



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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2009

OR

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

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

Commission File Number 000-28275

**PFsweb, Inc.**

(Exact name of registrant as specified in its charter)

Delaware

(State of Incorporation)

75-2837058

(I.R.S. Employer I.D. No.)

500 North Central Expressway, Plano, Texas

(Address of principal executive offices)

75074

(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

At August 14, 2009 there were 9,928,224 shares of registrant's common stock outstanding.

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

	<u>Page Number</u>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<u>Item 1. Financial Statements:</u>	
<u>Unaudited Condensed Consolidated Balance Sheets as of June 30, 2009 and December 31, 2008</u>	3
<u>Unaudited Interim Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2009 and 2008</u>	4
<u>Unaudited Interim Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2009 and 2008</u>	5
<u>Notes to Unaudited Interim Condensed Consolidated Financial Statements</u>	6
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3. Quantitative and Qualitative Disclosure about Market Risk</u>	27
<u>Item 4. Controls and Procedures</u>	27
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings</u>	28
<u>Item 1A. Risk Factors</u>	28
<u>Item 2. Changes in Securities and Use of Proceeds</u>	29
<u>Item 3. Defaults Upon Senior Securities</u>	29
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	29
<u>Item 5. Other Information</u>	29
<u>Item 6. Exhibits and Reports on Form 8-K</u>	30
<b><u>SIGNATURE</u></b>	31
<u>EX-3.1.1</u>	
<u>EX-10.1</u>	
<u>EX-10.2</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	

**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements**

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

	June 30, 2009	December 31, 2008
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 15,147	\$ 16,050
Restricted cash	2,089	2,008
Accounts receivable, net of allowance for doubtful accounts of \$625 and \$980 at June 30, 2009 and December 31, 2008, respectively	32,704	44,546
Inventories, net of reserves of \$1,997 and \$2,124 at June 30, 2009 and December 31, 2008, respectively	40,540	47,186
Other receivables	11,847	13,072
Prepaid expenses and other current assets	3,468	3,802
Total current assets	105,795	126,664
PROPERTY AND EQUIPMENT, net	10,878	12,106
IDENTIFIABLE INTANGIBLES	883	961
GOODWILL	3,602	3,602
OTHER ASSETS	1,560	1,188
Total assets	\$ 122,718	\$ 144,521
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt and capital lease obligations	\$ 22,010	\$ 22,251
Trade accounts payable	47,240	61,988
Accrued expenses	19,431	21,054
Total current liabilities	88,681	105,293
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	1,858	4,951
OTHER LIABILITIES	1,534	1,192
Total liabilities	92,073	111,436
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.001 par value; 35,000,000 shares authorized; 9,946,585 and 9,935,095 shares issued at June 30, 2009 and December 31, 2008, respectively; and 9,928,224 and 9,916,734 outstanding at June 30, 2009 and December 31, 2008, respectively	10	10
Additional paid-in capital	92,949	92,728
Accumulated deficit	(64,170)	(61,393)
Accumulated other comprehensive income	1,941	1,825
Treasury stock at cost, 18,361 shares	(85)	(85)
Total shareholders' equity	30,645	33,085
Total liabilities and shareholders' equity	\$ 122,718	\$ 144,521

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,	
	2009	2008	2009	2008
<b>REVENUES:</b>				
Product revenue, net	\$ 65,546	\$ 83,048	\$ 131,809	\$ 173,339
Service fee revenue	12,367	21,254	29,486	42,066
Pass-through revenue	4,417	6,382	9,972	13,748
Total net revenues	<u>82,330</u>	<u>110,684</u>	<u>171,267</u>	<u>229,153</u>
<b>COSTS OF REVENUES:</b>				
Cost of product revenue	60,303	76,368	121,134	160,347
Cost of service fee revenue	9,414	15,105	20,733	28,949
Pass-through cost of revenue	4,417	6,382	9,972	13,748
Total costs of revenues	<u>74,134</u>	<u>97,855</u>	<u>151,839</u>	<u>203,044</u>
Gross profit	<u>8,196</u>	<u>12,829</u>	<u>19,428</u>	<u>26,109</u>
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES, including stock based compensation expense of \$109 and \$128 in the three months ended June 30, 2009 and 2008, respectively, and \$212 and \$329 in the six months ended June 30, 2009 and 2008, respectively				
	10,643	11,849	21,310	23,943
AMORTIZATION OF IDENTIFIABLE INTANGIBLES				
Total operating expenses	<u>10,670</u>	<u>12,050</u>	<u>21,363</u>	<u>24,346</u>
Income (loss) from operations	<u>(2,474)</u>	<u>779</u>	<u>(1,935)</u>	<u>1,763</u>
INTEREST EXPENSE, NET				
Income (loss) before income taxes	<u>321</u>	<u>366</u>	<u>678</u>	<u>696</u>
INCOME TAX EXPENSE (BENEFIT), NET				
NET INCOME (LOSS)	<u>(2,795)</u>	<u>413</u>	<u>(2,613)</u>	<u>1,067</u>
NET INCOME (LOSS)	<u>(266)</u>	<u>351</u>	<u>164</u>	<u>591</u>
NET INCOME (LOSS)	<u>\$ (2,529)</u>	<u>\$ 62</u>	<u>\$ (2,777)</u>	<u>\$ 476</u>
NET INCOME (LOSS) PER SHARE:				
Basic	<u>\$ (0.25)</u>	<u>\$ 0.01</u>	<u>\$ (0.28)</u>	<u>\$ 0.05</u>
Diluted	<u>\$ (0.25)</u>	<u>\$ 0.01</u>	<u>\$ (0.28)</u>	<u>\$ 0.05</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic	<u>9,927</u>	<u>9,900</u>	<u>9,925</u>	<u>9,896</u>
Diluted	<u>9,927</u>	<u>10,037</u>	<u>9,925</u>	<u>10,045</u>

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,	
	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (2,777)	\$ 476
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,651	3,143
Loss on sale of assets	—	11
Provision for doubtful accounts	(159)	—
Provision for excess and obsolete inventory	564	651
Deferred income taxes	(42)	(12)
Stock-based compensation	212	329
Changes in operating assets and liabilities:		
Restricted cash	(8)	(111)
Accounts receivable	12,180	8,823
Inventories, net	6,294	(5,808)
Prepaid expenses, other receivables and other assets	1,333	(5,932)
Accounts payable, accrued expenses and other liabilities	(16,621)	10,034
Net cash provided by operating activities	<u>4,627</u>	<u>11,604</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(1,949)	(1,932)
Proceeds from sale of assets	—	117
Net cash used in investing activities	<u>(1,949)</u>	<u>(1,815)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Payments on capital lease obligations	(876)	(942)
Increase in restricted cash	(73)	(1,705)
Proceeds from issuance of common stock	9	45
Payments on debt, net	(2,971)	(7,805)
Net cash used in financing activities	<u>(3,911)</u>	<u>(10,407)</u>
<b>EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>	<u>330</u>	<u>318</u>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	(903)	(300)
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<u>16,050</u>	<u>14,272</u>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<u>\$ 15,147</u>	<u>\$ 13,972</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Non-cash investing and financing activities:		
Property and equipment acquired under capital leases	<u>\$ 369</u>	<u>\$ 145</u>

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

***PFSweb Overview***

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

***Supplies Distributors Overview***

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

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

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

***eCOST Overview***

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

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

**PFSweb, Inc. and Subsidiaries**

**Notes to Unaudited Interim Condensed Consolidated Financial Statements**

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

In the event eCOST is unable to increase its revenue and/or gross profit from its present levels, it may fail to comply with one or more of the financial covenants required under its working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding thereunder and exercise all other rights and remedies, including sale of collateral and demand for payment under the Company parent guaranty. Any acceleration of the repayment of the credit facilities would have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations.

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

***Basis of Presentation***

The unaudited interim condensed consolidated financial statements as of June 30, 2009, and for the three and six months ended June 30, 2009 and 2008, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and are unaudited. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. In the opinion of management and subject to the foregoing, the unaudited interim condensed consolidated financial statements of the Company include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company's financial position as of June 30, 2009, its results of operations for the three and six months ended June 30, 2009 and 2008 and its cash flows for the six months ended June 30, 2009 and 2008. Results of the Company's operations for interim periods may not be indicative of results for the full fiscal year.

**2. SIGNIFICANT ACCOUNTING POLICIES**

***Principles of Consolidation***

All intercompany accounts and transactions have been eliminated in consolidation.

***Use of Estimates***

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

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as the operating environment changes. These changes have been included in the consolidated financial statements as soon as they became known. In addition, management



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

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

**Investment in Affiliates**

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

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

**Concentration of Business and Credit Risk**

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

	Six Months Ended	
	June 30, 2009	June 30, 2008
<b>Product Revenue (as a percentage of Product Revenue):</b>		
Customer 1	12%	11%
Customer 2	9%	10%
<b>Service Fee Revenue (as a percentage of Service Fee Revenue):</b>		
Client 1	13%	39%
Client 2	15%	10%
<b>Accounts Receivable:</b>		
Client/Customer 1	12%	10%

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

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

**PFSweb, Inc. and Subsidiaries**

**Notes to Unaudited Interim Condensed Consolidated Financial Statements**

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

eCOST's arrangements with its vendors are terminable by either party at will. Loss of any vendors could have a material adverse effect on eCOST's financial position, results of operations and cash flows. Sales of HP and HP-related products represented 42% of eCOST's net revenues (10% of the Company's consolidated total net revenues) in the six months ended June 30, 2009 and 52% of eCOST's net revenues (12% of the Company's consolidated total net revenues) in the comparable 2008 period.

***Inventories***

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

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

***Property and Equipment***

The Company's property held under capital leases amounted to approximately \$2.8 million and \$3.4 million, net of accumulated amortization of approximately \$9.4 million and \$8.4 million, at June 30, 2009 and December 31, 2008, respectively.

***Stock-Based Compensation***

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

***Long-Lived Assets***

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

**PFSweb, Inc. and Subsidiaries**

**Notes to Unaudited Interim Condensed Consolidated Financial Statements**

***Cash Paid for Interest and Taxes***

The Company made payments for interest of approximately \$0.7 million and \$0.8 million during the six months ended June 30, 2009 and 2008, respectively. Income taxes of approximately \$0.5 million and \$0.1 million were paid by the Company during the six months ended June 30, 2009 and 2008, respectively.

***Subsequent Events***

The Company has evaluated its subsequent events through August 14, 2009. There were no events or transactions that occurred after June 30, 2009 that required disclosure in the financial statements.

***Impact of Recently Issued Accounting Standards***

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position ("FSP") 157-2, "Effective Date of FASB Statement No. 157," which delayed the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis, at least annually, until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and the Company adopted SFAS 157 for financial assets and liabilities on January 1, 2008, with no material impact to its consolidated financial statements. The Company adopted fair value measurement treatment for nonfinancial assets and liabilities on January 1, 2009, which did not have a material impact on its consolidated financial statements.

In December 2007, the FASB issued Statement No. 141R, *Business Combinations*, and Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. Statement No. 141R modified the accounting and disclosure requirements for business combinations and broadens the scope of the previous standard to apply to all transactions in which one entity obtains control over another business. Statement No. 160 establishes new accounting and reporting standards for noncontrolling interests in subsidiaries. The Company applied the provisions of the new standards in the first quarter of 2009. The adoption of the statement did not have a material impact on its consolidated financial statements.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets* ("FSP No. 142-3"). This guidance is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* ("SFAS No. 142"), and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) when the underlying arrangement includes renewal or extension of terms that would require substantial costs or result in a material modification to the asset upon renewal or extension. Companies estimating the useful life of a recognized intangible asset must now consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension as adjusted for SFAS No. 142's entity-specific factors. FSP No 142-3 was effective beginning January 1, 2009 and will be applied prospectively to intangible assets acquired after the effective date. The adoption of this FSP did not have a material impact on the Company's consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165 "Subsequent Events" ("SFAS 165"), which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Company adopted the provisions of SFAS 165 for the quarter ended June 30, 2009 with no material impact on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162"

## PFSweb, Inc. and Subsidiaries

## Notes to Unaudited Interim Condensed Consolidated Financial Statements

("SFAS 168"), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with generally accepted accounting principles. SFAS 168 explicitly recognizes rules and interpretive releases of the Securities and Exchange Commission ("SEC") under federal securities laws as authoritative GAAP for SEC registrants. SFAS 168 will become effective in the third quarter of 2009 and will not have a material impact on the Company's consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income (loss)	\$ (2,529)	\$ 62	\$ (2,777)	\$ 476
Other comprehensive income (loss):				
Foreign currency translation adjustment	801	(17)	116	660
Comprehensive income (loss)	<u>\$ (1,728)</u>	<u>\$ 45</u>	<u>\$ (2,661)</u>	<u>\$ 1,136</u>

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

Basic and diluted net income (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the reporting period. For both the three and six months ended June 30, 2009, outstanding options of 1.8 million to purchase common shares were anti-dilutive and have been excluded from the diluted weighted average share computation. For both the three and six months ended June 30, 2008, common stock equivalents of 0.8 million are included in the diluted weighted average number of shares outstanding. For both the three and six months ended June 30, 2008, outstanding options of 0.5 million to purchase common shares were anti-dilutive and have been excluded from the diluted weighted average share computation.

**5. VENDOR FINANCING:**

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

	June 30, 2009	December 31, 2008
Inventory and working capital financing agreements:		
United States	\$ 18,862	\$ 23,885
Europe	12,898	16,422
Total	<u>\$ 31,760</u>	<u>\$ 40,307</u>

***Inventory and Working Capital Financing Agreement, United States***

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of IPS products in the United States, providing financing for eligible IPS inventory and certain receivables up to \$30.5 million through its expiration in March 2010. As of June 30, 2009, Supplies Distributors had \$2.0 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of \$5.0 million and a minimum shareholders' equity of \$18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5% (3.75% as of

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

June 30, 2009). The facility also includes a monthly service fee. Given the structure of this facility and as outstanding balances, which represent inventory purchases, are repaid within twelve months, the Company has classified the outstanding amounts under this facility as accounts payable in the consolidated balance sheets.

***Inventory and Working Capital Financing Agreement, Europe***

Supplies Distributors' European subsidiary has a short-term credit facility with IBM Belgium Financial Services S.A. ("IBM Belgium") to finance its distribution of IPS products in Europe. The asset based credit facility with IBM Belgium provides up to 16.0 million euros (approximately \$22.6 million) in inventory financing and cash advances based on eligible inventory and accounts receivable through its expiration in March 2010. As of June 30, 2009, Supplies Distributors' European subsidiaries had 2.3 million euros (\$3.3 million) of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors and its European subsidiaries to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors' European subsidiary, as well as collateralized guaranties of Supplies Distributors and PFSweb. Additionally, PFSweb is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of \$5.0 million and a minimum shareholders' equity of \$18.0 million. Borrowings under the credit facility accrue interest at Euribor plus 1.94% for cash advances, and, after a defined free financing period, at Euribor plus 4.25% for inventory financings. As of June 30, 2009, the interest rate was 2.7% for the \$2.5 million of outstanding cash advances (see Note 6) and 5.0% on the \$12.9 million of outstanding inventory financings. Supplies Distributors' European subsidiary pays a monthly service fee on the commitment. Given the structure of this facility and as outstanding inventory financing balances are repaid within twelve months, the Company has classified the outstanding inventory financing amounts under this facility as accounts payable in the consolidated balance sheets.

**6. DEBT AND CAPITAL LEASE OBLIGATIONS:**

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

	<u>June 30, 2009</u>	<u>December 31, 2008</u>
Loan and security agreements, United States		
Supplies Distributors	\$ 7,405	\$ 9,649
PFS	5,000	6,000
Inventory and Working Capital Financing Agreement, Europe (see Note 5)	2,455	599
Credit facility — eCOST	—	—
Factoring agreement, Europe	1,910	2,577
Taxable revenue bonds	2,400	3,200
Master lease agreements	3,856	4,657
Other	842	520
Total	<u>23,868</u>	<u>27,202</u>
Less current portion of long-term debt	22,010	22,251
Long-term debt, less current portion	<u>\$ 1,858</u>	<u>\$ 4,951</u>

***Loan and Security Agreement — Supplies Distributors***

Supplies Distributors has a loan and security agreement with Wachovia Bank, N.A. ("Wachovia") to provide financing for up to \$25 million of eligible accounts receivable in the United States and Canada. As of June 30, 2009, Supplies Distributors had \$2.4 million of available credit under this agreement. The Wachovia facility expires on the earlier of March 2011 or the date on which the parties to the IPS master

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

distributor agreement no longer operate under the terms of such agreement and/or IPS no longer supplies products pursuant to such agreement. Borrowings under the Wachovia facility accrue interest at prime rate plus 0.25% to 0.75% or Eurodollar rate plus 2.5% to 3.0%, dependent on excess availability, as defined, (3.75% as of June 30, 2009). This agreement contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and is secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a Subordinated Note receivable balance from Supplies Distributors of no less than \$5.0 million and may not maintain restricted cash of more than \$5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and Wachovia pursuant to which a security interest was granted to Wachovia for all U.S. and Canadian customer remittances received in specified bank accounts. At June 30, 2009 and December 31, 2008, these bank accounts held \$0.3 million and \$0.1 million, respectively, which was restricted for payment to Wachovia.

