# FORM 10-Q

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

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2000

OR

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

For the Transition Period from _______ to _______

Commission File Number 000-28275

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

| DELAWARE | 75-2837058 |
|---|---|
| (State of Incorporation) | (I.R.S. Employer I.D. No.) |
| 500 NORTH CENTRAL EXPRESSWAY, PLANO, TEXAS | 75074 |
| (Address of principal executive offices) | (Zip Code) |

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

At November 3, 2000 there were 17,870,000 shares of registrant's common stock outstanding.

PFSWEB, INC. AND SUBSIDIARIES
FORM 10-Q
SEPTEMBER 30, 2000

INDEX

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PFSWEB, INC. AND SUBSIDIARIES

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

ASSETS

| | September 30, 2000 (unaudited) | March 31, 2000 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 22,218 | $ 24,896 |
| Accounts receivable, net of allowance for doubtful accounts of $2,573 and $690 at September 30, 2000 and March 31, 2000, respectively | 10,811 | 8,892 |
| Other receivables | -- | 3,482 |
| Prepaid expenses and other current assets | 2,660 | 1,052 |
| Total current assets | 35,689 | 38,322 |
| NET PROPERTY AND EQUIPMENT | 20,630 | 21,555 |
| OTHER ASSETS | 138 | 528 |
| Total assets | $ 56,457 | $ 60,405 |

LIABILITIES AND SHAREHOLDERS' EQUITY

| | September 30, 2000 (unaudited) | March 31, 2000 |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Current portion of long-term debt | $ 287 | $ 274 |
| Trade accounts payable | 6,787 | 6,277 |
| Accrued expenses | 5,262 | 3,525 |
| Payable to Daisytek | -- | 272 |
| Total current liabilities | 12,336 | 10,348 |
| CAPITAL LEASE OBLIGATIONS, less current portion | 2,257 | 2,407 |
| DEFERRED CREDIT | 1,000 | -- |
| COMMITMENTS AND CONTINGENCIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued and outstanding | -- | -- |
| Common stock, $0.001 par value; 40,000,000 shares authorized; 17,870,000 shares issued and outstanding | 18 | 18 |
| Additional paid-in capital | 50,711 | 50,673 |
| Retained deficit | (9,539) | (2,836) |
| Accumulated other comprehensive loss | (326) | (205) |
| Total shareholders' equity | 40,864 | 47,650 |
| Total liabilities and shareholders' equity | $ 56,457 | $ 60,405 |

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

PFSWEB, INC. AND SUBSIDIARIES

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

| | THREE MONTHS ENDED SEPTEMBER 30, | | SIX MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 2000 | 1999 | 2000 | 1999 |
| REVENUES: | | | | |
| Product revenue | $ -- | $ 23,158 | $ -- | $ 55,778 |
| Service fee revenue | 12,563 | 3,813 | 25,933 | 7,004 |
| Total revenues | 12,563 | 26,971 | 25,933 | 62,782 |
| COSTS OF REVENUES: | | | | |
| Cost of product revenue | -- | 21,846 | -- | 52,639 |
| Cost of service fee revenue (including $711 of net costs from certain terminated contracts) | 10,169 | 2,667 | 18,814 | 4,898 |
| Total costs of revenues | 10,169 | 24,513 | 18,814 | 57,537 |
| Gross profit | 2,394 | 2,458 | 7,119 | 5,245 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 7,358 | 3,083 | 12,588 | 5,871 |
| OTHER | 1,800 | -- | 1,800 | -- |
| Loss from operations | (6,764) | (625) | (7,269) | (626) |
| INTEREST EXPENSE (INCOME), net | (316) | 324 | (632) | 650 |
| Loss before income taxes | (6,448) | (949) | (6,637) | (1,276) |
| PROVISION (BENEFIT) FOR INCOME TAXES | 17 | (374) | 66 | (503) |
| NET LOSS | $ (6,465) | $ (575) | $ (6,703) | $ (773) |
| NET LOSS PER SHARE: | | | | |
| Basic and diluted | $ (0.36) | $ (0.04) | $ (0.38) | $ (0.05) |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING: | | | | |
| Basic and diluted | 17,870 | 14,305 | 17,870 | 14,305 |

