Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2004

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 [ ]

Indicate by a check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [ ] No [X]

At August 1, 2004 there were 21,382,971 shares of registrant's common stock outstanding, excluding 86,300 shares of common stock in treasury.

PFSWEB, INC. AND SUBSIDIARIES
Form 10-Q
June 30, 2004

INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

PFSWEB, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Data)

	June 30, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 15,487	$ 14,743
Restricted cash	605	1,091
Accounts receivable, net of allowance for doubtful accounts of $483 and $339 at June 30, 2004 and December 31, 2003, respectively	37,602	31,658
Inventories, net	42,716	44,589
Other receivables	4,763	3,091
Prepaid expenses and other current assets	2,608	2,417
Total current assets	103,781	97,589
PROPERTY AND EQUIPMENT, net	9,988	9,589
RESTRICTED CASH	675	900
OTHER ASSETS	319	281
Total assets	$114,763	$108,359
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt and capital lease obligations	$ 55,376	$ 57,085
Trade accounts payable	20,003	11,996
Accrued expenses	8,403	7,101
Total current liabilities	83,782	76,182
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	3,287	2,762
OTHER LIABILITIES	799	998
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; 21,342,092 and 21,247,941 shares issued at June 30, 2004 and December 31, 2003, respectively; and 21,255,792 and 21,161,641 outstanding at June 30, 2004 and December 31, 2003, respectively	21	21
Additional paid-in capital	56,294	56,156
Accumulated deficit	(30,591)	(29,303)
Accumulated other comprehensive income	1,256	1,628
Treasury stock at cost, 86,300 shares	(85)	(85)
Total shareholders' equity	26,895	28,417
Total liabilities and shareholders' equity	$114,763	$108,359

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

PFSWEB, INC. AND SUBSIDIARIES

UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
REVENUES:				
Product revenue, net	$65,304	$63,137	$133,874	$122,856
Gross service fee revenue	14,550	11,279	23,293	18,527
Less pass-through charges	3,685	798	5,466	1,438
Net service fee revenues	10,865	10,481	17,827	17,089
Total net revenues	76,169	73,618	151,701	139,945
COSTS OF REVENUES:				
Cost of product revenue	61,723	59,585	126,176	115,992
Cost of net service fee revenue	6,650	6,414	11,843	11,327
Total costs of revenues	68,373	65,999	138,019	127,319
Gross profit	7,796	7,619	13,682	12,626
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	6,805	6,443	13,828	12,555
Income (loss) from operations	991	1,176	(146)	71
INTEREST EXPENSE, NET	324	506	752	1,114
Income (loss) before income taxes	667	670	(898)	(1,043)
INCOME TAX EXPENSE	188	203	390	264
NET INCOME (LOSS)	$ 479	$ 467	$ (1,288)	$ (1,307)
NET INCOME (LOSS) PER SHARE:				
Basic	$ 0.02	$ 0.03	$ (0.06)	$ (0.07)
Diluted	$ 0.02	$ 0.03	$ (0.06)	$ (0.07)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic	21,239	18,429	21,212	18,422
Diluted	23,129	18,605	21,212	18,422

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

PFSWEB, INC. AND SUBSIDIARIES

UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (1,288)	$ (1,307)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	2,336	2,355
Provision for doubtful accounts	148	363
Provision for excess and obsolete inventory	728	—
Deferred income taxes	(95)	42
Non-cash compensation expense	14	6
Changes in operating assets and liabilities:		
Accounts receivables	(6,339)	(4,395)
Inventories, net	538	10,460
Prepaid expenses, other receivables and other current assets	(1,894)	(471)
Accounts payable, accrued expenses and deferred income	9,617	(381)
Net cash provided by operating activities	3,765	6,672
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,797)	(481)
Decrease in restricted cash	257	51
Net cash used in investing activities	(1,540)	(430)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on capital lease obligations	(529)	(558)
Decrease in restricted cash	448	239
Proceeds from issuance of common stock	124	32
Payments on debt, net	(1,498)	(4,467)
Net cash used in financing activities	(1,455)	(4,754)
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(26)	(203)
NET INCREASE IN CASH AND CASH EQUIVALENTS	744	1,285
CASH AND CASH EQUIVALENTS, beginning of period	14,743	8,595
CASH AND CASH EQUIVALENTS, end of period	$15,487	$ 9,880
SUPPLEMENTAL CASH FLOW INFORMATION		
Non-cash investing and financing activities:		
Fixed assets acquired under capital leases	$ 1,490	$ 64

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

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

1. OVERVIEW AND BASIS OF PRESENTATION

PFSweb Overview

PFSweb, Inc. and its subsidiaries are collectively referred to as the “Company,” while the term “PFSweb” refers to PFSweb, Inc. and its subsidiaries excluding Business Supplies Distributors Holdings, LLC and its subsidiaries.

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

Supplies Distributors Overview

In 2001, Business Supplies Distributors Holdings, LLC (“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 and its subsidiaries are master distributors of various products, primarily International Business Machines (“IBM”) products. Pursuant to a transaction management services agreement between PFSweb and Supplies Distributors, PFSweb provides to Supplies Distributors and its subsidiaries such services as managed web hosting and maintenance, procurement support, web-enabled customer contact center services, customer relationship management, financial services including billing and collection services, information management, and international distribution services. Additionally, IBM and Supplies Distributors and its subsidiaries have outsourced the product demand generation function for the IBM products distributed by Supplies Distributors and its subsidiaries. Supplies Distributors and its subsidiaries sell their products in the United States, Canada and Europe.

