revenue of \$2.1 million and \$0.1 million for fiscal 2001 and the nine months ended December 31, 2001, respectively, represents the fees charged to clients in conjunction with the early termination of certain contracts. Cost of other revenue for fiscal 2001 includes approximately \$0.4 million of employee severance costs, approximately \$0.5 million of asset impairments from fixed assets which were specific to terminated contracts and provided no further value to PFSweb, and approximately \$1.6 million of certain uncollectible amounts receivable from, and liabilities applicable to, clients who terminated contracts. Cost of other revenue for the nine months ended December 31, 2001 of \$0.6 million reflects the benefit associated with the reversal of accruals made in the prior year for estimated client terminations costs that were determined this period to be in excess of actual costs incurred.

The Company primarily performs its services under two to three year contracts that can be terminated by either party. In conjunction with these long-term contracts the Company generally receives start-up fees to cover its implementation costs, including certain technology infrastructure and development costs. The Company defers the fees received, and the related costs, and amortizes them over the life of the contract. The amortization of deferred revenue is included as a component of service fee revenue. The amortization of deferred implementation costs is included as a cost of service fee revenue. To the extent implementation costs exceed the fees received, excess costs are expensed as incurred. The following summarizes the deferred implementation costs and revenues (in thousands):

MARCH 31, 2001	DECEMBER 31, 2001	-----	----
----- Deferred implementation costs			
Current.....		\$ 518	\$ 845 Non-
current.....		434	655 -----
		\$ 952	\$1,500 =====
Deferred implementation revenues			
Current.....		1,283	1,434 Non-
current.....		974	988 -----
		\$2,257	\$2,422 =====

Current and non-current deferred implementation costs are a component of prepaid expenses and other assets, respectively. Current and non-current deferred implementation revenues are a component of accrued expenses and other liabilities, respectively.

Certain contracts involve third-party vendors who provide services such as package delivery. The costs incurred by the Company related to such third-party services are reimbursed at cost by its clients and are not reflected in revenue or expense.

CONCENTRATION OF BUSINESS AND CREDIT RISK

All of the Company's product revenue for fiscal 2000 was generated by sales of product purchased under master distributor agreements with one supplier. Product and service fee revenue from Daisysitek accounted for approximately 22%, 55% and 34% of the Company's total revenues for fiscal years 2000 and 2001, and the nine

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

month period ended December 31, 2001, respectively. The Company had one other client which accounted for approximately 19% of the Company's revenue for the nine-month period ended December 31, 2001. For the nine month period ended December 31, 2001, excluding Daisytek, two clients accounted for approximately 43% of the Company's revenue. As of March 31, 2001, Daisytek and one other customer accounted for approximately 55% of accounts receivable. As of December 31, 2001, two customers accounted for approximately 34% of accounts receivable, of which 12% is due from an affiliate (see Note 7).

RECLASSIFICATIONS

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

CASH AND CASH EQUIVALENTS

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

RESTRICTED CASH

In conjunction with certain long-term debt and leases, as of December 31, 2001, the Company had approximately \$2.8 million of cash restricted as collateral for of a letter of credit that secures these debt and lease obligations. The letter of credit expires in July, 2004.

OTHER RECEIVABLES AND LIABILITIES

As of March 31, 2001, other receivables includes the following items applicable to the Company's European operations (in thousands):

	MARCH 31, 2001 -----	
Note.....		
	\$1,132	Value added
tax.....		2,276
		Governmental
grant.....		1,564 -----
	- \$4,972	=====

The note receivable amount represented the remaining balance of a \$1.7 million contract termination fee which was collected in full during the nine months ended December 31, 2001. Value Added Tax ("VAT") receivables represent amounts due from European governments for refundable VAT payments made in the ordinary course of business. The Company received approximately \$2.2 million, net, associated with VAT in the nine months ended December 31, 2001. The governmental grant relates to investments made by the Company in fixed assets in its Belgium operation. The grant was fully collected as of December 31, 2001.

At establishment, the total grant of approximately \$1.6 million was deferred and is being recognized as a reduction in depreciation expense over the same period over which the related fixed assets are being depreciated. A deferred credit of \$1.1 million and \$1.0 million as of March 31, 2001 and December 31, 2001, respectively, is included in other liabilities in the accompanying consolidated balance sheets and represents the unamortized portion of the grant. For fiscal 2001 and the nine months ended December 31, 2001, approximately \$0.2 million and \$0.1 million, respectively, was recognized as a reduction of depreciation expense. The grant was earned by the Company upon the achievement of certain minimum capital expenditure requirements. Realization of the entire gain requires the Company to maintain a certain minimum workforce through December 2004. The Company's management believes that the likelihood that it would be required to refund this grant is remote.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

PROPERTY AND EQUIPMENT

The components of property and equipment as of March 31, 2001 and December 31, 2001 are as follows (in thousands):

MARCH 31,	DEC. 31,	2001	2001	DEPRECIABLE LIFE	---
-----	-----	-----	-----	Furniture and	
fixtures.....		\$13,882	\$		
		7,725		5-9 years Computer	
equipment.....		4,714			
		5,638		3-7 years Leasehold	
improvements.....		3,554			
		3,761		2-9 years Purchased and Capitalized	
software costs.....		6,968	8,482	1-3 years	
Other.....					
251	206	3-7 years	-----	-----	29,369 25,812
		Less-accumulated depreciation and			
amortization.....					
(8,494)	(10,483)	-----	-----	Property and	
equipment, net.....		\$20,875	\$	15,329	
		=====		=====	

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over the shorter of the useful life of the related asset or the remaining lease term.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value would be determined using appraisals, discounted cash flow analysis or similar valuation techniques. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

FOREIGN CURRENCY TRANSLATION AND TRANSACTIONS

For the Company's Canadian operations, the local currency is the functional currency. All assets and liabilities are translated at exchange rates in effect at the end of the period, and income and expense items are translated at the average exchange rates for the period. Translation adjustments are reported as a separate component of shareholders' equity.

For the Company's European operations, the U.S. dollar was the functional currency through March 31, 2001. Through this date, monetary assets and liabilities were translated at the rates of exchange on the balance sheet date and certain assets (notably property and equipment) were translated at historical rates. Income and expense items were translated at average rates of exchange for the period except for those items of expense, which related to asset amortization, which were translated at historical rates. The gains and losses from translation related to this subsidiary were included in net income through March 31, 2001.

Effective April 1, 2001, in response to a change to the Euro for transaction activity previously conducted in the U.S. dollar by the Company's largest European client, the Company adopted the Euro as its functional currency for its European operations. As a result, beginning April 1, 2001, all assets and liabilities are translated at exchange rates in effect at the end of the period, and income and expense items are translated at the average exchange rates for the period. Translation adjustments are reported as a separate component of shareholders' equity.

Gains and losses from foreign currency transactions are included in net income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

STOCK BASED COMPENSATION

The Company accounts for stock options using the intrinsic-value method as outlined under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB No. 25") and related interpretations, including FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation and Interpretation of APB No. 25, issued in March 2000, to account for its fixed plan stock options. Under this method, compensation expense is recorded on the date of the grant only if the current market price of the underlying stock exceeds the exercise price. Statement of Financial Standards ("SFAS") No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"), established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123.

INCOME TAXES

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

FAIR VALUE OF FINANCIAL INSTRUMENTS

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

COMPREHENSIVE LOSS

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

NET LOSS PER COMMON SHARE

Prior to the Offering, which was consummated in fiscal 2000, basic and diluted net loss per share attributable to PFSweb was determined based on net loss divided by the 14,305,000 shares of PFSweb, Inc. (see Note 1) outstanding. There were no potentially dilutive securities outstanding during the periods presented prior to the Offering. For fiscal years 2000 and 2001 and the nine-month period ended December 31, 2001 outstanding options to purchase common shares of PFSweb were anti-dilutive and have been excluded from the weighted average share computation. There are no other potentially dilutive securities outstanding.

CASH PAID DURING YEAR

The Company made payments for interest of approximately \$3,514,000, \$194,000 and \$238,000 and income taxes of approximately \$6,000, \$164,000 and \$94,000 during fiscal 2000 and 2001 and the nine-month period ended December 31, 2001, respectively (see Notes 5 and 8).

3. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

During the nine months ended December 31, 2001, the Company entered into a Term Lease Master Agreement with IBM Credit Corporation ("Master Agreement") which provides for leasing or financing

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

transactions of equipment with terms of 3 to 5 years. The leasing transactions are secured by the related equipment. The leasing and financing transactions are secured by a letter of credit (see Note 2). Financing transactions under the Master Agreement during the nine months ended December 31, 2001 totaled \$1.5 million and carried interest rates ranging from 6.2% to 7.0%. The aggregate maturities of long-term debt subsequent to December 31, 2001 are as follows.

Fiscal year ended December 31,	
2002.....	\$ 293
2003.....	306
2004.....	324
2005.....	320
2006.....	177
Thereafter.....	--

Total long-term debt payments.....	\$1,420
	=====

The Company has certain non-cancelable capital lease agreements including those under the Master Agreement, primarily involving warehouse and computer equipment.

The Company's property held under capital leases, included in furniture and fixtures amounted to approximately \$2.3 million and \$2.9 million, net of accumulated amortization of approximately \$0.4 million and \$1.0 million at March 31, 2001 and December 31, 2001, respectively.

The following is a schedule of future minimum lease payments under the capital leases together with the present value of the net minimum lease payments as of December 31, 2001 (in thousands):

Fiscal year ended December 31,	
2002.....	\$ 945
2003.....	942
2004.....	619
2005.....	466
2006.....	443
Thereafter.....	602

Total minimum lease payments.....	\$4,017
Less: Amount representing interest at rates ranging from 6.5% to 9.2%.....	(779)

Present value of net minimum lease payments.....	3,238
Less: Current portion.....	(702)

Long-term capital lease obligations.....	\$2,536
	=====

4. STOCK AND STOCK OPTIONS

TREASURY STOCK

On August 13, 2001, the Company announced that its Board of Directors had authorized the repurchase of up to two million shares of the Company's common stock. As of December 31, 2001, the Company had purchased 86,300 shares of common stock.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

PREFERRED STOCK PURCHASE RIGHTS

On June 8, 2000 the Company's Board of Directors declared a dividend distribution of one preferred stock purchase right (a "Right") for each share of the Company's common stock outstanding on July 6, 2000. Each Right entitles the registered shareholders to purchase from the Company one one-thousandth of a share of preferred stock at an exercise price of \$67, subject to adjustment. The Rights are not currently exercisable, but would become exercisable if certain events occurred relating to a person or group acquiring or attempting to acquire 15 percent or more of the Company's outstanding shares of common stock. The Rights expire on July 6, 2010, unless redeemed or exchanged by the Company earlier.

EMPLOYEE STOCK PURCHASE PLAN

On September 15, 2000, PFSweb shareholders adopted the PFSweb Employee Stock Purchase Plan (the "Stock Purchase Plan") which is qualified under Section 423 of the Internal Revenue Code of 1986, to provide employees of PFSweb an opportunity to acquire a proprietary interest in the Company. The Stock Purchase Plan provides for acquisition of PFSweb common stock at a 15% discount to the market value. The Stock Purchase Plan permits each U.S. employee who has completed ninety days of service to elect to participate in the plan. Eligible employees may elect to contribute up to 10 percent of their compensation with after-tax dollars up to a maximum annual contribution of \$21,250. The Company has reserved 2,000,000 shares of its common stock under the Stock Purchase Plan, as amended. The Stock Purchase Plan became effective for eligible employees in September 2000. During fiscal 2001 and the nine-month period ended December 31, 2001, 37,378 and 236,031 shares were issued under the Stock Purchase Plan, respectively.

STOCK OPTIONS AND STOCK OPTION PLANS

Spin-off

Prior to the Offering and Spin-off transaction described in Note 1, certain of the Company's employees were granted Daisytek stock options under Daisytek's stock option compensation plans (the "Daisytek Plans"). The stock options generally vest over a three to five-year period from the date of grant and expire 10 years after the date of grant.

In connection with the completion of the Spin-off, all outstanding Daisytek stock options were replaced with substitute stock options as described below:

Options held by PFSweb employees were replaced (at the option holder's election made prior to the Spin-off) with either options to acquire shares of PFSweb common stock or options to acquire shares of both Daisytek common stock and PFSweb common stock (which may be exercised separately) (the "Unstapled Options"). Options held by Daisytek employees were replaced (at the option holder's election made prior to the Spin-off) with either options to acquire shares of Daisytek common stock or Unstapled Options.

In general, the adjustments to the outstanding Daisytek options were established pursuant to a formula designed to ensure that: (1) the aggregate "intrinsic value" (i.e. the difference between the exercise price of the option and the market price of the common stock underlying the option) of the substitute options did not exceed the aggregate intrinsic value of the outstanding Daisytek stock options which were replaced by such substitute options immediately prior to the Spin-off, and (2) the ratio of the exercise price of the options to the market value of the underlying stock immediately before and after the Spin-off was preserved.

Substantially all of the other terms and conditions of each substitute stock option, including the time or times when, and the manner in which, each option is exercisable, the duration of the exercise period, the permitted method of exercise, settlement and payment, the rules that will apply in the event of the termination of employment of the employee, the events, if any, that may give rise to an employee's right to accelerate the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

vesting or the time or exercise thereof and the vesting provisions, are the same as those of the replaced Daisytek stock option, except that option holders who are employed by one company will be permitted to exercise, and will be subject to all of the terms and provisions of, options to acquire shares in the other company as if such holder was an employee of such other company.

As a result of the stock option replacement process described above, in conjunction with the Spin-off on July 6, 2000, 3,479,697 non-plan PFSweb stock options (the "PFSweb Non-plan") were issued to PFSweb and Daisytek officers, directors and employees.

Offer to Exchange

On April 30, 2001, the Company filed a Tender Offer Statement on Schedule TO (the "Schedule TO") relating to the Company's offer to exchange certain PFSweb Plan and Non-plan options to purchase shares of its common stock held by certain PFSweb officers, directors and employees for new options to purchase shares of its common stock at a per share price equal to the fair market value of one share of its common stock on the date of issuance, which occurred on December 5, 2001, upon the terms and subject to the conditions in the Offer to Exchange (the "Offer") dated April 30, 2001. On May 29, 2001, the Offer expired and the Company accepted for exchange options to purchase 3,753,044 shares of common stock, 2,663,544 of which were PFSweb Non-plan options and 1,089,500 were PFSweb Plan options. On May 29, 2001, the Company also repriced and fully vested 105,000 options issued under the PFSweb Plans and 698,860 PFSweb Non-plan options held by Daisytek officers, directors and employees and non-employees which resulted in a non-cash stock compensation charge of approximately \$0.7 million.

