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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2006

OR

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

For the Transition Period from __________ to __________

Commission File Number 000-28275

PFSweb, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**75-2837058**
(State of Incorporation)	(I.R.S. Employer I.D. No.)
500 North Central Expressway, Plano, Texas	**75074**
(Address of principal executive offices)	(Zip Code)

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

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

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer o

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

At November 14, 2006 there were 46,469,452 shares of registrant's common stock outstanding, excluding 86,300 shares of common stock in treasury.

PFSWEB, INC. AND SUBSIDIARIES
Form 10-Q
September 30, 2006

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

PFSWEB, INC. AND SUBSIDIARIES

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

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 14,068	$ 13,683
Restricted cash	1,224	2,077
Accounts receivable, net of allowance for doubtful accounts of $2,070 and $484 at September 30, 2006 and December 31, 2005, respectively	46,535	44,556
Inventories, net	53,409	43,654
Other receivables	8,946	9,866
Prepaid expenses and other current assets	4,297	3,213
Total current assets	128,479	117,049
PROPERTY AND EQUIPMENT, net	12,709	13,040
RESTRICTED CASH	—	150
IDENTIFIABLE INTANGIBLES	7,112	—
GOODWILL	18,345	—
OTHER ASSETS	760	1,487
Total assets	$ 167,405	$ 131,726
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt and capital lease obligations	$ 25,872	$ 21,626
Trade accounts payable	61,252	60,053
Accrued expenses	18,572	12,011
Total current liabilities	105,696	93,690
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	5,660	6,289
OTHER LIABILITIES	1,310	1,813
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued and outstanding	—	—
Common stock, $0.001 par value; 75,000,000 shares authorized; 46,539,077 and 22,613,314 shares issued at September 30, 2006 and December 31, 2005, respectively; and 46,452,777 and 22,527,014 outstanding at September 30, 2006 and December 31, 2005, respectively	47	23
Additional paid-in capital	91,076	58,736
Accumulated deficit	(37,904)	(29,824)
Accumulated other comprehensive income	1,605	1,084
Treasury stock at cost, 86,300 shares	(85)	(85)
Total shareholders' equity	54,739	29,934
Total liabilities and shareholders' equity	$ 167,405	$ 131,726

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 September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
REVENUES:				
Product revenue, net	$ 72,593	$ 62,284	$ 252,447	$ 189,352
Service fee revenue	15,553	14,891	47,681	45,274
Pass-through revenue	6,138	4,317	14,128	13,601
Total net revenues	94,284	81,492	314,256	248,227
COSTS OF REVENUES:				
Cost of product revenue	66,889	57,401	235,698	176,651
Cost of service fee revenue	11,768	10,990	34,513	33,860
Pass-through cost of revenue	6,138	4,317	14,128	13,601
Total costs of revenues	84,795	72,708	284,339	224,112
Gross profit	9,489	8,784	29,917	24,115
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	11,124	8,439	33,552	23,343
STOCK BASED COMPENSATION	206	2	686	16
MERGER INTEGRATION EXPENSE	486	—	1,129	—
AMORTIZATION OF IDENTIFIABLE INTANGIBLES	204	—	545	—
Total operating expenses	12,020	8,441	35,912	23,359
Income (loss) from operations	(2,531)	343	(5,995)	756
INTEREST EXPENSE, NET	557	532	1,505	1,325
Loss before income taxes	(3,088)	(189)	(7,500)	(569)
INCOME TAX EXPENSE	221	264	580	644
NET LOSS	$ (3,309)	$ (453)	$ (8,080)	$ (1,213)
NET LOSS PER SHARE:				
Basic and Diluted	$ (0.07)	$ (0.02)	$ (0.19)	$ (0.05)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic and Diluted	46,449	22,488	41,557	22,349

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)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (8,080)	$ (1,213)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,433	4,607
Loss on disposal of assets	143	—
Provision for doubtful accounts	480	(57)
Provision for excess and obsolete inventory	747	—
Deferred income taxes	(55)	76
Stock-based compensation	686	16
Changes in operating assets and liabilities:		
Restricted cash	738	—
Accounts receivables	4,377	(4,669)
Inventories, net	(2,519)	4,701
Prepaid expenses, other receivables and other assets	818	(2,305)
Accounts payable, accrued expenses and other liabilities	(6,634)	(1,214)
Net cash used in operating activities	(3,866)	(58)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(2,816)	(3,409)
Payment for purchase of eCOST, net of cash acquired	(1,299)	—
Decrease in restricted cash	748	1,348
Net cash used in investing activities	(3,367)	(2,061)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on capital lease obligations	(1,087)	(890)
Decrease in restricted cash	569	514
Proceeds from issuance of common stock	4,900	2,036
Proceeds from debt, net	3,350	1,564
Net cash provided by financing activities	7,732	3,224
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(114)	(16)
NET INCREASE IN CASH AND CASH EQUIVALENTS	385	1,089
CASH AND CASH EQUIVALENTS, beginning of period	13,683	13,592
CASH AND CASH EQUIVALENTS, end of period	$ 14,068	$ 14,681
SUPPLEMENTAL CASH FLOW INFORMATION		
Non-cash investing and financing activities:		
Property and equipment acquired under capital leases	$ 935	$ 891

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 such services 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 acts as a master distributor of various products, primarily International Business Machines Corporation ("IBM") product, under a master distributor agreement with IBM. Supplies Distributors has outsourced to PFSweb the transaction management and fulfillment service functions of its distribution business and has outsourced to a third party the sales and marketing functions. Supplies Distributors sells its products in the United States, Canada and Europe.

eCOST Overview

eCOST is a multi-category online discount retailer of new, "close-out" and refurbished brand-name merchandise, selling products primarily to customers in the United States. eCOST offers products in several merchandise categories, including computer hardware and software, home electronics, digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. eCOST carries products from leading manufacturers such as Apple, Canon, Citizen, Denon, Hewlett-Packard, Nikon, Onkyo, Seiko and Toshiba.

Acquisition of eCOST

Effective February 1, 2006, a wholly-owned subsidiary of PFSweb merged with and into eCOST, with eCOST surviving the merger as a wholly-owned subsidiary of PFSweb. Each of the 18,858,132 issued and outstanding shares of common stock of eCOST were converted into one share of common stock of the Company. In conjunction with the merger, PFSweb assumed 36,210 warrants previously issued to a former eCOST warrantholder with an exercise price of $2.00 per share, subject to the terms set forth therein. As a result of the merger, effective February 1, 2006, PFSweb began consolidating 100% of eCOST's financial position and results of operations into PFSweb's consolidated financial statements. The following table presents selected pro forma information, for comparative purposes, assuming the acquisition had occurred on January 1 for the periods presented (unaudited) (in thousands):

	Three Months Ended		Nine Months Ended	
	2006	2005	2006	2005
Net revenues	$94,284	$119,678	$327,190	$382,517
Net loss	(3,309)	(2,966)	(9,670)	(9,874)
Basic and diluted loss per share	(0.07)	(0.07)	(0.23)	(0.24)

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

The unaudited pro forma information combines the historical unaudited consolidated statements of the Company's operations and eCOST's operations for the three and nine months ended September 30, 2006 and 2005 giving effect to the merger and related events as if they had been consummated on January 1 for the periods presented. Pro forma adjustments have been made to reflect the amortization expense relating to the finite lives of certain acquired intangibles, such as trademark name and customer relationships and the reversal of the income tax expense recognized by eCOST in the three and nine months ended September 30, 2005.

The unaudited pro forma information does not reflect significant operational and administrative cost savings, which are referred to as synergies, that management estimates may be achieved as a result of the merger transaction, or other incremental costs that may be incurred as a direct result of the merger transaction. The unaudited pro forma net revenue and pro forma net loss are not necessarily indicative of the consolidated results of operations for future periods or the results of operations that would have been realized had the Company consolidated eCOST during the periods noted.