Basis of Presentation

The unaudited interim condensed consolidated financial statements as of June 30, 2004, and for the three and six months ended June 30, 2004 and 2003, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. In the opinion of management and subject to the foregoing, the unaudited interim condensed consolidated financial statements of the Company include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company’s financial position as of June 30, 2004, its results of operations for the three and six months ended June 30, 2004 and 2003 and its results of cash flows for the three and six months ended June 30, 2004 and 2003. 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 loss or shareholders’ equity.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

All intercompany accounts and transactions have been eliminated in consolidation. Accounts and transactions between PFSweb and Holdings and its subsidiaries have been eliminated as of June 30, 2004 and December 31, 2003 and for the three and six months ended June 30, 2004 and 2003.

Subordinated Loan to Affiliate

PFSweb has loaned Supplies Distributors monies in the form of a Subordinated Demand Note ("Subordinated Note"). Under certain terms of the Company's senior debt facilities, the outstanding balance of the Subordinated Note cannot be increased or decreased without prior approval of the Company's lenders. In March 2004, the Company's lenders agreed to reduce the required minimum Subordinated Note balance from $8.0 million to $7.0 million. As of June 30, 2004 and December 31, 2003, the outstanding balance of the Subordinated Note, which is eliminated upon the consolidation of Holdings' financial position, was $7.0 million and $8.0 million, respectively.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses, including allowances for the collectibility of accounts and other receivables and the recoverability of inventory. The recognition and allocation of certain operating expenses in these consolidated financial statements also required management estimates and assumptions. The Company's estimates and assumptions are continually evaluated based on available information and experience. Because the use of estimates is inherent in the financial reporting process, actual results could differ from estimates. If there is a significant unfavorable change to current conditions, it would likely result in a material adverse impact to the Company's business, operating results and financial condition.

Concentration of Business and Credit Risk

The Company's product revenue was primarily generated by sales of product purchased under master distributor agreements with one supplier. Sales to one customer accounted for approximately 12%, and sales to another customer accounted for approximately 11% of the Company's total product revenues for the six months ended June 30, 2004. Service fee revenue from two clients individually accounted for approximately 44% and 17% of net service fee revenue for the six months ended June 30, 2004. On a consolidated basis, one client accounted for approximately 16% of the Company's total revenues for the six months ended June 30, 2004. As of June 30, 2004, one customer/client accounted for approximately 18% of accounts receivable. As of December 31, 2003, two customers/clients accounted for approximately 37% of accounts receivable.

In conjunction with Supplies Distributors' and its subsidiaries' financings, PFSweb has provided certain collaterized guarantees on behalf of Supplies Distributors and its subsidiaries. Supplies Distributors' and its subsidiaries' ability to obtain financing on similar terms would be significantly impacted without these guarantees. Additionally, since Supplies Distributors and its subsidiaries have limited personnel and physical resources, their ability to conduct business could be materially impacted by contract terminations by the party performing product demand generation for the IBM products.

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

Cash and Cash Equivalents

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

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

Inventories

Inventories (merchandise, held for resale, all of which are finished goods) are stated at the lower of cost or market. Supplies Distributors and its subsidiaries assume responsibility for slow-moving inventory under certain master distributor agreements, subject to certain termination rights, but have the right to return product rendered obsolete by engineering changes, as defined. The Company reviews inventory for impairment on a periodic basis, but at a minimum, annually. Recoverability of the inventory on hand is measured by comparison of the carrying value of the inventory to the fair value of the inventory. The allowance for slow moving inventory was $2.1 million and $1.3 million at June 30, 2004 and December 31, 2003, respectively.

In the event PFSweb, Supplies Distributors and its subsidiaries and IBM terminate the master distributor agreements, the parties shall mutually agree on a plan of disposition of Supplies Distributors' and its subsidiaries' then existing inventory.

Inventories include merchandise in-transit that has not been received by the Company but that has been shipped and invoiced by Supplies Distributors' and its subsidiaries' vendors. The corresponding payable for inventories in-transit is included in debt in the accompanying consolidated financial statements.

Property and Equipment

The Company's property held under capital leases amounted to approximately $3.6 million and $3.1 million, net of accumulated amortization of approximately $4.7 million and $4.6 million, at June 30, 2004 and December 31, 2003, respectively.

Stock-Based Compensation

The Company accounts for stock options using the intrinsic-value method as outlined under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25") and related interpretations, including FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation and Interpretation of APB No. 25*, issued in March 2000. Under this method, compensation expense is recorded on the date of the grant only if the current market price of the underlying stock exceeds the exercise price. The exercise prices of all options granted during the three and six months ended June 30, 2004 and 2003 were equal to the market price of the Company's common stock at the date of grant. As such, no compensation cost was recognized during those periods for stock options granted to employees. The following table shows the pro forma effect on the Company's net income (loss) and income (loss) per share as if compensation cost had been recognized for stock options based on their fair value at the date of the grant. The pro forma effect of stock options on the Company's net income (loss) for those periods may not be representative of the pro forma effect for future periods due to the impact of vesting and potential future awards.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
	(In thousands, except per share amounts)			
Net income (loss) as reported	$ 479	$ 467	$(1,288)	$(1,307)
Add: Stock-based non-employee compensation expense included in reported net income (loss)	14	6	14	6
Deduct: Total stock-based employee and non-employee compensation expense determined under fair value based method	(201)	(168)	(272)	(312)
Pro forma net income (loss), applicable to common stock for basic and diluted computations	$ 292	$ 305	$(1,546)	$(1,613)
Income (loss) per common share – as reported				
Basic	$0.02	$0.03	$ (0.06)	$ (0.07)
Diluted	$0.02	$0.03	$ (0.06)	$ (0.07)
Income (loss) per common share – pro forma				
Basic	$0.01	$0.02	$ (0.07)	$ (0.09)
Diluted	$0.01	$0.02	$ (0.07)	$ (0.09)