Pursuant to the terms of the Offer, on December 5, 2001, the Company granted 3,184,963 options to officers, directors and employees of PFSweb, 2,462,614 of which were issued as PFSweb Plan options and 722,349 were issued as Non-plan options. At issuance, pursuant to terms of the Offer, 658,000 of the PFSweb Plan options and 293,000 of the Non-plan options were 75% vested on the date of issuance with the remaining 25% vesting quarterly over one year and 1,804,614 of the PFSweb Plan options and 429,349 of the Non-plan options vest quarterly over one year.

PFSweb Plan Options

PFSweb has authorized 6,000,000 shares of common stock for issuance under two 1999 stock option plans and 35,000 shares for issuance under a stock option agreement (the "PFSweb Plans"). The PFSweb Plans provide for the granting of incentive awards in the form of stock options to directors, executive management, key employees, and outside consultants of PFSweb. The right to purchase shares under the employee stock option agreements typically vest over a three-year period. Stock options must be exercised within 10 years from the date of grant. Stock options are generally issued at fair market value. The Company recorded stock based compensation expense of \$48,000, \$38,000 and \$7,000 in fiscal 2000 and 2001, and the nine month period ended December 31, 2001, respectively, in connection with stock options to purchase an aggregate of 72,500 shares issued under the PFSweb Plans to non-employees. At December 31, 2001 there is no unamortized stock based compensation expense.

As of December 31, 2001 there were 2,438,631 shares available for future options under the PFSweb Plans.

PRICES
 DECEMBER 31,
 2001
 CONTRACTUAL
 LIFE
 EXERCISE
 PRICE
 DECEMBER 31,
 2001
 EXERCISE
 PRICE - ----

 ----- \$
 0.60-\$ 2.69
 3,571,369
 9.5 \$ 1.20
 1,073,834 \$
 1.41
 \$10.45-\$16.00
 25,000 7.5
 \$10.67
 18,585
 \$10.62 -----

 -- 3,596,369
 9.5 \$ 1.27
 1,092,419 \$
 1.57
 =====
 =====

PFSweb Non-plan Options

As of December 31, 2001, 1,431,503 PFSweb Non-plan options were outstanding, of which 747,172 were held by PFSweb officers, directors and employees and 684,331 were held by Daisytek officers, directors and employees.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants of PFSweb options to PFSweb officers, directors, and employees under the PFSweb Plans:

FISCAL YEARS ENDED MARCH 31,			
NINE MONTH PERIOD -----			
----- ENDED			
DECEMBER 31, 2000 2001 2001			

----- Expected			
dividend yield..... -- --			
-- Expected stock price			
volatility.....			
45.00%-84.23% 98.37%-128.38%			
117.27%-126.08% Risk-free			
interest rate.....			
5.5%-6.2% 5.8%-6.3%			
4.6%-5.3% Expected life of			
options			
(years).....			
6 5 5			

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants of PFSweb options to PFSweb and Daisytek officers, directors, and employees under the PFSweb Non-Plans during fiscal 2001: no dividends; expected volatility of 112.08%, risk-free interest rate of 6.1%, and expected life of 5 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants of PFSweb options to PFSweb officers, directors, and employees and a Daisytek director under the PFSweb Non-Plan during fiscal the nine months ended December 31, 2001: no dividends; expected volatility between 117.27% and 124.12%, risk-free interest rate ranging between 4.9% and 5.5%, and expected life of 5 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants of Daisytek options to PFSweb employees under the Daisytek Plans during fiscal 2000: no dividends; expected volatility between 49.37% and 50.02%; risk-free interest rate ranging between 5.7% and 6.0%; and expected life of 6 years. No options were granted to PFSweb officers, directors or employees under the Daisytek Plans during fiscal 2001 or the nine-month period ended December 31, 2001.

On January 25, 2002, the Company issued 970,000 options to purchase shares of common stock at \$0.84, from the PFSweb Plans to officers, directors and employees of PFSweb and certain non-employees, recording a non-cash stock compensation charge of approximately \$24,000.

5. TRANSACTIONS WITH DAISYTEK

Prior to the Offering, monies advanced by Daisytek were used to fund the Company's operations, working capital requirements and certain investment activities. Interest expense charged by Daisytek was based on its weighted average interest rates of 6.7% for fiscal 2000 and approximated \$1.7 million.

During fiscal 2000, PFSweb used a portion of the proceeds from the Offering to repay its payable to Daisytek. Following the completion of the Offering, Daisytek is prohibited from advancing funds to PFSweb, except in the normal course of business, and PFSweb is restricted from borrowing from Daisytek.

As of March 31, 2001 the Company had payables to Daisytek of approximately \$7.2 million and receivables from Daisytek of \$3.1 million. As of December 31, 2001, the Company had receivables from Daisytek of \$0.1 million.

The Company's product revenue from sales to Daisytek was \$7.2 million in fiscal year 2000.

In fiscal years 2000 and 2001, the Company's costs and expenses include allocations from Daisytek for certain general administrative services including information technology, financial, treasury, legal, insurance and other

corporate functions as well as certain costs of operations including facility charges. These allocations were estimated on bases that Daisytek and the Company consider to be a reasonable reflection of the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

utilization of services provided or the benefit received by the Company. The methods used for allocation of expenses from Daisytek were either (i) percentage of: revenue, shipped orders, or number of employees, or (ii) management's best estimate. However, these allocations of costs and expenses do not necessarily indicate the costs and expenses that would have been or will be incurred by the Company on a stand-alone basis. Management estimates that incremental selling, general and administrative expenses associated with PFSweb operating as a stand-alone publicly traded company, including executive management, overhead and public company costs, insurance and risk management costs, and other costs would have been approximately \$2.0 million for fiscal year 2000, \$0.2 million for fiscal year 2001 and zero for the nine month period ended December 31, 2001.

During the quarter ended September 30, 1999, and in connection with the restructuring of certain IBM master distribution agreements under which both Daisytek and PFSweb are parties, the Company transferred to Daisytek certain related product inventory, accounts receivable and accounts payable that it held under its prior agreements. In consideration of this transfer, the Company received the net book value of these assets and liabilities of approximately \$20 million and reduced its payable to Daisytek by a corresponding amount.

In conjunction with the successful completion of the Offering, PFSweb entered into agreements with Daisytek, including a tax sharing agreement, a transaction management services agreement, transition services agreement and a master separation agreement. In addition, on a going forward basis, Daisytek will continue to be an obligor and guarantor for certain of the Company's facility and equipment leases.

On May 25, 2001, the Company completed the sale of certain assets to Daisytek pursuant to an Asset Purchase Agreement (the "Purchase Agreement") (See Notes 6 and 7). The Purchase Agreement included a termination by the Company and Daisytek of certain transaction management services agreements previously entered into between the Company and Daisytek and a Daisytek subsidiary. Concurrently with the closing of the asset sale, the Company and Daisytek also entered into a six-month transition services agreement under which the Company provided Daisytek with certain transitional and information technology services that expired in November 2001.

Through September 2001, the consolidated financial statements include service fee revenues and cost of service fee revenues for certain services subcontracted to PFSweb by Daisytek under Daisytek's contractual agreements.

Service fee revenues charged to Daisytek under (i) the IBM Master Distributor Agreements, entered into during the quarter ended September 30, 1999, (ii) terms of the transaction management services agreement with Daisytek, (iii) for certain subcontracted services, and (iv) for certain transaction and information technology services, were \$12.1 million, \$27.6 million and \$9.6 million for fiscal 2000 and 2001, and the nine-month period ended December 31, 2001, respectively.

As of December 31, 2001, the Company is not party to any agreement to provide services for Daisytek.

6. DISPOSITION OF ASSETS

On May 25, 2001, the Company completed the sale of certain assets to Daisytek pursuant to the Purchase Agreement. Under the Purchase Agreement, the Company transferred and sold to Daisytek certain distribution and fulfillment assets, including equipment and fixtures, that were previously used by the Company to provide outsourcing services to Daisytek. Daisytek also assumed certain related equipment leases and a warehouse lease and hired certain employees who were associated with the warehouse facility. The consideration payable under the Purchase Agreement of \$11.0 million included a termination by the Company and Daisytek of certain transaction management services agreements previously entered into between the Company and Daisytek and a Daisytek subsidiary. Proceeds of \$10.9 million were received for assets with an approximately \$4.5 million net book value with a resulting \$5.8 million gain, after closing costs of \$0.6 million. Concurrently with the closing of the asset sale, the Company and Daisytek also entered into a six-month

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

transition services agreement under which the Company provided Daisytek with certain transitional and information technology services.

Pro forma revenues and pro forma loss from operations for fiscal 2001, assuming the transaction had occurred in April 2000, would have been \$29.5 million and (\$18.9) million, respectively. Pro forma revenues and pro forma loss from operations for the nine months ended December 31, 2001, had the transaction occurred on April 2000, would have been \$22.0 million and (\$10.4) million, respectively. The pro forma data do not give effect to any fees earned by PFSweb for services provided to Daisytek under a six-month transition services agreement entered into on May 25, 2001 or the effect of the \$5.8 million gain on the sale of the assets. Additionally, these pro forma adjustments do not consider certain infrastructure costs, such as operating costs associated with the information technology function, salaries of certain management and personnel, telephone and lease costs, and depreciation expense which supported this business but that will continue in the future. Because these ongoing costs were not considered, the pro forma adjustments to the loss from operations are not indicative of the overall margin earned under these transaction management services agreements.

7. SUPPLIES DISTRIBUTORS AND OTHER RELATED PARTIES

SUPPLIES DISTRIBUTORS

The Company, Business Supplies Distributors (a Daisytek subsidiary -- "BSD"), Daisytek and IBM were parties to various Master Distributor Agreements which had various scheduled expiration dates through September 2001. Under these agreements, BSD and its affiliates Business Supplies Distributors Europe B.V. ("BSD Europe"), a Daisytek subsidiary, and BSD (Canada) Inc., a Daisytek subsidiary ("BSD Canada" and together with BSD and BSD Europe, the "BSD Companies"), acted as master distributors of various IBM products, Daisytek provided financing and credit support to the BSD Companies and the Company provided transaction management and fulfillment services to the BSD Companies.

On June 8, 2001, Daisytek notified the Company and IBM that it did not intend to renew these agreements upon their scheduled expiration dates. In July 2001, the Company and Inventory Financing Partners, LLC ("IFP") formed Holdings, and Holdings formed a wholly-owned subsidiary, Supplies Distributors ("Supplies Distributors"). Concurrently, Supplies Distributors formed its wholly-owned subsidiaries Supplies Distributors of Canada, Inc. ("SDC") and Supplies Distributors S.A. ("SDSA"), a Belgium corporation. Supplies Distributors, SDSA, the Company and IBM entered into new Master Distributor Agreements to replace the prior agreements. Under these agreements, Supplies Distributors and SDSA act as master distributors of various IBM products and, pursuant to a transaction management services agreement between the Company and Supplies Distributors, the Company provides transaction management and fulfillment services to Supplies Distributors.

The Company made an equity investment of \$0.75 million in Holdings, which is included in other assets in the accompanying consolidated financial statements, for a 49% voting interest, and IFP made an equity investment of \$0.25 million in Holdings for a 51% voting interest. Certain officers and directors of the Company own, individually, a 9.8% non-voting interest, and, collectively, a 49% non-voting interest, in IFP. In addition to its equity investment in Holdings, the Company has also provided Supplies Distributors with a subordinated loan, evidenced by the Note which, as of December 31, 2001, had an outstanding balance of \$11.7 million. The Note, which is classified as a note receivable from affiliate, accrues interest at a fluctuating rate per annum equal to the Company's cost of funds, as determined by the Company. For the period ended December 31, 2001, the Company charged interest at 10% and earned \$0.3 million associated with the Note.

On September 26, 2001, Supplies Distributors purchased all of the stock of the BSD Companies for a purchase price of \$923,000. On September 27, 2001, Supplies Distributors entered into short-term credit facilities with IBM Credit Corporation ("IBM Credit") and IBM Belgium Financial Services S.A. ("IBM Belgium") for the purpose of financing its distribution of IBM products. The facilities, which at inception

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

included \$40 million for the U.S. operations and 20 million Euros (approximately \$18 million) for the European operations, were subsequently increased to \$45 million and 27 million Euros (approximately \$24 million), respectively, and extended through March 25, 2002.

On March 29, 2002, Supplies Distributors entered into amended credit facilities with IBM Credit and SDSA and BSD Europe entered into amended credit facilities with IBM Belgium. The asset based credit facility with IBM Credit provides financing for purchasing IBM inventory up to \$32.5 million through June 30, 2002 and \$27.5 million from July 1, 2002 through its expiration on March 29, 2003. The asset based credit facility with IBM Belgium provides up to 27 million Euros (approximately \$24.3 million) in financing for purchasing IBM inventory through June 30, 2002 and 22 million Euros (approximately \$19.8 million) thereafter. The IBM Belgium facility remains in force until not less than 60 days written notice by any party, but no sooner than March 29, 2003. These credit facilities contain cross default provisions and various restrictions upon the ability of Holdings, Supplies Distributors, SDSA and BSD Europe to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, the Company is required to maintain a subordinated loan to Supplies Distributors of no less than \$6.5 million and shareholders' equity of at least \$25.0 million.

Concurrent with these amended agreements, Supplies Distributors entered into a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to \$25 million of eligible accounts receivables in the U.S. and Canada. The Congress facility expires on the earlier of three years or the date on which the parties to the IBM Master Distributor Agreement shall no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such agreement. Borrowings under the Congress facility accrue interest at prime rate plus 0.25% or Eurodollar rate plus 3.0% or on an adjusted basis, as defined. In Europe, SDSA entered into a two year factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 10 million Euros (approximately \$9 million) of eligible accounts receivables. Borrowings under this agreement accrue interest at 8.5%, or on an adjusted basis as defined. These credit facilities contain cross default provisions and various restrictions upon the ability of Holdings, Supplies Distributors and SDSA to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, the Company is required to maintain a subordinated loan to Supplies Distributors of no less than \$6.5 million and restricted cash of less than \$5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure.

The Company has provided a collateralized guaranty to secure the repayment of these credit facilities (see Note 9).

Pursuant to the terms of the Company's transaction management services agreement with Supplies Distributors, the Company earned service fees, which are reported as service fee revenue -- affiliate in the accompanying consolidated financial statements, of approximately \$1.4 million for the nine months ended December 31, 2001. For the nine months ended December 31, 2001, PFSweb fees earned from BSD (the Daisytek subsidiary and predecessor to Supplies Distributors) were \$3.6 million. For the nine months ended December 31, 2000, prior to becoming a related party, service fees earned by PFSweb from BSD, associated with the same business activities, were \$4.6 million. As of December 31, 2001, the Company has trade accounts receivables of \$0.9 million due from Supplies Distributors.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Pursuant to Holdings' operating agreement, Holdings allocates its earning and distributes its cash flow, as defined, in the following order of priority: first, to IFP until it has received a one-time amount equal to its capital contribution of \$0.25 million; second, to IFP until it has received an amount equal to a 35% cumulative annual return on its capital contribution; third, to PFSweb until it has received a one-time amount equal to its capital contribution of \$0.75 million; fourth, to PFSweb until it has received an amount equal to a 35% cumulative annual return on its capital contribution; and fifth, to PFSweb and IFP, pro rata, in accordance with their respective capital accounts. Notwithstanding the foregoing, no distribution may be made if, after giving effect thereto, the net worth of Holdings may be less than \$1.0 million. Under the terms of its credit agreements, Holdings is currently limited to annual cash dividends of \$0.6 million. The Company did not record any equity in the earnings of Holdings for the nine months ended December 31, 2001.