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

PFSWEB, INC. AND SUBSIDIARIES

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

| | Six Months Ended September 30, 2000 | Six Months Ended September 30, 1999 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | $ (6,703) | $ (773) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 3,550 | 634 |
| Non-cash compensation expense | 37 | -- |
| Provision for doubtful accounts | 2,448 | 147 |
| Deferred income tax provision | -- | 71 |
| Changes in operating assets and liabilities: | | |
| Accounts receivables | (4,261) | 16,022 |
| Inventories, net | -- | 29,864 |
| Prepaid expenses and other current assets | (1,257) | (413) |
| Accounts payable, accrued expenses and other liabilities | 2,985 | (31,547) |
| Net cash provided by (used in) operating activities | (3,201) | 14,005 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (2,626) | (6,232) |
| Decrease (increase) in other assets | 3,417 | (344) |
| Net cash provided by (used in) investing activities | 791 | (6,576) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Decrease in long-term debt | (137) | -- |
| Decrease in payable to Daisytek, net | -- | (6,710) |
| Net cash used in financing activities | (137) | (6,710) |
| EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS | (131) | (59) |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (2,678) | 660 |
| CASH AND CASH EQUIVALENTS, beginning of period | 24,896 | 587 |
| CASH AND CASH EQUIVALENTS, end of period | $ 22,218 | $ 1,247 |

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

PFSWEB, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED INTERIM CONDENSED 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 (the "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. Prior to the Offering, the financial position, results of operations and cashflows 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 financial statements of PFSweb, Inc. and subsidiaries.

PFSweb is an international outsourcing provider of integrated business infrastructure solutions to major brand name companies seeking to maximize their supply chain efficiencies and to extend their e-commerce initiatives in the United States, Canada, and Europe. The company offers such services as professional consulting, e-marketplace logistics, order management, web-enabled customer contact centers, customer lifecycle management, billing and collection services, information management, and international distribution services.

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 occurred at the close of business on July 6, 2000, to Daisytek shareholders of record as of June 19, 2000.

On June 8, 2000, the 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.

The unaudited interim condensed consolidated financial statements as of September 30, 2000, and for the three and six months ended September 30, 2000 and 1999, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. For all periods presented, certain expenses reflected in the unaudited interim condensed consolidated financial statements include an allocation of certain Daisytek corporate expenses and infrastructure costs. 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, 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 the opinion of management and subject to the foregoing, the unaudited interim condensed consolidated financial statements of the Company include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company's financial position as of September 30, 2000, its results of operations for the three and six months ended September 30, 2000 and 1999 and its

PFSWEB, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (CONTINUED)

results of cash flows for the six months ended September 30, 2000 and 1999. Results of the Company's operations for interim periods may not be indicative of results for the full fiscal year.

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

2. COMPREHENSIVE LOSS (IN THOUSANDS):

| | THREE MONTHS ENDED SEPTEMBER 30, | | SIX MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 2000 | 1999 | 2000 | 1999 |
| Net loss ........................ | $ (6,465) | $ (575) | $ (6,703) | $ (773) |
| Comprehensive income adjustments: | | | | |
| Foreign currency translation adjustment ............. | (14) | 11 | (121) | (46) |
| Comprehensive loss ............. | $ (6,479) | $ (564) | $ (6,824) | $ (819) |

3. NET LOSS PER COMMON SHARE AND COMMON SHARE EQUIVALENT:

Basic and diluted net loss per common share attributable to PFSweb common stock were determined based on dividing the loss available to common stockholders by the weighted average number of common shares outstanding. For purposes of this calculation, the 14,305,000 shares of PFSweb issued prior to the Offering were treated as outstanding for the periods presented prior to the Offering. There were no potentially dilutive securities outstanding during the period presented prior to the Offering. During the three and six months ended September 30, 2000, outstanding options to purchase common shares were anti-dilutive and have been excluded from the weighted average share computation.

4. TRANSACTIONS WITH DAISYTEK:

Until October 25, 2000, and for all periods presented prior to that date, two of the Company's executive officers served as directors of Daisytek.