The transaction was accounted for using the purchase method of accounting for business combinations and, accordingly, the results of operations of eCOST have been included in the Company's consolidated financial statements since the date of acquisition. For purposes of computing the purchase price, the value of the 18.9 million shares of PFSweb common stock issued was $1.42 per common share, based on the average closing price of PFSweb's common stock on NASDAQ for the period beginning two days prior to the consummation of the merger and ending on the consummation of the merger. The following table summarizes the preliminary unaudited, estimated fair value of the assets acquired and liabilities assumed as of February 1, 2006. The Company is in the process of finalizing the purchase price allocation and, accordingly, the allocation of the purchase price is subject to adjustment (in thousands):

Cash and restricted cash	$ 1,053
Accounts receivable, net	5,767
Inventories	6,898
Identifiable intangibles	7,657
Property and equipment	700
Other assets	322
Total assets acquired	22,397
Trade accounts payable	8,704
Accrued expenses	3,167
Other liabilities	793
Total liabilities assumed	12,664
Net assets acquired	9,733
Estimated purchase price	28,078
Goodwill acquired	$ 18,345

Estimated purchase price for eCOST is as follows (in thousands):

Number of shares of common stock issued	18,858
Multiplied by PFSweb's stock price	$ 1.42
Share consideration	$ 26,778
Estimated transaction costs	1,300
Estimated purchase price	$ 28,078

The above purchase price has been preliminarily allocated based on estimates of the fair values of assets acquired and liabilities assumed. The final valuation of net assets will be completed during the quarter ending December 31, 2006.

The excess of the purchase price over the fair value of the net assets acquired and liabilities assumed was allocated to goodwill. Total goodwill of $18.3 million, none of which is deductible for tax purposes, is not being amortized but is subject to an impairment test each year, which the Company will complete during the quarter ending December 31, 2006, using a fair-value-based approach

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

pursuant to SFAS No. 142. The Company is amortizing the identifiable intangible assets acquired on a straight-line basis over their estimated remaining useful lives.

Basis of Presentation

The unaudited interim condensed consolidated financial statements as of September 30, 2006, and for the three and nine months ended September 30, 2006 and 2005, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. In the opinion of management and subject to the foregoing, the unaudited interim condensed consolidated financial statements of the Company include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company's financial position as of September 30, 2006, its results of operations for the three and nine months ended September 30, 2006 and 2005 and its results of cash flows for the nine months ended September 30, 2006 and 2005. 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 in conformity with generally accepted accounting principles requires management to make 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 operating expenses in these consolidated financial statements also require management estimates and assumptions. The Company's estimates and assumptions are continually evaluated based on available information and experience. Because the use of estimates is inherent in the financial reporting process, actual results could differ from estimates.

Revenue Recognition

Net sales include product sales, gross outbound shipping charges, and related handling fees, and to a lesser extent, third-party extended warranties and other services. eCOST recognizes revenue from product sales, net of estimated returns, promotional discounts, credit card fraud and chargebacks, and coupon redemptions, when both title and risk of loss to the products has transferred to the customer, which eCOST has determined to occur upon receipt of products by the customer. eCOST generally requires payment by credit card upon placing an order, and to a lesser extent, grants credit to business customers on normal credit terms.

eCOST periodically provides incentive offers to customers including percentage discounts off current purchases. Such discounts are recorded as a reduction of the related purchase price at the time of sale based on actual and estimated redemption rates. Future redemption rates are estimated using eCOST's historical experience for similar sales inducement offers.

For product sales shipped directly from eCOST's vendors to end customers, eCOST records revenue and related costs at the gross amounts charged to the customer and paid to the vendor based on an evaluation of the criteria outlined in EITF No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*. eCOST's evaluation is performed based on a number factors, including whether eCOST is the primary obligor in the transaction, has latitude in establishing prices and selecting suppliers, takes title to the products sold upon shipment, bears credit risk, and bears inventory risk for returned products that are not successfully returned to third-party suppliers. eCOST recognizes revenue on extended warranties and other services for which it is not the primary obligor on a net basis.

Investment in Affiliates

Priority Fulfillment Services, Inc. ("PFS"), a wholly-owned subsidiary of PFSweb, has loaned Supplies Distributors and eCOST $6.5 million and $3.5 million, respectively, as of September 30, 2006, which are eliminated in consolidation. Under the terms of certain of the Company's debt facilities, the outstanding balance of the Supplies Distributors loan cannot be increased to more than $8.0 million or decreased to less than $6.5 million without prior approval of the Company's lenders and the outstanding balance of the eCOST loan amount cannot be less than $2.0 million without prior approval of eCOST's lender or increased above $3.5 million without the approval of PFS' lender. PFSweb has also loaned eCOST $6.6 million as of September 30, 2006. In October, eCOST repaid $400,000 of the outstanding balance to PFSweb.

In November, 2006, PFS's lender provided its approval for PFS to advance an additional $1.5 million to eCOST as needed.

Concentration of Business and Credit Risk

Supplies Distributors' product revenue was primarily generated by sales to customers of product purchased under master distributor agreements with one supplier. The Company's service fee revenue is generated under contractual service fee relationships with multiple client relationships. There was one customer that exceeded 10% of consolidated revenue during the three months ended September 30, 2006 and the three and nine months ended September 30, 2005 periods. A summary of the customer and client concentrations is as follows:

	Nine Months Ended	
	September 30, 2006	September 30, 2005
Product Revenue (as a percentage of Product Revenue):		
Customer 1	12%	13%
Customer 2	9%	11%
Customer 3	8%	11%
Service Fee Revenue (as a percentage of Service Fee Revenue):		
Client 1	25%	29%
Client 2	19%	15%
Client 3	12%	13%
Accounts Receivable:		
3 Clients/Customers	30%	30%

PFSweb has provided certain guarantees of its subsidiaries' financings and credit arrangements. These subsidiaries' ability to obtain financing or credit arrangements on similar terms would be significantly impacted without these guarantees. Additionally, since Supplies Distributors has limited personnel and physical resources, its ability to conduct business could be materially impacted by any termination of its contract with the party performing product demand generation for the IBM products sold by Supplies Distributors.

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

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

eCOST's arrangements with its vendors are terminable by either party at will. Loss of any vendors could have a material adverse effect on its financial position, results of operations and cash flows. Sales of HP and HP-related products represented 32% of eCOST's net revenues, or 7% of consolidated net revenues, in the nine months ended September 30, 2006.

Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivable consist primarily of amounts due from customers/clients to whom the Company has extended credit as well as amounts due from vendors related to co-op advertising costs. The Company records vendor receivables at such time as all conditions have been met that would entitle the Company to receive such vendor funding and is thereby considered fully earned.

The Company maintains an allowance for doubtful accounts receivable based upon estimates of future collection. The Company regularly evaluates customers' financial condition and credit history in determining the adequacy of the allowance for doubtful accounts. The Company also maintains an allowance for uncollectible vendor receivables, which arise from vendor rebate programs, price protections and other promotions. The Company determines the sufficiency of the vendor receivable allowance based upon various factors, including payment history. If estimated allowances for uncollectible accounts or vendor receivables subsequently prove insufficient, additional allowances may be required.

Inventories

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

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 IBM 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.

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

eCOST inventories include goods in-transit to customers.

The allowance for slow moving inventory was $2.2 million and $1.5 million at September 30, 2006 and December 31, 2005, respectively.

Property and Equipment

The Company's property held under capital leases amounted to approximately $3.2 million and $3.3 million, net of accumulated amortization of approximately $9.4 million and $8.3 million, at September 30, 2006 and December 31, 2005, respectively.

Advertising Costs

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

eCOST produces and circulates catalogs at various dates throughout the year and receives market development funds and co-op advertising funds from vendors included in each catalog. Pursuant to Statement of Position (“SOP”) 93-7, *Reporting on Advertising Costs*, the costs of developing, producing and circulating each catalog are deferred and charged to advertising expense ratably over the life of the catalog based on the revenue generated from each catalog, approximately eight weeks. Advertising expenses for eCOST, including those for catalog, internet and other methods, were $0.4 million for the three months ended September 30, 2006 and $2.3 million for the period from the eCOST acquisition date through September 30, 2006 and are included in selling, general and administrative expenses. There were no such expenses to the Company prior to the acquisition of eCOST.

Market development and co-op advertising funds pursuant to Emerging Issues Task Force (“EITF”) 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received form a Vendor*, are recognized as an offset to cost of goods sold. Direct market development and co-op funds for eCOST were $0.6 million for the three months ended September 30, 2006 and $1.7 million for the period from the acquisition date through September 30, 2006. There were no such funds recognized by the Company prior to the acquisition of eCOST.