Summarized financial information for Holdings as of December 31, 2001 is as follows (in thousands):

Current assets.....	\$80,247
Total assets.....	\$81,554
Current liabilities.....	\$ 9,651
Credit facilities (guaranteed by PFSweb).....	\$59,038
Subordinated note due to PFSweb.....	\$11,655
Members' capital.....	\$ 1,210

Summarized operating information for Holdings for the period from July 3, 2001 (Inception) through December 31, 2001 is as follows (in thousands):

Net revenues.....	\$75,444
Cost of goods sold.....	\$71,870
Income before taxes.....	\$ 673
Net income.....	\$ 401

OTHER RELATED PARTIES

In May 1999, the Company entered into an agreement to provide services to a certain company. During fiscal 2000, an executive officer and a director of PFSweb both served on the Board of Directors of this company. During fiscal 2001 an executive officer of PFSweb served on the Board of Directors of this company. PFSweb no longer provides services to this company. Service fee revenue earned from this company was approximately \$1.8 million and \$2.0 million for fiscal 2000 and 2001, respectively, and other revenue was \$1.7 million for fiscal 2001.

PFS had previously guaranteed an unsecured revolving line of credit with commercial banks of Daisytek. In December 1999, PFS was released from its guarantee.

A non-employee director of PFSweb was a Managing Director of Hambrecht and Quist LLP, one of the lead managing underwriters on the Offering.

8. INCOME TAXES

Prior to the Spin-off, the Company's operations were included in consolidated income tax returns filed by Daisytek. The provision for income taxes reflected in the consolidated statements of operations and the deferred tax assets reflected in the consolidated balance sheets have been prepared as computed on a separate return basis. Effective with the completion of the Spin-off, PFSweb ceased to be included in Daisytek's consolidated tax return.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

FISCAL YEARS ENDED MARCH 31, NINE MONTHS ENDED -	-----	DECEMBER 31, 2000	2001	2001 -
Income tax expense (benefit) computed at statutory rate.....		\$(2,628)		
\$(3,649) \$(267) Impact of foreign taxation at different rate....	(24)	(28)	(35)	
State income taxes, net of federal tax impact....	51	--	--	
Expenses not deductible for tax purposes.....	84	9	54	
Net operating loss carryback.....	(171)	--	--	
Change in valuation reserve.....	915	3,567	125	
Other.....	(18)	126	(96)	
Provision (benefit) for income taxes.....		\$(1,791)	\$	
	25	\$(219)	=====	=====

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

FISCAL YEARS ENDED MARCH 31, NINE MONTHS ENDED	-----	DECEMBER 31, 2000	2001	2001
Domestic.....		\$(5,331)	\$ (6,188)	\$ 988
Foreign.....		(2,399)	(4,543)	(1,772)
- Total.....		\$(7,730)	\$(10,731)	\$ (784)
		=====	=====	=====

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

FISCAL YEARS ENDED MARCH 31, NINE MONTHS ENDED	-----	DECEMBER 31, 2000	2001	2001
Current				
Domestic.....		\$(2,150)	\$ 57	\$ (68)
State.....		77	--	--
Foreign.....		(171)	77	(151)
Total current.....		(219)	Deferred	(2,244) 134
Domestic.....		453	(109)	--
State.....		--	--	--
Total deferred.....		453	(109)	--
Total.....		\$(1,791)	\$ 25	\$(219)
		=====	=====	=====

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

MARCH 31, DECEMBER 31, 2001 2001	-----	-----	
Deferred tax asset: Allowance for doubtful accounts.....	\$ 95	\$ 63	Net
operating loss carryforwards.....			
	4,639	5,411	
Other.....			
30 127 -----	4,764	5,601	Less -- Valuation
reserve.....	4,482	5,429	----
-- -----	Total deferred tax		
asset.....	282	172	-----
Deferred tax liability: Property and equipment.....	(470)	(360)	
-----	Total deferred		
liability.....	(470)	(360)	-----
----	Deferred tax liability,		
net.....	\$ (188)	\$ (188)	
	=====	=====	

Management believes a sufficient history of earnings has not been established by PFSweb, on a stand-alone basis, to support the more likely than not realization of deferred tax assets in excess of existing taxable temporary differences. A valuation allowance has been provided for the net deferred income tax asset as of March 31, 2001 and December 31, 2001. At December 31, 2001, net operating loss carryforwards relate to taxable losses of the Company's Europe subsidiary totaling approximately \$8.0 million and the Company's U.S. subsidiary, totaling approximately \$5.4 million that expire in 2017. Approximately \$0.8 million of the valuation allowance recorded against deferred tax assets relates to \$0.8 million of tax benefits of stock option exercises and will be recorded against additional paid-in-capital upon utilization rather than as an adjustment to income tax expense from continuing operations.

9. COMMITMENTS AND CONTINGENCIES

The Company leases facilities, warehouse, office, transportation and other equipment under operating leases expiring in various years through fiscal 2009. In most cases, management expects that, in the normal course of business, leases will be renewed or replaced by other leases. Minimum future annual rental payments under non-cancelable operating leases having original terms in excess of one year are as follows (in thousands):

Fiscal year ended December 31,	
2002.....	\$ 6,060
2003.....	5,985
2004.....	4,198
2005.....	2,782
2006.....	2,751
Thereafter.....	2,696

Total.....	\$24,472
	=====

Total rental expense under operating leases, net of sublease rental income, approximated \$3.7 million, \$7.7 million and \$4.4 million for fiscal 2000 and 2001, and the nine-month period ended December 31, 2001, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

For all periods prior to the Spin-off, Daisytek owned 80% of more of our capital stock, the Company was included in Daisytek's consolidated group for federal income tax purposes. If Daisytek or other members of the consolidated group fail to make any federal income tax payments, the Company would be liable for the shortfall since each member of a consolidated group is liable for the group's entire tax obligation.

In December 2001, the Company contracted with a marketing and lead generation firm to assist in new business development. In addition to a monthly retainer payment the Company is obligated to make a \$320,000 payment to this firm if it performs the requirements of the contract, as defined.

The Company has provided collateralized guarantees to secure the repayment of Supplies Distributors' credit facilities. As of December 31, 2001 the outstanding balance of the credit facilities guaranteed by the Company was approximately \$59.0 million. In association with the new credit facilities entered into in March 2002, the outstanding balance of the credit facilities guaranteed by the Company was approximately \$48.5 million. These guarantees expire concurrently with the expiration of the underlying credit agreements. To the extent Supplies Distributors or its subsidiaries fails to comply with its covenants, including its monthly financial covenant requirements, and the lenders accelerate the repayment of the credit facility obligations, Supplies Distributors or its subsidiaries would be required to repay all amounts outstanding thereunder. In such event, the Company would be obligated to perform under those guarantees and repay, to the extent Supplies Distributors or its subsidiaries was unable to, Supplies Distributors' or its subsidiaries credit facility obligations. Additionally, if the Company was unable to maintain the Company's required level of stockholders' equity of \$25.0 million, the Company could also be obligated to perform under these guarantees. Any requirement to perform under the Company's guarantees would have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company will have the financial ability to repay all of such guaranteed obligations. In addition, in the event Supplies Distributors or its subsidiaries is, or would be, in default of its obligations under its credit facilities, the Company is restricted from receiving any payment of its Note and such event would also have a material adverse impact upon the Company's financial condition and results of operations. Furthermore, the Company is obligated to repay any over-advance made to Supplies Distributors or its subsidiaries by its lenders. An over-advance would arise in the event borrowings exceeded the maximum amount available under the eligible borrowing base, as defined. The Company has also provided a guarantee of the obligations of Supplies Distributors and its subsidiaries to IBM, excluding the trade payables that are financed by IBM Credit.

10. SEGMENT AND GEOGRAPHIC INFORMATION

The Company is organized as a single operating segment, which is an international provider of integrated business process outsourcing solutions. Geographic areas in which the Company operates include the United States, Europe (primarily Belgium), and Canada.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The following is geographic information by area. Transfers between geographic areas were immaterial. Revenues are attributed based on the Company's domicile.

NINE MONTHS YEAR ENDED OR AT ENDED OR AT MARCH 31,			
DECEMBER 31, ----- 2000			
2001	2001	-----	Revenues: (in
			thousands) United
States.....			
	\$65,278	\$43,352	\$25,325
Europe.....			
	18,796	5,863	2,274
Canada.....			
	3,799	1,140	454
			----- \$87,873
\$50,355	\$28,053	=====	===== Long-lived
			assets: (in thousands) United
States.....			
	\$14,465	\$14,397	\$10,233
Europe.....			
	7,358	6,448	4,961
Canada.....			
	260	134	190
			----- \$22,083
	\$20,979	\$15,384	=====

11. EMPLOYEE SAVINGS PLAN

The Company has a defined contribution employee savings plan under Section 401(k) of the Internal Revenue Code. Substantially all full-time and part-time U.S. employees are eligible to participate in the plan. The Company, at its discretion, may match employee contributions to the plan and also make an additional matching contribution in the form of profit sharing in recognition of the Company performance. During fiscal year 2001, the Company matched 10% of employee contributions totaling approximately \$41,000, and provided an additional discretionary match of approximately \$38,000. During the nine months ended December 31, 2001, the Company matched 10% of employee contributions totaling approximately \$34,000.

12. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Unaudited quarterly results of operations for fiscal 2001 and the nine-month period ended December 31, 2001 were as follows (amounts in thousands except per share data):

FISCAL 2001 -----				
----- 1ST QTR. 2ND QTR. 3RD QTR. 4TH				
QTR. -----				
	Total			
revenues.....				
\$13,370	\$12,963	\$12,384	\$11,638	Total cost
of revenues.....				8,645
	11,869	8,567	7,650	Gross
profit.....				
4,725	1,094	3,817	3,988	Selling, general
and administrative expenses...	5,230	7,858		
	5,956	6,402		Loss from
operations.....				
	(505)	(6,764)	(2,139)	(2,414) Net
loss.....				
(238)	(6,465)	(1,861)	(2,192)	Basic and
				diluted loss per share.....
(0.01)	(0.36)	(0.10)	(0.12)	Shares used in
computation of basic and diluted loss per				share:.....
	17,870	17,870	17,870	17,907

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NINE-MONTH PERIOD ENDED DECEMBER 31, 2001 -----				
	1ST QTR.	2ND QTR.	3RD QTR.	-----
	----- Total			
revenues.....				\$
	9,517	\$ 9,289	\$ 9,247	Total cost of
revenues.....			6,087	5,053
		6,217	Gross	
profit.....				
3,430	4,236	3,030	Selling, general and administrative	
			5,978	5,301
			expenses..... 5,838	
Other.....				
	(4,280)	(500)	(361)	Income (loss) from
				operations..... 1,732 (565)
			(2,447)	Net income
(loss).....				1,903
(453)	(2,015)	Basic and diluted income (loss) per		
share.....	0.11	(0.03)	(0.11)	Shares used in
	computation of basic and diluted loss per			
share:.....				
	17,970	18,079	18,057	

The seasonality of the Company's business is dependent upon the seasonality of its clients' business and their sale of products. Management believes that with the Company's current client mix, the Company's business activity is expected to be at its lowest in the quarter ended March 31 and at its highest in the quarter ended June 30.

INDEPENDENT AUDITORS' REPORT

To the Members of
Business Supplies Distributors Holdings, LLC:

We have audited the accompanying consolidated balance sheet of Business Supplies Distributors Holdings, LLC and subsidiaries as of December 31, 2001, and the related consolidated statements of operations, members' capital and comprehensive income, and cash flows for the period from July 3, 2001 (inception) to December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Business Supplies Distributors Holdings, LLC and subsidiaries as of December 31, 2001, and the results of their operations and their cash flows for the period from July 3, 2001 (inception) to December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Dallas, Texas
March 29, 2002

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
AS OF DECEMBER 31, 2001
(IN THOUSANDS)

ASSETS

CURRENT ASSETS:

Cash and cash equivalents.....	\$ 578
Accounts receivable, net of allowance for doubtful accounts of \$616.....	23,231
Inventories, net.....	32,847
Inventories in-transit.....	10,544
Other receivables.....	12,364
Prepaid expenses and other current assets.....	683

Total current assets..... 80,247

OTHER ASSETS, net (including restricted cash of \$982)..... 1,307

Total assets..... \$81,554

LIABILITIES AND MEMBERS' CAPITAL

CURRENT LIABILITIES:

Trade accounts payable.....	\$ 4,205
Trade accounts payable -- related parties (Note 7).....	2,403
Value added tax payable.....	1,424
Marketing funds payable.....	493
Accrued expenses.....	717
Income taxes payable.....	409

Total current liabilities..... 9,651

LONG-TERM DEBT (Note 6)..... 59,038

NOTE PAYABLE TO AFFILIATE..... 11,655

COMMITMENTS AND CONTINGENCIES

MEMBERS' CAPITAL:

Capital contributions.....	1,000
Retained earnings.....	401
Unrealized loss on investment.....	(85)
Accumulated other comprehensive loss.....	(106)

Total members' capital..... 1,210

Total liabilities and members' capital..... \$81,554

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

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE PERIOD FROM JULY 3, 2001 (INCEPTION) THROUGH DECEMBER 31, 2001
(IN THOUSANDS)

NET REVENUES.....	\$75,444
COST OF GOODS SOLD.....	71,870

Gross profit.....	3,574
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (including affiliate expenses of \$1,384, Note 7).....	2,098

Income from operations.....	1,476
INTEREST EXPENSE, net.....	803

Income before income taxes.....	673
INCOME TAX EXPENSE.....	272

NET INCOME.....	\$ 401
	=====

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

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF MEMBERS' CAPITAL AND COMPREHENSIVE INCOME
 FOR THE PERIOD FROM JULY 3, 2001 (INCEPTION) THROUGH DECEMBER 31, 2001
 (IN THOUSANDS)

ACCUMULATED MEMBERS'			
UNREALIZED OTHER TOTAL			
CAPITAL RETAINED LOSS			
ON COMPREHENSIVE			
MEMBERS' COMPREHENSIVE			
CONTRIBUTIONS EARNINGS			
INVESTMENT LOSS CAPITAL			
INCOME -----			