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 have been estimated on bases that Daisytek and the Company consider to be a reasonable reflection of the 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 $0.2 million for the three and six months ended September 30, 2000 and $0.5 million and $1.0 million for the three and six months ended September 30, 1999, respectively.

The Company's product revenue from sales to Daisytek was zero for the three and six months ended September 30, 2000, and $3.1 million and $7.2 million for the three and six months ended September 30, 1999, respectively.

During the quarter ended September 30, 1999 and in connection with the restructuring of certain IBM master distribution agreements, the Company transferred to Daisytek certain related product inventory,

PFSWEB, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (CONTINUED)

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, a transition services agreement and a master separation agreement which are expected to have a significant impact on the financial position and results of operations of PFSweb.

In addition, included in the financial statements are service fee revenues and cost of service fee revenue which have been reflected by PFSweb for certain services subcontracted to PFSweb by Daisytek under Daisytek's contractual agreements.

Service fee revenues charged to Daisytek under (i) the new IBM contracts, entered into during the quarter ended September 30, 1999, (ii) terms of the transaction management services agreement with Daisytek and (iii) for certain subcontracted services, were $6.9 million and $14.4 million for the three and six months ended September 30, 2000, respectively. Service fee revenues applicable to the subcontracted services were $0.2 million and $0.4 million for the three and six months ended September 30, 1999.

5. COSTS FROM CERTAIN TERMINATED CONTRACTS

Included in cost of service fee revenue are costs from certain terminated contracts, net of termination fees to be collected by the Company. Costs that resulted from the contract terminations primarily include employee severance costs, asset impairments from fixed assets which were specific to terminated contracts and have no further value to PFSweb, and certain unbillable or uncollectible amounts receivables from, and liabilities applicable to, clients who have terminated contracts.

6. OTHER EXPENSE

Other expense represents a foreign currency transaction loss as a result of the recent devaluation in the Euro.

7. DEFERRED CREDIT

The deferred credit included in the accompanying financial statements represents the long-term portion of a governmental grant received by the Company related to investments in fixed assets made in its Belgium operation. The total grant of approximately $1.4 million has been deferred and will be recognized as a reduction to depreciation expense over the same period over which the costs of the related fixed assets will be depreciated. The current unrecognized portion of the grant is included in accrued expenses. The grant was earned by the company upon the achievement of certain minimum capital expenditure requirements. However, the Company could be required to refund some or all of the grant if a certain minimum workforce is not maintained through December 2004. The Company's management believes that the likelihood of a refund of this grant is remote.

8. STOCK OPTIONS

In connection with the completion of the spin-off, as of July 6, 2000, all outstanding Daisytek options ("Daisytek Pre-spin Options") were adjusted and/or replaced with Daisytek options (the "Daisytek Post-spin Options") and PFSweb options (the "PFSweb Post-spin Options," and together with the Daisytek Post-spin Options, the "Replacement Options").

In general, the exercise price and the number of shares subject to each of the Replacement Options was 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 Replacement Option did not exceed the aggregate intrinsic value of the outstanding Daisytek Pre-spin Option which is replaced by such Replacement 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 Replacement 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 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, is the same as those of the replaced Daisytek Pre-spin Option, except that option holders who are employed by one company are permitted to exercise, and are 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 spin-off, on July 6, 2000, 3,479,697 PFSweb Post-spin Options, with a weighted average exercise price of $7.26, were issued to Daisytek and PFSweb officers, directors and employees.

In addition to the stock options discussed above, during the three months ended September 30, 2000, stock options to purchase 1,210,700 shares of common stock, with a weighted average exercise price of $1.97, were issued to PFSweb officers, directors and employees.

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

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

### FORWARD-LOOKING INFORMATION

We have made forward-looking statements in this Report on Form 10-Q. These statements are subject to risks and uncertainties, and there can be no guarantee that these statements will prove to be correct. Forward-looking statements include assumptions as to how we may perform in the future. When we use words like "seek," "strive," "believe," "expect," "anticipate," "predict," "potential," "continue," "will," "may," "could," "intend," "plan," "target" and "estimate" or similar expressions, we are making forward-looking statements. You should understand that the following important factors, in addition to those set forth above or elsewhere in this Report on Form 10-Q, our Prospectus dated December 2, 1999, and our Form 10-K for the year ended March 31, 2000, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

- our reliance on the fees generated by the transaction volume or product sales of our clients;
- the impact of strategic alliances;
- 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;
- effects of changes in profit margins;
- the unknown effects of possible system failures and rapid changes in technology;
- trends in government regulation; and
- our relationship with and separation from Daisytek, our former parent corporation.