***Loan and Security Agreement — PFS***

PFS has a Loan and Security Agreement (“Comerica Agreement”) with Comerica Bank (“Comerica”). The Comerica Agreement provides for up to \$10.0 million of eligible accounts receivable financing through March 2010. Borrowings under the Comerica Agreement accrue interest at a defined rate, which will generally be prime rate plus 2%, with a minimum of 4.5% (5.25% at June 30, 2009). As of June 30, 2009, PFS had \$1.5 million of available credit under this facility. The Comerica Agreement contains cross default provisions, various restrictions upon PFS’ ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the subordinated note receivable from Supplies Distributors to a maximum of \$6.5 million. Comerica has provided approval for PFS to advance incremental amounts subject to certain cash inflows to PFS, as defined, to certain of its subsidiaries and/or affiliates, including eCOST, if needed. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc.

***Credit Facility — eCOST***

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

**PFSweb, Inc. and Subsidiaries**

**Notes to Unaudited Interim Condensed Consolidated Financial Statements**

***Factoring Agreement***

Supplies Distributors' European subsidiary has a factoring agreement with Fortis Commercial Finance N.V. ("Fortis") to provide factoring for up to 7.5 million euros (approximately \$10.6 million) of eligible accounts receivables through March 2010. As of June 30, 2009, Supplies Distributors' European subsidiary had approximately 0.9 million euros (\$1.3 million) of available credit under this agreement. Borrowings accrue interest at Euribor plus 0.8% (1.6% at June 30, 2009). This agreement contains various restrictions upon the ability of Supplies Distributors' European subsidiary to, among other things, merge, consolidate and incur indebtedness, as well as financial covenants, such as minimum net worth. This agreement is secured by a guarantee of Supplies Distributors, up to a maximum of 200,000 euros.

***Taxable Revenue Bonds***

PFS has a Loan Agreement with the Mississippi Business Finance Corporation (the "MBFC") in connection with the issuance by the MBFC of \$5 million MBFC Taxable Variable Rate Demand Limited Obligation Revenue Bonds, Series 2004 (Priority Fulfillment Services, Inc. Project) (the "Bonds"). The MBFC loaned the proceeds of the Bonds to PFS for the purpose of financing the acquisition and installation of equipment, machinery and related assets located in one of the Company's Southaven, Mississippi distribution facilities. The Bonds bear interest at a variable rate (1.3% as of June 30, 2009), as determined by Comerica Securities, as Remarketing Agent. PFS, at its option, may convert the Bonds to a fixed rate, to be determined by the Remarketing Agent at the time of conversion.

The primary source of repayment of the Bonds is a letter of credit (the "Letter of Credit") in the initial face amount of \$5.1 million issued by Comerica pursuant to a Reimbursement Agreement between PFS and Comerica under which PFS is obligated to pay to Comerica all amounts drawn under the Letter of Credit. The Letter of Credit has a maturity date of April 2010 at which time, if not renewed or replaced, will result in a draw on the undrawn face amount thereof. If the Letter of Credit is renewed or replaced, the Bonds require future annual principal repayments of \$800,000 in January of each year through 2012. PFS' obligations under the Reimbursement Agreement are secured by substantially all of the assets of PFS, including restricted cash of \$1.5 million and a Company parent guarantee.

***Debt Covenants***

To the extent the Company or any of its subsidiaries fail to comply with covenants applicable to its debt or vendor financing obligations, including the monthly financial covenant requirements and required level of shareholders' equity or net worth, and one or all of the lenders accelerate the repayment of the credit facility obligations, the Company would be required to repay all amounts outstanding thereunder. In particular, in the event eCOST is unable to increase its revenue and/or gross profit from its present levels, or if PFS service fee revenue declines from expected levels and it is unable to reduce costs to correspond to such reduced revenue levels or if Supplies Distributors revenue or gross profit declines from expected levels, such events may result in a breach of one or more of the financial covenants required under its working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding thereunder and exercise all other rights and remedies, including sale of collateral and demand for payment under the Company parent guaranty. Any acceleration of the repayment of the credit facilities would have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations.

***Master Lease Agreements***

The Company has a Term Lease Master Agreement with IBM Credit Corporation ("Master Lease Agreement") that provides for leasing or financing transactions of equipment and other assets, which generally have terms of three years. The amounts outstanding under this Master Lease Agreement (\$1.4 million as of June 30, 2009 and \$1.7 million as of December 31, 2008) are secured by the related equipment.

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

The Company has two other master agreements with financing companies that provide for leasing or financing transactions of certain equipment. The amounts outstanding under these agreements were \$1.2 million and \$1.5 million as of June 30, 2009 and December 31, 2008, respectively, and are secured by the related equipment.

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

**7. SEGMENT INFORMATION**

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
<b>Revenues (in thousands):</b>				
PFSweb	\$ 18,554	\$ 29,712	\$ 43,318	\$ 59,992
Supplies Distributors	45,269	60,025	90,600	122,347
eCOST	20,277	23,023	41,209	50,992
Eliminations	(1,770)	(2,076)	(3,860)	(4,178)
	<u>\$ 82,330</u>	<u>\$ 110,684</u>	<u>\$ 171,267</u>	<u>\$ 229,153</u>
<b>Income (loss) from operations (in thousands):</b>				
PFSweb	\$ (2,982)	\$ (394)	\$ (3,385)	\$ (295)
Supplies Distributors	981	2,057	2,398	3,709
eCOST	(473)	(884)	(948)	(1,651)
Eliminations	—	—	—	—
	<u>\$ (2,474)</u>	<u>\$ 779</u>	<u>\$ (1,935)</u>	<u>\$ 1,763</u>
<b>Depreciation and amortization (in thousands):</b>				
PFSweb	\$ 1,530	\$ 1,313	\$ 3,465	\$ 2,648
Supplies Distributors	8	6	18	10
eCOST	85	243	168	485
Eliminations	—	—	—	—
	<u>\$ 1,623</u>	<u>\$ 1,562</u>	<u>\$ 3,651</u>	<u>\$ 3,143</u>
<b>Capital expenditures (in thousands):</b>				
PFSweb	\$ 688	\$ 1,152	\$ 1,846	\$ 1,757
Supplies Distributors	2	71	2	77
eCOST	44	45	101	98
Eliminations	—	—	—	—
	<u>\$ 734</u>	<u>\$ 1,268</u>	<u>\$ 1,949</u>	<u>\$ 1,932</u>
<b>Assets (in thousands):</b>			<b>June 30,</b>	<b>December 31,</b>
			<b>2009</b>	<b>2008</b>
PFSweb			\$ 99,418	\$ 108,436
Supplies Distributors			73,325	82,280
eCOST			12,256	13,489
Eliminations			(62,281)	(59,684)
			<u>\$ 122,718</u>	<u>\$ 144,521</u>



**PFSweb, Inc. and Subsidiaries**

**Notes to Unaudited Interim Condensed Consolidated Financial Statements**

**8. COMMITMENTS AND CONTINGENCIES**

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

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

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

- our ability to retain and expand relationships with existing clients and attract and implement new clients;
- our reliance on the fees generated by the transaction volume or product sales of our clients;
- our reliance on our clients' projections or transaction volume or product sales;
- our dependence upon our agreements with International Business Machines Corporation ("IBM") and InfoPrint Solutions Company ("IPS"), a joint venture company owned by Ricoh and IBM;
- our dependence upon our agreements with our major clients;
- our client mix, their business volumes and the seasonality of their business;
- our ability to finalize pending contracts;
- the impact of strategic alliances and acquisitions;
- trends in e-commerce, outsourcing, government regulation both foreign and domestic and the market for our services;
- whether we can continue and manage growth;
- increased competition;
- our ability to generate more revenue and achieve sustainable profitability;
- effects of changes in profit margins;
- the customer and supplier concentration of our business;
- the unknown effects of possible system failures and rapid changes in technology;
- foreign currency risks and other risks of operating in foreign countries;
- potential litigation;
- impact of reverse stock split;
- potential delisting;
- our dependency on key personnel;
- the impact of new accounting standards, and changes in existing accounting rules or the interpretations of those rules;
- our ability to raise additional capital or obtain additional financing;
- our ability and the ability of our subsidiaries to borrow under current financing arrangements and maintain compliance with debt covenants;
- relationship with and our guarantees of certain of the liabilities and indebtedness of our subsidiaries;
- taxation on the sale of our products;
- eCOST's potential indemnification obligations to its former parent;
- eCOST's ability to maintain existing and build new relationships with manufacturers and vendors and the success of its advertising and marketing efforts;
- eCOST's ability to increase its sales revenue and sales margin and improve operating efficiencies; and
- eCOST's ability to generate projected cash flows sufficient to cover the values of its intangible assets.

We have based these statements on our current expectations about future events. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you

## [Table of Contents](#)

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.

### **Overview**

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

First, in our eCommerce and business process outsourcing segment we derive our revenues from a broad range of services, including professional consulting, technology collaboration, order management, managed web hosting and web development, the development of an eCommerce technology platform, customer relationship management, financial services including billing and collection services and working capital solutions, kitting and assembly services, information management and international fulfillment and distribution services. We offer our services as an integrated solution, which enables our clients to outsource their complete infrastructure needs to a single source and to focus on their core competencies. Our distribution services are conducted at warehouses that we lease or manage and include real-time inventory management and customized picking, packing and shipping of our clients’ customer orders. We currently offer the ability to provide infrastructure and distribution solutions to clients that operate in a range of vertical markets, including technology manufacturing, computer products, cosmetics, fragile goods, contemporary home furnishings, apparel, aviation, telecommunications and consumer electronics, among others.

In this eCommerce and business process outsourcing segment, we do not own the underlying inventory or the resulting accounts receivable, but provide management services for these client-owned assets. We typically charge our service fee revenue on a cost-plus basis, a percent of shipped revenue basis or a per-transaction basis, such as a per-minute basis for web-enabled customer contact center services and a per-item basis for fulfillment services. Additional fees are billed for other services. We price our services based on a variety of factors, including the depth and complexity of the services provided, the amount of capital expenditures or systems customization required, the length of contract and other factors.

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

Our second business segment is a product revenue model. In this segment, we are a master distributor of product for IPS and certain other clients. In this capacity, we purchase, and thus own, inventory and recognize the corresponding product revenue. As a result, upon the sale of inventory, we own the accounts receivable. Freight costs billed to customers are reflected as components of product revenue. This business segment requires significant working capital requirements, for which we have senior credit facilities to provide for approximately \$90 million of available financing.

Our third business segment is a web-commerce product revenue model focused on the sale of products to a broad range of consumer and small business customers. In this segment we operate as a multi-category online discount retailer of new, “close-out” and recertified brand-name merchandise. Our product line currently offers approximately 300,000 products in several primary merchandise categories, primarily including computers, networking, electronics and entertainment, TV’s, plasmas and monitors, cameras and camcorders, memory and storage, “For the Home” and sports and leisure.

Growth is a key element to achieving our future goals, including achieving and maintaining sustainable profitability. Growth in our eCommerce and business process outsourcing segment is driven by two main

## [Table of Contents](#)

elements: new client relationships and organic growth from existing clients. We focus our sales efforts on larger contracts with brand-name companies within two primary target markets, online brands and retailers and technology manufacturers, which, by nature, require a longer duration to close but also have the potential to be higher-quality and longer duration engagements.

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

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

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

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

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

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

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

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

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

## Results of Operations

### For the Interim Periods Ended June 30, 2009 and 2008

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

	Three Months Ended June 30,					Six Months Ended June 30,				
	2009	2008	Change	% of Net Revenues		2009	2008	Change	% of Net Revenues	
				2009	2008				2009	2008
<b>Revenues:</b>										
Product revenue, net	\$ 65.5	\$ 83.0	\$ (17.5)	79.6%	75.0%	\$ 131.8	\$ 173.3	\$ (41.5)	77.0%	75.6%
Service fee revenue	12.4	21.3	(8.9)	15.0%	19.2%	29.5	42.1	(12.6)	17.2%	18.4%
Pass-through revenue	4.4	6.4	(2.0)	5.4%	5.8%	10.0	13.7	(3.7)	5.8%	6.0%
<b>Total net revenues</b>	<b>82.3</b>	<b>110.7</b>	<b>(28.4)</b>	<b>100.0%</b>	<b>100.0%</b>	<b>171.3</b>	<b>229.1</b>	<b>(57.8)</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Cost of Revenues</b>										
Cost of product revenue (1)	60.3	76.4	(16.1)	92.0%	92.0%	121.1	160.3	(39.2)	91.9%	92.5%
Cost of service fee revenue (2)	9.4	15.1	(5.7)	76.1%	71.1%	20.7	29.0	(8.3)	70.3%	68.8%
Pass-through cost of revenue (3)	4.4	6.4	(2.0)	100.0%	100.0%	10.0	13.7	(3.7)	100.0%	100.0%
<b>Total cost of revenues</b>	<b>74.1</b>	<b>97.9</b>	<b>(23.8)</b>	<b>90.1%</b>	<b>88.4%</b>	<b>151.8</b>	<b>203.0</b>	<b>(51.2)</b>	<b>88.7%</b>	<b>88.6%</b>
Product revenue gross profit	5.2	6.6	(1.4)	9.0%	8.0%	10.7	13.0	(2.3)	8.1%	7.5%
Service fee gross profit	3.0	6.2	(3.2)	23.9%	28.9%	8.8	13.1	(4.3)	29.7%	31.2%
Pass-through gross profit	—	—	—	—%	—%	—	—	—	—%	—%
<b>Total gross profit</b>	<b>8.2</b>	<b>12.8</b>	<b>(4.6)</b>	<b>9.9%</b>	<b>11.6%</b>	<b>19.5</b>	<b>26.1</b>	<b>(6.6)</b>	<b>11.3%</b>	<b>11.4%</b>
<b>Operating Expenses</b>	<b>10.7</b>	<b>12.1</b>	<b>(1.4)</b>	<b>12.9%</b>	<b>10.9%</b>	<b>21.4</b>	<b>24.3</b>	<b>(2.9)</b>	<b>12.4%</b>	<b>10.7%</b>
Income from operations	(2.5)	0.7	(3.2)	(3.0)%	0.7%	(1.9)	1.8	(3.7)	(1.1)%	0.7%
Interest expense, net	0.3	0.3	—	0.4%	0.3%	0.7	0.7	—	0.4%	0.3%
Income before income taxes	(2.8)	0.4	(3.2)	(3.4)%	0.4%	(2.6)	1.1	(3.7)	(1.5)%	0.4%
Income tax expense, net	(0.3)	0.3	0.6	(0.4)%	0.4%	0.2	0.6	(0.4)	0.1%	0.3%
<b>Net income (loss)</b>	<b>\$ (2.5)</b>	<b>\$ 0.1</b>	<b>\$ (2.6)</b>	<b>(3.0)%</b>	<b>—%</b>	<b>\$ (2.8)</b>	<b>\$ 0.5</b>	<b>\$ (3.3)</b>	<b>(1.6)%</b>	<b>0.1%</b>

- (1) % of net revenues represents the percent of Product revenue, net.
- (2) % of net revenues represents the percent of Service fee revenue.
- (3) % of net revenues represents the percent of Pass-through revenue.

*Product Revenue, net.* eCOST product revenue was \$20.3 million in the three months ended June 30, 2009, an 11.9% decrease as compared to \$23.0 million in the comparable quarter of the prior year. eCOST product revenue was \$41.2 million in the six months ended June 30, 2009, a 19.2% decrease as compared to \$51.0 million in the comparable quarter of the prior year. The decreases are primarily due to a decline in sales in its business to business channel resulting from the impact of the current economic environment and eCOST's reduced emphasis on this lower margin channel. Partially offsetting these decreases is an increase in sales in the higher margin business to consumer sales channel, primarily due to continued emphasis on growth through an expanded product line, improved service capabilities and enhanced website capabilities.