----- Balance, at			
inception.....	\$ --		
\$ -- \$ -- \$ -- \$ -- Net			
income.....			
-- 401 -- 401 \$ 401			
Capital			
contributions.....			
1,000 -- -- 1,000 --			
Unrealized loss on			
investment.....			
-- -- (85) -- (85) (85)			
Other comprehensive			
loss -- foreign			
currency translation			
adjustment.....			
-- -- -- (106) (106)			
(106) -----			

Comprehensive			
income.....	\$ 210		
===== Balance, December			
31, 2001... \$1,000 \$401			
\$ (85) \$ (106) \$1,210			
=====			
=====			
=====			

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

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS
 FOR THE PERIOD FROM JULY 3, 2001 (INCEPTION) THROUGH DECEMBER 31, 2001
 (IN THOUSANDS)

CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income.....	\$ 401
Adjustments to reconcile net income to net cash used in operating activities:	
Amortization.....	51
Provision for doubtful accounts.....	353
Provision for inventory obsolescence.....	13
Deferred income taxes.....	(300)
Changes in operating assets and liabilities, net of effect of acquisition:	
Accounts receivables.....	(20,480)
Inventories, net.....	(30,154)
Prepaid expenses and other current assets.....	(7,229)
Accounts payable and accrued expenses.....	(20,625)

Net cash provided by (used in) operating activities.....	(77,970)

CASH FLOWS FROM INVESTING ACTIVITIES:	
Cash acquired in acquisition of BSD Companies, net (Note 3).....	7,555

Net cash provided by investing activities.....	7,555

CASH FLOWS FROM FINANCING ACTIVITIES:	
Capital contributions.....	1,000
Proceeds from debt.....	59,352
Proceeds from affiliate loan.....	11,655
Restricted cash.....	(982)

Net cash provided by financing activities.....	71,025

EFFECT OF EXCHANGE RATES ON CASH.....	(32)

NET INCREASE IN CASH.....	578
CASH AND CASH EQUIVALENTS, beginning of period.....	--

CASH AND CASH EQUIVALENTS, end of period.....	\$ 578
	=====
SUPPLEMENTAL CASH FLOW INFORMATION	
Cash paid for interest.....	\$ 463
	=====
Cash paid for taxes.....	\$ --
	=====

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

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. OVERVIEW AND BASIS OF PRESENTATION:

PFSweb, Inc. ("PFS"), Daisytek International, Inc. ("Daisytek"), Business Supplies Distributors, Inc., (a Daisytek subsidiary -- "BSD"), and International Business Machines Corporation ("IBM") were parties to various Master Distributor Agreements that had various scheduled expiration dates through September 2001. Under these agreements, BSD and its affiliates Business Supplies Distributors Europe B.V. ("BSD Europe"), a Daisytek subsidiary, and BSD (Canada) Inc., a Daisytek subsidiary ("BSD Canada" and together with BSD and BSD Europe, the "BSD Companies"), acted as master distributors of various IBM products. Daisytek provided financing and credit support to the BSD Companies and PFS provided transaction management and fulfillment services to the BSD Companies. On June 8, 2001, Daisytek notified PFS and IBM that it did not intend to renew these agreements upon their scheduled expiration dates.

On July 3, 2001, PFS and Inventory Financing Partners, LLC ("IFP") formed Business Supplies Distributors Holdings, LLC ("Holdings"), and Holdings formed a wholly-owned subsidiary, Supplies Distributors, Inc. ("Supplies Distributors"). Concurrently, Supplies Distributors formed its wholly-owned subsidiaries Supplies Distributors of Canada, Inc. ("SDC") and Supplies Distributors S.A. ("SDSA"), a Belgium corporation. Supplies Distributors, SDSA, PFS and IBM entered into new Master Distributor Agreements to replace the prior agreements (see Note 4). Under the new agreements, Supplies Distributors and SDSA act as master distributors of various IBM products and, pursuant to a transaction management services agreement between PFS and Supplies Distributors, PFS provides transaction management and fulfillment services to Supplies Distributors. On September 26, 2001, Supplies Distributors purchased all of the stock of the BSD Companies for a purchase price of \$923,000 and incurred \$60,000 of acquisition costs (see Note 3). In conjunction with the purchase, BSD and Supplies Distributors were merged with Supplies Distributors being the surviving corporation. Effective December 31, 2001, BSD Canada and SDC were amalgamated, with SDC being the surviving corporation.

All references to the "Company" include Holdings and Supplies Distributors and its subsidiaries.

The Company, through its subsidiaries, is primarily a master distributor of various IBM products. Supplies Distributors and SDSA have obtained certain financing (see Note 6 and 7) that allows them to fund the working capital requirements for the sale of IBM products. Pursuant to the transaction management services agreement between PFS and Supplies Distributors, PFS provides to Supplies Distributors and SDSA such services as managed website hosting and maintenance, procurement support, web-enabled customer contact center services, customer relationship management, financial services including billing and collection services, information management, selected financial services and international distribution services. Additionally, IBM and Holdings have outsourced its product demand generation to Global Marketing Services, Inc. ("GMS"). The Company, via its arrangements with GMS and PFS, sells its products in the United States, Canada and Europe.

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

2. SIGNIFICANT ACCOUNTING POLICIES:

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

REVENUE AND COST RECOGNITION

The Company recognizes revenue upon shipment of product to customers and collectibility is reasonably assured. Collectibility is evaluated on an individual customer basis taking into consideration historical payment trends, current financial position, results of independent credit evaluations and payment terms. The Company permits its customers to return defective products (which are then returned by the Company to the manufacturer) and incorrect shipments for credit against other purchases and provides for estimated returns and allowances. The Company offers terms to its customers that it believes are standard for its industry.

Freight costs billed to customers are reflected as components of net revenues. Freight costs incurred by the Company are recorded as a component of cost of good sold. The Company records its costs as they are incurred by the Company or its service providers.

CONCENTRATION OF BUSINESS AND CREDIT RISK

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

All of the Company's revenue was generated by sales of product purchased under master distributor agreements with one supplier. Sales to two customers accounted for approximately 25% of the Company's total revenues. No other client accounted for 10% or more of the Company's revenue. As of December 31, 2001, two customers accounted for over 37% of trade accounts receivable on an aggregate basis.

CASH AND CASH EQUIVALENTS

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

INVENTORIES

Inventories (merchandise, held for resale, all of which are finished goods) are stated at the lower of weighted average cost or market. As of December 31, 2001, the Company's allowance for obsolete inventory is approximately \$13,000.

INVENTORIES IN-TRANSIT

Inventories in-transit represents merchandise that has not been received by the Company but that has been shipped and invoiced by the Company's vendors. The corresponding payable for inventories in-transit is included in long-term debt in the accompanying consolidated financial statement.

OTHER RECEIVABLES

Other receivables represent \$7.1 million of Value Added Tax ("VAT") amounts due from European governments for refundable VAT payments made in the ordinary course of business and \$5.2 million of amounts due from IBM under the Master Distributor Agreements (see Note 4).

OTHER ASSETS

Other assets includes restricted cash of \$1.0 million, which represents customer remittances received in Holdings' bank accounts that are payable to certain of the Company's lenders, and the value attributable to the Master Distributor Agreements of \$0.4 million. This indentifiable intangible asset is being amortized on a straight-line basis over the terms of the Master Distributor Agreements which are two years. The Company assesses the recoverability of this intangible asset by determining whether the amortization of the remaining balance over its remaining life can be recovered through undiscounted future operating cash flows of the associated contracts.

FOREIGN CURRENCY TRANSLATION AND TRANSACTIONS

For the Company's Canadian and European operations, the local currency is the functional currency. All assets and liabilities are translated at exchange rates in effect at the end of the period, and income and expense items are translated at the average exchange rates for the period. Translation adjustments are reported as a separate component of members' equity.

Gains or losses on intercompany foreign currency transactions that are of a long-term investment nature are also reported as a separate component of members' capital.

INCOME TAXES

Although Holdings is an LLC, it has elected to be taxed, for federal income tax purposes, as a C corporation. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

FAIR VALUE OF FINANCIAL INSTRUMENTS

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

COMPREHENSIVE INCOME

Comprehensive income represents the change in members' capital available for distribution to the partners pursuant to the Operating Agreements (see Note 5). Comprehensive income consists of net income, foreign currency translation adjustments and the loss associated with long-term intercompany foreign currency transactions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

3. ACQUISITION OF THE BSD COMPANIES:

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed as of September 26, 2001, the acquisition date of the BSD Companies (unaudited, in thousands):

Cash.....	\$ 8,538
Accounts receivable, net.....	3,230
Receivable from Daisytek.....	5,715
Receivable from Supplies Distributors.....	5,877
Other receivables.....	6,022
Inventories, net.....	13,516
Other assets -- identifiable intangible (see Note 2).....	378

Total assets acquired.....	43,276

Trade accounts payable.....	40,557
Accrued expenses.....	1,679
Other current liabilities.....	57

Total liabilities assumed.....	42,293

Net assets acquired.....	\$ 983
	=====

The receivable from Daisytek was repaid concurrently with the acquisition. The results of the BSD Companies' operations have been included in the consolidated financial statements since the acquisition date. For the period from inception through December 31, 2001, the Company recorded approximately \$51,000 of amortization expense associated with the identifiable intangible.

Pro forma revenues and pro forma income from operations for the period from inception through December 31, 2001, assuming the transaction had occurred on July 3, 2001, would have been \$90.6 million and \$2.1 million, respectively. Because of the negative impact to revenue as a result of the transition of the master distributor agreements from Daisytek to Supplies Distributors, the pro forma adjustments to the operating results of the business may not be indicative of future results.

4. MASTER DISTRIBUTOR AGREEMENTS:

In August 2001, Supplies Distributors, SDSA, PFS and IBM entered into Master Distributor Agreements whereby Supplies Distributors and SDSA act as master distributors of various IBM products and PFS provides transaction management and fulfillment services to Supplies Distributors. The Master Distributor Agreements expire in August 2003 and can be extended for additional one year terms upon mutual agreement by all parties. Under the Master Distributor Agreements, IBM reimburses Supplies Distributors for certain freight costs, direct costs incurred in passing on any price decreases offered by IBM to Supplies Distributors customers to cover price protection and certain special bids, the cost of products provided to replace defective product returned by customers and other certain expenses as defined. Supplies Distributors can return to IBM product rendered obsolete by IBM engineering changes after customer demand ends. IBM determines when a product is obsolete. IBM and SDSA also have verbal agreements under which IBM reimburses or collects from SDSA amounts calculated in certain inventory cost adjustments, amounts applicable to currency related inventory cost variances, and amounts applicable to favorable or unfavorable gross margin performance versus targeted objectives.

Supplies Distributors and SDSA pass through to customers marketing programs specified by IBM and administer, along with GMS, such programs according to IBM guidelines.

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

5. MEMBERS' CAPITAL:

PFS made an equity investment of \$0.75 million in Holdings for a 49% voting interest, and IFP made an equity investment of \$0.25 million in Holdings for a 51% voting interest. Certain officers and directors of PFS own, individually, a 9.8% non-voting interest, and, collectively, a 49% non-voting interest, in IFP. The contributions do not accrue interest. No member, solely by reason of being a member, has any obligation to make any additional capital contribution or loan to Holdings or guaranty any indebtedness or obligation of Holdings. (See Note 6)

Holdings' comprehensive income is allocated and distributed to the members pursuant to the terms of the operating agreement, which expires on December 31, 2050. Pursuant to the operating agreement, Holdings allocates its earning and distributes its cash flow, as defined, in the following order of priority:

- to IFP until it has received a one-time amount equal to its capital contribution of \$0.25 million;
- to IFP until it has received an amount equal to a 35% cumulative annual return on its capital contribution;
- to PFS until it has received a one-time amount equal to its capital contribution of \$0.75 million;
- to PFS until it has received an amount equal to a 35% cumulative annual return on its capital contribution; and
- to PFS and IFP, pro rata, in accordance with their respective capital accounts.

Notwithstanding the foregoing, no distribution may be made if, after giving effect thereto, the net worth of Holdings shall be less than \$1.0 million. Pursuant to the terms of its credit agreements, Holdings is currently limited to annual cash dividends of \$0.6 million.

Following the earnings allocation priority, the members' capital accounts as of December 31, 2001 are as follows:

PFS.....	\$ 750
IFP.....	460

Total members' capital.....	\$1,210
	=====

In the event of liquidations, distributions will be made in accordance with the operating agreement. The distribution will be made based upon members' capital as determined on a basis in a manner similar to the comprehensive income and cash flow distributions described above.

6. LONG-TERM DEBT:

As of December 31, 2001, debt consists of the following (in thousands):

Inventory and working capital financing agreement, United States.....	\$39,292
Inventory and working capital financing agreement, Europe...	19,746

Total debt.....	\$59,038
	=====

INVENTORY AND WORKING CAPITAL FINANCING AGREEMENT, UNITED STATES

On September 27, 2001, Supplies Distributors entered into a short-term credit facility with IBM Credit Corporation ("IBM Credit") to finance its distribution of IBM products in the United States. At inception, the facility provided for a \$40 million credit line and expired on January 25, 2002. Prior to expiration, the credit line was increased to \$45 million and extended through March 25, 2002. Availability under the credit

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

facility was subject to certain borrowing base limitations, including eligible receivables and inventory, as defined. Borrowings under the credit facility accrued interest, after a defined free financing period, at prime rate plus 1%, which was 6.0% as of December 31, 2001. Supplies Distributors paid a quarterly commitment fee of 0.375% on the unused portion of the commitment, and a monthly service fee. The credit facility contained cross default provisions and various monthly financial covenant compliance requirements for Supplies Distributors and Holdings based on (i) annualized revenue to working capital, (ii) net profit after tax to revenue, and (iii) total liabilities to tangible net worth, as defined. In general, these covenants required minimum levels of net income and capitalization. Additionally, PFS was required to maintain shareholders' equity of at least \$30 million. The credit facility also contained restrictions on certain activities, including loans and payments to related parties, incurring additional debt, acquisitions, investments, dividends and asset sales. The credit facility was secured by a security interest in Supplies Distributors' assets, including accounts receivable and inventory and 65% of the stock of SDC, and was guaranteed by PFS and Holdings. Supplies Distributors entered into a Blocked Account Agreement with its bank and IBM Credit whereby a security interest was granted to IBM Credit for all customer remittances received in specified bank accounts. At December 31, 2001, these bank accounts held \$1.0 million, which was restricted for payment to IBM Credit.