During the six months ended June 30, 2004, the Company issued an aggregate of 767,500 options to purchase shares of common stock to officers, directors, employees and consultants of PFSweb.

3. COMPREHENSIVE INCOME (LOSS) (in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net income (loss)	$479	$467	$(1,288)	$(1,307)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(91)	520	(372)	808
Comprehensive income (loss)	$388	$987	$(1,660)	$ (499)

4. NET INCOME (LOSS) PER COMMON SHARE AND COMMON SHARE EQUIVALENT

Basic and diluted net income (loss) per common share attributable to the Company’s common stock were determined based on dividing the net income (loss) available to common stockholders by the weighted-average number of common shares outstanding. For the six months ended June 30, 2004 and 2003, all outstanding options to purchase common shares were anti-dilutive and have been excluded from the weighted diluted average share computation. For the three months ended June 30, 2004 and 2003, the effect of dilutive stock options increased the number of weighted average shares outstanding by 1,890,640 and 176,543, respectively, for computing diluted net income per share. As of June 30, 2004 and 2003 there were 5,081,913 and 5,124,405 options outstanding, respectively.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

5. *DEBT AND CAPITAL LEASE OBLIGATIONS:*

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

	June 30, 2004	December 31, 2003
Inventory and working capital financing agreements:		
United States	$24,481	$26,034
Europe	11,637	11,526
Loan and security agreements:		
Supplies Distributors	10,555	13,146
PFSweb	3,545	3,514
Factoring agreement, Europe	4,388	2,296
Term master lease agreement	3,815	3,080
Other	242	251
Total	58,663	59,847
Less current portion of long-term debt	55,376	57,085
Long-term debt, less current portion	$ 3,287	$ 2,762

Inventory and Working Capital Financing Agreement, United States

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of IBM products in the United States, providing financing for eligible IBM inventory and for certain other receivables up to $27.5 million through its expiration on March 29, 2005. As of June 30, 2004, Supplies Distributors had $2.4 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Holdings and Supplies Distributors to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, PFSweb is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of $7.0 million and a minimum shareholders' equity of $18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 1%. The facility accrues a quarterly commitment fee of 0.375% on the unused portion of the commitment, and a monthly service fee.

Inventory and Working Capital Financing Agreement, Europe

SDSA and Supplies Distributors' wholly-owned subsidiary Business Supplies Distributors Europe B.V. ("BSD Europe") have a short-term credit facility with IBM Belgium Financial Services S.A. ("IBM Belgium") to finance their distribution of IBM products in Europe. The asset based credit facility with IBM Belgium provides up to 12.5 million Euros (approximately $15.1 million) in financing for purchasing IBM inventory and for certain other receivables through March 29, 2005. As of June 30, 2004, SDSA and BSD Europe had 2.1 million euros ($2.5 million) of available credit under this facility. The credit facility contains 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 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 SDSA and BSD Europe, as well as collateralized guaranties of Holdings, Supplies Distributors and PFSweb. Additionally, PFSweb is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of $7.0 million and a minimum shareholders' equity of $18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at Euribor plus 2.5%. SDSA and BSD Europe pay a monthly service fee on the commitment.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

Loan and Security Agreement — Supplies Distributors

Supplies Distributors has a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to $25 million of eligible accounts receivable in the United States and Canada. As of June 30, 2004, Supplies Distributors had $4.7 million of available credit under this agreement. The Congress facility expires on the earlier of March 29, 2007 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, prime rate plus up to 0.25%, Eurodollar rate or Eurodollar rate plus up to 2.75%, as defined. This agreement contains cross default provisions, various restrictions upon the ability of Holdings and Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and is secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, PFSweb is required to maintain a Subordinated Note receivable balance from Supplies Distributors of no less than $6.5 million and restricted cash of less than $5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors and SDC entered into blocked account agreements with their banks and Congress whereby a security interest was granted to Congress for all customer remittances received in specified bank accounts. At June 30, 2004 and December 31, 2003, these bank accounts held $0.4 million and $0.8 million, respectively, which was restricted for payment to Congress.