Intangible Assets

Intangible assets acquired consisted of the following as of September 30, 2006 (in thousands):

	Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	8 years	$ 2,072	$ (173)	$ 1,899
Trademark/Domain name	10 years	5,585	(372)	5,213
Total intangible assets		$ 7,657	$ (545)	$ 7,112

3. *COMPREHENSIVE LOSS (in thousands)*

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Net loss	$ (3,309)	$ (453)	$ (8,080)	$ (1,213)
Other comprehensive loss:				
Foreign currency translation adjustment	(30)	(85)	521	(1,170)
Comprehensive loss	$ (3,339)	$ (538)	$ (7,559)	$ (2,383)

4. *NET LOSS PER COMMON SHARE*

Basic and diluted net loss per share is computed by dividing net loss available to common shareholders by the weighted-average number of common shares outstanding for the reporting period. For the three months ended September 30, 2006 and 2005 and the nine months ended September 30, 2006 and 2005, outstanding options of 5.9 million, 5.5 million, 5.9 million and 5.5 million, respectively, to purchase common shares were anti-dilutive and have been excluded from the weighted diluted average share computation. Warrants not included in the calculation of diluted net loss per share for the three and nine months ended September 30, 2006 were 601,190 and for the three and nine months ended September 30, 2005 were 395,486 as the effect would be anti-dilutive. Outstanding warrants have been adjusted to give effect to the recent merger with eCOST and the sale by the Company of 5,000,000 shares of common stock on June 1, 2006 in a private placement transaction.

5. *STOCK AND STOCK OPTIONS*

Private Placement Transaction

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

In June 2006, the Company entered into a Purchase Agreement and Registration Rights Agreement with certain institutional investors in a private placement transaction pursuant to which the Company issued and sold an aggregate of 5,000,000 shares of its common stock, par value $.001 per share (the "Common Stock"), at $1.00 per share, resulting in gross proceeds of $5.0 million. After deducting expenses, the net proceeds were approximately $4.8 million.

Stock Options and Stock Option Plans

On January 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement No. 123(R), *Share-Based Payment*, ("FAS 123R"). Prior to January 1, 2006, the Company accounted for share-based employee compensation plans using the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related Interpretations. In accordance with APB 25 no compensation was required to be recognized for options granted that had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant.

The Company adopted FAS 123R using the modified prospective transition method. Under that transition method, compensation cost recognized during the three and nine months ended September 30, 2006 includes: a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FAS 123, and b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of FAS 123R. Compensation cost is recognized on a straight-line basis, net of estimated forfeitures, over the requisite service period of each award. Results for prior periods have not been restated.

As a result of adoption FAS 123R, stock-based compensation charged against income was $0.2 million and $0.7 million for the three and nine months ended September 30, 2006, respectively. As of September 30, 2006, there was $1.2 million of total unrecognized compensation costs related to unvested stock options, which is expected to be recognized over a weighted average period of approximately 1.3 years.

The following table illustrates the effect on net loss and net loss per share for the three and nine months ended September 30, 2005 as if stock-based compensation had been determined based on the fair value at the grant date (in thousands, except per share amounts):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net loss as reported	$ (453)	$ (1,213)
Add: Stock-based non-employee compensation expense included in reported net loss	2	16
Deduct: Total stock-based employee and non-employee compensation expense determined under fair value based method	(223)	(798)
Pro forma net loss, applicable to common stock for basic and diluted computations	$ (674)	$ (1,995)
Loss per common share — as reported		
Basic and diluted	$ (0.02)	$ (0.05)
Loss per common share — pro forma		
Basic and diluted	$ (0.03)	$ (0.09)

As of September 30, 2006, the Company has the following share-based compensation plans:

PFSweb Plan Options

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Interim Condensed Consolidated Financial Statements

The Company has an Employee Stock and Incentive Plan and an Outside Director Stock Option and Retainer Plan under which an aggregate of 8,500,000 shares of common stock were originally authorized for issuance (the “Stock Options Plans”) and an outstanding stock option agreement under which 35,000 shares were originally authorized for issuance. The Stock Option Plans provide for the granting of incentive awards in the form of stock options to directors, executive management, key employees, and outside consultants of the Company. The rights to purchase shares under the employee stock option agreements typically vest over a three-year period, one-twelfth each quarter. Stock options must be exercised within 10 years from the date of grant. Stock options are generally issued such that the exercise price is equal to the fair market value of the Company’s common stock at the date of grant.

As of September 30, 2006, there were 2,366,516 shares available for future options under the Stock Option Plans.

The following table summarizes stock option activity under the Stock Option Plans:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding, December 31, 2005	4,947,950	$1.30	6.8	
Granted	750,000	$1.46		
Exercised	—			
Canceled	(14,250)	$2.23		
Outstanding, March 31, 2006	5,683,700	$1.32	7.0	$1,321,933
Granted	88,500	$1.08		
Exercised	(19,918)	$0.40		
Canceled	(52,750)	$1.84		
Outstanding, June 30, 2006	5,699,532	$1.32	6.7	$ 666,671
Granted	19,500	$1.08		
Exercised	(1,334)	$0.40		
Canceled	(210,750)	$1.84		
Outstanding, September 30, 2006	5,506,948	$1.30	6.4	$ 198,315
Exercisable, September 30, 2006	4,472,965	$1.19	5.9	$ 198,315

The weighted average fair value per share of options granted during the three and nine months ended September 30, 2006 was $0.81 and $1.14, respectively. The weighted average fair value per share of options granted during the three and nine months ended September 30, 2005 was $1.56 and $2.07, respectively. The total intrinsic value of options exercised under the Stock Option Plans during the three and nine months ended September 30, 2005 was $0.02 million and $0.2 million, respectively. Of the options granted during 2006, 750,000 of the options were granted to officers and key employees of eCOST in conjunction with the acquisition.

The following table summarizes information concerning currently outstanding and exercisable stock options issued under the Stock Option Plans as of September 30, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding as of September 30, 2006	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable as of September 30, 2006	Weighted Average Exercise Price
$0.39—$0.99	2,925,593	5.6	$ 0.78	2,893,800	$ 0.78
$1.13—$1.92	1,948,105	7.2	$ 1.63	1,237,332	$ 1.72
$2.05—$2.96	625,500	8.2	$ 2.58	334,083	$ 2.58
$10.45—$16.00	7,750	2.9	$11.17	7,750	$11.17
	5,506,948	6.4	$ 1.30	4,472,965	$ 1.19

PFSweb Non-plan Options

Prior to the Company’s initial public offering, certain of the Company’s employees were holders of stock options of the Company’s former parent company, Daisytek International Corporation (“Daisytek”),

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issued under Daisytek's stock option plans.

In connection with the completion of the Company's spin-off from Daisytek on July 6, 2000 (the "Spin-off"), all outstanding Daisytek stock options were replaced with substitute stock options. Daisytek options held by PFSweb employees were replaced (at the option holder's election made prior to the Spin-off) with either options to acquire shares of PFSweb common stock or options to acquire shares of both Daisytek common stock and PFSweb common stock (which may be exercised separately) (the "Unstapled Options"). Options held by Daisytek employees were replaced (at the option holder's election made prior to the Spin-off) with either options to acquire shares of Daisytek common stock or Unstapled Options.

As a result of the stock option replacement process described above, in conjunction with the Spin-off, PFSweb stock options (the "Non-plan Options") were issued to PFSweb and Daisytek officers, directors and employees. These options were issued as one-time grants and were not issued under the Stock Option Plans. The terms and provisions of the Non-plan Options are substantially the same as options issued under the Stock Option Plans.

As of September 30, 2006, 433,862 Non-plan Options were outstanding, all of which were held by PFSweb officers, directors and employees.

The following table summarizes stock option activity under the Non-plan Options:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding, December 31, 2005	439,235	$0.95	5.9	
Granted	—			
Exercised	—			
Canceled	—			
Outstanding, March 31, 2006	439,235	$0.95	5.7	$139,842
Granted	—			
Exercised	(4,623)			
Canceled	—			
Outstanding, June 30, 2006	434,612	$0.95	5.4	$ 43,238
Granted	—			
Exercised	—			
Canceled	(750)			
Outstanding, September 30, 2006	433,862	$0.95	5.2	$ —
Exercisable, September 30, 2006	433,862	$0.95	5.2	$ —

The following table summarizes information concerning Non-plan Options outstanding and exercisable as of September 30, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding as of September 30, 2006	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable as of September 30, 2006	Weighted Average Exercise Price
$0.91	431,632	5.2	$0.91	431,632	$0.91
$5.78-$10.58	2,230	1.3	$8.83	2,230	$8.83
	433,862	5.2	$0.95	433,862	$0.95

Fair Value

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants of options under the Stock Option Plans for the periods indicated:

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Expected dividend yield	—	—	—	—
Expected stock price volatility	94% — 103%	94% — 103%	104%	104% — 105%
Risk-free interest rate	4.7% — 5.2%	4.5% — 5.2%	3.8% — 3.9%	3.6% — 4.6%
Expected life of options (years)	6	0.5 — 6	6	5 — 6

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock-price volatility. The assumptions listed above represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, our recorded and pro forma stock-based compensation expense could have been different. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the share-based compensation expense could be materially different. The expected life of options has been computed using the simplified method as prescribed by Staff Accounting Bulletin No. 107.