In addition, some forward-looking statements are based upon assumptions as to future events that may not prove to be accurate. Therefore, actual outcomes and results may differ materially from what is expected or forecasted in such forward-looking statements. We undertake no obligation to update publicly any forward-looking statement for any reason, even if new information becomes available or other events occur in the future. There may be additional risks that we do not currently view as material or that are not presently known.

### OVERVIEW

PFSweb is an international outsourcing provider of integrated business infrastructure 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, e-marketplace logistics, order management, web-enabled customer contact centers, customer lifecycle management, billing and collection services, payment processing and fraud protection, data mining, and international 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 over 30 clients that operate in a range of vertical markets, including apparel, computer products, printers, cosmetics, fragile goods, 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:

- on an historical basis prior to September 30, 1999, cost of product revenue, which consisted of the purchase price of product sold and net 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, on an historical basis, certain direct contract costs related to our IBM master distributor agreements have been reflected as selling and administrative expenses.

## ADJUSTED FINANCIAL PRESENTATION

We believe our historical financial statements for the three and six months ended September 30, 1999 may not provide a meaningful comparison to our current and future financial statements 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 customer contact 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 acts as the master distributor of the IBM products and we will continue to provide 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 three and six months ended September 30, 1999 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. Currently, however, our revenue under the new IBM agreements is service fee revenue that is payable by Daisytek and is based upon a variable percentage of Daisytek's gross profit arising from its IBM product sales.

As a result of this restructuring of our IBM agreements, our total revenues arising under our new IBM agreements will be 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 anticipated to be significantly higher as compared to our gross profit margin as a percent of product revenue under the prior IBM agreements.

In addition, upon completion of the Offering in December 1999, we entered into a new transaction management services agreement with Daisytek. Under this agreement, we receive service fee revenue based upon a percentage of Daisytek's shipped product revenue. Consequently, the service fee revenue we receive from Daisytek under this new agreement have been recognized only subsequent to the Offering.

Additionally, upon completion of the Offering, Daisytek transferred to us fixed assets and other assets which are used in our business. We paid to Daisytek a portion of the net proceeds of the Offering and assumed capital and operating lease obligations related to these assets.

We have set forth below an adjusted presentation of our total current and historical revenue and cost of revenue. This presentation shows, retroactively, what our service fee revenue and cost of service fee revenue for the three and six months ended September 30, 1999, would have been if (i) our modified agreement with IBM and our new agreement with Daisytek had been in effect for this period, and (ii) our acquisition of the assets and liabilities that Daisytek transferred to us upon completion the IPO had occurred as of the beginning of the three and six months ended September 30, 1999. This presentation also shows what our results of operations over the three and six months ended September 30, 2000 would have been excluding approximately $0.5 million of previously deferred revenue associated with terminated contracts and approximately $1.8 million of incremental costs primarily related to net costs of certain terminated contracts which we do not believe will be incurred in future periods. The incremental costs, net of termination fees to be collected by the Company, include (i) previously deferred costs associated with terminated contracts, (ii) costs that resulted from the contract terminations such as employee severance costs and asset impairments from fixed assets which were specific to terminated contracts and have no further value to PFSweb, (iii) costs related to certain unbillable or uncollectible amounts receivable from, and liabilities applicable to, clients who have terminated contracts and (iv) other incremental costs incurred during the three months ended September 30, 2000, related to the terminated contracts.

| | THREE MONTHS ENDED SEPTEMBER 30, | | SIX MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 2000 | 1999 | 2000 | 1999 |
| | (IN THOUSANDS) (UNAUDITED) | | (IN THOUSANDS) (UNAUDITED) | |
| Service fee revenue ................ | $ 12,073 | $ 9,831 | $ 25,443 | $ 19,081 |
| Cost of service fee revenue ........ | 8,335 | 6,280 | 16,980 | 12,107 |
| Service fee gross profit ........... | 3,738 | 3,551 | 8,463 | 6,974 |
| Service fee gross profit margin .... | 31.0% | 36.1% | 33.3% | 36.5% |