Supplies Distributors product revenue of \$45.3 million decreased \$14.8 million, or 24.6%, in the three months ended June 30, 2009 as compared to the same quarter of the prior year. Product revenue of \$90.6 million decreased \$31.7 million, or 25.9%, in the six months ended June 30, 2009 as compared to the same period of the prior year. The decreases are primarily due to decreased sales volume resulting from the impact of the overall global economic pressures and inventory rationalization by customers. In addition, product revenue in the six months ended June 30, 2009 was negatively impacted by a \$1.4 million reduction of revenue arising from a customer bankruptcy.

## [Table of Contents](#)

*Service Fee Revenue.* Service fee revenue of \$12.4 million decreased \$8.9 million, or 41.8%, in the three months ended June 30, 2009 as compared to the same quarter of the prior year. Service fee revenue of \$29.5 million decreased \$12.6 million, or 29.9%, in the six months ended June 30, 2009 as compared to the same period of the prior year. The decrease in service fee revenue for the three and six months ended June 30, 2009 is primarily due to the non-renewal of a certain U.S. government agency client relationship partially offset by increased service fees generated from the impact of new service contract relationships. The change in service fee revenue is shown below (\$ millions):

	Three Months	Six Months
Period ended June 30, 2008	\$ 21.3	\$ 42.1
New service contract relationships, including certain incremental projects under new contracts	1.9	2.8
Change in existing client service fees	(9.7)	(13.9)
Terminated clients not included in 2009 revenue	(1.1)	(1.5)
Period ended June 30, 2009	<u>\$ 12.4</u>	<u>\$ 29.5</u>

The impact of the non-renewal of the U.S. government agency client is included in the existing client line item above as there was activity with this client in each period presented.

*Cost of Product Revenue.* The gross margin for eCOST was \$1.9 million or 9.7% of product revenue in the three months ended June 30, 2009 and \$1.9 million or 8.3% of product revenue during the comparable period of 2008. The gross margin for eCOST was \$4.0 million or 9.7% of product revenue in the six months ended June 30, 2009 and \$4.1 million or 8.1% of product revenue during the comparable period of 2008. The increase in gross margin percentage in both periods is primarily due to a shift in product sales to the higher margin business-to-consumer channel. As we continue to target an increasing percentage of eCOST revenues to be generated from the business-to-consumer channel, we expect overall gross margin for eCOST in 2009 will continue to be higher than the prior year.

Supplies Distributors cost of product revenue decreased by \$13.2 million, or 24.0%, to \$42.0 million in the three months ended June 30, 2009 primarily as a result of decreased product sales. The resulting gross profit margin was \$3.3 million, or 7.3% of product revenue, for the three months ended June 30, 2009 and \$4.8 million, or 8.0% of product revenue, for the comparable 2008 period. Supplies Distributors cost of product revenue decreased by \$29.6 million, or 26.0%, to \$83.9 million in the six months ended June 30, 2009 primarily as a result of decreased product sales. The resulting gross profit margin was \$6.7 million, or 7.4% of product revenue, for the six months ended June 30, 2009 and \$8.8 million, or 7.2% of product revenue, for the comparable 2008 period. The 2008 three and six month periods include the impact of certain incremental inventory cost reductions. The 2009 margin percentages include an increase due to incremental gross margin earned on product sales resulting from certain product price increases, which is partially offset by a reduction in revenue arising from a customer bankruptcy during the first quarter of 2009.

*Cost of Service Fee Revenue.* Gross profit as a percentage of service fees was 23.9% in the three months ended June 30, 2009, compared to 28.9% in the same period of the prior year. Gross profit as a percentage of service fees was 29.7% in the six months ended June 30, 2009, compared to 31.2% in the same period of the prior year. The margins in the prior year periods included the benefit of six months of higher margin incremental project work associated with the U.S. government contract relationship that was not renewed and was completed in the second quarter of 2009.

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

*Operating Expenses.* Operating expenses for the three months ended June 30, 2009 decreased \$1.4 million to \$10.7 million from \$12.1 million in the same 2008 period. As a percentage of total net revenue, operating expenses were 12.9% in the three months ended June 30, 2009 and 10.9% in the comparable period. The increase in percentage of total net sales is primarily due to the reduction in total net revenues and the impact of certain personnel related expenses.

## Table of Contents

Operating expenses for the six months ended June 30, 2009 decreased \$2.9 million to \$21.4 million from \$24.3 million in the same 2008 period. As a percentage of total net revenue, operating expenses were 12.4% in the six months ended June 30, 2009 and 10.7% in the comparable period. The increase in percentage of total net sales is primarily due to the reduction in total net revenues and the impact of certain personnel related expenses. During the six months ended June 30, 2009, we implemented certain cost reductions, primarily including personnel related adjustments, to help reduce the impact of the lower service fee revenue.

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

### **Liquidity and Capital Resources**

Net cash provided by operating activities was \$4.6 million for the six months ended June 30, 2009, and primarily resulted from a \$12.2 million decrease in accounts receivable, a decrease in inventories of \$6.3 million, cash income before working capital changes of \$1.4 million and a \$1.3 million decrease in prepaid expenses, other receivables and other assets, partially offset by a \$16.6 million decrease in accounts payable, accrued expenses and other liabilities.

Net cash provided by operating activities was \$11.6 million for the six months ended June 30, 2008, and primarily resulted from a \$10.0 million of increase in accounts payable, accrued expenses and other liabilities, a \$8.8 million decrease in accounts receivable and cash income before working capital changes of \$4.6 million. These benefits were offset by a \$5.9 million increase in prepaid expenses, other receivables and other assets and a \$5.8 million increase in inventories.

Net cash used in investing activities for the six months ended June 30, 2009 and 2008 totaled \$1.9 million and \$1.8 million, respectively, resulting primarily from capital expenditures.

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

Net cash used in financing activities was approximately \$3.9 million for the six months ended June 30, 2009, primarily representing payments on debt and capital lease obligations.

Net cash used in financing activities was approximately \$10.4 million for the six months ended June 30, 2008, primarily representing payments on debt and capital lease obligations and a \$1.7 million increase in restricted cash.

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

## [Table of Contents](#)

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

During the six months ended June 30, 2009, our working capital decreased to \$17.1 million from \$21.4 million at December 31, 2008, partially due to the reclassification of our taxable revenue bonds to short-term debt due to the April 2010 maturing of the related letters of credit securing the taxable revenue bonds and the paydown of other long-term debt facilities. To obtain additional financing in the future, in addition to our current cash position, we plan to evaluate various financing alternatives including the sale of equity, utilizing capital or operating leases, borrowing under our credit facilities, expanding our current credit facilities, entering into new debt agreements or transferring to third parties a portion of our subordinated loan balance due from Supplies Distributors. In conjunction with certain of these alternatives, we may be required to provide certain letters of credit to secure these arrangements. We currently believe that our cash position, financing available under our credit facilities and funds generated from operations (including cost reductions related to the nonrenewal of our U.S. government contract) will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our current debt and lease obligations, and additional loans to our subsidiaries Supplies Distributors and eCOST, if necessary, for at least the next twelve months.

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

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

Contractual Obligations	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Debt and vendor financing	\$ 53,450	\$ 52,377	\$ 875	\$ 198	\$ —
Capital lease obligations	2,693	1,746	940	7	—
Operating leases	17,836	8,050	7,929	1,857	—
Total	<u>\$ 73,979</u>	<u>\$ 62,173</u>	<u>\$ 9,744</u>	<u>\$ 2,062</u>	<u>\$ —</u>

In support of certain debt instruments and leases, as of June 30, 2009, we had \$2.1 million of cash restricted for repayment to lenders. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain of our subsidiaries' credit facilities. Many of these facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other credit facilities and agreements. These covenants include minimum levels of net worth for the individual borrower subsidiaries and restrictions on the ability of the borrower subsidiaries to advance funds to other borrower subsidiaries. As a result, it is possible for one or more of these borrower subsidiaries to fail to meet their respective covenants even if another borrower subsidiary otherwise has available excess funds, which, if not restricted, could be used to cure the default. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders' equity, and the lenders accelerate the repayment of the credit facility obligations, we would be required to repay all amounts outstanding thereunder. In particular, in the event eCOST is unable to increase its revenue and/or gross profit from its present levels, or if PFS service fee revenue declines from expected levels and it is unable to reduce costs to correspond to such reduced revenue levels or if Supplies Distributors revenue or gross profit declines from expected levels, such events may result in a breach of one or more of the financial covenants required under its working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding



## Table of Contents

thereunder and exercise all other rights and remedies, including sale of collateral and payment under our parent guaranty. A requirement to accelerate the repayment of the credit facility obligations would have a material adverse impact on our financial condition and results of operations. We can provide no assurance that we will have the financial ability to repay all of such obligations. As of June 30, 2009, we were in compliance with all debt covenants. We do not have any other material financial commitments, although future client contracts may require capital expenditures and lease commitments to support the services provided to such clients.

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

To finance their distribution of IPS products, Supplies Distributors and its subsidiaries have short-term credit facilities with IBM Credit LLC (“IBM Credit”) and IBM Belgium Financial Services S.A. (“IBM Belgium”). We have provided a collateralized guaranty to secure the repayment of these credit facilities. These asset-based credit facilities provided financing for up to \$30.5 million and up to 16.0 million euros (approximately \$22.6 million) with IBM Credit and IBM Belgium, respectively. These agreements expire in March 2010.

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

Supplies Distributors’ European subsidiary has a factoring agreement with Fortis Commercial Finance N.V. (“Fortis”) to provide factoring for up to 7.5 million euros (approximately \$10.6 million) of eligible accounts receivables through March 2010.

These credit facilities contain cross default provisions, various restrictions upon the ability of Supplies Distributors and its subsidiaries to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as cash flow from operations, annualized revenue to working capital, net profit after tax to revenue, minimum net worth and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors of no less than \$5.0 million, not maintain restricted cash of more than \$5.0 million, are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure and a minimum shareholders’ equity of at least \$18.0 million. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries under these facilities if they are unable to do so. We have also provided a guarantee of the obligations of Supplies Distributors and its subsidiaries to IBM and IPS, excluding the trade payables that are financed by IBM credit.

Our subsidiary, Priority Fulfillment Services, Inc. (“PFS”), has a Loan and Security Agreement (“Agreement”) with Comerica Bank (“Comerica”), which provides for up to \$10.0 million of eligible accounts receivable financing through March 2010. We entered this Agreement to supplement our existing cash position, and provide funding for our current and future operations, including our targeted growth. The Agreement contains cross default provisions, various restrictions upon our ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to subsidiaries, affiliates and related parties (including entities directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation

## Table of Contents

accruals, if any, as defined, and a minimum liquidity ratio, as defined. The agreement also limits PFS' ability to increase the subordinated loan to Supplies Distributors to more than \$6.5 million and permits PFS to advance incremental amounts subject to certain cash inflows to PFS, as defined, to certain of its subsidiaries and/or affiliates, including eCOST. The Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb.

eCOST currently has an asset-based line of credit facility of up to \$7.5 million with Wachovia, which is collateralized by substantially all of eCOST's assets and expires in May 2011. Borrowings under the facility are limited to a percentage of eligible accounts receivable and letter of credit availability is limited to a percentage of accounts receivable and inventory. As of June 30, 2009, eCOST had \$1.0 million of letters of credit outstanding and \$1.3 million of available credit under this facility. The credit facility restricts eCOST's ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as a minimum tangible net worth of \$0 million, as defined. PFSweb has guaranteed all current and future obligations of eCOST under this line of credit.

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

To the extent we fail to comply with the various debt covenants described above, 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, 2009, we were in compliance with all debt covenants.

eCOST has historically incurred significant operating losses and used cash to fund its operations. As a result, we have been required to invest cash to fund eCOST's operations, which we may not be able to continue to do without approval from our lenders. The amount of further cash needed to support eCOST operations depends upon the financing available under its credit line as well as eCOST's ability to improve its financial results. Through June 30, 2009, we have advanced \$15.6 million to eCOST to fund eCOST's cash flow requirements and have lender approval to advance incremental amounts subject to certain cash inflows to PFS, as defined, to certain of our subsidiaries and/or affiliates, including eCOST. In the event we need to invest further cash to eCOST, we may be required to seek approval from our lenders to provide such funds. We can provide no assurance that we will receive such approval from our lenders or any terms or conditions required by our lenders in order to obtain such approval. In addition, PFSweb has provided a guaranty of eCOST's bank line of credit and certain eCOST vendor trade payables.

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

**Seasonality**

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

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

**Inflation**

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

**Critical Accounting Policies**

A description of our critical accounting policies, including goodwill and long-lived assets, is included in Note 2 of the consolidated financial statements in our December 31, 2008 Annual Report on Form 10-K.

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

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

#### *Interest Rate Risk*

Our interest rate risk exists from our outstanding balances on our inventory and working capital financing agreements, taxable revenue bonds, factoring agreement, and loan and security agreements for the financing of inventory, accounts receivable and certain other receivables and certain equipment, which amounted to \$51.8 million at June 30, 2009. A 100 basis point movement in interest rates would result in approximately \$0.3 million annualized increase or decrease in interest expense based on the outstanding balance of these agreements at June 30, 2009.

#### *Foreign Exchange Risk*

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

### **ITEM 4. Controls and Procedures**

#### *Disclosure Controls and Procedures*

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

#### *Changes in Internal Control over Financial Reporting*

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

## **PART II. OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

None.

### **ITEM 1A. Risk Factors**

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

#### **Risks Related to All Our Business Segments**

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

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

Our business and future growth currently depend on our ability to access bank and commercial lines of credit. We currently depend on an aggregate of approximately \$110 million in credit facilities provided by various banks and commercial lenders. These facilities currently mature at various dates through May 2011 and are secured by substantially all our assets. Our ability to renew our credit facilities depends upon various factors, including the availability of bank loans and commercial credit in general, as well as our financial condition and prospects. Therefore, we cannot guarantee that these credit facilities will continue to be available beyond their current maturity on reasonable terms or at all. Our inability to renew or replace our credit facilities or find alternative financing would materially adversely affect our business, financial condition, operating results and cash flow.

#### **Risks Related to Our PFS and Supplies Distributors Operating Segments**

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

For the six months ended June 30, 2009 and 2008, a U.S. government agency and Xerox Corporation represented the source of approximately 13% and 15%, respectively, and approximately 39% and 10%, respectively, of our total service fee revenue, excluding pass-through revenue. The loss of, or non-payment of invoices by, any or all such clients would have a material adverse effect upon our business. In particular, the agreements under which we provide services to such clients are terminable at will upon notice by such clients. Our activity under our contract with the U.S. government agency concluded in the second quarter of 2009 and the nonrenewal of that contract, as well as the loss of, or non-payment of invoices by, any or all of such other clients are likely to have a material adverse effect upon our business.

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

Sales by Supplies Distributors to two customers accounted for approximately 31% and 29% of Supplies Distributors' total product revenue for the six months ended June 30, 2009 and 2008, respectively (17% and 15% of our consolidated net revenues in each six month period, respectively). The loss of any one or both of such customers, or non-payment of any material amount by these or any other customer, are likely to have a material adverse effect upon Supplies Distributors' business.

**Risks Related to eCOST, our Online Discount Retailer Segment**

***Our business is subject to the risk of supplier concentration.***

Our business is dependent on sales of Hewlett Packard (HP) and HP-related products, which represented approximately 42% of eCOST's net revenues (10% of our consolidated net revenues) in the six months ended June 30, 2009 and 52% of eCOST's net revenues (12% of our consolidated net revenues) in the comparable period of 2008. If our ability to purchase direct from HP is terminated or restricted, or if the demand for HP and HP-related products declines, our business will be materially adversely affected.

**ITEM 2. Changes in Securities and Use of Proceeds**

None

**ITEM 3. Defaults Upon Senior Securities**

None

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

On June 5, 2009, the Company held its Annual Meeting of Stockholders. The following matters were acted upon and votes cast or withheld:

1. Election of Directors:

David I. Beatson For: 8,314,481 Withheld: 553,718

James F. Reilly For: 8,030,449 Withheld: 837,750

2. Approval to Amend the Company's Amended and Restated Certificate of Incorporation:

For: 8,505,350 Against: 265,996 Abstentions: 96,853 No Vote: 1,073,941

3. Approval of the Amendments to the Company's 2005 Employee Stock and Incentive Plan:

For: 3,591,842 Against: 431,241 Abstentions: 13,237 No Vote: 5,905,820

4. Approval of the Amendments to the Company's Non-Employee Director Stock Option and Retainer Plan:

For: 3,574,247 Against: 446,090 Abstentions: 15,983 No Vote: 5,905,820

5. Appointment of Grant Thornton LLP as auditors for the fiscal year ending December 31, 2009:

For: 8,798,636 Against: 67,118 Abstentions: 2,445 No Vote: 1,073,941

**ITEM 5. Other Information**

None

[Table of Contents](#)

**ITEM 6. Exhibits**

a) Exhibits:

<b>Exhibit No.</b>	<b>Description of Exhibits</b>
3.1(1)	Amended and Restated Certificate of Incorporation
3.1.1*	Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.
3.2(1)	Amended and Restated Bylaws
10.1*	Amended and Restated 2005 Employee Stock and Incentive Plan of PFSweb, Inc.
10.2*	Amended and Restated Non-Employee Director Stock Option and Retainer Plan of PFSweb, Inc.
31.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

---

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

\* Filed Herewith

**SIGNATURE**

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

Date: August 14, 2009

PFSweb, Inc.