6. *VENDOR FINANCING:*

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

	September 30, 2006	December 31, 2005
Inventory and working capital financing agreements:		
United States	$ 25,861	$ 30,092
Europe	11,422	12,071
Total	$ 37,283	$ 42,163

Inventory and Working Capital Financing Agreement, United States

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of IBM products in the United States, providing financing for eligible IBM inventory and for certain receivables up to $30.5 million through its expiration in March 2007. As of September 30, 2006, Supplies Distributors had $4.7 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 $6.5 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% (8.75% as of September 30, 2006). The facility also includes a monthly service fee. The Company has classified the outstanding amounts under this credit facility as accounts payable in the consolidated balance sheets.

Inventory and Working Capital Financing Agreement, Europe

Supplies Distributors' European subsidiaries have a short-term credit facility with IBM Belgium Financial Services S.A. ("IBM Belgium") to finance their distribution of IBM products in Europe. The asset based credit facility with IBM Belgium provides up to 12.5 million Euros (approximately $15.8 million) in financing for purchasing IBM inventory and for certain receivables through its expiration in March 2007. As of September 30, 2006, Supplies Distributors' European subsidiaries had 2.2 million euros ($2.8 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 subsidiaries, as well as collateralized guaranties of Supplies Distributors and PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of $6.5 million and a minimum shareholders' equity of $18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at Euribor plus 1.5% (4.8% as of September 30, 2006). Supplies Distributors' European subsidiaries pay a monthly service fee on the commitment. The Company has classified the outstanding amounts under this facility as accounts payable in the consolidated balance sheets.

7. ***DEBT AND CAPITAL LEASE OBLIGATIONS;***

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

	September 30, 2006	December 31, 2005
Loan and security agreements, United States		
Supplies Distributors	$ 13,415	$ 11,673
PFS	6,500	6,640
Factoring agreement, Europe	2,610	576
Taxable revenue bonds	4,500	5,000
Master lease agreements	4,139	3,713
Other	368	313
Total	31,532	27,915
Less current portion of long-term debt	25,872	21,626
Long-term debt, less current portion	$ 5,660	$ 6,289

Loan and Security Agreement — Supplies Distributors

Supplies Distributors has a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to $25 million of eligible accounts receivable in the United States and Canada. As of September 30, 2006, Supplies Distributors had $1.5 million of available credit under this agreement. The Congress facility expires on the earlier of March 29, 2007 or the date on which the parties to the IBM master distributor agreement no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such agreement. Borrowings under the Congress facility accrue interest at prime rate to prime rate plus 0.25% or Eurodollar rate plus 2.25% to 2.75%, dependent on excess availability, as defined. The interest rate as of September 30, 2006 was 8.25% for $8.4 million of outstanding borrowings, 7.5% for $2.0 million of outstanding borrowings, and 7.6% for $3.0 million of outstanding borrowings. This agreement contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, 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 $6.5 million and restricted cash of less than $5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and Congress pursuant to which a security interest was granted to Congress for all U.S. and Canadian customer remittances received in specified bank accounts. At September 30, 2006 and December 31, 2005, these bank accounts held $0.6 million and $1.0 million, respectively, which was restricted for payment to Congress.

Loan and Security Agreement — PFSweb

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PFS has a Loan and Security Agreement ("Comerica Agreement") with Comerica Bank ("Comerica"). The Comerica Agreement provides for up to $7.5 million of eligible accounts receivable financing ("Working Capital Advances") through March 2007 and $2.5 million of equipment financing ("Equipment Advances") through June 15, 2008. Outstanding Working Capital Advances, $6.0 million as of September 30, 2006, accrue interest at prime rate plus 1% (9.25% as of September 30, 2006). Outstanding Equipment Advances, $0.5 million as of September 30, 2006, accrue interest at prime rate plus 1.5% (9.75% as of September 30, 2006). As of September 30, 2006, PFS had $1.1 million of available credit under the Working Capital Advance portion of this facility and no available credit under the Equipment Advance portion of this facility. In October 2006, the Company repaid the $6.0 million of Working Capital Advances outstanding as of September 30, 2006. 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 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 note receivable from Supplies Distributors to a maximum of $8 million. Comerica has provided approval for PFS to use $3.5 million in cash to fund the cash flow requirements of eCOST, which, as of September 30, 2006 PFS had advanced to eCOST. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc. The Comerica Agreement requires PFS to maintain a minimum cash balance of $1.3 million at Comerica.

In November, 2006, PFS and Comerica executed an amendment to the Comerica Agreement that extends the maturity date through April 2008, provides for an incremental $1.5 million term loan due in monthly installments through December 2007, and permits an incremental $1.5 million of advances to eCOST.

Credit Facility — eCOST

eCOST currently has an asset-based line of credit facility of up to $15.0 million with Wachovia Capital Finance Corporation (Western), 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 from the prime rate to the prime rate plus 0.5% (8.75% as of September 30, 2006), depending on eCOST's financial results. As of September 30, 2006, eCOST had $1.6 million of letters of credit outstanding and $0.4 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 swept and used to repay outstanding amounts under the line of credit. 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 $1 million, as defined. PFSweb has guaranteed all current and future obligations of eCOST under this line of credit.

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 $9.5 million) of eligible accounts receivables through March 2007. As of September 30, 2006, Supplies Distributors' European subsidiary had approximately 1.9 million euros ($2.4 million) of available credit under this agreement. Borrowings accrue interest at Euribor plus 0.6% (3.9% at September 30, 2006). 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.

PFSweb, Inc. and Subsidiaries

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Taxable Revenue Bonds

PFSweb 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 PFSweb for the purpose of financing the acquisition and installation of equipment, machinery and related assets located in the Company's Southaven, Mississippi distribution facility. The Bonds bear interest at a variable rate (5.35% as of September 30, 2006), as determined by Comerica Securities, as Remarketing Agent. PFSweb, 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 PFSweb and Comerica under which PFSweb is obligated to pay to Comerica all amounts drawn under the Letter of Credit. The Letter of Credit has a maturity date of April 2008 at which time, if not renewed or replaced, will result in a draw on the undrawn face amount thereof. The Letter of Credit requires future principal repayments of $500,000 in January 2007 and $800,000 in each of January 2008 through 2012. PFSweb has established a sinking fund account with Comerica, which at September 30, 2006 includes $40,000 restricted for payments on the Bonds.

Debt Covenants

To the extent the Company or any of its subsidiaries fail to comply with its covenants applicable to its debt or vendor financing obligations, including the monthly financial covenant requirements and required level of stockholders' 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 and does not achieve targeted operating efficiencies, 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 or any portion 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 3 to 5 years. The outstanding leasing transactions ($0.8 million and $0.7 million as of September 30, 2006 and December 31, 2005, respectively) are secured by the related equipment and letters of credit. The outstanding financing transactions ($0 and $0.2 million as of September 30, 2006 and December 31, 2005, respectively) are secured by a letter of credit.

The Company has a master agreement with a leasing company that provided for leasing transactions of certain equipment. The amounts outstanding under this agreement as of September 30, 2006 and December 31, 2005 were $0.5 million and $1.9 million, 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.