INVENTORY AND WORKING CAPITAL FINANCING AGREEMENT, EUROPE

On September 27, 2001, SDSA entered into a short-term credit facility with IBM Belgium Financial Services S.A. ("IBM Belgium") to finance its distribution of IBM products in Europe. At inception, the facility provided for a 20 million euro credit line (approximately \$18 million) and expired on January 25, 2002. Prior to expiration, the credit line was increased to 27 million euros (approximately \$24.3 million) and extended through March 25, 2002. Availability under the credit facility was subject to certain borrowing base limitations, including eligible receivables and inventory, as defined. Borrowings under the credit facility accrued interest, after a defined free financing period, at euribor plus 4%, which was 7.425% as of December 31, 2001. SDSA paid a monthly service fee on the commitment. The credit facility contained cross default provisions and various monthly financial covenant compliance requirements for SDSA based on (i) annualized revenue to working capital, (ii) net profit after tax to revenue, and (iii) total liabilities to tangible net worth, as defined. In general, these covenants required minimum levels of net income and capitalization. Additionally, PFS was required to have shareholders' equity of at least \$30 million. The credit facility also contained restrictions on certain activities, including acquisitions, liquidations, dividends, asset sales and payments on SDSA's intercompany debt with Supplies Distributors. The credit facility was secured by a security interest in all of SDSA's assets, including accounts receivable, bank accounts, inventory and 65% of the stock of SDSA and BSD Europe and was guaranteed by Holdings, Supplies Distributors and PFS. SDSA entered into a Blocked Account Agreement with its bank and IBM Belgium whereby a security interest was granted to IBM Belgium for all customer remittances received in specified bank accounts.

AMENDED AGREEMENTS

On March 29, 2002, Supplies Distributors entered into amended credit facilities with IBM Credit and SDSA and BSD Europe entered into amended credit facilities with IBM Belgium. The asset based credit facility with IBM Credit provides financing for purchasing IBM inventory up to \$32.5 million through June 30, 2002 and \$27.5 million from July 1, 2002 through its expiration on March 29, 2003. The asset based credit facility with IBM Belgium provides up to 27 million Euros (approximately \$24.3 million) in financing for purchasing IBM inventory through June 30, 2002 and 22 million Euros (approximately \$19.8 million) thereafter. The IBM Belgium facility remains in force until not less than 60 days written notice by any party, but no sooner than March 29, 2003. These credit facilities contain cross default provisions, various restrictions upon the ability of Holdings, Supplies Distributors, SDSA and BSD Europe to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFS. Additionally, PFS is required to maintain a subordinated receivable balance of no less than \$6.5 million from Supplies Distributors, and shareholders' equity of at least \$25.0 million.

LOAN AND SECURITY AND FACTORING AGREEMENT

Concurrent with these amended agreements, Supplies Distributors entered into a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to \$25 million of eligible accounts receivables in the U.S. and Canada. The Congress facility expires on the earlier of three years or the date on which the parties to the IBM Master Distributor Agreement shall no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such agreement. Borrowings under the Congress facility accrue interest at prime rate plus 0.25% or Eurodollar rate plus 3.0% or on an adjusted basis, as defined. In Europe, SDSA entered into a two year factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 10 million Euros (approximately \$9 million) of eligible accounts receivables. Borrowings under this agreement accrue interest at 8.5%, or on an adjusted basis as defined. These credit facilities contain cross default provisions, various restrictions upon the ability of Holdings, Supplies Distributors and SDSA to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guaranties, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFS. Additionally, PFS is required to maintain a subordinated loan to Supplies Distributors of no less than \$6.5 million and restricted cash of less than \$5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure.

GUARANTEES

PFS has provided collateralized guarantees to secure the repayment of all of the Company's credit facilities. As of December 31, 2001 the outstanding balance of the credit facilities guaranteed by PFS was approximately \$59.0 million. In association with the new credit facilities entered into on March 29, 2002, the outstanding balance of the credit facilities guaranteed by PFS was approximately \$48.5 million. These guarantees expire concurrently with the expiration of the underlying credit agreements. To the extent Supplies Distributors fails to comply with its covenants, including its monthly financial covenant requirements, and the lenders accelerate the repayment of the credit facility obligations, Supplies Distributors would be required to repay all amounts outstanding thereunder. In such event, PFS would be obligated to perform under those guarantees and repay, to the extent Supplies Distributors was unable to, Supplies Distributors' credit facility obligations. Additionally, if PFS was unable to maintain PFS' required level of stockholders' equity of \$25.0 million, PFS could also be obligated to perform under these guarantees. Any requirement to perform under PFS' guarantees would have a material adverse impact on PFS' financial condition and results of operations and no assurance can be given that PFS will have the financial ability to repay all of such guaranteed obligations. Furthermore, PFS is obligated to repay any over-advance made to Supplies Distributors by its lenders. An over-advance would arise in the event borrowings exceeded the maximum amount available under the eligible borrowing base, as defined.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

7. TRANSACTIONS WITH RELATED PARTIES:

In August 2001, Supplies Distributors entered into an Agreement for Sales Forces Services ("ASFS") with IBM, whereby Supplies Distributors is to actively generate demand for and promote brand loyalty for IBM products. The ASFS expires on the earlier of December 31, 2003 or the termination of the Master Distributor Agreements. The ASFS automatically renews for successive one-year periods unless either party provides prior written notice. Pursuant to the ASFS, IBM pays to Supplies Distributors a quarterly service fee as agreed to by both parties. Supplies Distributors has subcontracted with GMS to provide the sales force activities for an amount equal to the fees received by Supplies Distributors. The principal officer of GMS owns 46% of IFP. As of December 31, 2001, Supplies Distributors has \$1.1 million due from IBM under the terms of the ASFS included in accounts receivable and approximately \$1.5 million of unpaid service fees due to GMS.

In August 2001, PFS and Supplies Distributors entered into Transaction Management Services Agreements ("TMSA") whereby PFS provides transaction management and fulfillment services to Supplies Distributors (see Note 1). Under terms of the TMSA, PFS is required to conduct its services within certain performance levels, as defined, and is liable to indemnify Supplies Distributors for inventory losses, as defined. The TMSA has terms corresponding with the Master Distributor Agreements (see Note 4).

Under the terms of the TMSA, PFS charges Supplies Distributors for its services based on a percentage of Supplies Distributors' shipped revenue. Percentages vary by geographic location and by the amount of shipped revenue. Dependent on changes in the type and levels of transactions, percentages charged by PFS can be amended by mutual consent of PFS and Supplies Distributors. Pursuant to the TMSA, Supplies Distributors incurred service expenses, reported as selling, general and administrative expenses in the accompanying consolidated financial statement, of approximately \$1.4 million to PFS. As of December 31, 2001, the Company owes PFS \$0.9 million.

In September 2001, Supplies Distributors issued a Subordinated Demand Note (the "Note") to PFS in exchange for proceeds of \$8.8 million. The balance of the Note can be increased by PFS, at its discretion or as required to meet the senior financial obligations of the Company, as needed, and as of December 31, 2001, had an outstanding balance of \$11.7 million, which is classified as note payable to affiliate. The Note can be decreased to \$6.5 million subject to Supplies Distributors' compliance with the covenants of its senior loan facilities, as amended. The Note accrues interest at a fluctuating rate per annum equal to PFS' cost of funds as determined by PFS, approximately 10% as of December 31, 2001. During the period from inception through December 31, 2001, Supplies Distributors recorded \$0.3 million of interest associated with the amount due to PFS.

In December 2001, PFS issued 12,500 stock options to Supplies Distributors' President. The options were immediately vested and have an exercise price of \$0.91.

8. INCOME TAXES:

The Company has elected to be taxed as a C corporation. A reconciliation of the difference between the expected income tax expense at the U.S. federal statutory corporate tax rate of 34%, and the Company's effective tax rate, for the period from inception through December 31, 2001, is as follows (in thousands):

Income tax expense (benefit) computed at statutory rate.....	\$228
Impact of foreign taxation at different rate.....	27
Expenses not deductible for tax purposes.....	17

Provision for income taxes.....	\$272
	====

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The consolidated income before income taxes, by domestic and foreign entities, for the period from inception through December 31, 2001, is as follows (in thousands):

Domestic.....	\$243
Foreign.....	429

Total.....	\$672
	=====

Current and deferred income tax expense for the period from inception through December 31, 2001, is summarized as follows (in thousands):

Current	
Domestic.....	\$ 156
Foreign.....	416

Total current.....	572

Deferred	
Domestic.....	(55)
Foreign.....	(245)

Total deferred.....	(300)

Total.....	\$ 272
	=====

The components of the deferred tax asset (liability) as of December 31, 2001 are as follows (in thousands):

Deferred tax asset:	
Allowance for doubtful accounts.....	\$300
Other.....	31

Total deferred tax asset.....	331

Deferred tax liability:	
Total deferred liability.....	89

Deferred tax asset, net.....	\$242
	=====

9. SEGMENT AND GEOGRAPHIC INFORMATION:

The Company is organized as a single operating segment, which is international distribution of computer supplies. Geographic areas in which the Company operates include the United States, Europe (primarily Belgium), and Canada.

BUSINESS SUPPLIES DISTRIBUTORS HOLDINGS, LLC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The following is geographic information by area. Revenues are attributed based on the Company's domicile. Amounts shown are for the period from inception through December 31, 2001 (in thousands):

Revenues:	
United States.....	\$ 53,077
Europe.....	42,116
Canada.....	4,073
Eliminations.....	(23,822)

	\$ 75,444
	=====

The eliminations amount above primarily relates to intercompany sales in Europe from BSD Europe to SDSA.

The company has \$0.3 million of long-lived assets in the United States associated with the acquisition of the BSD companies.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Reference is made to the information to be set forth in the section entitled "Election of Directors" in the definitive proxy statement involving the election of directors in connection with the Annual Meeting of Stockholders of the Company to be held in June 2002 (the "Proxy Statement") which section is incorporated herein by reference. The Proxy Statement (or an amendment to this Form 10-K containing the relevant information) will be filed with the Securities and Exchange Commission not later than 120 days after the last day of the Company's transition period ended December 31, 2001.

ITEM 11. EXECUTIVE COMPENSATION

Information required by Part III, Item 11, will be included in the section entitled "Election of Directors" of the Company's Proxy Statement relating to the Company's annual meeting of stockholders to be held in June 2002, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required by Part III, Item 12, will be included in the Sections entitled "Election of Directors" and "Security Ownership of Certain Beneficial Owners and Management" of the Company's Proxy Statement relating to the Company's annual meeting of stockholders to be held in June 2002, and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIP AND RELATED TRANSACTIONS

Information regarding certain of the Company's relationships and related transactions will be included in the section entitled "Certain Relationship and Related Transactions" of the Company's Proxy Statement relating to the Company's annual meeting of stockholders to be held in June 2002, and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

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

1. Financial Statements

PFSweb, Inc. and Subsidiaries

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

Business Supplies Distributors Holdings, LLC

Independent Auditors' Report
Consolidated Balance Sheet

Consolidated Statement of Operations
Consolidated Statement of Members' Capital and Comprehensive Income
Consolidated Statement of Cash Flows
Notes to Consolidated Financial Statements

Financial Statements Schedules

Report of Independent Public Accountants
Schedule II -- Valuation and Qualifying Accounts

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

2. Exhibits

EXHIBIT NUMBER
DESCRIPTION OF
EXHIBITS - ----

2.1* Master
Separation
Agreement by
and among
Daisytek
International
Corporation,
Daisytek,
Incorporated,
Priority
Fulfillment
Services, Inc.
and PFSweb,
Inc. 2.2*
Initial Public
Offering and
Distribution
Agreement by
and among
Daisytek
International
Corporation,
Daisytek,
Incorporated,
and PFSweb,
Inc. 2.3*
Registration
Rights
Agreement by
and among
Daisytek
International
Corporation,
Daisytek,
Incorporated
and PFSweb,
Inc. 2.4* Tax
Indemnification
and Allocation
Agreement
between
Daisytek,
International
Corporation and
PFSweb, Inc.
3.1* Amended
and Restated
Certificate of
Incorporation
3.2* Amended
and Restated
Bylaws 10.1*
Non-Employee
Director Stock
Option and
Retainer Plan

10.2* Employee
Stock Option
Plan 10.3*
Employee Annual
Incentive Plan
10.4*
Industrial
Lease Agreement
between Shelby
Drive
Corporation and
Priority
Fulfillment
Services, Inc.
10.5* Lease
Contract
between
Transports
Weerts and
Priority
Fulfillment
Services Europe
B.V. 10.6**
Asset Purchase
Agreement by
and among
PFSweb, Inc.,
Priority
Fulfillment
Services, Inc.,
Daisytek, Inc.
and Daisytek
International
Corporation
10.7**
Transition
Services
Agreement by
and between
PFSweb, Inc.
and Daisytek
International
Corporation
10.8** Form of
Change of
Control
Agreement
between the
Company and
each of its
executive
officers
10.9*** Offer
to Exchange
dated April 30,
2001 10.10****
Inventory and
Working Capital
Financing
Agreement by
and among
Business
Supplies
Distributors
Holdings, LLC,
BSD Acquisition
Corp., Priority
Fulfillment
Services, Inc.,
PFSweb, Inc.,
Inventory
Financing
Partners, LLC
and IBM Credit
Corporation
10.11****
Collateralized
Guaranty by and
between
Priority
Fulfillment

Services, Inc.
and IBM Credit
Corporation
10.12****
Guaranty to IBM
Credit
Corporation by
PFSweb, Inc.
10.13**** Notes
Payable
Subordination
Agreement by
and between
Priority
Fulfillment
Services, Inc.,
BSD Acquisition
Corp. and IBM
Credit
Corporation
10.14**** Stock
Purchase
Agreement by
and among
Daisytek,
Incorporated,
BSD Acquisition
Corp., Priority
Fulfillment
Services, Inc.,
PFSweb, Inc.
and Priority
Fulfillment
Services Europe
B.V. 10.15****
Operating
Agreement of
Business
Supplies
Distributors
Holdings, LLC

EXHIBIT
NUMBER
DESCRIPTION
OF EXHIBITS -

10.16**** IBM
Global
Financing
Platinum Plan
Agreement
(with Invoice
Discounting)
by and among
Supplies
Distributors,
S.A.,
Business
Supplies
Distributors
Europe, B.V.,
PFSweb B.V.,
and IBM
Belgium
Financial
Services S.A.

10.17****
Collateralized
Guaranty
between
Priority
Fulfillment
Services,
Inc. and IBM
Belgium
Financial
Services S.A.

10.18****
Guaranty to
IBM Belgium
Financial
Services S.A.
by PFSweb,
Inc.

10.19****
Subordinated
Demand Note
by and among
BSD
Acquisition
Corp. and
Priority
Fulfillment
Services,
Inc.

10.20****
Ninth
Amendment to
Lease
Agreement by
and between
AGBRI ATRIUM,
L.P., and
Priority
Fulfillment
Services,
Inc.