Based on this presentation, our largest clients for the three months ended September 30, 2000 were Daisytek (42.2%) and IBM (14.2%), and our largest clients for the three months ended September 30, 1999 would have been Daisytek (55.7%) and IBM (18.2%). Based on this presentation, our largest clients for the six months ended September 30, 2000 were Daisytek (42.6%) and IBM (13.8%), and our largest clients for the six months ended September 30, 1999 would have been Daisytek (52.2%) and IBM (13.4%). In calculating these percentages, we have considered IBM as our client under our new IBM agreements even though the service fees arising under these agreements are paid by Daisytek.

We based the adjusted operating data on available information and certain estimates and assumptions. We believe that such assumptions provide a reasonable basis for presenting our results, adjusting for the transactions described above. This adjusted financial information does not reflect what our operating income or net income would have been during the period presented or what our results of operations may be in the future.

RESULTS OF OPERATIONS

| | THREE MONTHS ENDED SEPTEMBER 30, | | SIX MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 2000 | 1999 | 2000 | 1999 |
| Product revenue | 0.0% | 85.9% | 0.0% | 88.8% |
| Service fee revenue | 100.0 | 14.1 | 100.0 | 11.2 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of product revenue (as % of product revenue) | 0.0 | 94.3 | 0.0 | 94.4 |
| Cost of service fee revenue (as % of service fee revenue) | 80.9 | 69.9 | 72.5 | 69.9 |
| Total costs of revenues | 80.9 | 90.9 | 72.5 | 91.6 |
| Gross profit | 19.1 | 9.1 | 27.5 | 8.4 |
| Selling, general and administrative expenses | 58.6 | 11.4 | 48.6 | 9.4 |
| Other | 14.3 | -- | 6.9 | -- |
| Loss from operations | (53.8) | (2.3) | (28.0) | (1.0) |
| Interest (income) expense, net | (2.4) | 1.2 | (2.4) | 1.0 |
| Loss before income taxes | (51.4) | (3.5) | (25.6) | (2.0) |
| Provision (benefit) for income taxes | 0.1 | (1.4) | 0.2 | (0.8) |
| Net loss | (51.5)% | (2.1)% | (25.8)% | (1.2)% |

RESULTS OF OPERATIONS FOR THE INTERIM PERIODS ENDED SEPTEMBER 30, 2000 AND 1999

We believe our historical financial statements for the three and six months ended September 30, 1999 may not provide a meaningful comparison to our current and future financial statements for the reasons described above.

Product Revenue. Product revenue was zero for the three and six months ended September 30, 2000. Product revenue was $23.2 and $55.8 million for the three and six months ended September 30, 1999. 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 agreements, the activities performed under these contracts since that date were accounted for as service fee revenue as opposed to product revenue. In future periods, we do not expect to have any product revenue.

Service Fee Revenue. Service fee revenue was $12.6 million for the three months ended September 30, 2000, as compared to $3.8 million during the three months ended September 30, 1999, an increase of $8.8 million or 229.5%. Service fee revenue was $25.9 million for the six months ended September 30, 2000, as compared to $7.0 million during the six months ended September 30, 1999, an increase of $18.9 million or 270.3%. The increases in service fee revenues over prior periods were due to the further expansion of existing contracts, the restructuring of all the IBM contracts, and new service contract relationships, including our new transaction management services agreement with Daisytek which commenced on the completion of the Offering in December 1999. Service fee revenue from existing contracts increased $1.5 million and new service contract relationships added $6.8 million for the three months ended September 30, 2000. Service fee revenue from existing contracts increased $0.9 million and new service contract relationships added $17.5 million for the six months ended September 30, 2000. Service fee revenue for the three and six months ended September 30, 2000, also includes approximately $0.5 million of previously deferred revenue associated with terminated contracts. For the three and six months ended September 30, 2000, service fee revenue totaling $6.9 million and $14.4 million, respectively, 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. As a result of certain contract terminations with annualized service fee revenues of approximately $7 to $10 million and a longer implementation cycle associated with new larger contracts, service fee revenue performance is expected to be generally flat or declining for the next few quarters.