8. *SEGMENT INFORMATION*

The Company is organized into three operating segments: PFSweb is an international provider of

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integrated business process outsourcing solutions and operates as a service fee business; Supplies Distributors is a master distributor of primarily IBM products; and eCOST is a multi-category online discount retailer of new, “close-out” and refurbished brand-name merchandise.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues (in thousands):				
PFSweb	$ 23,720	$ 21,476	$ 68,567	$ 65,674
Supplies Distributors	55,917	62,284	185,199	189,352
eCOST	16,676	—	67,248	—
Eliminations	(2,029)	(2,268)	(6,758)	(6,799)
	$ 94,284	$ 81,492	$ 314,256	$ 248,227
Income (loss) from operations (in thousands):				
PFSweb	$ (1,657)	$ (1,990)	$ (1,966)	$ (4,346)
Supplies Distributors	3,060	2,333	6,364	5,102
eCOST	(3,934)	—	(10,393)	—
Eliminations	—	—	—	—
	$ (2,531)	$ 343	$ (5,995)	$ 756
Depreciation and amortization (in thousands):				
PFSweb	$ 1,555	$ 1,595	$ 4,661	$ 4,607
Supplies Distributors	4	—	7	—
eCOST	285	—	765	—
Eliminations	—	—	—	—
	$ 1,844	$ 1,595	$ 5,433	$ 4,607
Capital expenditures (in thousands):				
PFSweb	$ 690	$ 848	$ 2,674	$ 3,409
Supplies Distributors	2	—	47	—
eCOST	1	—	95	—
Eliminations	—	—	—	—
	$ 693	$ 848	$ 2,816	$ 3,409

	September 30, 2006	December 31, 2005
Assets (in thousands):		
PFSweb	$ 98,461	$ 60,337
Supplies Distributors	84,285	87,542
eCOST	39,475	—
Eliminations	(54,816)	(16,153)
	$ 167,405	$ 131,726

9. ***COMMITMENTS AND CONTENGENCIES***

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. The Company plans to dispute the notice. If the dispute is not resolved favorably, the Company could be assessed additional taxes from January 1, 2004. The Company has not accrued for the additional taxes, which through September 30, 2006 could be approximately $1.5 million, as it does not believe that it is probable that an additional assessment will be incurred.

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On May 9, 2005, a lawsuit was filed in the District Court of Collin County, Texas, by J. Gregg Pritchard, as Trustee of the D.I.C. Creditors Trust, naming the former directors of Daisytek International Corporation and the Company as defendants. Daisytek filed for bankruptcy in May 2003 and the Trust was created pursuant to Daisytek's Plan of Liquidation. The complaint alleges, among other things, that the spin-off of the Company from Daisytek in December 1999 was a fraudulent conveyance and that Daisytek was damaged thereby in the amount of at least $38 million. The Company believes the claim has no merit and is vigorously defending the action. Through September 30, 2006, the Company has incurred outstanding legal costs of $1.0 million which have not been paid as the Company expects such costs to be covered by insurance.

On August 24, 2006, a lawsuit was filed in the Chancery Court of Davidson County, Tennessee, by ClientLogic Corp. alleging, among other things, that the Company breached its obligations under a Confidentiality and Nondisclosure Agreement. The complaint seeks injunctive relief and damages in an unspecified amount. The Company believes the claim has no merit and is vigorously defending the action. The Company has not accrued for any amount applicable to this case.

On July 12, 2004, eCOST received correspondence from MercExchange LLC alleging infringement of MercExchange's U.S. patents relating to e-commerce and offering to license its patent portfolio to eCOST. On July 15, 2004, eCOST received a follow-up letter from MercExchange specifying which of its technologies MercExchange believed infringed certain of its patents, alone or in combination with technologies provided by third parties. Some of those patents are currently being litigated by third parties, and eCOST is not involved in those proceedings. In addition, three of the four patents identified by MercExchange are under reexamination at the U.S. Patent and Trademark Office, which may or may not result in the modification of those claims. In the July 15 letter, MercExchange also advised eCOST that it has a number of applications pending for additional patents. MercExchange has filed lawsuits alleging infringement of some or all of its patents against third parties, resulting in settlements or verdicts in favor of MercExchange. At least one such verdict was appealed to the United States Court of Appeals for the Federal Circuit and was affirmed in part. Based on eCOST's investigation of this matter to date, eCOST believes that its current operations do not infringe any valid claims of the patents identified by MercExchange in these letters. There can be no assurance, however, that such claims will not be material or adversely affect eCOST's business, financial position, results of operations or cash flows.

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 and Form 10-K/A for the year ended December 31, 2005, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

- our ability to retain and expand relationships with existing clients and attract and implement new clients;
- our reliance on the fees generated by the transaction volume or product sales of our clients;
- our reliance on our clients' projections or transaction volume or product sales;
- our dependence upon our agreements with IBM;
- our 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 the market for our services;
- trends in e-commerce;
- whether we can continue and manage growth;
- changes in the trend toward outsourcing;
- increased competition;
- our ability to generate more revenue and achieve sustainable profitability;
- effects of changes in profit margins;
- the customer and supplier concentration of our business;
- the unknown effects of possible system failures and rapid changes in technology;
- trends in government regulation both foreign and domestic;
- foreign currency risks and other risks of operating in foreign countries;
- potential litigation;
- potential delisting;
- our dependency on key personnel;
- the impact of new accounting standards and rules regarding revenue recognition, stock options and other matters;
- changes in 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;
- whether outstanding warrants issued in a prior private placement will be exercised in the future;
- the transition costs resulting from our merger with eCOST;
- our ability to successfully integrate eCOST into our business to achieve the anticipated benefits of the merger:
- 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; and
- eCOST's ability to increase its sales revenue and sales margin and improve operating efficiencies.

We have based these statements on our current expectations about future events. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations actually will be achieved. In addition, some forward-looking statements are based upon assumptions as to future events that may not prove to be accurate. Therefore, actual outcomes and results may differ materially from what is expected or forecasted in such forward-looking statements. We undertake no obligation to update publicly any forward-looking statement for any reason, even if new information becomes available or other events occur in the future. In addition to the risks set forth in our Annual Report on From 10-K and Form 10-K/A for the year ended December 31, 2005 under the caption “Risk Factors”, there may be additional risks that we do not currently view as material or that are not presently known.

Overview

We are an international provider of integrated business process outsourcing solutions to major brand name companies seeking to maximize their supply chain efficiencies and to extend their traditional business and e-commerce initiatives as well as a leading multi-category online discount retailer of new, “close-out” and refurbished brand-name merchandise. We derive our revenues from three business segments.

In our first business segment, a service fee revenue model, we derive our revenues from a broad range of services, including professional consulting, technology collaboration, order management, managed web hosting and web development, customer relationship management, financial services including billing and collection services and working capital solutions, kitting and assembly services, information management and international fulfillment and distribution services and on-line retail sales. 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, printers, cosmetics, fragile goods, high security collectibles, pharmaceuticals, contemporary home furnishings, apparel, aviation, telecommunications and consumer electronics, among others.

In our service fee revenue 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 IBM 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 more than $87 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 refurbished brand-name merchandise. Our web-commerce product line currently offers more than 100,000 products in several primary merchandise categories, including computer hardware and software, home electronics, digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. Our product revenue in this segment is reduced by consumer chargeback activities and credit card fraud matters.

Growth is a key element to achieving our future goals, including achieving and maintaining sustainable profitability. Growth in our service fee business is driven by two main elements: new client relationships and organic growth from existing clients. We have refocused our sales efforts on larger contracts with brand-name companies within two primary target markets, which, by nature, require a longer duration to close but also often prove to be higher-quality and longer duration engagements. Our results for the nine months ended September 30, 2006 include approximately $1.8 million of new revenue including certain incremental projects. Growth within our product revenue business is primarily driven by our ability to attract new master distributor arrangements with IBM 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 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) selling, general and administrative ("SG&A") expenses.

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

SG&A expenses — consist primarily of compensation and related expenses for sales and marketing staff, advertising, on-line 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 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. In recent years we have added to our available cash and liquidity positions through various transactions:

- Each of our primary operating subsidiaries has one or more asset based working capital financing agreements with various lenders.
- In 2003 we completed a private placement of approximately 1.6 million shares of our common stock to certain investors that provided net proceeds of approximately $3.2 million. In January 2005, we issued an additional 0.4 million shares of common stock to certain of these investors who exercised warrants issued in the private placement. The warrants exercised provided $1.3 million of additional proceeds.

- In 2004 we received proceeds of $5.0 million of taxable revenue bonds to finance capital additions to our new facility in Southaven, MS.
- In June 2006, we completed another private placement of 5.0 million shares of our common stock to certain investors that provided net proceeds of $4.8 million.

Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)
Product revenue, net	77.0%	76.4%	80.3%	76.3%
Service fee revenue	16.5	18.3	15.2	18.2
Pass-through revenue	6.5	5.3	4.5	5.5
Total revenues	100.0	100.0	100.0	100.0
Cost of product revenue (as % of product revenue)	92.1	92.2	93.4	93.3
Cost of service fee revenue (as % of net service fee revenue)	75.7	73.8	72.4	74.8
Cost of pass-through revenue (as % of pass-through revenue)	100.0	100.0	100.0	100.0
Total costs of revenues	89.9	89.2	90.5	90.3
Gross profit	10.1	10.8	9.5	9.7
Selling, general and administrative expenses	12.7	10.4	11.4	9.4
Income (loss) from operations	(2.6)	0.4	(1.9)	0.3
Interest expense, net	0.6	0.6	0.5	0.5
Loss before income taxes	(3.2)	(0.2)	(2.4)	(0.2)
Income tax expense	0.2	0.3	0.3	0.3
Net loss	(3.4)%	(0.5)%	(2.7)%	(0.5)%

Results of Operations for the Interim Periods Ended September 30, 2006 and 2005

Product Revenue. Product revenue was $72.6 million for the three months ended September 30, 2006, as compared to $62.3 million for the three months ended September 30, 2005, an increase of $10.3 million, or 16.6%. Excluding the $16.7 million of product revenue of eCOST following its acquisition in February 2006, product revenue decreased $6.4 million, or 10.2%, primarily due to lower volumes and reduced promotional activity. Product revenue for the nine months ended September 30, 2006 was $252.4 million as compared to $189.4 million, an increase of $63.0 million, or 33.3%, in the same period of the prior year. Excluding the $67.2 million of product revenue of eCOST following its acquisition in February 2006, revenue decreased $4.2 million, or 2.2%, primarily due to lower volumes and reduced promotional activity. In addition, while product revenue for the Supplies Distributors segment declined this quarter as compared to the same period of the prior year, this decrease was primarily due to the timing of vendor promotional activity, and annual revenue is expected to remain relatively consistent with the prior year.

Service Fee Revenue. Service fee revenue was $15.6 million for the three months ended September 30, 2006 as compared to $14.9 million for the three months ended September 30, 2005, an increase of $0.7 million or 4.4%. Service fees for the nine months ended September 30, 2006 and 2005 were $47.7 million and $45.3 million, respectively, an increase of $2.4 million or 5.3%. Service fee revenue for the three months and nine months ended September 30, 2006 and 2005 included increased service fees generated from incremental projects with certain client relationships. The change in service fee revenue is shown below ($ millions):

	Three Months	Nine Months
Period ended September 30, 2005	$ 14.9	$ 45.3
New service contract relationships, including certain incremental projects under new contracts	0.8	1.8
Change in existing client service fees from organic growth and certain incremental projects with existing clients	0.9	2.3
Terminated clients not included in 2006 revenue	(1.0)	(1.7)
Period ended September 30, 2006	$ 15.6	$ 47.7

Cost of Product Revenue. Cost of product revenue was $66.9 million for the three months ended September 30, 2006, as compared to $57.4 million for the three months ended September 30, 2005, an increase of $9.5 million or 16.5%. Excluding the $16.4 million of cost of product revenue of eCOST following its acquisition in February 2006, cost of product revenue decreased $6.7 million or 12.0%. Cost of product revenue, excluding eCOST, decreased primarily as the result of decreased sales volumes of certain products. Cost of product revenue as a percent of product revenue, excluding the impact of eCOST, was 90.4% during the three months ended September 30, 2006 and 92.2% during the three months ended September 30, 2005. The resulting gross profit margin was 9.6% for the three months ended September 30, 2006 and 7.8% for the three months ended September 30, 2005. The gross profit margin for the 2006 period includes certain incremental inventory cost reductions. eCOST's cost of product revenue, as a percentage of product revenue was 98.1% during the three month period ended September 30, 2006. The resulting gross margin for eCOST was 1.9% during the same period, which is lower than expected primarily due to unusually high levels of credit card chargeback activity partially due to credit card systems controls not operating effectively during certain IT integration activities. This resulted in approximately $1.0 million higher than normal credit card chargebacks in the current quarter. Such activity is accounted for as a reduction in product revenue, resulting in lower gross margin.

Cost of product revenue was $235.7 million for the nine months ended September 30, 2006, as compared to $176.7 million for the nine months ended September 30, 2005, an increase of $59.0 million or 33.4%. Excluding the $64.5 million of cost of product revenue of eCOST following its acquisition in February 2006, cost of product revenue decreased $5.5 million or 3.1%. Cost of product revenue, excluding eCOST, decreased primarily as the result of the lower sales volume of certain products. Cost of product revenue, as a percent of product revenue, excluding the impact of eCOST, was 92.5% during the nine months ended September 30, 2006 and 93.3% during the nine months ended September 30, 2005. The resulting gross profit margin was 7.5% for the nine months ended September 30, 2006 and 6.7% for the nine months ended September 30, 2005. The gross profit margin for the 2006 period includes certain incremental inventory cost reductions. eCOST's cost of product revenue, as a percentage of product revenue was 95.9% during the nine month period ended September 30, 2006. The resulting gross margin for eCOST was 4.1% during the same period, which is lower than we expected primarily due to unusually high levels of credit card activity that resulted in approximately $1.7 million higher than normal chargebacks, an increased provision for excess and obsolete inventory, and the impact of a $0.4 million loss applicable to a sales transaction to a former eCOST customer during the nine months ended September 30, 2006.

Cost of Service Fee Revenue. Cost of service fee revenue was $11.8 million for the three months ended September 30, 2006, as compared to $11.0 million during the three months ended September 30, 2005, an increase of $0.8 million or 7.1%. The resulting service fee gross profit was $3.8 million or 24.3% of service fee revenue, during the three months ended September 30, 2006 as compared to $3.9 million, or 26.2% of service fee revenue for the three months ended September 30, 2005. The decrease in gross profit as a percent of service fees for the three months ended September 30, 2006 is primarily due to lower run rate and project revenues on certain larger existing clients. Cost of service fee revenue was $34.5 million for the nine months ended September 30, 2006, as compared to $33.9 million during the nine months ended September 30, 2005, an increase of $0.6 million or 1.9%. The resulting service fee gross profit was $13.2 million or 27.6% of service fee revenue, during the nine months ended September 30, 2006 as compared to $11.4 million, or 25.2% of service fee revenue for the nine months ended September 30, 2005. Our gross profit as a percent of service fees increased in the nine months ended September 30, 2006 primarily due to higher gross margins on certain client project revenue as well as the prior year having lower gross margins on certain new contracts, including certain start up costs. As we add new service fee revenue in the future, we currently intend to target the underlying contracts to earn an average gross profit percentage of 25-35%, 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 were $12.0 million for the three months ended September 30, 2006, or 12.7% of total net revenues, as compared to $8.4 million, or 10.4% of total net revenues, for the three months ended September 30, 2005. Excluding the $4.3 million of operating expenses of eCOST following its acquisition in February 2006, operating expenses were $7.8 million, or 10.0% of total net revenues, during the current period. The decrease in operating expenses, excluding eCOST, for the three months ended September 30, 2006 compared to 2005 is primarily due to the decrease of certain personnel related costs and certain incremental costs in the 2005 period incurred to relocate certain of our operations from Memphis, TN to a new facility in Southaven, MS. Operating expenses were $35.9 million for the nine months ended September 30, 2006, or 11.4% of total net revenues, as compared to $23.4 million, or 9.4% of total net revenues, for the nine months September 30, 2005. Excluding the $13.2 million of operating expenses of eCOST following its acquisition in February 2006, operating expenses were $22.8 million or 9.2% of total net revenues, for the nine months ended September 30, 2006. As we are nearly complete with the integration process of eCOST into our current infrastructure, we have begun to realize certain operating savings through the reduction of certain eCOST overhead expenses, changes in corporate infrastructure and a reduction in integration related costs. Operating expenses in the three and nine month periods ended September 30, 2006 included $0.2 million and $0.7 million, respectively, of costs applicable to stock-based compensation, which were zero in the prior year.

Interest Expense, net. Net interest expense was $0.6 million and $1.5 million for the three and nine months ended September 30, 2006 respectively as compared to $0.5 million and $1.3 million for the three and nine months ended September 30, 2005.

Income Taxes. For the three months ended September 30, 2006 and 2005, we recorded a tax provision of $0.2 million and $0.3 million, respectively, primarily associated with our subsidiary Supplies Distributors' Canadian and European operations. For the nine month periods ended September 30, 2006 and 2005, we recorded a tax provision of $0.6 million for those same operations. We did not record an income tax benefit associated with our consolidated net loss in our U.S. operations. A valuation allowance has been provided for our net U.S. deferred tax assets as of September 30, 2006 and December 31, 2005, which are primarily related to our net operating loss carryforwards. We did not record an income tax benefit for our PFSweb Canadian pre-tax losses in the current or prior periods. Due to the consolidation of Supplies Distributors, in the future we anticipate that we will continue to record an income tax provision associated with Supplies Distributors' Canadian and European results of operations.