Loan and Security Agreement – PFSweb

Priority Fulfillment Services, Inc. and Priority Fulfillment Services of Canada, Inc. (both wholly-owned subsidiaries of PFSweb and collectively the "Borrowers") have a Loan and Security Agreement with Comerica Bank ("Comerica Agreement"). The Comerica Agreement provides for up to $5.0 million of eligible accounts receivable financing in the United States and Canada ("Working Capital Advances") through March 28, 2005 and up to $2.5 million of eligible equipment purchases ("Equipment Advances") through September 10, 2006. Outstanding Working Capital Advances, $1.9 million as of June 30, 2004, accrue interest at prime rate plus 1%. Outstanding Equipment Advances, $1.6 million as of June 30, 2004, accrue interest at prime rate plus 1.5%. As of June 30, 2004, the Borrowers had $2.4 million of available credit under the Working Capital Advance portion of this facility. In July 2004, the Company repaid the $1.9 million of Working Capital Advances outstanding as of June 30, 2004. The Comerica Agreement contains cross default provisions, various restrictions upon the Borrowers' ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth, as defined, of $19.0 million and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the Subordinated Note to a maximum of $8.0 million. The Comerica Agreement is secured by all of the assets of the Borrowers, as well as a guarantee of PFSweb, Inc. The Comerica Agreement requires the Borrowers to maintain a minimum cash balance of $1.25 million at Comerica Bank.

Factoring Agreement

SDSA has a factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 7.5 million euros (approximately $9.1 million) of eligible accounts receivables through March 29, 2005. As of June 30, 2004, SDSA had approximately 0.7 million euros ($0.8 million) of available credit under this agreement. Borrowings under this agreement can be either cash advances or straight loans, as defined. Cash advances accrue interest at the fixed interest rate of Belgium banks plus .75%, or on an adjusted basis as defined, but not lower than 6%; and straight loans accrue interest at Euribor plus 1.3%. This agreement contains various restrictions upon the ability of SDSA to, among other things, merge, consolidate and incur indebtedness, as well as financial covenants, such as minimum net worth. This agreement is secured by a guarantee of Supplies Distributors, up to a maximum of 200,000 euros.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

Debt Covenants

To the extent the Company fails to comply with its covenants, including the monthly financial covenant requirements and required level of consolidated shareholders' equity ($19.0 million), and the lenders accelerate the repayment of the credit facility obligations, the Company would be required to repay all amounts outstanding thereunder. Any acceleration of the repayment of the credit facilities would have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations. At June 30, 2004, the Company was in compliance with all debt covenants.

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

Master Lease Agreements

The Company has a Term Lease Master Agreement with IBM Credit Corporation ("Master Lease Agreement") that provides for leasing or financing transactions of equipment and other assets, which generally have terms of 3 to 5 years. The outstanding leasing transactions ($1.4 million and $0.1 million as of June 30, 2004 and December 31, 2003, respectively) are secured by the related equipment and a letter of credit. The outstanding financing transactions ($0.6 million and $0.8 million as of June 30, 2004 and December 31, 2003, respectively) are secured by a letter of credit.

The Company has a master agreement with a leasing company that has provided for leasing transactions of certain equipment. The amounts outstanding under this agreement were $1.4 million and $1.5 million as of June 30, 2004 and December 31, 2003, respectively, and are secured by the related equipment.

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

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

6. SEGMENT INFORMATION

The Company is organized into two operating segments, PFSweb and Holdings. PFSweb is an international provider of integrated business process outsourcing solutions and operates as a service fee business. Holdings and its subsidiaries are master distributors of primarily IBM products, and recognize revenues and costs when product is shipped.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Revenues (in thousands):				
PFS	$12,967	$12,530	$ 22,191	$ 21,058
Holdings	65,304	63,137	133,874	122,856
Eliminations	(2,102)	(2,049)	(4,364)	(3,969)
	$76,169	$73,618	$151,701	$139,945
Income (loss) from operations (in thousands):				
PFS	$ (236)	$ (231)	$ (3,057)	$ (2,431)
Holdings	1,227	1,400	2,904	2,488
Eliminations	—	7	7	14
	$ 991	$ 1,176	$ (146)	$ 71
Depreciation and amortization (in thousands):				
PFS	$ 1,210	$ 1,158	$ 2,329	$ 2,340
Holdings	—	15	14	29
Eliminations	—	(7)	(7)	(14)
	$ 1,210	$ 1,166	$ 2,336	$ 2,355
Capital expenditures (in thousands):				
PFS	$ 841	$ 214	$ 1,797	$ 481
Holdings	—	—	—	—
Eliminations	—	—	—	—
	$ 841	$ 214	$ 1,797	$ 481

	June 30, 2004	December 31, 2003
Assets (in thousands):		
PFS	$ 47,430	$ 43,629
Holdings	80,548	77,878
Eliminations	(13,215)	(13,148)
	$114,763	$108,359

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

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

Forward-Looking Information

We have made forward-looking statements in this Report on Form 10-Q. These statements are subject to risks and uncertainties, and there can be no guarantee that these statements will prove to be correct. Forward-looking statements include assumptions as to how we may perform in the future. When we use words like "seek," "strive," "believe," "expect," "anticipate," "predict," "potential," "continue," "will," "may," "could," "intend," "plan," "target" and "estimate" or similar expressions, we are making forward-looking statements. You should understand that the following important factors, in addition to those set forth above or elsewhere in this Report on Form 10-Q and our Form 10-K for the year ended December 31, 2003, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

- our ability to retain and expand relationships with existing clients and attract and implement new clients;
- our reliance on the fees generated by the transaction volume or product sales of our clients;
- our reliance on our clients' projections or transaction volume or product sales;
- our dependence upon our agreements with IBM;
- our client mix, their business volumes and the seasonality of their business;
- our ability to finalize pending contracts;
- the impact of strategic alliances and acquisitions;
- trends in 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 and supplier 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;
- our dependency on key personnel;
- our ability to raise additional capital or obtain additional financing; and
- our ability or the ability of our subsidiaries to borrow under current financing arrangements and maintain compliance with debt covenants.