Cost of Product Revenue. Cost of product revenue was zero for the three and six months ended September 30, 2000. Cost of product revenue as a percent of product revenue was 94.3% and 94.4% during the three and six months ended September 30, 1999, respectively. The resulting gross profit margin was 5.7% and 5.6% during the three and six months ended September 30, 1999, respectively. As a result of the new IBM arrangements, we do not expect to incur any cost of product revenue in future periods.

Cost of Service Fee Revenue. Cost of service fee revenue was $10.2 million for the three months ended September 30, 2000, as compared to $2.7 million during the three months ended September 30, 1999, an increase of $7.5 million or 281.3%. The resulting service fee gross profit margin was 19.1% during the three months ended September 30, 2000, and 30.1% during the three months ended September 30, 1999. Cost of service fee revenue was $18.8 million for the six months ended September 30, 2000, as compared to $4.9 million during the six months ended September 30, 1999, an increase of $13.9 million or 284.1%. The resulting service fee gross profit margin was 27.5% during the six months ended September 30, 2000, and 30.1% during the six months ended September 30, 1999. During both the three and six months ended September 30, 2000, cost of service fee revenue increased related to a large number of new service contract relationships. In addition, cost of service fee revenue for the three and six months ended September 30, 2000 increased over prior quarters due to approximately $0.5 million of previously deferred costs associated with terminated contracts, $0.7 million of costs primarily related to net costs of certain contract terminations, other incremental costs related to the terminated contract, and certain infrastructure costs that, due to late notification of reduced volume expectations by certain clients, we were unable to reduce.

Gross Profit. Gross profit was $2.4 million, or 19.1% of revenues, for the three months ended September 30, 2000, as compared to $2.5 million, or 9.1% of revenues, for the three months ended September 30, 1999. Gross profit was $7.1 million, or 27.5% of revenues, for the six months ended September 30, 2000, as compared to $5.2 million, or 8.4% of revenues, for the six months ended September 30, 1999. The changes in total gross profit, for the three and six month comparable periods, resulted primarily from the further expansion of existing contracts and new service contract relationships, including our new transaction management services agreement with Daisytek, which commenced on the completion of the Offering in December 1999, being offset by incremental costs primarily related to net costs of certain terminated contracts. The increases in gross profit as a percentage of revenues resulted from 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. In the Adjusted Financial Presentation data above for the three and six months ending September 30, 2000, we have provided an adjusted presentation of our gross profit margin excluding deferred revenue and incremental costs primarily related to net costs of certain terminated contracts. We have also provided, retroactively, what our service fee gross profit margin would have been for the three and six months ended September 30, 1999, considering the impact of our modified agreement with IBM and our new agreement with Daisytek and our acquisition of the assets and liabilities which Daisytek transferred to us upon completion of the Offering.

Selling, General and Administrative and Other Expenses. SG&A expenses were $7.4 million for the three months ended September 30, 2000, or 58.6% of revenues, as compared to $3.1 million, or 11.4% of revenues, for the three months ended September 30, 1999. SG&A expenses were $12.6 million for the six months ended September 30, 2000, or 48.6% of revenues, as compared to $5.9 million, or 9.4% of revenues, for the six months ended September 30, 1999. Primarily, as a result of the restructuring of the IBM agreements and the related reduction in product revenue, SG&A expenses as a percentage of total revenue are higher for the three and six month comparable periods. SG&A expenses increased as a result of costs incurred to support the higher transaction volumes under both new and existing contracts, incremental investments in resources and technology to support our continued growth, public company costs and incremental costs attributable to client disputed items. In the future, while we anticipate that we will continue to incur incremental costs as we make further SG&A investments in our sales, marketing, and technology areas to support our growth strategies, we are targeting our SG&A, as a percent of sales, to decrease as we increase our service fee revenue. For the three and six months ended September 30, 2000, we also incurred other costs of $1.8 million related to a foreign currency transaction loss as a result of the recent devaluation in the Euro.