10.21****
Stock Option
Agreement
21****

Subsidiaries
of the
Registrant
23.1****
Consent of
KPMG LLP

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

** Incorporated by reference from PFSweb, Inc. Form 10-K for the fiscal year ended March 31, 2001

*** Incorporated by reference from PFSweb, Inc. Schedule T0 filed on April 30, 2001

**** Incorporated by reference from PFSweb, Inc. Form 10-Q/A for the quarterly period ended September 30, 2001

***** Filed herewith.

(b) Reports on Form 8-K:

None.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

The Shareholders of PFSweb, Inc.:

We have audited, in accordance with auditing standards generally accepted in the United States, the consolidated statement of operations, shareholders' equity and cash flows of PFSweb, Inc. (a Delaware corporation) and subsidiaries (see Note 1) for the year ended March 31, 2000 included in this report on Form 10-K and have issued our report thereon dated May 4, 2000. Our audit was made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. Schedule II of this report on Form 10-K is the responsibility of the Company's management and is presented for the purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic consolidated financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, fairly states in all material respects, the financial data required to be set forth therein in relation to the basic consolidated financial statements as of March 31, 2000 and for the year then ended taken as a whole.

ARTHUR ANDERSEN LLP

Dallas, Texas
May 4, 2000

PFSWEB, INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS
 FOR THE FISCAL YEARS ENDED MARCH 31, 2000 AND 2001,
 AND THE NINE MONTH PERIOD ENDED DECEMBER 31, 2001
 (AMOUNTS IN THOUSANDS)

ADDITIONS -----

 BALANCE AT
 CHARGES TO
 CHARGES TO
 BALANCE AT
 BEGINNING COST
 AND OTHER END OF
 OF PERIOD
 EXPENSES ACCOUNTS
 DEDUCTIONS PERIOD

--- Fiscal Year
 Ended March 31,
 2000: Allowance
 for doubtful
 accounts.....
 \$ 635 458 --
 (403) \$ 690
 Income tax
 valuation

allowance.....
 \$ -- 915 -- -- \$
 915 Fiscal Year
 Ended March 31,
 2001: Allowance
 for doubtful
 accounts.....
 \$ 690 2,203 --
 (2,614) \$ 279
 Income tax
 valuation

allowance.....
 \$ 915 3,567 -- --
 \$4,482 Nine
 Months Ended
 December 31,
 2001: Allowance
 for doubtful
 accounts.....
 \$ 279 17 -- (42)
 \$ 254 Income tax
 valuation

allowance.....
 \$4,482 125 822 --
 \$5,429

SIGNATURES

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

By: /s/ THOMAS J. MADDEN

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

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

SIGNATURE
TITLE DATE

/s/ MARK
C. LAYTON
Chairman
of the
Board,
President
and April
2, 2002 --

--- Dr.
Neil

Jacobs /s/
TIMOTHY M.
MURRAY
Director
April 2,
2002 -----

Timothy M.
Murray /s/
JAMES F.
REILLY
Director
April 2,
2002 -----

--- James
F. Reilly
/s/ DAVID
I. BEATSON
Director
April 2,
2002 -----

--- David
I. Beatson

EXHIBIT INDEX

EXHIBIT NUMBER
DESCRIPTION OF
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Contract
between
Transports
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Priority
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Services Europe
B.V. 10.6**
Asset Purchase
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PFSweb, Inc.,
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Services, Inc.,
Daisytek, Inc.
and Daisytek
International
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to Exchange
dated April 30,
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Working Capital
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and among
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Supplies
Distributors
Holdings, LLC,
BSD Acquisition
Corp., Priority
Fulfillment
Services, Inc.,
PFSweb, Inc.,
Inventory
Financing
Partners, LLC
and IBM Credit
Corporation
10.11****
Collateralized
Guaranty by and
between
Priority
Fulfillment
Services, Inc.
and IBM Credit
Corporation
10.12****
Guaranty to IBM
Credit
Corporation by
PFSweb, Inc.
10.13**** Notes
Payable
Subordination
Agreement by
and between
Priority
Fulfillment

Services, Inc.,
BSD Acquisition
Corp. and IBM
Credit
Corporation
10.14**** Stock
Purchase
Agreement by
and among
Daisytek,
Incorporated,
BSD Acquisition
Corp., Priority
Fulfillment
Services, Inc.,
PFSweb, Inc.
and Priority
Fulfillment
Services Europe
B.V. 10.15****
Operating
Agreement of
Business
Supplies
Distributors
Holdings, LLC
10.16**** IBM
Global
Financing
Platinum Plan
Agreement (with
Invoice
Discounting) by
and among
Supplies
Distributors,
S.A., Business
Supplies
Distributors
Europe, B.V.,
PFSweb B.V.,
and IBM Belgium
Financial
Services S.A.
10.17****
Collateralized
Guaranty
between
Priority
Fulfillment
Services, Inc.
and IBM Belgium
Financial
Services S.A.
10.18****
Guaranty to IBM
Belgium
Financial
Services S.A.
by PFSweb, Inc.
10.19****
Subordinated
Demand Note by
and among BSD
Acquisition
Corp. and
Priority
Fulfillment
Services, Inc.
10.20****
Ninth Amendment
to Lease
Agreement by
and between
AGBRI ATRIUM,
L.P., and
Priority
Fulfillment
Services, Inc.
10.21****
Stock Option

Agreement

21*****

Subsidiaries of
the Registrant

23.1*****

Consent of KPMG

LLP 23.2*****

Consent of
Arthur Andersen

LLP

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

** Incorporated by reference from PFSweb, Inc. Form 10-K for the fiscal year
ended March 31, 2001

*** Incorporated by reference from PFSweb, Inc. Schedule T0 filed on April 30,
2001

**** Incorporated by reference from PFSweb, Inc. Form 10-Q/A for the quarterly
period ended September 30, 2001

***** Filed herewith.

NINTH AMENDMENT TO LEASE AGREEMENT

THIS NINTH AMENDMENT TO LEASE AGREEMENT (this "Amendment") is entered into as of the 13th day of November, 2001 (the "Effective Date"), by and between AGBRI ATRIUM, L.P., a Delaware limited partnership ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation ("Tenant").

WITNESSETH:

WHEREAS, AmWest Savings Association, a Texas savings and loan association ("AmWest"), and Daisytek Incorporated, a Texas corporation ("Daisytek"), entered into that certain Lease Agreement (Office) (the "Original Lease") dated as of September 30, 1991, covering premises in the building (the "Building") commonly known as The Atrium at Collin Ridge located at 500 N. Central Expressway, Plano, Texas;

WHEREAS, AmWest and Daisytek entered into that certain Modification and Ratification of Lease (the "First Amendment") dated January 7, 1992;

WHEREAS, AmWest sold the Building to Atrium Associates, L.P., a Texas limited partnership, d/b/a The Atrium at Collin Ridge ("Atrium"), and assigned to Atrium all of its rights under the Original Lease, as amended by the First Amendment;

WHEREAS, Atrium and Daisytek entered into that certain Modification and Ratification of Lease (the "Second Amendment") dated July 22, 1992;

WHEREAS, Atrium and Daisytek entered into that certain Modification of Lease No. 3 (the "Third Amendment") dated November 12, 1992;

WHEREAS, Atrium and Daisytek entered into that certain Modification of Lease No. 4 (the "Fourth Amendment") dated April 26, 1993;

WHEREAS, Atrium and Daisytek entered into that certain Modification of Lease No. 5 (the "Fifth Amendment") dated as of November 1, 1994;

WHEREAS, Atrium and Daisytek entered into that certain Sixth Modification to Lease Agreement (the "Sixth Amendment") dated November 30, 1995, pursuant to which, among other things, Daisytek leased from Atrium, and Atrium leased to Daisytek, a certain 13,056 rentable square foot space on the 1st floor of the Building (such space together with any other space hereafter leased by Tenant on the 1st floor of the Building is herein referred to as the "First Floor Space"), which 13,056 rentable square foot space is more particularly described on the Exhibit B of the Sixth Amendment;

WHEREAS, Atrium and Daisytek entered into that certain Seventh Modification to Lease Agreement (the "Seventh Amendment") dated July 31, 1996;

WHEREAS, Atrium and Daisytek entered into that certain Eighth Amendment to Lease (the "Eighth Amendment") dated effective as of February 20, 1998 (the First Amendment, the Second Amendment, the Third Amendment, the Fourth Amendment, the Fifth Amendment, the Sixth Amendment, the Seventh Amendment and the Eighth Amendment are herein collectively called the "Amendments" and the Original Lease, as amended by the Amendments, is herein called the "Lease");

WHEREAS, Landlord has purchased the Building from Atrium;

WHEREAS, the lease currently covers approximately 65,419 rentable square feet of space (the "Premises");

WHEREAS, Daisytek assigned its rights under the Lease to Tenant pursuant to that certain Assignment of Lease dated as of February 1, 2000, and, in connection therewith, Landlord, Tenant and Daisytek entered into that certain Consent to Assignment which was attached to such Assignment of Lease;

WHEREAS, Tenant exercised its renewal right pursuant to the Lease by delivering to Landlord written notice thereof, a copy of which is attached hereto as Exhibit B; and

WHEREAS, Landlord and Tenant desire to modify the terms and provisions of the Lease as set forth herein;

NOW, THEREFORE, for and in consideration of the mutual terms and conditions set forth herein and for Ten Dollars (\$10.00) and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant agree as follows:

1. Defined Terms. All capitalized terms used herein and not otherwise defined herein shall have the meanings given to those terms in the Lease.

2. Extension of Term of the Lease. The term of the Lease is hereby extended until, and the Lease is hereby renewed through, March 15, 2007 (such date of expiration is herein referred to as the "Scheduled Expiration Date"). As used herein or in the Lease and all exhibits attached hereto or thereto, the term "Lease Term" shall mean the period beginning on December 16, 1991, and ending on the Scheduled Expiration Date, unless sooner terminated in accordance with the Lease. As used herein, the term "2002 Renewal Term" shall mean the period of time beginning on March 16, 2002, and ending on the Scheduled Expiration Date.

3. Base Rental for the Premises. Tenant shall pay to Landlord as Base Rental for the Premises in lawful money of the United States of America as follows:

(a) Prior to March 15, 2002, Tenant shall pay Base Rental for the Premises as provided in the Lease;

(b) Commencing March 16, 2002, through November 15, 2003, Tenant shall pay \$92,676.92 per month for the Premises (i.e., \$17.00 per rentable square foot on an annual basis for the Premises);

(c) Commencing November 16, 2003, through July 15, 2005, Tenant shall pay \$98,128.50 per month for the Premises (i.e., \$18.00 per rentable square foot on an annual basis for the Premises); and

(d) From and after July 16, 2005 through the Scheduled Expiration Date, Tenant shall pay \$103,580.08 per month for the Premises (i.e., \$19.00 per rentable square foot on an annual basis for the Premises).

4. Base Expense Amount Adjustment. During the 2002 Renewal Term, the term "Base Expense Amount" shall mean the actual Operating Expenses for the calendar year 2002 subject to adjustment as provided below in this paragraph. In the event that during all or any portion of any calendar year the rentable area of the Building is not fully rented, fully occupied and/or being completely provided with Building standard services, Landlord may make an appropriate adjustment of Operating Expenses for such year, employing sound accounting and management principles, to determine the Operating Expenses that would have been paid or incurred by Landlord had the rentable area of the Building been fully rented, fully occupied and/or completely provided with Building standard services during such period of time and the amount so determined shall be deemed to have been the Operating Expenses for such year. As a result, the last sentence of Section 4.(d) of the Lease is hereby deleted in its entirety.

5. Leasehold Improvements. Tenant is currently occupying the Premises and hereby accepts the same in its "as is" condition and Landlord shall have no obligation to perform any work therein and shall not be obligated to reimburse Tenant or provide an allowance for any costs related to the demolition or construction of improvements therein except for the \$322,916.00 refurbishment allowance provided pursuant to the Rider No. 102 attached to the Lease (i.e., \$5.50 per usable square feet of space in the Premises).

6. Renewal Option; Waiver of Rights of First Offer. Tenant shall have the right to renew the 2002 Renewal Term in accordance with the terms and provisions set forth in Exhibit A attached hereto. This renewal right is the only such right available to Tenant after the Effective Date, and any other such rights are hereby deleted from the Lease and/or the Amendments and shall be of no further force or effect. Notwithstanding anything to the contrary contained in the Lease, Tenant hereby agrees and acknowledges that Tenant has no expansion rights, first offer or first refusal or similar rights under the Lease or any of the Amendments. Any and all such provisions contained in the Lease or any of the Amendments regarding Tenant's expansion rights, first offer or first refusal or similar rights, if any (including, without limitation, Paragraph 8 of the Sixth Amendment), are hereby deleted from the Lease and/or the Amendments and shall be of no further force or effect.

7. Brokers. Tenant represents and warrants to Landlord that it has dealt directly with (and only with) Jones Lang LaSalle Americas, Inc. ("Landlord's Broker") and Cushman & Wakefield ("Tenant's Broker") as brokers in connection with this Amendment, and that insofar as Tenant knows, no other broker negotiated or participated in the negotiations of this Amendment, or is entitled to any commission in connection therewith. Tenant hereby agrees to indemnify, save and hold Landlord harmless from and against any and all claims or demands made upon Landlord for any commissions, fees or other compensation by any broker, agent or salesman (other than Landlord's Broker and Tenant's Broker) in connection with this Amendment. Landlord agrees to pay Landlord's Broker and Tenant's Broker each a commission pursuant to separate written agreements between Landlord's Broker and Landlord and Tenant's Broker and Landlord, and

Landlord hereby agrees to indemnify, save and hold Tenant harmless from and against any and all claims or demands made upon Tenant for any commissions, fees or other compensation by Landlord's Broker and Tenant's Broker. The provisions of this paragraph shall survive the expiration or any earlier termination of the Lease.

8. Tenant Certification. By its execution of this Amendment, Tenant hereby certifies that as of the date of such execution, and to the best of Tenant's knowledge, Landlord is not in default in the performance of any its obligations under the Lease, and Tenant has no offsets, claims against Landlord or the rent payable by

Tenant under the Lease and no defenses with respect to the Lease. By its execution of this Amendment, Landlord hereby certifies that as of the date of such execution, and to the best of Landlord's knowledge, Tenant is not in default in the performance of any of its obligations under the Lease.

9. Continuing Effect; References to this Amendment. The Lease, as amended herein, are hereby ratified and confirmed and shall continue in full force and effect. Any reference to "this Amendment" shall include all of the provisions set forth in all exhibits attached hereto.

10. Counterparts. This Amendment may be executed in multiple counterparts with the same effect as if all parties hereto had signed the same document. All such counterparts shall be construed together and shall constitute one and the same instrument.

11. Authority. Tenant hereby warrants and represents that it has the requisite authority and ability to enter into this Amendment and to fully perform all obligations of Tenant hereunder. Landlord hereby warrants and represents that it has the requisite authority and ability to enter into this Amendment and to fully perform all obligations of Landlord hereunder.