Liquidity and Capital Resources

Net cash used in operating activities was $3.9 million for the nine months ended September 30, 2006, and primarily resulted from a $6.6 million decrease in accounts payable, accrued expenses and other liabilities, an increase in inventories of $2.5 million and a decrease in net income, as adjusted for non-cash items, of $0.6 million, offset by a decrease in accounts receivable of $4.4 million, a $0.8 million decrease in prepaid expenses, other receivables and other current assets and a $0.7 million decrease in restricted cash.

Net cash used in operating activities was $0.1 million for the nine months ended September 30, 2005, and primarily resulted from an increase in accounts receivable of $4.7 million, a $2.3 million increase in prepaid expenses, other receivables and other current assets, and a $1.2 million decrease in accounts payable, accrued expenses and other liabilities offset by net income, as adjusted for non-cash items, of $3.4 million and a $4.7 million decrease in inventories. The increase in accounts receivable was primarily due to increased service fee billings for certain client relationships and the timing of payments received by certain clients.

Net cash used in investing activities for the nine months ended September 30, 2006 totaled $3.4 million, representing capital expenditures of $2.8 million and cash paid to acquire eCOST, net of cash acquired, of $1.3 million, partially offset by a decrease in restricted cash of $0.7 million.

Net cash used in investing activities for the nine months ended September 30, 2005 totaled $2.1 million, representing capital expenditures of $3.4 million partially offset by a decrease in restricted cash of $1.3 million.

Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, and general expansion of 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 that our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months will be approximately $4 to $7 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients as well as the eCOST infrastructure. To maintain our current operating cash position, a portion of these expenditures may be financed through debt, operating or capital leases or additional equity. We may elect to modify or defer a portion of such anticipated investments in the event that we do not obtain the financing or achieve the revenue necessary to support such investments.

Net cash provided by financing activities was approximately $7.7 million for the nine months ended September 30, 2006, primarily representing $4.9 million of net proceeds on issuance of common stock pursuant to a private placement transaction, $3.4 million of proceeds on debt and $0.6 decrease in restricted cash, partially offset by $1.1 million of payments on capital leases.

Net cash provided by financing activities was approximately $3.2 million for the nine months ended September 30, 2005, primarily representing $2.0 million from the issuance of common stock pursuant to our employee stock purchase and stock option programs and warrant exercises, $1.6 million of proceeds from debt and $0.5 million decrease in restricted cash partially offset by payments on capital leases of $0.9 million.

Our liquidity has been negatively impacted as a result of the merger with eCOST. During 2005 and the nine month period ended September 30, 2006, eCOST experienced a significant net usage of cash primarily due to losses incurred. As a result, during the process of transitioning and integrating the eCOST operations, we have had to support eCOST's cash needs to help it achieve a stabilized operational position. The amount of further cash needed to support eCOST operations will depend upon the financing available as well as the length of time it takes to successfully transition and incorporate eCOST into our current infrastructure and eCOST's ability to improve its financial results.

We currently expect that eCOST, as part of a combined Company, should achieve annual recurring cost savings of approximately $4 to $5 million, dependent upon sales volumes, as compared to pre merger levels once the related integration efforts are complete. These savings are expected to result from, among other things, the reduction of certain overhead expenses, changes in corporate infrastructure and reduced freight costs, although there can be no assurance that these cost savings will be achieved. We are nearly complete with the incorporation of eCOST into our infrastructure and we have begun to realize expected cost savings.

During the nine months ended September 30, 2006, our working capital decreased to $22.8 million from $23.4 million at December 31, 2005, primarily as a result of the use of cash related to the integration activities of eCOST into the PFS infrastructure. A portion of these cash outflows were offset by the net proceeds from the sale of our common stock in a private placement transaction. 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. No assurances can be given that we will be successful in obtaining any additional financing or the terms thereof. We currently believe that our cash position, financing available under our credit facilities and funds generated from operations (including our anticipated revenue growth and/or cost reductions to offset lower than anticipated revenue growth) will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our lease obligations, and additional loans to our subsidiaries Supplies Distributors and eCOST, if necessary, for at least the next twelve months.

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 September 30, 2006, (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	$ 65,271	$ 60,678	$ 4,588	$ 5	$ —
Capital lease obligations	4,150	2,752	1,276	122	—
Operating leases	29,395	8,800	12,783	6,597	1,215
Total	$ 98,816	$ 72,230	$ 18,647	$ 6,724	$ 1,215

In support of certain debt instruments and leases, as of September 30, 2006, we had $0.3 million of cash restricted as collateral for letters of credit. The letters of credit expire in 2007. As of September 30, 2006, we had $0.9 million of cash restricted for payment of capital expenditures or repayments 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 our debt facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other agreements. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders' equity, and the lenders accelerate the repayment of the credit facility obligations, we would be required to repay all amounts outstanding thereunder. In particular, in the event eCOST is unable to increase its revenue and/or gross profit from its present levels and does not achieve the operating efficiencies targeted to occur upon completion of its integration into the Company's infrastructure, 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 payment under the Company 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 September 30, 2006, 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 IBM 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 12.5 million Euros (approximately $15.8 million) with IBM Credit and IBM Belgium, respectively. These agreements expire in March 2007.

Supplies Distributors also has a loan and security agreement with Congress Financial Corporation (Southwest) ("Congress") to provide financing for up to $25 million of eligible accounts receivables in the United States and Canada. The Congress facility expires on the earlier of March 29, 2007 or the date on which the parties to the IBM master distributor agreement no longer operate under the terms of such agreement and/or IBM 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 $9.5 million) of eligible accounts receivables through March 2007.

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 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 $6.5 million, maintain restricted cash of less than $5.0 million, are restricted with regard to transactions with related parties (including entities directly or indirectly owned by PFSweb, Inc.), 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, excluding the trade payables that are financed by IBM credit.

Our subsidiary, Priority Fulfillment Services, Inc. ("PFS"), has entered into a Loan and Security Agreement with Comerica Bank ("Comerica"), which provides for up to $7.5 million of eligible accounts receivable financing through March 2007, and up to $2.5 million of eligible equipment purchases through June 2008. 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 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, and a minimum liquidity ratio, as defined. The agreement also limits PFS' ability to increase the subordinated loan to Supplies Distributors to more than $8.0 million or advance more than $3.5 million to eCOST without the lender's approval. The agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb. In November, 2006, the Loan and Security Agreement was amended to extend the maturity date through April 2008, provide for an incremental $1.5 million term loan due in monthly installments through December 2007, and permit an incremental $1.5 million of advances to eCOST.

In 2003, we entered into a Securities Purchase Agreement with certain institutional investors in a private placement transaction pursuant to which we issued and sold an aggregate of 1.6 million shares of our common stock, par value $.001 per share (the "Common Stock"), at $2.16 per share, resulting in gross proceeds of $3.4 million. After deducting expenses, the net proceeds were approximately $3.2 million. In addition to the Common Stock, the investors received one-year warrants to purchase an aggregate 525,692 shares of Common Stock at an exercise price of $3.25 per share and four-year warrants to purchase an aggregate of 395,486 shares of Common Stock at an exercise price of $3.30 per share. In January 2005, 394,865 of the one-year warrants were exercised prior to their expiration, generating net proceeds to us of $1.3 million, and 131,277 of the one-year warrants expired unexercised. As a result of the merger with eCOST and the private placement transaction of our common stock in June 2006 (discussed below), the exercise price of the four-year warrants has been adjusted to $2.31 per share and the number of warrants has been adjusted to 564,980. In addition, in connection with the merger with eCOST, we assumed outstanding warrants to issue an aggregate of 36,210 shares of common stock at an exercise price of $2.00 per share, subject to the terms set forth therein.

In 2004, to fulfill our obligations under certain new client relationships, we entered into a three-year operating lease arrangement for a new distribution facility in Southaven, MS, near our existing distribution complex in Memphis, TN. We have incurred more than $5 million in capital expenditures to support the incremental business in this new distribution center. We 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 us the proceeds of the Bonds for the purpose of financing the acquisition and installation of equipment, machinery and related assets located in our new 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 we are obligated to pay to Comerica all amounts drawn under the Letter of Credit. The Letter of Credit has a maturity date of April 2008 at which time, if not renewed or replaced, will result in a draw on the undrawn face amount thereof.