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

Overview

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

We provide these services, and earn our revenue, through two separate business segments, which have operationally similar business models. The first business segment is a service fee revenue model. In this segment, we do not own the underlying inventory or the resulting accounts receivable, but provide management services for these client-owned assets. We typically charge our service fee revenue on a percent of shipped revenue basis or a per-transaction basis, such as a per-minute basis for web-enabled customer contact center services and a per-item basis for fulfillment services. Additional fees are billed for other services. We price our services based on a variety of factors, including the depth and complexity of the services provided, the amount of capital expenditures or systems customization required, the length of contract and other factors.

Many of our service fee contracts involve third-party vendors who provide additional services such as package delivery. The costs we are charged by these third-party vendors for these services are often passed on to our clients (and, in many cases, our clients' customers). Our billings for reimbursements of these and other 'out-of-pocket' expenses, such as travel, shipping and handling costs and telecommunication charges are included in gross service fee revenue. The related reimbursable costs for pass-through expenditures are reflected as pass-through charges and reduce total gross service fee revenue in computing net service fee revenue.

Our second business segment is a product revenue model. In this segment, we are a master distributor of product for IBM and certain other clients. In this capacity, we purchase, and thus own, inventory. As a result, upon the sale of inventory, we own the accounts receivable. This business segment requires significant working capital requirements, for which we have senior financing facilities to provide for up to approximately $77 million of available financing. Our services include purchasing and reselling client product inventory within this product revenue segment. In these arrangements, our product revenue is recognized at the time product is shipped. Product revenue includes freight costs billed to customers and is reduced for pass through customer marketing programs.

Growth is a key element to us achieving our future goals, including reaching sustainable profitability. Our growth is driven by two main elements: new client relationships and organic growth from existing clients. On an overall basis, we have experienced an increase in service fee revenues from existing clients and an increase in product revenues in recent periods. In recent months we have also seen an increase in the activity with new service contract relationships. While the lead times to close new deals continue to be unpredictable, our recent closure rate has been more successful than in the past. Due to the time period estimated to fully implement recent wins, we expect to realize the majority of the financial benefit of these recent wins beginning in calendar year 2005.

Our expenses comprise primarily three categories: 1) cost of service fee revenue, 2) cost of product revenue and 3) selling, general and administrative ("SG&A") expenses.

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

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

SG&A expenses — 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, certain direct contract costs related to our IBM and other master distributor agreements are reflected as selling and administrative expenses.

Monitoring and controlling our available cash balances continues to be a primary focus. Our cash and liquidity positions are important components of our financing of both current operations and our targeted growth. During 2003 we added to our available cash and liquidity positions through two primary transactions. First, we entered into a working capital financing agreement with a bank that currently provides financing for up to $5 million of eligible accounts receivable and financing for up to $2.5 million of eligible capital expenditures. Secondly, we completed a private placement of approximately 1.6 million shares of our common stock to certain investors that provided net proceeds of approximately $3.2 million.

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Product revenue	85.7%	85.8%	88.2%	87.8%
Gross service fee revenue	19.1	15.3	15.4	13.2
Pass-through charges	(4.8)	(1.1)	(3.6)	(1.0)
Net service fee revenue	14.3	14.2	11.8	12.2
Total net revenues	100.0	100.0	100.0	100.0
Cost of product revenue (as % of product revenue)	94.5	94.4	94.2	94.4
Cost of service fee revenue (as % of net service fee revenue)	61.2	61.2	66.4	66.3
Total costs of revenues	89.8	89.7	91.0	91.0
Gross profit	10.2	10.3	9.0	9.0
Selling, general and administrative expenses	8.9	8.8	9.1	9.0
Income (loss) from operations	1.3	1.5	(0.1)	0.0
Interest expense, net	0.4	0.7	0.4	0.8
Income (loss) before income taxes	0.9	0.9	(0.5)	(0.7)
Income tax expense	0.3	0.3	0.3	0.2
Net income (loss)	0.6%	0.6%	(0.8)%	(0.9)%

Results of Operations for the Interim Periods Ended June 30, 2004 and 2003

Product Revenue. Product revenue was $65.3 million for the three months ended June 30, 2004, as compared to $63.1 million for the three months ended June 30, 2003, an increase of $2.2 million, or 3.4%. Product revenue was $133.9 million for the six months ended June 30, 2004, as compared to $122.9 million for the six months ended June 30, 2003, an increase of $11.0 million, or 9.0 %. The increase in product revenue for both periods resulted primarily from the favorable impact of exchange rates on our European and Canadian operations, increased sales volumes of certain existing products, and the addition of certain new products.