By: /s/ Thomas J. Madden

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



CERTIFICATE OF AMENDMENT  
TO  
CERTIFICATE OF INCORPORATION  
OF  
PFSWEB, INC.

(Pursuant to Section 242 of the General Corporation Law of the State of Delaware)

PFSWEB, INC., a corporation organized and existing under the General Corporation Law of the State of Delaware, hereby certifies that:

FIRST: The name of the corporation is PFSweb, Inc.

SECOND: At a meeting of the Board of Directors of PFSweb, Inc., resolutions were duly adopted declaring the advisability of an amendment to the Certificate of Incorporation, as follows, and providing that:

“Article FOURTH of Certificate of Incorporation of PFSweb, Inc. shall be hereby amended to read as follows:

“FOURTH: The total number of shares of stock which the Corporation shall have authority to issue is 36,000,000 shares, divided into two classes as follows: (i) 1,000,000 shares of Preferred Stock, par value \$1.00 per share (“Preferred Stock”); and (ii) 35,000,000 shares of Common Stock, par value \$.001 per share (“Common Stock”).”

THIRD: This Certificate of Amendment of Certificate of Incorporation was duly approved at a duly held meeting of the stockholders of the Corporation in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Amendment to be signed by the undersigned as of the 6th day of June, 2009.

PFSweb, Inc.

By: /s/ Thomas J. Madden

Thomas J. Madden  
Executive Vice President  
Chief Financial Officer

**PFSWEB, INC. 2005 EMPLOYEE STOCK AND INCENTIVE PLAN**

WHEREAS, PFSweb, Inc., a Delaware corporation (the “Company”) has adopted that certain 1999 Employee Stock Option Plan (the “1999 Plan”); and

WHEREAS, the Company has authorized and adopted the 2005 Employee Stock and Incentive Plan, as an amendment and restatement of the 1999 Plan (as so amended and restated, the Plan”); and

WHEREAS, subject to the requisite approval of the Company’s stockholders at the Company’s 2009 Annual Meeting of Stockholders, the Company has authorized and adopted certain amendments to the Plan;

NOW, THEREFORE, in order to implement and effectuate said amendments, the Plan, as so amended, shall read as follows:

**ARTICLE 1  
PURPOSE**

1.1. GENERAL. The PFSweb, Inc. 2005 Employee Stock and Incentive Plan is designed to focus management on business performance that creates stockholder value; encourage innovative approaches to the business of the Company; reward for results; and encourage ownership of Company common stock by management.

**ARTICLE 2  
DEFINITIONS**

2.1. DEFINITIONS. As used herein the following words and phrases shall have the following meanings:

(a) “Affiliate” means (i) any Subsidiary or Parent, or (ii) any entity of which the Company owns or controls, directly or indirectly, 10% of more of the outstanding shares of stock entitled to vote for the election of directors, or of comparable equity participation and voting power.

(b) “Award” means any Option, Stock Appreciation Right, Restricted Stock Award, Restricted Stock Unit Award, Deferred Stock Unit Award, Performance Award, Dividend Equivalent Award, Other Stock-Based Award, Performance-Based Cash Awards, or any other right or interest relating to Stock or cash, granted to a Participant under the Plan. A “Full-Value Award” means an Award other than in the form of an Option or Stock Appreciation Right, and which is settled by the issuance of Shares.

(c) “Award Certificate” means a written document, in such form as the Committee prescribes from time to time, setting forth the terms and conditions of an Award. Award Certificates may be in the form of individual award agreements or certificates or a program document describing the terms and provisions of an Awards or series of Awards under the Plan.

(d) “Board” means the Board of Directors of the Company.

(e) “Cause” means, with respect to a Participant’s termination of employment or termination of consultancy, the following: (a) in the case where there is no employment agreement, consulting agreement, change in control agreement or similar agreement in effect between the Company or an Affiliate and the Participant at the time of determination (or such an agreement does not define “cause” (or words of like import)), (i) a Participant’s gross negligence or willful misconduct with regard to the Company or an Affiliate or their assets, (ii) a Participant’s misappropriation or fraud with regard to the Company or an Affiliate or their assets (other than good-faith expense account disputes), (iii) a Participant’s willful and continued failure to substantially perform the Participant’s duties (other than any such failure resulting from incapacity due to physical or mental illness), which is not remedied within 10 days of delivery of notice to the Participant thereof, (iv) a Participant’s conviction of, or the pleading of guilty or nolo contendere to, a felony or criminal offense punishable by a term of imprisonment (other than a traffic violation), or (v) the Participant’s willful violation of any written policy of the Company or an Affiliate or breach of

---

any confidentiality or non-competition covenant entered into between the Participant and the Company or an Affiliate; or (b) in the case where there is an employment agreement, consulting agreement, change in control agreement or similar agreement in effect between the Company or an Affiliate and the Participant at the time of determination that defines “cause” (or words of like import), “cause” as defined under such agreement; provided, however, that with regard to any agreement under which the definition of “cause” only applies on occurrence of a Change in Control, such definition of “cause” shall not apply until a Change in Control actually takes place and then only with regard to a termination thereafter, and prior to a Change in Control “cause” shall be defined as provided in subsection (a) above. With respect to a Participant’s termination of directorship, “cause” means an act or failure to act that constitutes cause for removal of a director under applicable Delaware law. The determination of the Committee as to the existence of “Cause” shall be conclusive on the Participant and the Company.

(f) “Change in Control” unless otherwise determined by the Committee in the applicable Award Certificate, a “Change in Control” shall be deemed to have occurred after the Effective Date:

(1) upon any “person” as such term is used in Sections 13(d) and 14(d) of the 1934 Act (other than the Company, any trustee or other fiduciary holding securities under any employee benefit plan of the Company, or any company owned, directly or indirectly, by all of the stockholders of the Company in substantially the same proportions as their ownership of Stock of the Company), becoming the owner (as defined in Rule 13d-3 under the 1934 Act), directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the combined voting power of the Company’s then outstanding securities (including, without limitation, securities owned at the time of any increase in ownership);

(ii) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board, and any new director (other than (x) a director designated by a person who has entered into an agreement with the Company to effect a transaction described in paragraph (i) or (iii) of this section, or (y) a director whose initial assumption of office occurs as a result of either an actual or threatened election contest (as such terms are used in Rule 14a-11 of Regulation 14A promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a person other than the Board) whose election by the Board or nomination for election by the Company’s stockholders was approved by a vote of at least two-thirds of the directors then still in office who either were directors at the beginning of the two-year period or whose election or nomination for election was previously so approved (the “Incumbent Board”), cease for any reason to constitute at least a majority of the Board;

(iii) upon the merger or consolidation of the Company with, or the sale of all or substantially all of the assets of the Company to, any other corporation or other entity, in each case, unless, following such merger, consolidation or sale (A) the voting securities of the Company outstanding immediately prior thereto continue to represent (either by remaining outstanding or by being converted into voting securities of the surviving or purchasing entity (the “Surviving Entity”)) more than fifty percent (50%) of the combined voting power of the voting securities of the Company or the Surviving Entity outstanding immediately after such merger, consolidation or sale; and (B) at least a majority of the members of the board of directors of the Surviving Entity were Incumbent Directors at the time of the execution of the initial agreement, or of the action of the Board, providing for such merger, consolidation or sale; or

(iv) upon the approval by the Company’s stockholders of a plan of complete liquidation or dissolution of the Company.

Notwithstanding the foregoing, for any Awards that constitute a nonqualified deferred compensation plan within the meaning of Section 409A(d) of the Code, Change in Control shall have the same meaning as set forth in any regulations, revenue procedure or revenue rulings issued by the Secretary of the United States Treasury applicable to such plans.

(g) “Code” means the Internal Revenue Code of 1986, as amended from time to time, and includes a reference to the underlying final regulations.

(h) “Committee” means the committee of the Board described in Article 4.

(i) “Company” means PFSweb, Inc., a Delaware corporation, or any successor corporation.

(j) “Continuous Status as a Participant” means the absence of any interruption or termination of service as an employee, officer, consultant or director of the Company or any Affiliate, as applicable; provided, however, that for purposes of an Incentive Stock Option, or a Stock Appreciation Right issued in tandem with an Incentive Stock Option, “Continuous Status as a Participant” means the absence of any interruption or termination of service as an employee of the Company or any Parent or Subsidiary, as applicable, pursuant to applicable tax regulations. Continuous Status as a Participant shall continue to the extent provided in a written severance or employment agreement during any period for which severance compensation payments are made to an employee, officer, consultant or director and shall not be considered interrupted in the case of any short-term disability or leave of absence authorized in writing by the Company prior to its commencement; provided, however, that for purposes of Incentive Stock Options, no such leave may exceed 90 days, unless reemployment upon expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, on the 91st day of such leave any Incentive Stock Option held by the Participant shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Nonstatutory Stock Option. Notwithstanding the foregoing, for any Awards that constitute a nonqualified deferred compensation plan within the meaning of Section 409A(d) of the Code, Continuous Status as a Participant shall mean the absence of any “separation from service” or similar concept as set forth in any regulations, revenue procedure or revenue rulings issued by the Secretary of the United States Treasury applicable to such plans.

(k) “Covered Employee” means a covered employee as defined in Code Section 162(m)(3).

(l) “Deferred Stock Unit” means a right granted to a Participant under Article 11.

(m) “Disability” or “Disabled” has the same meaning as provided in the long-term disability plan or policy maintained by the Company or if applicable, most recently maintained, by the Company or if applicable, an Affiliate, for the Participant, whether or not such Participant actually receives disability benefits under such plan or policy. If no long-term disability plan or policy was ever maintained on behalf of Participant or if the determination of Disability relates to an Incentive Stock Option, or a Stock Appreciation Right issued in tandem with an Incentive Stock Option, Disability means Permanent and Total Disability as defined in Section 22(e)(3) of the Code. In the event of a dispute, the determination whether a Participant is Disabled will be made by the Committee and may be supported by the advice of a physician competent in the area to which such Disability relates. Notwithstanding the foregoing, for any Awards that constitute a nonqualified deferred compensation plan within the meaning of Section 409A(d) of the Code, Disability shall have the same meaning as set forth in any regulations, revenue procedure or revenue rulings issued by the Secretary of the United States Treasury applicable to such plans.

(n) “Dividend Equivalent” means a right granted to a Participant under Article 12.

(o) “Effective Date” has the meaning assigned such term in Section 3.1.

(p) “Eligible Participant” means an employee, officer, consultant or director of the Company or any Affiliate.

(q) “Exchange” means the Nasdaq National Market, Small Cap Market or any other national securities exchange on which the Stock may from time to time be listed or traded.

(r) “Fair Market Value”, on any date, means (i) if the Stock is listed on a securities exchange or is traded over the Nasdaq Capital Market, the closing sales price on such exchange or over such system on such date or, in the absence of reported sales on such date, the closing sales price on the immediately preceding date on which sales were reported, or (ii) if the Stock is not listed on a securities exchange or traded over the Nasdaq Capital Market, the mean between the bid and offered prices as quoted by Nasdaq for such date, provided that if it is determined that the fair market value is not properly reflected by such Nasdaq quotations, Fair Market Value will be determined by such other method as the Committee determines in good faith to be reasonable.

(s) “Good Reason” means, with respect to a Participant’s termination of employment or termination of consultancy, the following: (a) in the case where there is no employment agreement, consulting agreement, change

in control agreement or similar agreement in effect between the Company or an Affiliate and the Participant at the time of determination (or such an agreement does not define “good reason” (or words of like import)), without the Participant’s consent: (i) a reduction in the Participant’s base salary as then in effect, or (ii) a material reduction, measured in terms of aggregate value rather than on an individual benefit basis, of employee benefits to which the Participant is entitled (other than an overall reduction in benefits that affects substantially all full-time employees of the Company and its Affiliates); provided that any event described in clause (i) or (ii) above shall constitute Good Reason only if the Company fails to cure such event within 20 days after receipt from the Participant of written notice of the event which constitutes Good Reason; and provided, further, that Good Reason shall cease to exist for an event on the 60th day following the later of its occurrence or the Participant’s knowledge thereof, unless the Participant has given the Company written notice thereof prior to such date; or (b) in the case where there is an employment agreement, consulting agreement, change in control agreement or similar agreement in effect between the Company or an Affiliate and the Participant at the time of determination that defines “good reason” (or words of like import), “good reason” as defined under such agreement; provided, however, that with regard to any agreement under which the definition of “good reason” only applies on occurrence of a Change in Control, such definition of “good reason” shall not apply until a Change in Control actually takes place and then only with regard to a termination thereafter, and prior to a change in control “good reason” shall be defined as provided in subsection (a) above.

(t) “Grant Date” of an Award means the first date on which all necessary corporate action has been taken to approve the grant of the Award as provided in the Plan, or such later date as is determined and specified as part of that authorization process.

(u) “Incentive Stock Option” means an Option that is intended to be an incentive stock option and meets the requirements of Section 422 of the Code or any successor provision thereto.

(v) “Non-Employee Director” means a director of the Company who is not a common law employee of the Company or an Affiliate.

(w) “Nonstatutory Stock Option” means an Option that is not an Incentive Stock Option.

(x) “Option” means a right granted to a Participant under Article 7 of the Plan to purchase Stock at a specified price during specified time periods. An Option may be either an Incentive Stock Option or a Nonstatutory Stock Option.

(y) “Other Stock-Based Award” means a right, granted to a Participant under Article 13, that relates to or is valued by reference to Stock or other Awards relating to Stock.

(z) “Parent” means a corporation, limited liability company, partnership or other entity which owns or beneficially owns a majority of the outstanding voting stock or voting power of the Company. Notwithstanding the above, with respect to an Incentive Stock Option, Parent shall have the meaning set forth in Section 424(e) of the Code.

(aa) “Participant” means a person who, as an employee, officer, director or consultant of the Company or any Affiliate, has been granted an Award under the Plan; provided that in the case of the death of a Participant, the term “Participant” refers to a beneficiary designated pursuant to Section 15.5 or the legal guardian or other legal representative acting in a fiduciary capacity on behalf of the Participant under applicable state law.

(bb) “Performance Award” means Performance Shares, Performance Units or Performance-Based Cash Awards granted pursuant to Article 9.

(cc) “Performance-Based Cash Award” means a right granted to a Participant under Article 9 to a cash award to be paid upon achievement of such performance goals as the Committee establishes with regard to such Award.

(dd) “Performance Share” means any right granted to a Participant under Article 9 to a share to be valued by reference to a designated number of Shares to be paid upon achievement of such performance goals as the Committee establishes with regard to such Performance Share.

(ee) “Performance Unit” means a right granted to a Participant under Article 9 to a unit valued by reference to a designated amount of cash or property other than Shares, to be paid to the Participant upon achievement of such performance goals as the Committee establishes with regard to such Performance Unit.

(ff) “Person” means any individual, entity or group, within the meaning of Section 3(a)(9) of the 1934 Act and as used in Section 13(d)(3) or 14(d)(2) of the 1934 Act.

(gg) “Plan” means this PFSweb, Inc. 2005 Employee Stock and Incentive Plan, as amended or supplemented from time to time.

(hh) “Qualified Performance-Based Award” means an Award granted to an officer of the Company that is either (i) intended to qualify for the Section 162(m) Exemption and is made subject to performance goals based on Qualified Business Criteria as set forth in Section 14.2, or (ii) an Option or SAR having an exercise price equal to or greater than the Fair Market Value of the underlying Stock as of the Grant Date.

(ii) “Qualified Business Criteria” means one or more of the Business Criteria listed in Section 14.2 upon which performance goals for certain Qualified Performance-Based Awards may be established by the Committee.

(jj) “Restricted Stock Award” means Stock granted to a Participant under Article 10 that is subject to certain restrictions and to risk of forfeiture.

(kk) “Restricted Stock Unit Award” means the right granted to a Participant under Article 10 to receive Shares (or the equivalent value in cash or other property) in the future, which right is subject to certain restrictions and to risk of forfeiture.