Interest (Income) Expense, Net. Interest income was $0.3 million for the three months ended September 30, 2000 as compared to interest expense of $0.3 million for the three months ended September 30, 1999.

Interest income was earned for the three months ended September 30, 2000 at a weighted average interest rate of 6.5%. The weighted average interest rate charged for the three months ended September 30, 1999 was 6.5%. Interest income was $0.6 million for the six months ended September 30, 2000 as compared to interest expense of $0.6 million for the six months ended September 30, 1999. Interest income was earned for the six months ended September 30, 2000 at a weighted average interest rate of 6.3%. The weighted average interest rate charged for the six months ended September 30, 1999 was 6.3%. In December 1999, we used a portion of the funds from the Offering to repay our intercompany payable balance to Daisytek and purchase certain assets from Daisytek. The remaining available cash will be used for future capital expenditures, general working capital needs and possible acquisitions. To the extent that we have excess cash available, we expect to generate interest income in future periods.

Income Taxes. Our income tax provision as a percentage of pre-tax loss was 0.3% for the three months ended September 30, 2000 as compared to an income tax benefit of 39.4% for the three months ended September 30, 1999. Our income tax provision as a percentage of pre-tax loss was 1.0% for the six months ended September 30, 2000 as compared to and income benefit of 39.4% for the six months ended September 30, 1999. Although we had a pre-tax loss for the three and six months ended September 30, 2000, we recorded an income tax provision associated with a pre-tax income from 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 those pre-tax losses. To the extent we have future losses in Europe, it will continue to negatively impact our income tax provision. Additionally, 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, on a stand-alone basis, a valuation allowance has been provided for the remaining net deferred income tax asset as of September 30, 2000. For the three and six months ended September 30, 1999, the income tax percentage is impacted by the differences between our U.S. and foreign subsidiaries, which are taxed at different rates.

LIQUIDITY AND CAPITAL RESOURCES

As a subsidiary of Daisytek, we have historically funded our business through intercompany borrowings from Daisytek. As a result of the Offering, we repaid such intercompany borrowings. Since Daisytek is prohibited from advancing funds to us, except in the normal course of business, in order to provide additional financing flexibility in the future above the over $22 million current cash position, we plan to seek our own credit facility. Working capital decreased to $23.4 million at September 30, 2000 from $28.0 million at March 31, 2000 as a result of funding operations and capital expenditures. We currently believe that the remaining net proceeds from the Offering and funds generated from operations will satisfy our working capital and capital expenditure requirements for the next twelve months.

Net cash used in financing activities was $0.1 million for the six months ended September 30, 2000, representing payments on our capital lease obligations. Net cash used in financing activities was $6.7 million for the six months ended September 30, 1999. This usage relates to the reduction in the intercompany payable arising primarily from the transfer of the IBM related working capital assets from us to Daisytek in conjunction with the new IBM agreements, which was partially offset by capital expenditures and incremental financing of one of our client's inventory.

Cash flows used in operating activities totaled $3.2 million during the six months ended September 30, 2000. For the six months ended September 30, 2000, the net cash used in operating activities primarily reflected increases in prepaid expenses and accounts receivables partially offset by increases in accounts payable and accrued expenses. Cash flows provided by operating activities totaled $14.0 million during the six months ended September 30, 1999. For the six months ended September 30, 1999, the net cash provided by operating activities primarily reflected a reduction in accounts payable and accrued expenses of $31.5 million, accounts receivable of $16.0 million and inventory of $29.9 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.

Cash provided by investing activities was $0.8 million for the six months ended September 30, 2000 as compared to cash used of $6.6 million for the six months ended September 30, 1999. During the six months ended September 30, 2000, our capital expenditures of $2.6 million for property and equipment were more than offset by a $3.4 million reduction of third-party financed inventory. Cash used in investing activities for the six months ended September 30, 1999 was primarily related to the $6.2 million of capital expenditures. Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, including our Internet-based customer tools, other methods of e-commerce and general expansion of our facilities, both domestic and foreign. We expect to incur significant 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 fiscal year 2001 will be approximately $7 to $10 million. Some of these expenditures may be financed through operating or capital leases.