Net Service Fee Revenue. Net service fee revenue was $10.9 million for the three months ended June 30, 2004 as compared to $10.5 million for the three months ended June 30, 2003, an increase of $0.4 million or 3.7%. Net service fee revenue for both the three months ended June 30, 2004 and 2003 included increased service fees generated from the favorable impact of seasonality of our largest service fee client and from incremental projects with certain client relationships. Net service fee revenue was $17.8 million for the six months ended June 30, 2004 as compared to $17.1 million for the six months ended June 30, 2003, an increase of $0.7 million or 4.3%. The change in net service fee revenue is shown below ($ millions):

	Three Months	Six Months
Period ended June 30, 2003	$10.5	$17.1
New service contract relationships, including certain incremental projects	1.0	1.3
Increase (decrease) in existing client service fees from organic growth and certain incremental projects	(0.3)	0.1
Terminated clients not included in 2004 revenue	(0.3)	(0.7)
Period ended June 30, 2004	$10.9	$17.8

Net service fee revenue for the three and six months ended June 30, 2004 included approximately $0.5 million and $1.0 million, respectively, of fees earned from clients contracts terminated during 2004.

Cost of Product Revenue. Cost of product revenue was $61.7 million for the three months ended June 30, 2004, as compared to $59.6 million for the three months ended June 30, 2003, an increase of $2.1 million or 3.6%. Cost of product revenue as a percent of product revenue was 94.5% during the three months ended June 30, 2004 and 94.4% during the three months ended June 30, 2003. The resulting gross profit margin was 5.5% for the three months ended June 30, 2004 and 5.6% for the three months ended June 30, 2003. Cost of product revenue was $126.2 million for the six months ended June 30, 2004, as compared to $116.0 million for the six months ended June 30, 2003, an increase of $10.2 million or 8.8%. Cost of product revenue as a percent of product revenue was 94.2% during the six months ended June 30, 2004 and 94.4 % during the six months ended June 30, 2003. The resulting gross profit margin was 5.8% for the six months ended June 30, 2004 and 5.6% for the six months ended June 30, 2003. Cost of product revenue increased during each period from the impact of exchange rates on our European and Canadian operations, increased volumes of certain existing products and the addition of certain new products and additional reserves for inventory impairment.

Cost of Net Service Fee Revenue. Cost of net service fee revenue was $6.7 million for the three months ended June 30, 2004, as compared to $6.4 million during the three months ended June 30, 2003, an increase of $0.3 million or 3.7%. The resulting service fee gross profit was $4.2 million or 38.8% of net service fee revenue, during the three months ended June 30, 2004 as compared to $4.1 million, or 38.8% of net service fee revenue for the three months ended June 30, 2003. Our gross profit as a percent of net service fee revenue is higher during the three months ending June 30, 2004 and 2003, as compared to other quarters, due to the seasonality of our largest service fee client and incremental projects with certain client relationships. Cost of net service fee revenue was $11.8 million for the six months ended June 30, 2004, as compared to $11.3 million during the six months ended June 30, 2003, an increase of $0.5 million or 4.6%. The resulting service fee gross profit was $6.0 million or 33.6% of net service fee revenue, during the six months ended June 30, 2004 as compared to $5.8 million, or 33.7% of net service fee revenue for the six months ended June 30, 2003. As we add new service fee revenue in the future, we currently intend to target the underlying contracts to earn an average gross profit percentage of 30-40%, but we may target lower percentages on certain larger contracts depending on contract scope and other factors.

Selling, General and Administrative Expenses. SG&A expenses were $6.8 million for the three months ended June 30, 2004, or 8.9% of total net revenues, as compared to $6.4 million, or 8.8% of total net revenues, for the three months ended June 30, 2003. SG&A expenses were $13.8 million for the six months ended June 30, 2004, or 9.1% of total net revenues, as compared to $12.6 million, or 9.0% of total net revenues, for the six months ended June 30, 2003. SG&A expenses increased from the prior year periods primarily due to additional expenses incurred in preparation of complying with the Sarbanes-Oxley Act and incremental sales and marketing expenses.

Interest Expense, net. Interest expense was $0.3 million for the three months ended June 30, 2004 as compared to $0.5 million for the three months ended June 30, 2003. Interest expense was $0.8 million for the six months ended June 30, 2004 as compared to $1.1 million for the six months ended June 30, 2003. The decrease in interest expense is primarily due to lower average loan balances as a result of reduced inventory levels.

Income Taxes. For the three months ended June 30, 2004 and 2003, we recorded a tax provision of $0.2 million primarily associated with our subsidiary Supplies Distributors' Canadian and European operations. For the six months ended June 30, 2004 and 2003, we recorded a tax provision of $0.4 million and $0.3 million, respectively, primarily associated with our subsidiary Supplies Distributors' Canadian and European operations. We did not record an income tax benefit associated with our consolidated net loss in our U.S. operations. A valuation allowance has been provided for our net deferred tax assets as of June 30, 2004, which are primarily related to our net operating loss carryforwards. We did not record an income tax benefit for our PFSweb European pre-tax losses in the current or prior periods. Due to the consolidation of Supplies Distributors, in the future we anticipate that we will continue to record an income tax provision associated with Supplies Distributors' Canadian and European results of operations.

Liquidity and Capital Resources

Net cash provided by operating activities was $3.8 million for the six months ended June 30, 2004, and primarily resulted from a $9.6 million increase in accounts payable, accrued expenses and deferred income partially offset by increases in accounts receivable of $6.3 million and prepaid expenses, other receivables and other current assets of $1.9 million. The increase in accounts payable was due to the timing of invoice processing by one of our master distribution vendors and an increase in certain liabilities due to clients for unremitted funds collected on their behalf and reimbursable expense deposits. The increase in accounts receivable is partially due to increased service fee billings for our largest client, which has a seasonally high second quarter of business activity, and increased revenue from our Supplies Distributors business segment. Net cash provided by operating activities was $6.7 million for the six months ended June 30, 2003, and primarily resulted from a $10.5 million decrease in inventory, partially offset by an increase in accounts receivable of $4.4 million. The increase in accounts receivable was partially due to increased service fee billings for our largest client, which has a seasonally high second quarter of business activity, and increased revenue from our Supplies Distributors business segment.