(ll) “Retirement” means a Participant’s voluntary termination of employment or consultancy at or after age sixty-five (65) or such earlier retirement date as may be approved by the Committee with regard to such Participant. With respect to a Participant’s termination of service as a director, Retirement means the failure to stand for reelection or other retirement as a director after a Participant has attained age sixty-five (65) or such earlier retirement date as may be approved by the Committee with regard to such Participant.

(mm) “Section 162(m) Exemption” means the exemption from the limitation on deductibility imposed by Section 162(m) of the Code that is set forth in Section 162(m)(4)(C) of the Code or any successor provision thereto.

(nn) “Shares” means shares of the Company’s Stock. If there has been an adjustment or substitution pursuant to Section 16.1, the term “Shares” shall also include any shares of stock or other securities that are substituted for Shares or into which Shares are adjusted pursuant to Section 16.1.

(oo) “Stock” means the common stock of the Company and such other securities of the Company as may be substituted for Stock pursuant to Article 16.

(pp) “Stock Appreciation Right” or “SAR” means a right granted to a Participant under Article 8 to receive a payment equal to the difference between the Fair Market Value of a Share as of the date of exercise of the SAR over the grant price of the SAR, all as determined pursuant to Article 8.

(qq) “Subsidiary” means any corporation, limited liability company, partnership or other entity of which a majority of the outstanding voting stock or voting power is beneficially owned directly or indirectly by the Company. Notwithstanding the above, with respect to an Incentive Stock Option, Subsidiary shall have the meaning set forth in Section 424(f) of the Code.

(rr) “1933 Act” means the Securities Act of 1933, as amended from time to time.

(ss) "1934 Act" means the Securities Exchange Act of 1934, as amended from time to time.

### **ARTICLE 3 EFFECTIVE DATE**

3.1 EFFECTIVE DATE. The Plan shall be effective as of June 10, 2005 (the "Effective Date"). No further grants may be made under this Plan after December 31, 2014.

### **ARTICLE 4 ADMINISTRATION**

4.1. COMMITTEE. The Plan shall be administered by a Committee appointed by the Board (which Committee shall consist of at least two directors) or, at the discretion of the Board from time to time, the Plan may be administered by the Board. Unless otherwise designated by the Board, the Compensation Committee of the Board shall serve as the Committee administering the Plan. The Board may reserve to itself any or all of the authority and responsibility of the Committee under the Plan or may act as administrator of the Plan for any and all purposes. To the extent the Board has reserved any authority and responsibility or during any time that the Board is acting as administrator of the Plan, it shall have all the powers of the Committee hereunder, and any reference herein to the Committee (other than in this Section 4.1) shall include the Board. To the extent any action of the Board under the Plan conflicts with actions taken by the Committee, the actions of the Board shall control.

4.2. ACTION AND INTERPRETATIONS BY THE COMMITTEE. For purposes of administering the Plan, the Committee may from time to time adopt rules, regulations, guidelines and procedures for carrying out the provisions and purposes of the Plan and make such other determinations, not inconsistent with the Plan, as the Committee may deem appropriate. The Committee's interpretation of the Plan, any Awards granted under the Plan, any Award Certificate and all decisions and determinations by the Committee with respect to the Plan are final, binding, and conclusive on all parties. Each member of the Committee is entitled to, in good faith, rely or act upon any report or other information furnished to that member by any officer or other employee of the Company or any Affiliate, the Company's or an Affiliate's independent certified public accountants, Company counsel or any executive compensation consultant or other professional retained by the Company to assist in the administration of the Plan.

4.3. AUTHORITY OF COMMITTEE. Except as provided below, the Committee has the exclusive power, authority and discretion to: (a) grant Awards; (b) designate Participants; (c) determine the type or types of Awards to be granted to each Participant; (d) determine the number of Awards to be granted and the number of Shares or dollar amount to which an Award will relate; (e) determine the terms and conditions of any Award granted under the Plan, including but not limited to, the exercise price, grant price, or purchase price, any restrictions or limitations on the Award, any schedule for lapse of forfeiture restrictions or restrictions on the exercisability of an Award, and accelerations or waivers thereof, based in each case on such considerations as the Committee in its sole discretion determines; (f) determine whether, to what extent, and under what circumstances an Award may be settled in, or the exercise price of an Award may be paid in, cash, Stock, other Awards, or other property, or an Award may be canceled, forfeited, or surrendered; (g) prescribe the form of each Award Certificate, which need not be identical for each Participant; (h) decide all other matters that must be determined in connection with an Award; (i) establish, adopt or revise any rules, regulations, guidelines or procedures as it may deem necessary or advisable to administer the Plan; (j) make all other decisions and determinations that may be required under the Plan or as the Committee deems necessary or advisable to administer the Plan; (k) amend the Plan or any Award Certificate as provided herein; and (l) adopt such modifications, procedures, and subplans as may be necessary or desirable to comply with provisions of the laws of non-U.S. jurisdictions in which the Company or any Affiliate may operate, in order to assure the viability of the benefits of Awards granted to participants located in such other jurisdictions and to meet the objectives of the Plan.

Notwithstanding the above, the Board or the Committee may, by resolution, expressly delegate to a special committee, consisting of one or more directors who are also officers of the Company, the authority, within specified parameters, to (i) designate Eligible Participants to be recipients of Awards under the Plan, and (ii) to determine the number of such Awards to be granted to any such Participants; provided that such delegation of duties and responsibilities to such special committee may not be made with respect to the grant of Awards to eligible

participants (a) who are subject to Section 16(a) of the 1934 Act at the Grant Date, or (b) who as of the Grant Date are reasonably anticipated to become Covered Employees during the term of the Award. The acts of such delegates shall be treated hereunder as acts of the Board and such delegates shall report regularly to the Board or the Committee regarding the delegated duties and responsibilities and any Awards so granted.

4.4. AWARD CERTIFICATES. Each Award shall be evidenced by an Award Certificate. Each Award Certificate shall include such provisions, not inconsistent with the Plan, as may be specified by the Committee.

## **ARTICLE 5 SHARES SUBJECT TO THE PLAN**

5.1. NUMBER OF SHARES. Subject to adjustment as provided in Sections 5.2 and 16.1, the aggregate number of Shares reserved and available for issuance pursuant to Awards granted under the Plan shall be 2,808,580. The maximum number of Shares that may be issued upon exercise of Incentive Stock Options granted under the Plan shall be the number determined in the preceding sentence.

### 5.2. SHARE COUNTING.

(a) To the extent that an Award is canceled, terminates, expires, is forfeited or lapses for any reason, any unissued Shares from such Award will again be available for issuance pursuant to Awards granted under the Plan.

(b) For purposes of computing how many Shares remain available for Awards under the Plan, each Share that is granted in a Full-Value Award will be counted against the Share limit set forth in Section 5.1 as 1.14 Shares. To the extent that a Full Value Award is canceled, terminates, expires, is forfeited or lapses for any reason, any unissued Shares from such Award will again be available for issuance pursuant to Awards granted under the Plan at the rate of 1.14 Shares.

(c) The following Shares may not again be made available for issuance as Awards under the Plan: (i) Shares not issued or delivered as a result of the net settlement of an outstanding Stock Appreciation right or Option, (ii) Shares used to pay the exercise price or withholding taxes related to an outstanding Award, or (iii) Shares repurchased on the open market with the proceeds of the Option exercise price.

(d) Substitute Awards granted pursuant to Section 15.13 of the Plan shall not count against the Shares otherwise available for issuance under the Plan under Section 5.1.

5.3. STOCK DISTRIBUTED. Any Stock distributed pursuant to an Award may consist, in whole or in part, of authorized and unissued Stock or treasury Stock.

5.4. LIMITATION ON AWARDS. Notwithstanding any provision in the Plan to the contrary (but subject to adjustment as provided in Section 16.1), the maximum number of Shares with respect to one or more Options and/or SARs that may be granted during any one calendar year under the Plan to any one Participant shall be 250,000. The maximum aggregate grant with respect to Awards of Restricted Stock, Restricted Stock Units, Deferred Stock Units, Performance Shares or other Stock-Based Awards (other than Options or SARs) granted in any one calendar year to any one Participant shall be 250,000. The aggregate dollar value of any Performance-Based Cash Award or other cash-based award that may be paid to any one Participant during any one calendar year under the Plan shall be \$2,500,000.

## **ARTICLE 6 ELIGIBILITY**

6.1. GENERAL. Awards may be granted only to Eligible Participants; except as limited for Incentive Stock Options under Section 7.2 (g).

## **ARTICLE 7 STOCK OPTIONS**



7.1. GENERAL. The Committee is authorized to grant Options to Participants on the following terms and conditions:

- (a) *Exercise Price*. The exercise price per Share under an Option shall be determined by the Committee; provided, however, that the exercise price of an Option (other than an Option issued as a substitute Award pursuant to Section 15.13) shall not be less than the Fair Market Value as of the Grant Date.
- (b) *Time and Conditions of Exercise*. The Committee shall determine the time or times at which an Option may be exercised in whole or in part, subject to Section 7.1(d). The Committee shall also determine the performance or other conditions, if any, that must be satisfied before all or part of an Option may be exercised or vested.
- (c) *Payment*. The Committee shall determine the methods by which the exercise price of an Option may be paid, the form of payment, including, without limitation, cash, Shares, or other property (including “cashless exercise” arrangements), and the methods by which Shares shall be delivered or deemed to be delivered to Participants, subject, however, to compliance with applicable law.
- (d) *Exercise Term*. In no event may any Option be exercisable for more than ten years from the Grant Date.

7.2. INCENTIVE STOCK OPTIONS. The terms of any Incentive Stock Options granted under the Plan must comply with the following additional rules:

- (a) *Exercise Price*. The exercise price of an Incentive Stock Option shall not be less than the Fair Market Value as of the Grant Date.
- (b) *Lapse Of Option*. Subject to any earlier termination provision contained in the Award Certificate, an Incentive Stock Option shall lapse upon the earliest of the following circumstances; provided, however, that the Committee may, prior to the lapse of the Incentive Stock Option under the circumstances described in subsections (3), (4) or (5) below, provide in writing that the Option will extend until a later date, but if an Option is so extended and is exercised after the dates specified in subsections (3) and (4) below, it will automatically become a Nonstatutory Stock Option:
  - (1) The expiration date set forth in the Award Certificate.
  - (2) The tenth anniversary of the Grant Date.
  - (3) Three months after termination of the Participant’s Continuous Status as a Participant for any reason other than the Participant’s Disability or death.
  - (4) One year after the Participant’s Continuous Status as a Participant by reason of the Participant’s Disability.
  - (5) One year after the Participant’s death if the Participant dies while employed, or during the three-month period described in paragraph (3) or during the one-year period described in paragraph (4) and before the Option otherwise lapses.

Unless the exercisability of the Incentive Stock Option is accelerated as provided in Article 15, if a Participant exercises an Option after termination of employment, the Option may be exercised only with respect to the Shares that were otherwise vested on the Participant’s termination of employment. Upon the Participant’s death, any exercisable Incentive Stock Options may be exercised by the Participant’s beneficiary, determined in accordance with Section 15.5.

(c) *Individual Dollar Limitation*. The aggregate Fair Market Value (determined as of the Grant Date) of all Shares with respect to which Incentive Stock Options are first exercisable by a Participant in any calendar year may not exceed \$100,000.00.

(d) *Ten Percent Owners*. No Incentive Stock Option shall be granted to any individual who, at the Grant Date, owns stock possessing more than ten percent of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary unless the exercise price per share of such Option is at least 110% of the Fair Market Value per Share at the Grant Date and the Option expires no later than five years after the Grant Date.

(e) *Expiration of Authority to Grant Incentive Stock Options*. No Incentive Stock Option may be granted pursuant to the Plan after the day immediately prior to the tenth anniversary of the Effective Date of the Plan, or the termination of the Plan, if earlier.

(f) *Right To Exercise*. During a Participant's lifetime, an Incentive Stock Option may be exercised only by the Participant or, in the case of the Participant's Disability, by the Participant's guardian or legal representative.

(g) *Eligible Grantees*. The Committee may not grant an Incentive Stock Option to a person who is not at the Grant Date an employee of the Company or a Parent or Subsidiary.

## **ARTICLE 8 STOCK APPRECIATION RIGHTS**

8.1. GRANT OF STOCK APPRECIATION RIGHTS. The Committee is authorized to grant Stock Appreciation Rights to Participants on the following terms and conditions:

(a) *Right To Payment*. Upon the exercise of a Stock Appreciation Right, the Participant to whom it is granted has the right to receive upon exercise, a payment in cash or Shares equal to the excess, if any, of:

- (1) The Fair Market Value of one Share on the date of exercise; over
- (2) The base value of the Stock Appreciation Right as determined by the Committee, which shall not be less than the Fair Market Value of one Share on the Grant Date (unless the SAR is granted in tandem with an Option after the Grant Date of the Option, in which case, the base price of the SAR may equal the exercise price of the related Option even if less than the Fair Market Value of one Share on the Grant Date of the SAR).

(b) *Other Terms*. The terms, methods of exercise, methods of settlement, form of consideration payable in settlement, and any other terms and conditions of any Stock Appreciation Right shall be determined by the Committee.

## **ARTICLE 9 PERFORMANCE AWARDS**

9.1. GRANT OF PERFORMANCE AWARDS. The Committee is authorized to grant Performance Shares, Performance Units or Performance-Based Cash Awards to Participants on such terms and conditions as may be selected by the Committee.

9.2. PERFORMANCE GOALS. The Committee may establish performance goals for Performance Awards which may be based on any criteria selected by the Committee. Such performance goals may be described in terms of Company-wide objectives or in terms of objectives that relate to the performance of the Participant, an Affiliate or a division, region, department or function within the Company or an Affiliate. If the Committee determines that a change in the business, operations, corporate structure or capital structure of the Company or the manner in which the Company or an Affiliate conducts its business, or other events or circumstances render performance goals to be unsuitable, the Committee may modify such performance goals in whole or in part, as the Committee deems appropriate. If a Participant is promoted, demoted or transferred to a different business unit or function during a performance period, the Committee may determine that the performance goals or performance period are no longer appropriate and may (i) adjust, change or eliminate the performance goals or the applicable performance period as it deems appropriate to make such goals and period comparable to the initial goals and period, or (ii) make a cash payment to the participant in amount determined by the Committee. The foregoing two

sentences shall not apply with respect to a Performance Award that is intended to be a Qualified Performance-Based Award.

9.3. RIGHT TO PAYMENT. The grant of a Performance Share to a Participant will entitle the Participant to receive at a specified later time a specified number of Shares, or the equivalent cash value, if the performance goals established by the Committee are achieved and the other terms and conditions thereof are satisfied. The grant of a Performance Unit to a Participant will entitle the Participant to receive at a specified later time a specified dollar value, which may be settled in cash or other property, including Shares, variable under conditions specified in the Award, if the performance goals in the Award are achieved and the other terms and conditions thereof are satisfied. The grant of a Performance-Based Cash Award to a Participant will entitle the Participant to receive at a specified later time a specified dollar value in cash variable under conditions specified in the Award, if the performance goals in the Award are achieved and the other terms and conditions thereof are satisfied. The Committee shall set performance goals and other terms or conditions to payment of the Performance Awards in its discretion which, depending on the extent to which they are met, will determine the value of the Performance Awards that will be paid to the Participant.

9.4. OTHER TERMS. The terms, methods of exercise, methods of settlement, form of consideration payable in settlement, and any other terms and conditions of any Performance Awards shall be determined by the Committee. For purposes of determining the number of Shares to be used in payment of a Performance Award denominated in cash but payable in whole or in part in Shares or Restricted Stock, the number of Shares to be so paid will be determined by dividing the cash value of the Award to be so paid by the Fair Market Value of a Share on the date of determination by the Committee of the amount of the payment under the Award, or, if the Committee so directs, the date immediately preceding the date the Award is paid.

## **ARTICLE 10 RESTRICTED STOCK AND RESTRICTED STOCK UNIT AWARDS**

10.1. GRANT OF RESTRICTED STOCK AND RESTRICTED STOCK UNITS. The Committee is authorized to make Awards of Restricted Stock or Restricted Stock Units to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee, subject to Section 5.4.

10.2. ISSUANCE AND RESTRICTIONS. Restricted Stock or Restricted Stock Units shall be subject to such restrictions on transferability and other restrictions as the Committee may impose (including, without limitation, limitations on the right to vote Restricted Stock or the right to receive dividends on the Restricted Stock or dividend equivalents on the Restricted Stock Units) covering a period of time specified by the Committee (the "Restriction Period"). These restrictions may lapse separately or in combination at such times, under such circumstances, in such installments, upon the satisfaction of performance goals or otherwise, as the Committee determines at the time of the grant of the Award or thereafter. Except as otherwise provided in an Award Certificate, the Participant shall have all of the rights of a stockholder with respect to the Restricted Stock, and the Participant shall have none of the rights of a stockholder with respect to Restricted Stock Units until such time as Shares of Stock are paid in settlement of the Restricted Stock Units.