We may consider entering into forward exchange contracts in order to hedge our net investment in our Canadian or European operations or in other international countries in which we establish a presence, although no assurance can be given that we will be able to do so on acceptable terms.

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.

Currently, the Company believes that it is operating with and incurring costs applicable to excess capacity in both its North American and European operations. The Company estimates that it will require approximately $15 million of quarterly service fee revenue to more fully utilize its capacity, cover existing operating costs and incremental stand-alone public company costs and reach profitability. Based on current sales and contract implementation cycles, the Company is targeting that profitability will be achieved in the last half of calendar year 2001. No assurance can be given that the Company can achieve such service fee revenue levels, or that, if achieved, the Company will be profitable in any particular fiscal period.

SEASONALITY

The seasonality of our business is dependent upon the seasonality of our clients' business and their sale of their products. Accordingly, our management must rely upon the projections of our clients in assessing quarterly variability. We believe that with our current client mix, our business activity is expected to be slightly more significant in the quarter ended December 31.

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

INFLATION

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

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires that an entity recognize all derivative financial instruments as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be used to hedge certain types of transactions, including foreign currency exposures of a net investment in a foreign operation. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000, with initial application as of the beginning of an entity's fiscal quarter. The Company is currently evaluating the provisions of SFAS No. 133 and its effect on the accounting treatment of its financial instruments.

During 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition." SAB No. 101 requires that revenue generally is realized or realizable and earned when all of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the seller's price to the buyer is fixed or determinable, and (iv) collectibility is reasonably assured. SAB No. 101 is effective for the Company's fourth quarter ending March 31, 2001. The Company is currently evaluating the provisions of SAB No. 101 and its effect, if any, on the Company's financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The carrying value of the Company's financial instruments, which include cash and cash equivalents and a capital lease obligation, approximate their fair values based on current market prices and rates.

Currently, our foreign currency exchange rate risk is primarily limited to Canadian dollars and the Euro. In the future, we believe our foreign currency exchange risk will also include other currencies applicable to certain of our international operations. In order to mitigate foreign currency rate risk, we will consider entering into forward currency exchange contracts to hedge our net investment and long-term intercompany payable balances.

PART II. OTHER INFORMATION

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

On September 15, 2000, the Company held its Annual Meeting of Stockholders. The following matters were acted upon and votes cast or withheld:

1. Election of two Class I directors:

   Peter P. J. Vikanis:

   For: 12,917,874 Withheld: 2,083,548

   James F. Reilly

   For: 12,916,202 Withheld: 2,085,220

2. Approval of Company's 2000 Employee Stock Purchase Plan:

   For: 12,763,181 Against: 2,167,665 Abstained: 70,596

3. Appointment of Arthur Andersen LLP as auditors for 2001 fiscal year:

   For: 13,114,603 Against: 1,414,915 Abstained: 411,904

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits:

| EXHIBIT NO. | DESCRIPTION OF EXHIBITS |
|---|---|
| 3.1* | Amended and Restated Certificate of Incorporation |
| 3.2* | Amended and Restated Bylaws |
| 27.1** | Financial Data Schedule for the six months ended September 30, 2000 |

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

** Filed herewith.

b) Reports on Form 8-K:

None.

## SIGNATURES

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

Date: November 14, 2000

PFSweb, Inc.

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

INDEX TO EXHIBITS

| EXHIBIT NUMBER | DESCRIPTION |
|---|---|
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| 3.2* | Amended and Restated Bylaws |
| 27.1** | Financial Data Schedule for the six months ended September 30, 2000 |

- ----------

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

** Filed herewith.

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE FINANCIAL STATEMENTS OF PFSWEB, INC. AND SUBSIDIARIES FOR SIX MONTHS ENDED SEPTEMBER 30, 2000 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

6-MOS
MAR-31-2001
SEP-30-2000
22,218
0
13,384
2,573
0
35,689
26,256
5,626
56,457
12,336
2,544
0
0
18
40,846
56,457
25,933
25,933
18,814
18,814
11,940
2,448
(632)
(6,637)
66
(6,703)
0
0
0
(6,703)
(0.38)
(0.38)