Net cash used in investing activities for the six months ended June 30, 2004 and 2003 totaled $1.5 million and $0.4 million, respectively, primarily representing capital expenditures. Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, including our Internet-based customer tools, other methods of e-commerce and general expansion of and upgrades to our facilities, both domestic and foreign. We expect to incur capital expenditures in order to support new contracts and anticipated future growth opportunities. Based on our current client business activity, 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. Future client contracts may require additional capital expenditures to support the services to such clients. A portion of these expenditures may be financed through operating or capital leases. We may elect to modify or defer a portion of such anticipated investments in the event that we do not achieve the revenue necessary to support such investments.

Net cash used in financing activities was approximately $1.5 million for the six months ended June 30, 2004, primarily representing $0.5 million of payments on our capital lease obligations and $1.5 million of payments on debt. Net cash used in financing activities was approximately $4.8 million for the six months ended June 30, 2003, primarily representing $0.6 million of payments on our capital lease obligations and $4.5 million of payments on debt.

During the six months ended June 30, 2004, our working capital decreased to $20.0 million from $21.4

million at December 31, 2003, primarily as a result of funding operating losses and capital expenditures. To obtain additional financing in the future, in addition to our current cash position, we plan to evaluate various financing alternatives including utilizing capital or operating leases, borrowing under our credit facilities, expanding our credit facilities, or transferring a portion of our subordinated loan balance due from Supplies Distributors, to third-parties. In conjunction with certain of these alternatives, we may be required to provide certain letters of credit to secure these arrangements. No assurances can be given that we will be successful in obtaining any additional financing or the terms thereof. We currently believe that our cash position, financing available under our credit facilities and funds generated from operations (including our anticipated revenue growth and/or cost reductions to offset lower than anticipated revenue growth) will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our lease obligations, and additional subordinated loans to our subsidiary Supplies Distributors, Inc. ("Supplies Distributors"), if necessary, for at least the next twelve months.

Supplies Distributors has a short-term credit facility with IBM Credit LLC ("IBM Credit") and its subsidiaries Supplies Distributors S.A. ("SDSA") and Business Supplies Distributors Europe B.V., European corporations, have a short-term credit facility with IBM Belgium Financial Services S.A. ("IBM Belgium") to finance their distribution of IBM products. We have provided a collateralized guaranty to secure the repayment of these credit facilities. As of June 30, 2004, the asset-based credit facilities provided financing for up to $27.5 million and up to 12.5 million Euros (approximately $15.1 million) with IBM Credit and IBM Belgium, respectively. These agreements expire in March 2005.

Supplies Distributors also has 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 United States and Canada. The Congress facility expires on the earlier of March 29, 2007 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.

SDSA has a factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 7.5 million Euros (approximately $9.1 million) of eligible accounts receivables through March 29, 2005. Borrowings under this agreement can be either cash advances or straight loans, as defined.

These credit facilities contain cross default provisions, various restrictions upon the ability of our subsidiaries Business Supplies Distributors Holdings, LLC (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 cash flow from operations, annualized revenue to working capital, net profit after tax to revenue, minimum net worth and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as collateralized guaranties of Holdings and PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors of no less than $7.0 million, maintain restricted cash of less than $5.0 million, are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure and a minimum shareholders' equity of at least $19.0 million. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or SDSA under these facilities if Supplies Distributors or SDSA is unable to do so. We have also provided a guarantee of the obligations of Supplies Distributors and SDSA to IBM, excluding the trade payables that are financed by IBM credit.

Priority Fulfillment Services, Inc. and Priority Fulfillment Services of Canada, Inc., (both wholly-owned subsidiaries of PFSweb and collectively the "Borrowers") have a Loan and Security Agreement (the "Agreement") with Comerica Bank ("Comerica"). The Agreement provides for up to $5.0 million of eligible accounts receivable financing in the U.S. and Canada through March 28, 2005, and up to $2.5 million of eligible equipment purchases through September 10, 2006. We entered this Agreement to supplement our existing cash position, and provide funding for our future operations, including our targeted growth. The Agreement contains cross default provisions, various restrictions upon the Borrowers' ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth, as defined, and a minimum liquidity ratio, as defined. The Agreement also limits our ability to increase the subordinated loan to

Supplies Distributors without the lender's approval. The Agreement is secured by all of the assets of the Borrowers, as well as a guarantee of PFSweb.