10.3. FORFEITURE. Except as provided in an Award Certificate or otherwise determined by the Committee at the time of the grant of the Award or thereafter, immediately after termination of Continuous Status as a Participant during the applicable Restriction Period or upon failure to satisfy a performance goal during the applicable Restriction Period, Restricted Stock or Restricted Stock Units that are at that time subject to restrictions shall be forfeited.

10.4. DELIVERY OF RESTRICTED STOCK. Shares of Restricted Stock shall be delivered to the Participant at the time of grant either by book-entry registration or by delivering to the Participant, or a custodian or escrow agent (including, without limitation, the Company or one or more of its employees) designated by the Committee, a stock certificate or certificates registered in the name of the Participant. If physical certificates representing shares of Restricted Stock are registered in the name of the Participant, such certificates must bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Restricted Stock.

**ARTICLE 11  
DEFERRED STOCK UNITS**

11.1. GRANT OF DEFERRED STOCK UNITS. The Committee is authorized to grant Deferred Stock Units to Participants subject to such terms and conditions as may be selected by the Committee. Deferred Stock Units shall entitle the Participant to receive Shares of Stock (or the equivalent value in cash or other property if so determined by the Committee) at a future time as determined by the Committee, or as determined by the Participant within guidelines established by the Committee in the case of voluntary deferral elections.

**ARTICLE 12  
DIVIDEND AND INTEREST EQUIVALENTS**

12.1. GRANT OF DIVIDEND EQUIVALENTS. The Committee is authorized to grant Dividend Equivalents to Participants subject to such terms and conditions as may be selected by the Committee. Dividend Equivalents shall entitle the Participant to receive payments equal in value to the cash dividends that would have been paid with respect to all or a portion of the number of Shares subject to any Award, if such Shares had been outstanding, as determined by the Committee. The Committee may provide that Dividend Equivalents be paid or distributed when accrued or be deemed to have been reinvested in additional Shares or units equivalent to Shares, or otherwise reinvested.

12.2. GRANT OF INTEREST EQUIVALENTS. The Committee is authorized to grant Interest Equivalents to Participants subject to such terms and conditions as may be selected by the Committee. Interest Equivalents shall entitle the Participant to receive payments equal to a stated rate of return on the value of an outstanding Award, as determined by the Committee. The Committee may provide that Interest Equivalents be paid or distributed when accrued or be deemed to have been reinvested in additional Shares or units equivalent to Shares, or otherwise reinvested.

12.3. NO PAYMENT. Notwithstanding the foregoing, no Dividend Equivalents or Interest Equivalents may be paid until such time as the applicable performance goal(s) in respect of the Award thereof is achieved.

**ARTICLE 13  
STOCK OR OTHER STOCK-BASED AWARDS**

13.1. GRANT OF STOCK OR OTHER STOCK-BASED AWARDS. The Committee is authorized, subject to limitations under applicable law, to grant to Participants such other Awards that are payable in, valued in whole or in part by reference to, or otherwise based on or related to Shares or other property, as deemed by the Committee to be consistent with the purposes of the Plan, including without limitation Shares awarded purely as a "bonus" and not subject to any restrictions or conditions, convertible or exchangeable debt securities, other rights convertible or exchangeable into Shares, and Awards valued by reference to book value of Shares or the value of securities of or the performance of specified Parents or Affiliates ("Other Stock-Based Awards"). Such Other Stock-Based Awards shall also be available as a form of payment in the settlement of other Awards granted under the Plan. The Committee shall determine the terms and conditions of such Other Stock-Based Awards.

**ARTICLE 14  
QUALIFIED PERFORMANCE-BASED AWARDS**

14.1. OPTIONS AND STOCK APPRECIATION RIGHTS. The provisions of the Plan are intended to ensure that all Options and Stock Appreciation Rights granted hereunder to any Covered Employee shall qualify for the Section 162(m) Exemption.

14.2. OTHER AWARDS. When granting an Award other than an Option or a Stock Appreciation Right, the Committee may designate such Award as a Qualified Performance-Based Award, based upon a determination that the recipient is or may be a Covered Employee with respect to such Award, and the Committee wishes such Award to qualify for the Section 162(m) Exemption. If an Award is so designated, the Committee shall establish performance goals for such Award within the time period prescribed by Section 162(m) of the Code based on one or more of the following Qualified Business Criteria, which may be expressed in terms of Company-wide objectives or in terms of objectives that relate to the performance of an Affiliate or a division, region, department, function or

combination thereof within the Company or an Affiliate: revenue; sales; profit (net profit, gross profit, operating profit, economic profit, profit margins or other corporate profit measures); earnings (EBIT, EBITDA, earnings per share, or other corporate earnings measures); net income (before or after taxes, operating income or other income measures); cash (cash flow, cash generation or other cash measures); stock price or performance; total stockholder return (stock price appreciation plus reinvested dividends divided by beginning share price); return measures (including, but not limited to, return on assets, capital, equity, or sales, and cash flow return on assets, capital, equity, or sales); market share; improvements in capital structure; expenses (expense management, expense ratio, expense efficiency ratios or other expense measures); business expansion or consolidation (acquisitions and divestitures); internal rate of return or increase in net present value; working capital targets relating to inventory and/or accounts receivable; or planning accuracy (as measured by comparing planned results to actual results).

Performance goals with respect to the foregoing Qualified Business Criteria may be specified in absolute terms, in percentages, or in terms of growth from period to period or growth rates over time, as well as measured relative to an established or specially-created performance index of Company competitors or peers. Any member of a specially-created performance index that undergoes a corporate event or transaction of a kind described in Article 16 or that files a petition for bankruptcy during a measurement period shall be disregarded from and after such event. Performance goals need not be based upon an increase or positive result under a business criterion and could include, for example, the maintenance of the status quo or the limitation of economic losses (measured, in each case, by reference to a specific business criterion).

14.3. **PERFORMANCE GOALS.** Each Qualified Performance-Based Award (other than a market-priced Option or SAR) shall be earned, vested and payable (as applicable) only upon the achievement of performance goals established by the Committee based upon one or more of the Qualified Business Criteria, together with the satisfaction of any other conditions, such as continued employment, as the Committee may determine to be appropriate; provided, however, that the Committee may provide, either in connection with the grant thereof or by amendment thereafter, that achievement of such performance goals will be waived upon the death or Disability of the Participant, or upon a Change in Control. Performance periods established by the Committee for any such Qualified Performance-Based Award may be as short as three months and may be any longer period. In addition, the Committee may reserve the right, in connection with the grant of a Qualified Performance-Based Award, to exercise negative discretion to determine that the portion of such Award actually earned, vested and/or payable (as applicable) shall be less than the portion that would be earned, vested and/or payable based solely upon application of the applicable performance goals.

14.4. **INCLUSIONS AND EXCLUSIONS FROM PERFORMANCE CRITERIA.** The Committee may provide in any Qualified Performance-Based Award that any evaluation of performance may include or exclude any of the following events that occurs during a performance period: asset write-downs or impairment charges; litigation or claim judgments or settlements; the effect of changes in tax laws, accounting principles or other laws or provisions affecting reported results; accruals for reorganization and restructuring programs; extraordinary nonrecurring items as described in Accounting Principles Board Opinion No. 30 and/or in management's discussion and analysis of financial condition and results of operations appearing in the Company's annual report to stockholders for the applicable year; acquisitions or divestitures; and foreign exchange gains and losses. To the extent such inclusions or exclusions affect Awards to Covered Employees, they shall be prescribed in a form that meets the requirements of Code Section 162(m) for deductibility.

14.5. **CERTIFICATION OF PERFORMANCE GOALS.** Any payment of a Qualified Performance-Based Award granted with performance goals pursuant to Section 14.3 above shall be conditioned on the written certification of the Committee in each case that the performance goals and any other material conditions were satisfied. Except as specifically provided in Section 14.3, no Qualified Performance-Based Award held by a Covered Employee or by an employee who in the reasonable judgment of the Committee may be a Covered Employee on the date of payment, may be amended, nor may the Committee exercise any discretionary authority it may otherwise have under the Plan with respect to a Qualified Performance-Based Award under the Plan, in any manner to waive the achievement of the applicable performance goal based on Qualified Business Criteria or to increase the amount payable pursuant thereto or the value thereof, or otherwise in a manner that would cause the Qualified Performance-Based Award to cease to qualify for the Section 162(m) Exemption.

**ARTICLE 15**  
**PROVISIONS APPLICABLE TO AWARDS**

15.1. **STAND-ALONE AND TANDEM AWARDS.** Awards granted under the Plan may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with, any other Award granted under the Plan. Subject to Section 17.2, Awards granted in addition to or in tandem with other Awards may be granted either at the same time as or at a different time from the grant of such other Awards.

15.2. **TERM OF AWARD.** The term of each Award shall be for the period as determined by the Committee, provided that in no event shall the term of any Option or a Stock Appreciation Right exceed a period of ten years from its Grant Date (or, if Section 7.2(d) applies, five years from its Grant Date).

15.3. **FORM OF PAYMENT FOR AWARDS.** Subject to the terms of the Plan and any applicable law or Award Certificate, payments or transfers to be made by the Company or an Affiliate on the grant or exercise of an Award may be made in such form as the Committee determines at or after the Grant Date, including without limitation, cash, Stock, other Awards, or other property, or any combination, and may be made in a single payment or transfer, in installments, or on a deferred basis, in each case determined in accordance with rules adopted by, and at the discretion of, the Committee.

15.4. **LIMITS ON TRANSFER.** No right or interest of a Participant in any unexercised or restricted Award may be pledged, encumbered, or hypothecated to or in favor of any party other than the Company or an Affiliate, or shall be subject to any lien, obligation, or liability of such Participant to any other party other than the Company or an Affiliate. No unexercised or restricted Award shall be assignable or transferable by a Participant other than by will or the laws of descent and distribution or, except in the case of an Incentive Stock Option, pursuant to a domestic relations order that would satisfy Section 414(p)(1)(A) of the Code if such Section applied to an Award under the Plan; provided, however, that the Committee may (but need not) permit other transfers where the Committee concludes that such transferability (i) does not result in accelerated taxation, (ii) does not cause any Option intended to be an Incentive Stock Option to fail to be described in Code Section 422(b), and (iii) is otherwise appropriate and desirable, taking into account any factors deemed relevant, including without limitation, state or federal tax or securities laws applicable to transferable Awards. Any purported transfer in violation of this Section 15.4 shall be null and void.

15.5. **BENEFICIARIES.** Notwithstanding Section 15.4, a Participant may, in the manner determined by the Committee, designate a beneficiary to exercise the rights of the Participant and to receive any distribution with respect to any Award upon the Participant's death. A beneficiary, legal guardian, legal representative, or other person claiming any rights under the Plan is subject to all terms and conditions of the Plan and any Award Certificate applicable to the Participant, except to the extent the Plan and Award Certificate otherwise provide, and to any additional restrictions deemed necessary or appropriate by the Committee. If no beneficiary has been designated or survives the Participant, payment shall be made to the Participant's estate. Subject to the foregoing, a beneficiary designation may be changed or revoked by a Participant at any time provided the change or revocation is filed with the Company.

15.6. **STOCK CERTIFICATES.** All Stock issuable under the Plan is subject to any stop-transfer orders and other restrictions as the Committee deems necessary or advisable to comply with federal or state securities laws, rules and regulations and the rules of any national securities exchange or automated quotation system on which the Stock is listed, quoted, or traded. The Committee may place legends on any Stock certificate or issue instructions to the transfer agent to reference restrictions applicable to the Stock.

15.7. **ACCELERATION UPON DEATH, DISABILITY OR RETIREMENT.** Except as otherwise provided in the Award Certificate or any special Plan document governing an Award, upon a Participant's death, Disability or Retirement during his or her Continuous Status as a Participant, (i) all of such Participant's outstanding Options, SARs, and other Awards in the nature of rights that may be exercised shall become fully exercisable, (ii) all time-based vesting restrictions on the Participant's outstanding Awards shall lapse, and (iii) the target payout opportunities attainable under all of such Participant's outstanding performance-based equity Awards shall be deemed to have been fully earned as of the date of termination based upon an assumed achievement of all relevant performance goals at the "target" level and there shall be a pro rata payout to the Participant or his or her estate within thirty (30) days following the date of termination based upon the length of time within the performance

period that has elapsed prior to the date of termination. In addition, upon a Participant's death, Disability or Retirement of a Participant, the Committee may determine that any performance-based criteria with respect to any Performance-Based Cash Awards held by that Participant shall be deemed to be wholly or partially satisfied, in each case, as of such date as the Committee may, in its sole discretion, declare. Any Awards shall thereafter continue or lapse in accordance with the other provisions of the Plan and the Award Certificate. To the extent that this provision causes Incentive Stock Options to exceed the dollar limitation set forth in Section 7.2(c), the excess Options shall be deemed to be Nonstatutory Stock Options.

15.8. ACCELERATION UPON A CHANGE IN CONTROL. Except as otherwise provided in the Award Certificate or in an employment agreement, consulting agreement, change in control agreement or similar agreement in effect between the Company or an Affiliate and the Participant, in the event of a Change in Control or if a Participant's employment is terminated without Cause or the Participant resigns for Good Reason within six months after the effective date of a Change in Control, then, in the discretion of the Committee (which may be exercised prior to or following any Change in Control), the Committee may determine (which determination may be selective and non-uniform among Participants) that: (i) all of that Participant's outstanding Options, SARs and other Awards in the nature of rights that may be exercised may be terminated or may be accelerated to become fully exercisable, (ii) all time-based vesting restrictions on the Participant's outstanding Awards shall lapse, and/or (iii) the target payout opportunities attainable under all outstanding of that Participant's performance-based Awards shall be deemed to have been fully earned based upon an assumed achievement of all relevant performance goals at the "target" level and there shall be pro rata payout to such Participant within thirty (30) days following the date of Change in Control or termination of employment based upon the length of time within the performance period that has elapsed prior to the date of Change in Control or termination of employment.

15.9. DISCRETIONARY ACCELERATION. Regardless of whether an event has occurred as described in Section 15.7 or 15.8 above, and subject to Article 14 as to Qualified Performance-Based Awards, the Committee may in its sole discretion at any time determine that, upon the termination of service of a Participant, or the occurrence of a Change in Control, all or a portion of such Participant's Options, SARs and other Awards in the nature of rights that may be exercised shall terminate or become fully or partially exercisable, that all or a part of the restrictions on all or a portion of the Participant's outstanding Awards shall lapse, and/or that any performance-based criteria with respect to any Awards held by that Participant shall be deemed to be wholly or partially satisfied, in each case, as of such date as the Committee may, in its sole discretion, declare. The Committee may be selective and non-uniform among Participants and among Awards granted to a Participant in exercising its discretion pursuant to this Section 15.9.

15.10. TERMINATION OF EMPLOYMENT. Whether military, government or other service or other leave of absence shall constitute a termination of employment shall be determined by the Committee at its discretion, and any determination by the Committee shall be final and conclusive. A Participant's Continuous Status as a Participant shall not be deemed to terminate (i) in a circumstance in which a Participant transfers from the Company to an Affiliate, transfers from an Affiliate to the Company, or transfers from one Affiliate to another Affiliate, or (ii) in the discretion of the Committee as specified at or prior to such occurrence, in the case of a spin-off, sale or disposition of the Participant's employer from the Company or any Affiliate. To the extent that this provision causes Incentive Stock Options to extend beyond three months from the date a Participant is deemed to cease to be an employee of the Company, a Parent or Subsidiary for purposes of Sections 424(e) and 424(f) of the Code, the Options held by such Participant shall be deemed to be Nonstatutory Stock Options.

15.11. DEFERRAL. Subject to applicable law, the Committee may permit or require a Participant to defer such Participant's receipt of the payment of cash or the delivery of Shares or other property that would otherwise be due to such Participant by virtue of the exercise of an Option or SAR, the lapse or waiver of restrictions with respect to Restricted Stock or Restricted Stock Units, or the satisfaction of any requirements or goals with respect to Performance Awards, and Other Stock-Based Awards. If any such deferral election is required or permitted, the Committee shall, in its sole discretion, establish rules and procedures for such payment deferrals.