12. Conflicts. In the event of any conflict between the terms of this Amendment and either the Lease or the Amendments, the terms of this Amendment shall control.

13. Confidentiality. Except as hereinafter provided, Tenant covenants and agrees, for itself and its officers, partners, employees, attorneys, consultants and agents (including, without limitation, Tenant's Broker), to keep the terms, conditions and provisions of this Amendment strictly confidential and not disclose the terms, conditions and provisions hereof except as follows: (a) to the extent disclosure of some or all of such terms, conditions or provisions may be required by law including the filing of this Amendment as an exhibit to any SEC filing of Tenant; (b) the financial terms of this Amendment to the extent that the disclosure of the same is required in connection with any financing sought by Tenant; and (c) in connection with the enforcement of Tenant's rights hereunder or under the Lease. The covenants of Tenant in this paragraph have been given by Tenant as a material inducement to Landlord to enter into this Amendment and grant the rights to Tenant contained herein. In the event of any disclosure by Tenant or any of the parties described above, Landlord shall be entitled to recover from Tenant any and all damages resulting therefrom and to otherwise pursue any and all other rights and remedies available to Landlord at law, in equity or otherwise.

14. Effect of Submission. Submission of this Amendment for examination does not constitute an offer, right of first refusal, reservation of, or option for, any premises at the Building. This Amendment shall become effective only upon the execution and delivery by both Landlord and Tenant.

[THE REMAINDER OF THIS PAGE IS INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the parties hereto have executed this Amendment effective for all purposes as of the Effective Date.

LANDLORD:

AGBRI ATRIUM, L.P., a Delaware limited partnership

By: SWSG II, L.P., a Delaware limited partnership,
its Authorized Agent

By: SWSG II, Inc., a Delaware corporation, its
general partner

By:

Name:

Title:

TENANT:

PRIORITY FULFILLMENT SERVICES, INC., a Delaware
corporation

By:

Name:

Title:

By:

Name:

Title:

EXHIBIT A

RENEWAL OPTION

AGBRI ATRIUM, L.P., a Delaware limited partnership ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation ("Tenant") have entered into that certain Ninth Amendment to Lease Agreement (the "Amendment") dated as of November 13, 2001. This Exhibit A (this "Exhibit") is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment.

1. Tenant shall have the right to renew and extend the 2002 Renewal Term with respect to the Premises then subject to the Lease for the Extension Term (as hereinafter defined) upon and subject to the following terms and conditions.

2. Tenant shall have one (1) option (the "Renewal Option") to extend the Lease Term and Scheduled Expiration Date for a period (the "Extension Term") of five (5) years, commencing upon the then-current Scheduled Expiration Date upon the same terms and conditions previously applicable, except for the grant of the exercised Renewal Option and the amount of Base Rental payable under the Lease (which amount shall be determined as set forth below). Not earlier than twelve (12) months or later than nine (9) months prior to the expiration of the 2002 Renewal Term, Tenant shall have the right to deliver to Landlord written notice (a "Notice of Intent to Renew") of Tenant's intent to extend the 2002 Renewal Term on the terms and conditions set forth herein. In such event, Landlord shall, within ninety (90) days after its receipt of a Notice of Intent to Renew, notify Tenant in writing of the Fair Market Value Rate (as defined in Paragraph 5 below) as determined by Landlord for the Premises during the Extension Term (such determination is herein referred to as the "Landlord's Assessment"). Landlord's Assessment shall reflect the fact that Landlord will provide to Tenant in connection with Tenant's exercise of the Renewal Option a refurbishment allowance (the "Refurbishment Allowance") in an amount equal to \$7.00 per usable square foot of space then comprising the Premises. Tenant shall have the right, within fifteen (15) days after its receipt of written notice of the Landlord's Assessment, to either (i) accept in writing such Landlord's Assessment and exercise the Renewal Option (the "Notice of Exercise"), or (ii) reject such Landlord's Assessment but nevertheless elect to exercise the applicable Renewal Option by, in either instance, delivering written notice thereof to Landlord within such fifteen (15) day period; provided, however, that the Renewal Option may be validly exercised only if no uncured Tenant default exists as of the date of exercise. If Tenant timely delivers to Landlord written notice that Tenant is exercising the Renewal Option but that Tenant does not accept Landlord's Assessment ("Tenant's Objection Notice"), the Fair Market Value Rate shall be determined as provided in Paragraph 6 below. Tenant's Objection Notice must identify Tenant's determination of the Fair Market Value Rate ("Tenant's Assessment") to trigger the appraisal process set forth in Paragraph 6 below.

3. If Tenant does not either timely (i) accept Landlord's Assessment, or (ii) deliver to Landlord Tenant's Objection Notice, Tenant will be deemed to have elected to not exercise the Renewal Option. In no event shall Landlord have any obligation to provide Tenant with the Refurbishment Allowance in the event Tenant elects not to exercise the Renewal Option or is deemed to have elected not to exercise the Renewal Option. The Extension Term shall commence immediately upon the expiration of the 2002 Renewal Term, and upon Tenant's exercise of the renewal option set forth in this Exhibit, the date of expiration of the 2002 Renewal Term shall automatically become the last day of the Extension Term.

4. The exercise by Tenant of the Renewal Option must be made, if at all, by written notice (i.e., the Notice of Exercise or Tenant's Objection Notice, as applicable) executed by Tenant and delivered to Landlord within the fifteen (15) day period set forth in the preceding paragraph. Once Tenant shall exercise the Renewal Option, Tenant may not thereafter revoke such exercise. Tenant's failure, for any reason whatsoever, to exercise the Renewal Option in strict accordance with the provisions of this Exhibit shall conclusively be deemed a waiver of the same.

5. Base Rental for the Extension Term shall be equal to 100% of either (y) the product of the Landlord's Assessment received by Tenant prior to Tenant's exercise of the Renewal Option multiplied by the number of rentable square feet of space then comprising the Premises if Tenant has accepted such Landlord's Assessment, or (z) if Tenant has timely delivered to Landlord Tenant's Objection Notice in which Tenant's Assessment has been identified, the product of the Fair Market Value Rate determined as provided in Paragraph 6

below multiplied by the number of rentable square feet of space comprising the Premises. As used herein, the term "Fair Market Value Rate" shall mean the base rent payable during the applicable lease period to a willing landlord by a willing tenant (neither having a compulsion to lease and Landlord having sufficient time to locate a replacement tenant), for the lease of non-sublease, non-equity and renewal space in an office building comparable in quality to the Building, which space is of like size to the Premises, of like and comparable quality to the Premises, and which comparable office building is located in the Richardson/Plano Telecom Corridor (as hereinafter defined), taking into consideration the terms of the Lease (including, without limitation, the available parking being made available to Tenant) and, as applicable, the following: (1) the location and floor level within the Building; (2) the condition of the existing improvements in the Premises and the premises covered by such renewed leases; (3) parking charges or the inclusion of the same in rental; (4) the extent of services to be provided by Landlord to Tenant and such renewal tenants; (5) the base year or dollar amount, if any, for escalation purposes; (6) credit rating and financial condition and stature of such renewal tenants as of the date of

the exercise of the applicable lease renewal, and the credit rating and financial condition and stature of Tenant as of the date of the Landlord's Assessment; (7) the length of the lease renewal; (8) whether any broker's commission is payable; (9) the date on which the Extension Term will commence; and (10) any other appropriate term or condition. Notwithstanding the foregoing, in calculating the Fair Market Value Rate, no consideration shall be given to (i) any period of rental abatement, if any, granted to tenants in comparable transactions in connection with the design, permitting and construction of improvements for such comparable property, and (ii) any portion of leasehold improvement allowances in excess of the Refurbishment Allowance. As used herein, the term "Richardson/Plano Telecom Corridor" shall mean the area located within portions of the Cities of Richardson and Plano, Texas generally recognized by real estate professionals as the "Telecom Corridor".

6. If Tenant timely delivers to Landlord Tenant's Objection Notice in which Tenant's Assessment has been identified, Landlord shall have the right to accept Tenant's Assessment by giving Tenant written notice thereof within ten (10) business days after Landlord's receipt of Tenant's Objection Notice. If Landlord does not so accept Tenant's Assessment, then Landlord and Tenant shall, within fifteen (15) days after the expiration of such ten (10) business day period, jointly appoint an independent real estate broker or other person with at least ten (10) years' commercial real estate experience in Dallas, Texas (an "Appraiser") to determine the Fair Market Value Rate. If the parties are unable to agree upon an Appraiser within such fifteen (15) day period, either party may request that the Dallas office of the American Arbitration Association designate, within ten (10) days of such request, a broker with at least ten (10) years' commercial real estate experience in Dallas, Texas to be the Appraiser for the purposes of this subparagraph; provided, however, in no event shall such designated Appraiser be employed, or have been employed, by either Landlord or Tenant or their respective affiliates; and provided further, however, that such broker must also have experience with lease transactions in the Richardson/Plano Telecom Corridor. Such designation shall be binding on Landlord and Tenant. Within ten (10) business days after the selection of an Appraiser, each of Landlord and Tenant shall submit to the Appraiser such party's assessment of the Fair Market Value Rate (revised, if applicable, from any earlier assessment), together with such supporting data used to make such assessment (each such assessment is herein referred to as an "Assessment"). Within fifteen (15) days after the Appraiser's receipt Landlord's and Tenant's respective Assessments of the Fair Market Value Rate and the aforementioned supporting data, the Appraiser shall determine his or her assessment of the Fair Market Value Rate for the Extension Term and shall provide Landlord and Tenant with written notice thereof together with such supporting data used to make such assessment). The Fair Market Value Rate for the Extension Term shall be the Assessment of either Landlord or Tenant which is closest to the Appraiser's assessment of the Fair Market Value Rate; provided, however, if either Landlord or Tenant fails within such ten (10) business day period to supply the Appraiser with such party's assessment of the Fair Market Value Rate and/or the applicable supporting data, then the Fair Market Value Rate for the Extension Term shall be the Fair Market Value Rate submitted to the Appraiser by the party that has submitted to the Appraiser its assessment of the Fair Market Value Rate and the applicable supporting data. The entire cost for the Appraiser's services shall be borne equally by Landlord and Tenant.

7. Except as set forth in this Exhibit, the leasing of the Premises for the Extension Term shall be upon the same terms and conditions as are applicable for the Premises under the Lease for the term thereof as extended by the Amendment, and shall be upon and subject to all of the provisions of the Lease and the Amendment. Additionally, the Refurbishment Allowance will be paid to Tenant in the same manner as the refurbishment allowances described in the third paragraph of the Rider No. 102 attached to the Lease and will only be used for the same work described in such paragraph. Any portion of the Refurbishment Allowance not used by Tenant on or before the twelfth (12th) full calendar month of the Extension Term will be forfeited by Tenant and Landlord shall have no further obligation to disburse the same to Tenant notwithstanding anything to the contrary contained in this Exhibit.

8. Once the Fair Market Value Rate for the Extension Term has been established following a valid exercise by Tenant of the Renewal Option, Landlord and Tenant will, within fifteen (15) days thereafter, enter into an amendment (the "Lease Amendment") to the Lease reflecting (i) the extension of the 2002 Renewal Term, (ii) any change in Base Rental payable by Tenant as provided by this Exhibit, (iii) any change in the Base Year operating expenses, and (iv) such other amendments to the Lease as are necessary. Notwithstanding Landlord's and Tenant's obligation to execute and deliver the Lease Amendment within the time period provided above, Tenant's leasing of the Premises during the Extension Term is not conditioned on any such execution and delivery as the Lease Amendment is being executed merely to memorialize the terms and conditions of Tenant's leasing of the Premises during the Extension Term pursuant to this

Exhibit after Landlord's receipt of the Notice of Exercise or Tenant's Objection Notice, as applicable.

9. If, on the date of Landlord's receipt of Tenant's Notice of Intent to Renew, all or any portion of the First Floor Space is covered by a sublease, Landlord shall have the right, but not any obligation, to in its sole discretion elect in writing to recapture, effective as of the Scheduled Expiration Date, all of the First Floor Space or such portion thereof as Landlord may identify in such written election notice. Such written election must be delivered to Tenant on or before the date of Landlord's delivery to Tenant of written notice of the Landlord's Assessment. If Landlord so elects to recapture such First Floor Space, the Lease Amendment shall contain such provisions as are necessary to document (i) the decrease in the size of the Premises as of the Scheduled Expiration Date, and (ii) the fact that the premises in the Building to be leased by Tenant during the Extension Term will not include all or the applicable portion(s) of the First Floor Space.

10 8. Tenant's rights under this Exhibit shall terminate following the occurrence of any of the following events: (a) Tenant's right to possess all or any of the Premises is terminated; (b) Tenant assigns any of its interest in the Lease or sublets any portion of the Premises located on the 5th floor of the Building; and/or (c) any termination of the Lease.

EXHIBIT B
RENEWAL OPTION NOTICE

B-1

STOCK OPTION AGREEMENT

THIS AGREEMENT is made by and between PFSWEB, INC., a Delaware corporation (hereinafter referred to as "COMPANY") and the individual whose name and signature appear on the signature page hereof (hereinafter referred to as "HOLDER"):

WHEREAS, the Company wishes to evidence the issuance to the Holder of the Options set forth herein; and

WHEREAS, in addition to the terms and provisions set forth herein, this Option shall be subject to, and governed in accordance with, the terms and provisions of the Company's Stock Option Plan (the "PLAN") (the terms of which are hereby incorporated by reference and made a part of this Agreement);

NOW, THEREFORE, in consideration of the mutual covenants herein contained and other good and valuable consideration, receipt of which is hereby acknowledged, the parties hereto do hereby agree as follows:

I. DEFINITIONS

Except as otherwise defined herein, terms defined in the Plan shall have the same meaning when used herein.

II. GRANT OF OPTION

2.1 GRANT OF OPTION. For good and valuable consideration, effective as of the date set forth on the signature page hereof as the "Date of Grant" (the "DATE OF GRANT"), the Company hereby grants to the Holder the option to purchase any part or all of the number of shares of the Company's Common Stock, \$.001 par value (the "COMMON STOCK") set forth on the signature page hereof, subject to and upon the terms and conditions set forth in the Plan and this Agreement.

2.2 PURCHASE PRICE. The purchase price per share of the shares of Common Stock covered by the Option shall be the Purchase Price set forth on the signature page hereof, without commission or other charge.

2.3 CONSIDERATION TO COMPANY. In consideration of the granting of this Option by the Company, the Holder agrees to render faithful and efficient services to the Company, a Parent Corporation or a Subsidiary, with such duties and responsibilities as the Company shall from time to time prescribe. Nothing in this Agreement or in the Plan shall confer upon the Holder any right to continue in the employ of the Company, any Parent Corporation or any Subsidiary or shall interfere with or restrict in any way the rights of the Company, its Parent Corporation and its Subsidiaries, which are hereby expressly reserved, to discharge the Holder at any time for any reason whatsoever, with or without cause.