The following is a schedule of our total contractual cash and other obligations as of June 30, 2004, which is comprised of operating leases, debt and capital leases, including interest (in millions):

	Payments Due By Period				
Contractual Obligations	**Total**	**Less than 1 Year**	**1 - 3 Years**	**3 - 5 Years**	**More than 5 Years**
Debt	$55,478	$54,309	$ 1,169	$ —	$ —
Capital lease obligations	3,619	1,297	1,933	389	—
Operating leases	18,472	5,050	9,078	4,344	—
Total	$77,569	$60,656	$12,180	$4,733	$ —

In support of certain debt instruments and leases, as of June 30, 2004, we had $0.9 million of cash restricted as collateral for a letter of credit. The letter of credit automatically decreases at certain dates through its expiration in March 2007. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain Supplies Distributors' credit facilities. Many of the debt facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other agreements. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders' equity, and the lenders accelerate the repayment of the credit facility obligations, we would be required to repay all amounts outstanding thereunder. Any requirement to accelerate the repayment of the credit facility obligations would have a material adverse impact on our financial condition and results of operations. We can provide no assurance that we will have the financial ability to repay all of such obligations. As of June 30, 2004, we were in compliance with all debt covenants and we believe that we will maintain such compliance throughout calendar year 2004. We do not have any other material financial commitments, although future client contracts may require capital expenditures and lease commitments to support the services provided to such clients.

We currently believe that we are still operating with and incurring costs applicable to excess capacity in certain of our North American and European operations. We currently estimate that the net service fee revenue needed to leverage our existing infrastructure and cost structure and reach profitability is approximately between $12.5 million to $15 million per quarter, including service fees earned from our subsidiary Supplies Distributors, which are eliminated in consolidation, dependent upon the gross margins earned from existing business and the incremental service fee revenue business. No assurance can be given that we can achieve such operating levels, or that, if achieved, we will be profitable in any particular fiscal period. We will reevaluate the carrying value of certain of the excess long-lived warehouse operation and information technology infrastructure assets for impairment in 2004, in conjunction with our future operating plans, and determine if additional asset impairment costs should be recognized.

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

Seasonality

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

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

Inflation

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

Critical Accounting Policies

A description of critical accounting policies is included in Note 2 to the accompanying unaudited interim condensed consolidated financial statements. For other significant accounting policies, see Note 2 to the consolidated financial statements in our December 31, 2003 Annual Report on Form 10-K.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

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

Interest Rate Risk

Our interest rate risk is limited to our outstanding balances on our inventory and working capital financing agreements, loan and security agreements and factoring agreement for the financing of inventory, accounts receivable and certain other receivables, which amounted to $54.8 million at June 30, 2004. A 100 basis point movement in interest rates would result in approximately $0.2 million annualized increase or decrease in interest expense based on the outstanding balance of these agreements at June 30, 2004.

Foreign Exchange Risk

Currently, our foreign currency exchange rate risk is primarily limited to the Canadian Dollar and the Euro. In the future, our foreign currency exchange risk may also include other currencies applicable to certain of our international operations. From time to time, we employ derivative financial instruments to manage our exposure to fluctuations in foreign currency rates. To hedge our net investment and intercompany payable or receivable balances in foreign operations, from time to time we may enter into forward currency exchange contracts.

ITEM 4. Controls and Procedures

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

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

None

ITEM 2. Changes in Securities and Use of Proceeds

None

ITEM 3. Defaults Upon Senior Securities

None

ITEM 4. Submission of Matters to a Vote of Security Holders

On June 4, 2004, the Company held its Annual Meeting of Stockholders. The following matters were acted upon and votes cast or withheld:

1. Appointment of KPMG LLP as auditors for the fiscal year ending December 31, 2004

For: 19,190,013	Against: 65,038	Abstained: 22,259

ITEM 5. Other Information

None.

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
31.1**	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2**	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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

** Filed herewith

b) Reports on Form 8-K:

Form 8-K furnished on May 10, 2004 reporting Item 12, Results of Operations and Financial Condition, that on May 10, 2004, PFSweb, Inc. issued a press release announcing its financial results for the quarter ended March 31, 2004.

Form 8-K furnished on May 20, 2004 reporting Item 5, Other Events, that on May 19, 2004, PFSweb, Inc. issued a press release regarding its presentation at the sixth annual AeA Micro Cap Financial Conference in Monterey, California.

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: August 16, 2004

PFSweb, Inc.

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

INDEX TO EXHIBITS

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

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

** Filed herewith

EXHIBIT 31.1

CERTIFICATIONS OF PRINCIPAL EXECUTIVE OFFICER

PURSUANT TO 18 U.S.C. SECTION 1350

I, Mark Layton, certify that:

1. I have reviewed this report on Form 10-Q of PFSweb, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2004

By: /s/ Mark C. Layton

Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS OF PRINCIPAL EXECUTIVE OFFICER

PURSUANT TO 18 U.S.C. SECTION 1350

I, Tom Madden, certify that:

1. I have reviewed this report on Form 10-Q of PFSweb, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 16, 2004

By: /s/ Thomas J. Madden

Chief Financial Officer

EXHIBIT 32.1

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

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of PFSweb, Inc. (the “Company”), does hereby certify that:

The Quarterly Report on Form 10-Q for the period ended June 30, 2004 (the “Form 10-Q”) of the Company fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Form 10-K.

August 16, 2004	/s/ Mark C. Layton Mark C. Layton Chief Executive Officer
August 16, 2004	/s/ Thomas J. Madden Thomas J. Madden Chief Financial Officer

The foregoing certification is being furnished as an exhibit to the Form 10-Q pursuant to Item 601(b)(32) of Regulation S-K and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and, accordingly, is not being filed as part of the Form 10-Q for purposes of Section 18 of the Securities Exchange Act of 1934, as whether made before or after the date hereof, regardless of any general incorporation language in such filing.

A signed original of this written statement required by Section 906 has been provided to PFSweb, Inc. and will be retained by PFSweb, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.