15.12. FORFEITURE EVENTS. The Committee may specify in an Award Certificate that the Participant's rights, payments and benefits with respect to an Award shall be subject to reduction, cancellation, forfeiture or recoupment upon the occurrence of certain specified events. Such events may include, but are not limited to, termination of employment for cause, violation of material Company or Affiliate policies, breach of non-

competition, confidentiality or other restrictive covenants that may apply to the Participant, or other conduct by the Participant that is detrimental to the business or reputation of the Company or any Affiliate.

15.13. **SUBSTITUTE AWARDS.** The Committee may grant Awards under the Plan in substitution for stock and stock-based awards held by employees of another entity who become employees of the Company or an Affiliate as a result of a merger or consolidation of the former employing entity with the Company or an Affiliate or the acquisition by the Company or an Affiliate of property or stock of the former employing corporation. The Committee may direct that the substitute awards be granted on such terms and conditions as the Committee considers appropriate in the circumstances.

## **ARTICLE 16 CHANGES IN CAPITAL STRUCTURE**

16.1. **GENERAL.** In the event of a corporate event or transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination or exchange of shares), the authorization limits under Section 5.1 and 5.4 shall be adjusted proportionately, and the Committee may adjust the Plan and Awards to preserve the benefits or potential benefits of the Awards. Action by the Committee may include: (i) adjustment of the number and kind of shares which may be delivered under the Plan; (ii) adjustment of the number and kind of shares subject to outstanding Awards; (iii) adjustment of the exercise price of outstanding Awards or the measure to be used to determine the amount of the benefit payable on an Award; and (iv) any other adjustments that the Committee determines to be equitable. In addition, the Committee may, in its sole discretion, provide (i) that Awards will be settled in cash rather than Stock, (ii) that Awards will become immediately vested and exercisable and will expire after a designated period of time to the extent not then exercised, (iii) that Awards will be assumed by another party to a transaction or otherwise be equitably converted or substituted in connection with such transaction, (iv) that outstanding Awards may be settled by payment in cash or cash equivalents equal to the excess of the Fair Market Value of the underlying Stock, as of a specified date associated with the transaction, over the exercise price of the Award, (v) that performance targets and performance periods for Performance Awards will be modified, consistent with Code Section 162(m) where applicable, or (vi) any combination of the foregoing. The Committee's determination need not be uniform and may be different for different Participants whether or not such Participants are similarly situated. Without limiting the foregoing, in the event of a subdivision of the outstanding Stock (stock-split), a declaration of a dividend payable in Shares, or a combination or consolidation of the outstanding Stock into a lesser number of Shares, the authorization limits under Section 5.1 and 5.4 shall automatically be adjusted proportionately, and the Shares then subject to each Award shall automatically be adjusted proportionately without any change in the aggregate purchase price therefor. To the extent that any adjustments made pursuant to this Article 16 cause Incentive Stock Options to cease to qualify as Incentive Stock Options, such Options shall be deemed to be Nonstatutory Stock Options.

## **ARTICLE 17 AMENDMENT, MODIFICATION AND TERMINATION**

### **17.1. AMENDMENT, MODIFICATION AND TERMINATION.**

(a) The Board or the Committee may, at any time and from time to time, amend, modify or terminate the Plan without stockholder approval; provided, however, that if an amendment to the Plan would, in the reasonable opinion of the Board or the Committee, (i) materially increase the benefits accruing to Participants, (ii) materially increase the number of Shares available under the Plan, (iii) expand the types of awards under the Plan, (iv) materially expand the class of participants eligible to participate in the Plan, (v) materially extend the term of the Plan, or (vi) otherwise constitute a material change requiring stockholder approval under applicable laws or the applicable listing or other requirements of an Exchange, then such amendment shall be subject to stockholder approval; and provided, further, that the Board or Committee may condition any amendment or modification on the approval of stockholders of the Company for any reason, including by reason of such approval being necessary or deemed advisable to (i) to comply with the listing or other requirements of an Exchange, or (ii) to satisfy any other tax, securities or other applicable laws, policies or regulations.



(b) No termination, amendment, or modification of the Plan shall adversely affect any Award previously granted under the Plan, without the written consent of the Participant affected thereby. An outstanding Award shall not be deemed to be “adversely affected” by a Plan amendment if such amendment would not reduce or diminish the value of such Award determined as if the Award had been exercised, vested, cashed in or otherwise settled on the date of such amendment (with the per-share value of an Option or Stock Appreciation Right for this purpose being calculated as the excess, if any, of the Fair Market Value as of the date of such amendment over the exercise price or base value of such Award).

17.2. AWARDS PREVIOUSLY GRANTED. At any time and from time to time, the Committee may amend, modify or terminate any outstanding Award without approval of the Participant; provided, however:

(a) Subject to the terms of the applicable Award Certificate, such amendment, modification or termination shall not, without the Participant’s consent, reduce or diminish the value of such Award determined as if the Award had been exercised, vested, cashed in or otherwise settled on the date of such amendment or termination (with the per-share value of an Option or Stock Appreciation Right for this purpose being calculated as the excess, if any, of the Fair Market Value as of the date of such amendment or termination over the exercise or base price of such Award);

(b) The original term of an Option may not be extended without the prior approval of the stockholders of the Company; and

(c) Except as otherwise provided in Article 16, the exercise price of an Option or SAR may not be reduced, directly or indirectly, without the prior approval of the stockholders of the Company.

## **ARTICLE 18 GENERAL PROVISIONS**

18.1. NO RIGHTS TO AWARDS; NON-UNIFORM DETERMINATIONS. No Participant or any Eligible Participant shall have any claim to be granted any Award under the Plan. Neither the Company, its Affiliates nor the Committee is obligated to treat Participants or Eligible Participants uniformly, and determinations made under the Plan may be made by the Committee selectively among Eligible Participants who receive, or are eligible to receive, Awards (whether or not such Eligible Participants are similarly situated).

18.2. NO STOCKHOLDER RIGHTS. No Award gives a Participant any of the rights of a stockholder of the Company unless and until Shares are in fact issued to such Participant in connection with the Award.

18.3. WITHHOLDING. The Company or any Affiliate shall have the authority and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, and local taxes (including the Participant’s FICA obligation) required by law to be withheld with respect to any exercise, lapse of restriction or other taxable event arising as a result of the Plan or an Award. If Shares are permitted to be surrendered to the Company to satisfy tax obligations in excess of the minimum tax withholding obligation, such Shares must have been held by the Participant as fully vested shares for such period of time, if any, as the Committee may determine. The Company shall have the authority to require a Participant to remit cash to the Company in lieu of the surrender of Shares for tax withholding obligations if the Committee so determines. With respect to withholding required upon any taxable event under the Plan, the Committee may, at the time the Award is granted or thereafter, require or permit that any such withholding requirement be satisfied, in whole or in part, by withholding from the Award Shares having a Fair Market Value on the date of withholding equal to the minimum amount (and not any greater amount) required to be withheld for tax purposes.

18.4. NO RIGHT TO CONTINUED SERVICE. Nothing in the Plan, any Award Certificate or any other document or statement made with respect to the Plan, shall interfere with or limit in any way the right of the Company or any Affiliate to terminate any Participant’s employment or status as an officer, director or consultant at

any time, nor confer upon any Participant any right to continue as an employee, officer, director or consultant of the Company or any Affiliate, whether for the duration of a Participant's Award or otherwise.

18.5. UNFUNDED STATUS OF AWARDS. The Plan is intended to be an "unfunded" plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant pursuant to an Award, nothing contained in the Plan or any Award Certificate shall give the Participant any rights that are greater than those of a general creditor of the Company or any Affiliate. This Plan is not intended to be subject to ERISA.

18.6. RELATIONSHIP TO OTHER BENEFITS. No payment under the Plan shall be taken into account in determining any benefits under any pension, retirement, savings, profit sharing, group insurance, welfare or benefit plan of the Company or any Affiliate unless specifically provided otherwise in such other plan.

18.7. EXPENSES. The expenses of administering the Plan shall be borne by the Company and its Affiliates.

18.8. TITLES AND HEADINGS. The titles and headings of the Sections in the Plan are for convenience of reference only, and in the event of any conflict, the text of the Plan, rather than such titles or headings, shall control.

18.9. GENDER AND NUMBER. Except where otherwise indicated by the context, any masculine term used herein also shall include the feminine; the plural shall include the singular and the singular shall include the plural.

18.10. FRACTIONAL SHARES. No fractional Shares shall be issued and the Committee shall determine, in its discretion, whether cash shall be given in lieu of fractional Shares or whether such fractional Shares shall be eliminated by rounding up or down.

18.11. GOVERNMENT AND OTHER REGULATIONS.

(a) Notwithstanding any other provision of the Plan, no Participant who acquires Shares pursuant to the Plan may, during any period of time that such Participant is an affiliate of the Company (within the meaning of the rules and regulations of the Securities and Exchange Commission under the 1933 Act), sell such Shares, unless such offer and sale is made (i) pursuant to an effective registration statement under the 1933 Act, which is current and includes the Shares to be sold, or (ii) pursuant to an appropriate exemption from the registration requirement of the 1933 Act, such as that set forth in Rule 144 promulgated under the 1933 Act.

(b) Notwithstanding any other provision of the Plan, if at any time the Committee shall determine that the registration, listing or qualification of the Shares covered by an Award upon any Exchange or under any foreign, federal, state or local law or practice, or the consent or approval of any governmental regulatory body, is necessary or desirable as a condition of, or in connection with, the granting of such Award or the purchase or receipt of Shares thereunder, no Shares may be purchased, delivered or received pursuant to such Award unless and until such registration, listing, qualification, consent or approval shall have been effected or obtained free of any condition not acceptable to the Committee. Any Participant receiving or purchasing Shares pursuant to an Award shall make such representations and agreements and furnish such information as the Committee may request to assure compliance with the foregoing or any other applicable legal requirements. The Company shall not be required to issue or deliver any certificate or certificates for Shares under the Plan prior to the Committee's determination that all related requirements have been fulfilled. The Company shall in no event be obligated to register any securities pursuant to the 1933 Act or applicable state or foreign law or to take any other action in order to cause the issuance and delivery of such certificates to comply with any such law, regulation or requirement.

18.12. GOVERNING LAW. To the extent not governed by federal law, the Plan and all Award Certificates shall be construed in accordance with and governed by the laws of the State of Delaware.

18.13. ADDITIONAL PROVISIONS. Each Award Certificate may contain such other terms and conditions as the Committee may determine; provided that such other terms and conditions are not inconsistent with the provisions of the Plan.

18.14. NO LIMITATIONS ON RIGHTS OF COMPANY. The grant of any Award shall not in any way affect the right or power of the Company to make adjustments, reclassification or changes in its capital or business structure or to merge, consolidate, dissolve, liquidate, sell or transfer all or any part of its business or assets. The Plan shall not restrict the authority of the Company, for proper corporate purposes, to draft or assume awards, other than under the Plan, to or with respect to any person. If the Committee so directs, the Company may issue or transfer Shares to an Affiliate, for such lawful consideration as the Committee may specify, upon the condition or understanding that the Affiliate will transfer such Shares to a Participant in accordance with the terms of an Award granted to such Participant and specified by the Committee pursuant to the provisions of the Plan.

18.15. INDEMNIFICATION. Each person who is or shall have been a member of the Committee, or of the Board, or an officer of the Company to whom authority was delegated in accordance with Article 4 shall be indemnified and held harmless by the Company against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him or her in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid by him or her in settlement thereof, with the Company's approval, or paid by him or her in satisfaction of any judgment in any such action, suit, or proceeding against him or her, provided he or she shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf, unless such loss, cost, liability, or expense is a result of his or her own willful misconduct or except as expressly provided by statute. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's charter or bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

18.16. FOREIGN PARTICIPANTS. In order to facilitate the granting of Awards to Eligible Participants who are foreign nationals or who are employed outside of the United States of America, the Committee may provide for such special terms and conditions, including without limitation substitutes for Awards, as the Committee may consider necessary or appropriate to accommodate differences in local law, tax policy or custom. The Committee may approve any supplements to, or amendments, restatements or alternative versions of this Plan as it may consider necessary or appropriate for the purposes of this Section 18.16 without thereby affecting the terms of this Plan as in effect for any other purpose, and the Secretary or other appropriate officer of the Company may certify any such documents as having been approved and adopted pursuant to properly delegated authority; provided, that no such supplements, amendments, restatements or alternative versions shall include any provisions that are inconsistent with the spirit of this Plan, as then in effect. Participants subject to the laws of a foreign jurisdiction may request copies of, or the right to view, any materials that are required to be provided by the Company pursuant to the laws of such jurisdiction.

18.17. NOTICE. Except as otherwise provided in this Plan, all notices or other communications required or permitted to be given under this Plan to the Company shall be in writing and shall be deemed to have been duly given if delivered personally or mailed, postage pre-paid, as follows: (i) if to the Company, at its principal business address to the attention of the Secretary; and (ii) if to any Participant, at the last address of the Participant known to the sender at the time the notice or other communication is sent.

18.18. INUREMENT OF RIGHTS AND OBLIGATIONS. The rights and obligations under this Plan and any related documents shall inure to the benefit of, and shall be binding upon, the Company, its successors and assigns, and the Participants and their beneficiaries.

18.19. COSTS AND EXPENSES. Except as otherwise provided herein, the costs and expenses of administering this Plan shall be borne by the Company, and shall not be charged to any Award nor to any Participant receiving an Award. Costs and expenses associated with the redemption or exercise of any Award under this Plan, including, but not limited to, commissions charged by any agent of the Company, may be charged to the Participant.

**APPENDIX B****NON-EMPLOYEE DIRECTOR STOCK OPTION AND RETAINER PLAN  
OF  
PFSWEB, INC.**

WHEREAS, PFSweb, Inc., a Delaware corporation (the “Company”) has adopted that certain 1999 Non-Employee Director Stock Option and Retainer Plan (as amended to date, the “Plan”); and

WHEREAS, subject to the requisite approval of the Company’s stockholders at the Company’s 2009 Annual Meeting of Stockholders, the Company has authorized and adopted certain amendments to the Plan;

NOW, THEREFORE, in order to implement and effectuate said amendments, the Plan, as so amended, shall read as follows:

PFSweb, Inc., a corporation organized under the laws of the State of Delaware, hereby adopts this Non-Employee Director Stock Option and Retainer Plan. The purposes of this Plan are as follows:

(1) To further the growth, development and financial success of the Company by providing incentives to its non-employee Directors by assisting them to become owners of the Company’s Common Stock and thus to benefit directly from its growth, development and financial success.

(2) To enable the Company to obtain and retain the services of qualified non-employee Directors in order to contribute to the long-range success of the Company by providing and offering them an opportunity to become owners of the Company’s Common Stock.

**ARTICLE I  
DEFINITIONS**

Whenever the following terms are used in this Plan, they shall have the meaning specified below unless the context clearly indicates to the contrary. The masculine pronoun shall include the feminine and neuter and the singular shall include the plural, where the context so indicates.

**Section 1.1 — Board**

“Board” shall mean the Board of Directors of the Company.

**Section 1.2 — Code**

“Code” shall mean the Internal Revenue Code of 1986, as amended.

**Section 1.3 — Committee**

“Committee” shall mean the Committee appointed by the Board, as provided in Section 6.1.

**Section 1.4 — Company**

“Company” shall mean PFSweb, Inc., a Delaware corporation.

**Section 1.5 — Director**

“Director” shall mean a member of the Board who is not an Employee.

**Section 1.6 — Effective Date**

---

“Effective Date” shall mean July 1, 1999.

Section 1.7 — Employee

“Employee” shall mean any employee (as defined in accordance with the regulations and revenue rulings then applicable under Section 3401(c) of the Code) of the Company, or of any corporation which is then a Subsidiary.

Section 1.8 — Exchange Act

“Exchange Act” shall mean the Securities Exchange Act of 1934, as amended.

Section 1.9 — Non-Qualified Option

“Non-Qualified Option” shall mean an Option which is not an incentive stock option and is not qualified under Section 422 of the Code.

Section 1.10 — Officer

“Officer” shall mean an officer of the Company, as defined in Rule 16a-1(f) under the Exchange Act, as such Rule may be amended in the future.

Section 1.11 — Option

“Option” shall mean an option to purchase Common Stock of the Company granted under the Plan.

Section 1.12 — Optionee

“Optionee” shall mean a Director to whom an Option is granted under the Plan.

Section 1.13 — Parent Corporation

“Parent Corporation” shall mean any corporation in an unbroken chain of corporations ending with the Company if each of the corporations other than the Company then owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Section 1.14 — Plan

“Plan” shall mean this Non-Employee Director Stock Option and Retainer Plan of PFSweb, Inc.