2.4 ADJUSTMENTS IN OPTION. In the event that the outstanding shares of Common Stock subject to the Option are increased, decreased, changed into or exchanged for a different number or kind of shares of the Company or other securities of the Company by reason of merger, consolidation, recapitalization, reclassification, stock split up, spin-off, stock dividend or combination of shares or other recapitalization or reorganization, the Committee shall make an appropriate and equitable adjustment in the number and kind of shares as to which the Option, or portions thereof then unexercised, shall be exercisable. Such adjustment in the Option shall be made without change in the total price applicable to the unexercised portion of the Option (except for any change in the aggregate price resulting from rounding-off of share quantities or prices) and with any necessary corresponding adjustment in the Option price per share. Any such adjustment made by the Committee shall be final and binding upon the Holder, the Company and all other interested persons.

2.5 NON-QUALIFIED STOCK OPTION. This Option shall be deemed a non-qualified stock option under the Code.

III. PERIOD OF EXERCISABILITY

3.1 COMMENCEMENT OF EXERCISABILITY.

(a) Except as otherwise set forth in any authorized appendix to the signature page hereto, the Option shall vest and become exercisable as follows:

(i) on the Date of Grant, the Option shall not be vested and shall not be exercisable as to any of the Shares subject hereto;

(ii) on the 91st day from the Date of Grant, the Option shall be fully vested and exercisable as to 25% of the original Shares subject hereto;

(iii) on the 181st day from the Date of Grant, the Option shall be fully vested and exercisable as to an additional 25% of the original Shares subject hereto;

(iv) on the 271st day from the Date of Grant, the Option shall be fully vested and exercisable as to an additional 25% of the original Shares subject hereto; and

(v) on the date which is one year from the Date of Grant, the Options shall be fully vested and exercisable as to all of the original Shares subject hereto.

(b) Except as otherwise set forth in the Plan, no portion of the Option which is unexercisable at Termination of Employment shall thereafter become exercisable.

3.2 DURATION OF EXERCISABILITY. The installments provided for in Section 3.1 are cumulative. Each such installment which becomes exercisable pursuant to Section 3.1 shall remain exercisable until it becomes unexercisable under Section 3.3.

3.3 EXPIRATION OF OPTION. Subject to the terms and provisions of the Plan, the Option may not be exercised to any extent by anyone after the first to occur of the following events:

(i) The expiration of ten (10) years from the Date of Grant;

(ii) The date of the Holder's Termination of Employment for any reason, other than death or disability (within the meaning of Section 22(e)(3) of the Code), unless the Committee otherwise elects to permit the exercise of such Option for a period of time thereafter; provided, however (a) such period of time shall end no later than ten years from the Date of Grant, and (b) the Committee may make such elections in such manner as it deems appropriate, which may be non-uniform and selective, and based upon such factors as it deems relevant;

(iii) With respect to an Option held by an Holder who is disabled (within the meaning of Section 22(e)(3) of the Code), the expiration of one year from the date of the Holder's Termination of Employment for any reason other than death, unless the Holder dies within said one-year period;

(iv) The expiration of one year from the date of the Holder's death with respect to all Options held by such Holder; and

(v) With respect to all Options, and notwithstanding any other provision contained herein, the date of the Holder's Termination of Employment in the event such Termination is for "cause".

3.4 ACCELERATION OF EXERCISABILITY. In the event of the merger or consolidation of the Company with or into another corporation, or the acquisition by another corporation or person of all or substantially all of the Company's assets or eighty percent (80%) or more of the Company's then outstanding voting stock, or the liquidation or dissolution of the Company, the Committee may, in its absolute discretion and upon such terms and conditions as it deems appropriate, provide by resolution, adopted prior to such event, that at some time prior to the effective date of such event this Option shall be exercisable as to all or a portion of the shares covered hereby, notwithstanding that this Option may not yet have become fully exercisable under Section 3.1(a); provided, however, that the Committee may, in its sole discretion, forego such acceleration of exercisability if:

(i) This Option becomes unexercisable under Section 3.3 prior to said effective date; or

(ii) In connection with such an event, provision is made for an assumption of this Option or a substitution therefor of a new option by an employer corporation or a parent or subsidiary of such corporation, so that such assumption or substitution complies with the provisions of Section 424(a) of the Code.

The Committee may make such determinations and adopt such rules and conditions as it, in its absolute discretion, deems appropriate in connection with such acceleration of exercisability, including, but not by way of limitation, provisions to ensure that any such acceleration and resulting exercise shall be conditioned upon the consummation of the contemplated corporate transaction, and determinations regarding whether provisions for assumption or substitution have been made as defined in clause (ii) above.

IV. EXERCISE OF OPTION

4.1 PERSON ELIGIBLE TO EXERCISE. During the lifetime of the Holder, only he or she may exercise the Option or any portion thereof. After the death of the Holder, any exercisable portion of the Option may, prior to the time when the Option becomes unexercisable under Section 3.3, be exercised by his or her personal representative or by any person empowered to do so under the Holder's will or under the then applicable laws of descent and distribution. Notwithstanding the foregoing, the Committee may, in its sole discretion, permit the transfer of this Option, in whole or in part, and the exercise thereof by any transferee thereof.

4.2 PARTIAL EXERCISE. Any exercisable portion of the Option or the entire Option, if then wholly exercisable, may be exercised in whole or in part at any time prior to the time when the Option or portion thereof becomes unexercisable under Section 3.3; provided, however, that each partial exercise shall be for not less than one-hundred (100) shares (or the minimum installment set forth in Section 3.1, if a smaller number of shares) and shall be for whole shares only.

4.3 MANNER OF EXERCISE. The Option, or any exercisable portion thereof, may be exercised solely by delivery to the Secretary or his office of all of the following (except as otherwise waived by such officer) prior to the time when the Option or such portion becomes unexercisable under Section 3.3:

(a) Notice in writing signed by the Holder or the other person then entitled to exercise the Option or portion, stating that the Option or portion is thereby exercised, such notice complying with all applicable rules established by the Committee; and

(b) (i) Full payment (in cash or by check) for the shares with respect to which such Option or portion is exercised; or

(ii) With the consent of the Committee, (A) shares of the Company's Common Stock owned by the Holder duly endorsed for transfer to the Company or (B) subject to the requirements of Section 5.4 of the Plan, shares of the Company's Common Stock issuable to the Holder upon exercise of the Option, in each case, with a fair market value (as determined under Section 4.2(b) of the Plan) on the date of Option exercise equal to the aggregate Option price of the shares with respect to which such Option or portion is thereby exercised; or

(iii) With the consent of the Committee, a promissory note duly executed and delivered by the Holder in the principal amount of the exercise price thereof, or any portion thereof, in each case upon such terms and conditions (including without limitation, terms regarding rates of interest, payment schedule, collateral or other security) as the Committee may establish in its sole and absolute discretion; or

(iv) With the consent of the Committee, any combination of the consideration provided in the foregoing subsections (i), (ii) and (iii);

(c) A bona fide written representation and agreement, in a form satisfactory to the Committee, signed by the Holder or other person then entitled to exercise such Option or portion, stating that the shares of stock are being acquired for his own account, for investment and without any present intention of distributing or reselling said shares or any of them except as may be permitted under the Securities Act and then applicable rules and regulations thereunder, and that the Holder or other person then entitled to exercise such Option or portion will indemnify the Company against, and hold it free and harmless from, any loss, damage, expense or liability resulting to the Company if any sale or distribution of the shares by such person is contrary to the representation and agreement referred to above. The Committee may, in its absolute discretion, take whatever additional actions it deems appropriate to insure the observance and performance of such representation and agreement and to effect compliance with the Securities Act and any other federal or state securities laws or regulations. Without limiting the generality of the foregoing, the Committee may require an opinion of counsel acceptable to it to the effect that any subsequent transfer of shares acquired upon exercise of an Option does not violate the Securities Act, and may issue stop-transfer orders covering such shares. Share certificates evidencing stock issued on exercise of this Option shall bear an appropriate legend referring to the provisions of this subsection (c) and the agreements herein. The written representation and agreement referred to in the first sentence of this subsection (c) shall, however, not be required if the shares to be issued pursuant to such exercise have been registered under the Securities Act, and such registration is then effective in respect of such shares; and

(d) Full payment to the Company (or other employer corporation) of all amounts which, under federal, state or local tax law, it is required to withhold upon exercise of the Option; provided, however, with the consent of the Committee, any combination of the consideration provided in the foregoing subsections (i), (ii) and (iii) of the preceding paragraph (b) may be used to make all or part of such payment; and

(e) In the event the Option or portion shall be exercised pursuant to Section 4.1 by any person or persons other than the Holder, appropriate proof of the right of such person or persons to exercise the Option.

4.4 CONDITIONS TO ISSUANCE OF STOCK CERTIFICATES. The shares of stock deliverable upon the exercise of the Option, or any portion thereof, may be either previously authorized but unissued shares or issued shares which have then been reacquired by the Company. Such shares shall

be fully paid and nonassessable. The Company shall not be required to issue or deliver any certificate or certificates for shares of stock purchased upon the exercise of the Option or portion thereof prior to fulfillment of all of the following conditions (except as otherwise waived by the Committee):

(a) The admission of such shares to listing on all stock exchanges on which such class of stock is then listed; and

(b) The completion of any registration or other qualification of such shares under any state or federal law or under rulings or regulations of the Securities and Exchange Commission or of any other governmental regulatory body, which the Committee shall, in its absolute discretion, deem necessary or advisable; and

(c) The obtaining of any approval or other clearance from any state or federal governmental agency which the Committee shall, in its absolute discretion, determine to be necessary or advisable; and

(d) The payment to the Company (or other employer corporation) of all amounts which, under federal, state or local tax law, it is required to withhold upon exercise of the Option; and

(e) The lapse of such reasonable period of time following the exercise of the Option as the Committee may from time to time establish for reasons of administrative convenience.

4.5 RIGHTS AS A SHAREHOLDER. The holder of the Option shall not be, nor have any of the rights or privileges of, a shareholder of the Company in respect of any shares purchasable upon the exercise of any part of the Option unless and until certificates representing such shares shall have been issued by the Company to such holder.

V. OTHER PROVISIONS

5.1 ADMINISTRATION. The Committee shall have the power to interpret the Plan and this Agreement and to adopt such rules for the administration, interpretation and application of the Plan as are consistent therewith and to interpret or revoke any such rules. All actions taken and all interpretations and determinations made by the Committee in good faith shall be final and binding upon the Holder, the Company and all other interested persons. No member of the Committee shall be personally liable for any action, determination or interpretation made in good faith with respect to the Plan or the Option.

5.2 OPTION NOT TRANSFERABLE. Neither the Option nor any interest or right therein or part thereof shall be liable for the debts, contracts or engagements of the Holder or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of

law by judgment, levy, attachment, garnishment of any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that this Section 5.2 shall not prevent transfers by will or by the applicable laws of descent and distribution. Notwithstanding the foregoing, the Committee may, in its discretion, permit the holder of this Option to transfer such Option, or any portion thereof, to such holder's spouse, lineal descendent or trust established for the benefit thereof or any other person or entity.

5.3 SHARES TO BE RESERVED. The Company shall at all times during the term of the Option reserve and keep available such number of shares of stock as will be sufficient to satisfy the requirements of this Agreement.

5.4 NOTICES. Any notice to be given under the terms of this Agreement to the Company shall be addressed to the Company in care of its Secretary, and any notice to be given to the Holder shall be addressed to him or her at the address given beneath his or her signature hereto. By a notice given pursuant to this Section 5.4, either party may hereafter designate a different address for notices to be given to such party. Any notice which is required to be given to the Holder shall, if the Holder is then deceased, be given to the Holder's personal representative if such representative has previously informed the Company of his status and address by written notice under this Section 5.4. Any notice shall be deemed duly given upon receipt and shall be delivered by hand, reputable overnight courier or deposited (with postage prepaid) in a post office or branch post office regularly maintained by the United States Postal Service.

5.5 TITLES. Titles are provided herein for convenience only and are not to serve as a basis for interpretation or construction of this Agreement.

5.6 TERMS OF THE PLAN. All of the terms and provisions of the Plan are incorporated herein by reference as if fully set forth at length herein, and the Holder acknowledges receipt and review of the Plan. In the event of any conflict or inconsistency between the Plan and the terms set forth herein, the same shall be determined and interpreted by the Committee, whose determination and interpretation shall be final and binding in all respects and upon all interested persons.

5.7 NOTIFICATION OF DISPOSITION. The Holder shall give prompt notice to the Company of any disposition or other transfer of any shares of stock acquired upon exercise of this Option if such disposition or transfer is made (a) within two (2) years from the date of grant of the Option with respect to such shares so exercised or (b) within one (1) year after the exercise of the Option with respect to such shares. Such notice shall specify the date of such disposition or other transfer and the amount realized, in cash, other property, assumption of indebtedness or other consideration, by the Holder in such disposition or other transfer.

STOCK OPTION SIGNATURE PAGE

In Witness Whereof, effective as of the Date of Grant, the Company and the undersigned Holder have executed and delivered this Option.

Date of Grant:	December 5, 2001
Name of Holder:	Mark C. Layton
Number of Shares:	180,587
Exercise Price Per Share:	\$0.91
Option Certificate Number:	NP2-100

HOLDER: PFSWEB, INC.

By: _____
Signature of Holder

By: _____
Its: Secretary

Address of Holder

SUBSIDIARIES OF THE REGISTRANT

JURISDICTION
OF NAME
INCORPORATION

- - - - -

Priority
Fulfillment
Services,
Inc.

Delaware
Priority
Fulfillment
Services of
Canada, Inc
Canada

Priority
Fulfillment
Services
Europe BV
Netherlands
PFSM, LLC
Delaware

CONSENT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders
of PFSweb, Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 333-77764, 333-75772, 333-40020, 333-42186 and 333-46096) on Form S-8 of PFSweb, Inc. of our report dated February 15, 2002, except for Notes 7 and 9, as to which the date is as of March 29, 2002, relating to the consolidated balance sheets of PFSweb, Inc. and subsidiaries as of as of March 31, 2001 and December 31, 2001, and the related consolidated statements of operations, shareholders' equity, and comprehensive loss and cash flows for the year ended March 31, 2001 and the nine-month period ended December 31, 2001 and the related financial statement schedule for the year ended March 31, 2001 and the nine-month period ended December 31, 2001, which report appears in the December 31, 2001 annual report on Form 10-K of PFSweb, Inc.

/s/ KPMG LLP

Dallas, Texas
April 1, 2002

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports dated May 4, 2000 included in this Form 10-K, into the Company's previously filed Registration Statements File Nos. 333-75764, 333-75772, 333-40020, 333-42186 and 333-46096.

ARTHUR ANDERSEN LLP

Dallas, Texas
March 27, 2002