Section 1.15 — Retainer

“Retainer” shall mean the annual cash retainer payable to each Director for services as a member of the Board and any committee or committees of the Board.

Section 1.16 — Rule 16b-3

“Rule 16b-3” shall mean that certain Rule 16b-3 under the Exchange Act, as such Rule may be amended in the future.

Section 1.17 — Secretary

“Secretary” shall mean the Secretary of the Company.

Section 1.18 — Securities Act

“Securities Act” shall mean the Securities Act of 1933, as amended.

Section 1.19 — Shares

“Shares” shall mean shares of the Company’s Common Stock.

Section 1.20 — Subsidiary

“Subsidiary” shall mean any corporation in an unbroken chain of corporations beginning with the Company if each of the corporations other than the last corporation in the unbroken chain then owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Section 1.21 — Termination

“Termination” shall mean the time when the Director no longer serves as a member of the Board, including, but not by way of limitation, a termination by resignation, discharge, death or retirement.

ARTICLE II  
SHARES SUBJECT TO PLAN

Section 2.1 — Shares Subject to Plan

The Shares of stock subject to this Plan shall be shares of the Company’s Common Stock. The aggregate number of such Shares which may be issued pursuant to this Plan shall be 155,643.

Section 2.2 — Unexercised Options

If any Option expires or is canceled without having been fully exercised, the number of Shares subject to such Option but as to which such Option was not exercised prior to its expiration or cancellation, may again be optioned hereunder, subject to the limitations of Section 2.1.

Section 2.3 — Changes in Company’s Shares

In the event that the outstanding Shares of Common Stock of the Company are hereafter changed into or exchanged for a different number or kind of shares or other securities of the Company, or of another corporation, or in the event of any other capital transaction involving the outstanding shares of Common Stock of the Company as the Committee shall determine in its sole discretion, whether by reason of reorganization, merger, consolidation, recapitalization, reclassification, stock split-up, stock dividend, combination of shares or otherwise, appropriate adjustments shall be made by the Committee in the number and kind of Shares which may be issued hereunder, including adjustment to the number, exercise price and kind of shares for the purchase of which Options may be granted, and further including adjustments of the limitations in Section 2.1 on the maximum number and kind of shares which may be issued hereunder and adjustments to the number of Options set forth in Section 3.5 below.

ARTICLE III  
RETAINER FEES AND GRANTING OF OPTIONS

Section 3.1 — Payment of Retainer

(a) Each Director may elect under the Plan to receive payment of any Retainer (in such installments as such Retainer shall be payable) in Shares, in lieu of cash, by submitting a written election (the

“Notice of Election”) to the Company. The Notice of Election shall become effective six months following the date of the Notice of Election or such earlier date as may be permitted under Rule 16b-3 (the “Election Effective Date”) and, from and after the Election Effective Date, all Retainers payable to the electing Director (whether in installments or otherwise) shall be payable in Shares in the manner set forth herein.

(b) Subject to the foregoing, each Notice of Election shall become effective on its Election Effective Date and shall continue in effect until revoked by the electing Director in a written notice of revocation (the “Notice of Revocation”) delivered to the Company; provided, however, that no Notice of Revocation shall become effective until six months following the date of the Notice of Revocation or such earlier date as may be permitted under Rule 16b-3.

(c) If no Notice of Election is submitted to the Company, and prior to any Election Effective Date, all Retainers shall be payable in cash.

#### Section 3.2 — Number of Shares

The number of Shares to be issued to each Director electing to have his or her Retainer paid in Shares shall be determined by dividing the dollar amount of the then payable Retainer by the fair market value of the Shares as of the most recent trading day immediately prior to the date the Retainer is otherwise payable. No fractional Shares shall be issued and any fractional Share shall be rounded to the nearest whole Share. Subject to the terms and provisions hereof, all Shares shall be issued in certificate form in the name of the Director (or any designee) as promptly as practicable following the date of payment. For purposes of this Section, fair market value shall be determined in accordance with Section 4.2(b) below.

#### Section 3.3 — Eligibility

Each Director shall be granted Options in accordance with the provisions set forth herein.

#### Section 3.4 — Non-Qualification of Options

Each Option shall be a Non-Qualified Option.

#### Section 3.5 — Granting of Options

Each person who is a Director immediately following each annual meeting of stockholders of the Company shall receive an Option to purchase 4,255 Shares as of the date of such annual meeting; provided that such Director shall have attended at least 75% of the meetings of the Board (which may include committee meetings) during the most recent completed fiscal year prior to such annual meeting (or such shorter period of time as such Director held office during such fiscal year).

### ARTICLE IV TERMS OF OPTIONS

#### Section 4.1 — Option Agreement

Each Option shall be evidenced by a written Stock Option Agreement, which shall be executed by the Optionee and an authorized Officer of the Company and which shall contain such terms and conditions as are consistent with the Plan.

#### Section 4.2 — Option Price

(a) The price of the Shares subject to each Option shall be equal to 100% of the fair market value of such Shares on the date such Option is granted.

(b) For purposes of the Plan, the fair market value of a Share of the Company's Common Stock as of a given date shall be: (i) the closing price of a Share of the Company's Common Stock on the principal exchange on which Shares of the Company's Common Stock are then trading; or (ii) if such Common Stock is not traded on an exchange but is quoted on NASDAQ or a successor quotation system, (1) the last sales price (if the Company's Common Stock is then listed as a National Market Issue under the NASD National Market System) or (2) the mean between the closing representative bid and asked prices (in all other cases) for the Company's Common Stock, in each case, on such date as reported by NASDAQ or such successor quotation system; or (iii) if such Common Stock is not publicly traded on an exchange and not quoted on NASDAQ or a successor quotation system, the mean between the closing bid and asked prices for the Company's Common Stock, on such date, as determined in good faith by the Committee; or (iv) if the Company's Common Stock is not publicly traded, the fair market value established by the Committee acting in good faith.

#### Section 4.3 — Commencement of Exercisability

(a) No Option may be exercised in whole or in part during the six months after such Option is granted.

(b) Subject to the provisions hereof, each Option granted hereunder shall be subject to the following cumulative vesting schedule:

(i) Until the date which is one year from the date of grant, the Option shall not be vested and shall not be exercisable as to any of the shares subject thereto; and

(ii) From and after the date which is one year from the date of grant, the Option shall vest and be fully exercisable.

#### Section 4.4 — Expiration of Options

No Option may be exercised to any extent after the first to occur of the following events:

(i) The expiration of ten years from the date the Option was granted; or

(ii) Except in the case of any Optionee who is disabled (within the meaning of Section 22(e)(3) of the Code), the expiration of three months from the date of the Optionee's Termination for any reason other than such Optionee's death; or

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

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

#### Section 4.5 — Adjustments in Outstanding Options

In the event that the outstanding Shares of the stock subject to Options are changed into or exchanged for a different number or kind of shares of the Company or other securities of the Company, or in the event of any other capital transaction involving the outstanding shares of Common Stock of the Company as the Committee shall determine in its sole discretion, whether by reason of merger, consolidation, recapitalization, reclassification, stock split-up, stock dividend, combination of shares or otherwise, the Committee shall make an appropriate and equitable adjustment in the number and kind of shares as to which all outstanding Options, or portions thereof then unexercised, shall be exercisable, to the end that after such event the Optionee's proportionate interest shall be maintained as before the occurrence of such event. Such adjustment in an outstanding Option shall be made without change in the total price applicable to the Option or the unexercised portion of the Option (except for any change in the aggregate price resulting from rounding-off of share quantities or prices) and with any



necessary corresponding adjustment in Option price per share. Any such adjustment made by the Committee shall be final and binding upon all Optionees, the Company and all other interested persons.

#### Section 4.6 — No Repricing

Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, or exchange of shares), the terms of outstanding Options may not be amended to reduce the exercise price of outstanding Options or cancel outstanding Options in exchange for cash, other awards or Options with an exercise price that is less than the exercise price of the original Options without stockholder approval.

### ARTICLE V EXERCISE OF OPTIONS

#### Section 5.1 — Person Eligible to Exercise

During the lifetime of the Optionee, only such Optionee may exercise an Option (or any portion thereof) granted to him; provided, however, that, unless otherwise prohibited by Rule 16b-3, an Optionee may transfer all or any portion of an Option to his spouse or immediate family member or any trust for the benefit thereof or as the Committee may otherwise permit in its sole discretion. After the death of the Optionee, any exercisable portion of an Option may, prior to the time when such portion becomes unexercisable under the Plan, be exercised by his personal representative or by any person empowered to do so under the deceased Optionee's will or under the then applicable laws of descent and distribution.

#### Section 5.2 — Partial Exercise

At any time and from time to time prior to the time when any exercisable Option or exercisable portion thereof becomes unexercisable under the Plan, such Option or portion thereof may be exercised in whole or in part; provided, however, that the Company shall not be required to issue fractional shares and the Committee may, by the terms of the Option, require any partial exercise to be with respect to a specified minimum number of shares.

#### Section 5.3 — Manner of Exercise

An exercisable Option, or any exercisable portion thereof, may be exercised solely by delivery to the Secretary or his office of all of the following prior to the time when such Option or such portion becomes unexercisable under the Plan or the applicable Stock Option Agreement:

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

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

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

(iii) Any combination of the consideration provided in the foregoing subsections (i) and (ii); and

(c) The payment to the Company (or other employer corporation) of all amounts which it is required to withhold under federal, state or local law in connection with the exercise of the Option; provided, that, with the consent of the Committee, any combination of the following may be used to make all or part of such payment: (i) Shares of the Company's Common Stock owned by the Optionee duly endorsed for transfer or (ii) subject to the timing requirements of Section 5.4, Shares of the Company's Common Stock issuable to the Optionee upon exercise of the Option, valued in accordance with Section 4.2(b) at the date of Option exercise; and

(d) Such representations and documents as the Committee, in its absolute discretion, deems necessary or advisable to effect compliance with all applicable provisions of the Securities Act and any other federal or state securities laws or regulations. The Committee may, in its absolute discretion, also take whatever additional actions it deems appropriate to effect such compliance including, without limitation, placing legends on Share certificates and issuing stop-transfer orders to transfer agents and registrars; and

(e) In the event that the Option or portion thereof shall be exercised pursuant to Section 5.1 by any person or persons other than the Optionee, appropriate proof of the right of such person or persons to exercise the Option or portion thereof.

#### Section 5.4 — Certain Timing Requirements

Shares of the Company's Common Stock issuable to the Optionee upon exercise of the Option may be used to satisfy the Option price or the tax withholding consequences of such exercise only with the consent of the Committee and (i) during the trading window period following the date of release of the quarterly or annual summary statement of sales and earnings of the Company as may be established by the Company for its senior executives from time to time or (ii) pursuant to an irrevocable written election by the Optionee to use Shares of the Company's Common Stock issuable to the Optionee upon exercise of the Option to pay all or part of the Option price or the withholding taxes made at least six months prior to the payment of such Option price or withholding taxes.

#### Section 5.5 — Conditions to Issuance of Stock Certificates

The Shares of stock issuable and deliverable upon the exercise of an Option, or any portion thereof, may be either previously authorized but unissued Shares or issued Shares which have then been reacquired by the Company. The Company shall not be required to issue or deliver any certificate or certificates for Shares of stock issued in payment of any Retainer or purchased upon the exercise of any Option or portion thereof prior to the fulfillment of all of the following conditions:

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

(b) The completion of any registration or other qualification of such Shares under any state or federal law or under the rulings or regulations of the Securities and Exchange Commission or any other governmental regulatory body, if any such registration or qualification may be necessary or advisable; and

(c) The obtaining of any approval or other clearance from any state or federal governmental agency which may be necessary or advisable; and

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

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

## ARTICLE VI

### ADMINISTRATION

#### Section 6.1 — Committee

The Plan shall be administered by the Committee which shall consist of two or more members of the Board, as the Board may appoint from time to time; provided, however that, in the absence of such appointment, the Plan shall be administered by the Board (in which event the term “Committee” as used herein shall mean the Board); provided, further, however, that, notwithstanding the foregoing, the Plan shall be construed, interpreted, implemented and administered in a manner sufficient to comply with the provisions of Rule 16b-3, and, in particular, in order to provide that the members of the Committee shall at all times satisfy the requirements set forth therein.

#### Section 6.2 — Duties and Powers of Committee

It shall be the duty of the Committee to conduct the general administration of the Plan in accordance with its provisions. The Committee shall have the power to interpret the Plan and the Options and to adopt such rules for the administration, interpretation and application of the Plan as are consistent therewith and to interpret, amend or revoke any such rules.

#### Section 6.3 — Majority Rule

The Committee shall act by a majority of its members in office. The Committee may act either by vote at a meeting or by a memorandum or other written instrument signed by a majority of the Committee.

#### Section 6.4 — Compensation; Professional Assistance; Good Faith Actions

Members of the Committee shall receive such compensation for their services as members as may be determined by the Board. All expenses and liabilities incurred by members of the Committee in connection with the administration of the Plan shall be borne by the Company. The Committee may employ attorneys, consultants, accountants, appraisers, brokers or other persons. The Committee, the Company and its Officers and Directors shall be entitled to rely upon the advice, opinions or valuations of any such persons. All actions taken and all interpretations and determinations made by the Committee in good faith shall be final and binding upon all Optionees, the Company and all other interested persons. No member of the Committee shall be personally liable for any action, determination or interpretation made in good faith with respect to the Plan or the Options, and all members of the Committee shall be fully protected by the Company in respect to any such action, determination or interpretation.

### ARTICLE VII OTHER PROVISIONS

#### Section 7.1 — Options Not Transferable

Except as set forth in Section 5.1 hereof, no Option or interest or right therein or part thereof shall be liable for the debts, contracts or engagements of the Optionee or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of law by judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that nothing in this Section 7.1 shall prevent transfers by will or by the applicable laws of descent and distribution.

#### Section 7.2 — Amendment, Suspension or Termination of the Plan

The Plan may be wholly or partially amended or otherwise modified, suspended or terminated at any time or from time to time by the Committee; provided, however, that no amendment or modification which requires shareholder approval under Rule 16b-3, if any, shall be effective in the absence of such approval. Neither the amendment, suspension nor termination of the Plan shall, without the consent of the holder of the Option, impair any rights or obligations under any Option theretofore granted. No Option may be granted during any period of

suspension nor after termination of the Plan. The Plan shall terminate and no Option be granted under this Plan after December 31, 2017.

#### Section 7.3 — Approval of Plan by Shareholder(s)

This Plan will be submitted for the approval of the Company's shareholder(s) within 12 months after the date of the Board's initial adoption of the Plan. No Options shall be granted prior to such shareholder approval. The Company shall take such actions with respect to the Plan as may be necessary to satisfy the requirements of Rule 16b-3(b).

#### Section 7.4 — Effect of Plan Upon Other Option and Compensation Plans

The adoption of this Plan shall not affect any other compensation or incentive plans in effect for the Company, any Parent Corporation or any Subsidiary. Nothing in this Plan shall be construed to limit the right of the Company, any Parent Corporation or any Subsidiary to (a) establish any other forms of incentives or compensation for employees and Directors of the Company, any Parent Corporation or any Subsidiary or (b) grant or assume options otherwise than under this Plan in connection with any proper corporate purpose, including, but not by way of limitation, the grant or assumption of options in connection with the acquisition by purchase, lease, merger, consolidation or otherwise, of the business, stock or assets of any corporation, firm or association.

#### Section 7.5 — Titles

Titles are provided herein for convenience only and are not to serve as a basis for interpretation or construction of the Plan.

#### Section 7.6 — Conformity to Securities Laws and Section 409A(d) of the Code

The Plan is intended to conform to the extent necessary with all provisions of the Securities Act and the Exchange Act and any and all regulations and rules promulgated by the Securities and Exchange Commission thereunder, including without limitation Rule 16b-3, as well as of Section 409A(d) of the Code. Notwithstanding anything herein to the contrary, the Plan shall be administered, and Options shall be granted and may be exercised, only in such a manner as to conform to such laws, rules and regulations. To the extent permitted by applicable law, the Plan and Options granted hereunder shall be deemed amended to the extent necessary to conform to such laws, rules and regulations.

**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 quarterly 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 operations 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 14, 2009

By: /s/ Mark C. Layton  
Chief Executive Officer

**CERTIFICATIONS OF PRINCIPAL FINANCIAL 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 quarterly 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 operations 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:

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;

- a) 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
  - b) 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 14, 2009

By: /s/ Thomas J. Madden  
Chief Financial Officer

**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, 2009 (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-Q 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-Q.

August 14, 2009

/s/ Mark C. Layton  
Mark C. Layton  
Chief Executive Officer

August 14, 2009

/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.