In June 2006, we entered into a Securities Purchase Agreement with certain institutional investors in a private placement transaction pursuant to which we issued and sold an aggregate of 5.0 million shares of our common stock, par value $.001 per share, at $1.00 per share, resulting in gross proceeds of $5.0 million. After deducting expenses, the net proceeds were approximately $4.8 million. We have advanced the net proceeds to eCOST to support their operating requirements.

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 September 30, 2006, we were in compliance with all debt covenants.

Through our merger with eCOST, we plan to align the core strengths of each company, to leverage our operational infrastructure and technology expertise with eCOST's customer base and supplier relationships. Specifically, we are targeting for eCOST to achieve $4 to $5 million in annual cost savings, dependent upon sales volumes, as compared to pre merger levels once the related integration efforts are complete. These savings are expected to result from, among other things, reductions in the following costs:

- Certain redundant administrative and public company activities;
- Excess capacity and other related facility expenses;
- Technology, telecommunications and operational costs; and
- Overall outbound freight costs due to additional freight options.

We are now nearing completion of the integration of eCOST into our infrastructure and we are beginning to realize the expected cost savings.

Additionally, we believe the combined companies can pursue a variety of incremental revenue and gross profit-related opportunities, such as:

- Increase the number of "virtual warehouse" partnerships for both electronics and non-electronic goods;
- Develop higher margin non-product and service categories;
- Expand international sales, particularly in Europe and Canada, where we maintain a presence; and
- Utilize our stronger financial platform to enhance eCOST's working capital resources to expand access to exclusive products and deals.

We can provide no assurance that such plans or the underlying financial benefits will be achieved. Additionally, even with such plans, eCOST will operate at a loss during 2006 and will require further funding to support its operations.

eCOST currently has an asset-based line of credit facility of up to $15.0 million with Wachovia Capital Finance Corporation (Western), which is collateralized by substantially all of eCOST's assets. 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. Outstanding amounts under the facility bear interest at rates ranging from the prime rate to the prime rate plus 0.5% (8.75% as of September 30, 2006), depending on eCOST's financial results. As of September 30, 2006, eCOST had $1.6 million of letters of credit outstanding and $0.4 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, and requires a minimum tangible net worth of $1 million, as defined. PFSweb has guaranteed all current and future obligations of eCOST under this line of credit.

eCOST expects to enter into an amendment to this credit facility to reduce the line of credit to $7.5 million and reduce the tangible net worth covenant to $0.

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 the length of time it takes to successfully transition and incorporate eCOST into our current infrastructure. Through November 1, 2006, we have advanced $10.1 million to eCOST to fund eCOST's cash flow requirements. We currently expect that it will be necessary to invest further cash to fund eCOST's cash flow requirements. In such event, 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.

If eCOST is unable to meet its requirements under its debt obligations and bank facility, the guarantees referred to above could be called upon.

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. We plan to dispute the notice. If the dispute is not resolved favorably, we could be assessed additional taxes from January 1, 2004. We have not accrued for the additional taxes, which through September 30, 2006 could be approximately $1.5 million in the aggregate, as we do not believe that it is probable that an additional assessment will be incurred.

On May 9, 2005, a lawsuit was filed in the District Court of Collin County, Texas, by J. Gregg Pritchard, as Trustee of the D.I.C. Creditors Trust, naming the former directors of Daisytek International Corporation and the Company as defendants. Daisytek filed for bankruptcy in May 2003 and the Trust was created pursuant to Daisytek's Plan of Liquidation. The complaint alleges, among other things, that the spin-off of the Company from Daisytek in December 1999 was a fraudulent conveyance and that Daisytek was damaged thereby in the amount of at least $38 million. We believe the claim has no merit and are vigorously defending the action. Through September 30, 2006, the Company has incurred outstanding legal costs of $1.0 million which have not been paid as the Company expects such costs to be covered by insurance.

On August 24, 2006, a lawsuit was filed in the Chancery Court of Davidson County, Tennessee, by ClientLogic Corp. alleging, among other things, that the Company breached its obligations under a Confidentiality and Nondisclosure Agreement. The complaint seeks injunctive relief and damages in an unspecified amount. The Company believes the claim has no merit and is vigorously defending the action. The Company has not accrued for any amount applicable to this case.

On July 12, 2004, eCOST received correspondence from MercExchange LLC alleging infringement of MercExchange's U.S. patents relating to e-commerce and offering to license its patent portfolio to eCOST. On July 15, 2004, eCOST received a follow-up letter from MercExchange specifying which of its technologies MercExchange believes infringe certain of its patents, alone or in combination with technologies provided by third parties. Some of those patents are currently being litigated by third parties, and eCOST is not involved in those proceedings. In addition, three of the four patents identified by MercExchange are under reexamination at the U.S. Patent and Trademark Office, which may or may not result in the modification of those claims. In the July 15 letter, MercExchange also advised eCOST that it has a number of applications pending for additional patents. MercExchange has filed lawsuits alleging infringement of some or all of its patents against third parties, resulting in settlements or verdicts in favor of MercExchange. At least one such verdict was appealed to the United States Court of Appeals for the Federal Circuit and was affirmed in part. Based on eCOST's investigation of this matter to date, eCOST believes that its current operations do not infringe any valid claims of the patents identified by MercExchange in these letters. There can be no assurance, however, that such claims will not be material or adversely affect eCOST's business, financial position, results of operations or cash flows.

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 that with our current client mix and their current business volumes, our service fee business activity will be at it lowest in the quarter ended March 31. We anticipate that our product revenue will be highest during the quarter ended December 31.

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

Inflation

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

Critical Accounting Policies

A description of critical accounting policies is included in Note 2 to the accompanying unaudited interim condensed consolidated financial statements. For other significant accounting policies, see Note 2 to the consolidated financial statements in our December 31, 2005 Annual Report on Form 10-K and Form 10-K/A.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

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

Interest Rate Risk

Our interest rate risk is limited to our outstanding balances on our inventory and working capital financing agreements, taxable revenue bonds, loan and security agreements and factoring agreement for the financing of inventory, accounts receivable and certain other receivables and certain equipment, which amounted to $64.7 million at September 30, 2006. 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 September 30, 2006.

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, within 90 days prior to the filing date of this report. Based upon the evaluation, our Chief Executive Officer and Principal Financial and Accounting Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic Securities and Exchange Commission filings. No significant changes were made to our internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation.

Remediation of Material Weakness in Internal Control

As reported in the Company’s 2006 June Quarterly Report, management identified the following material weakness related to fraudulent credit card activity in the Company’s internal control over financial reporting as of June 30, 2006, which continued to exist as of July 1, 2006. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

The Company acquired eCOST.com, Inc. (eCOST), a wholly owned subsidiary, on February 1, 2006. In the June 2006 quarter, problems with eCOST’s credit card systems controls resulted in increased fraudulent credit card activity. Further problems with eCOST’s credit card systems controls arose during the course of a systems conversion in late June 2006 resulting in even higher fraudulent credit card activity. These system control issues were identified and the issues and the material control weakness were resolved in July 2006.

As of June 30, 2006, the Company’s policies and procedures did not provide for an effective review of fraudulent credit card activity. During the third quarter ending September 30, 2006, the Company instituted controls to remediate the control deficiency. These controls include enhanced procedures to ensure that additional substantiating documentation and support related to the validity of credit card activity is obtained prior to order release. We believe this remediation initiative is sufficient to eliminate the material weakness in internal controls over financial reporting discussed above.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

On August 24, 2006, a lawsuit was filed in the Chancery Court of Davidson County, Tennessee, by ClientLogic Corp. alleging, among other things, that the Company breached its obligations under a Confidentiality and Nondisclosure Agreement. The complaint seeks injunctive relief and damages in an unspecified amount. The Company believes the claim has no merit and is vigorously defending the action. The Company has not accrued for any amount applicable to this case.

ITEM 1A. Risk Factors

Our business, financial condition and operating results could be adversely affected by any of the following factors, in which event the trading price of our common stock could decline, and you could lose part or all of your investment.

Risks Related to PFSweb

We anticipate incurring significant expenses in the foreseeable future, which may reduce our ability to achieve or maintain profitability.

To reach our business growth objectives, we may increase our operating and marketing expenses, as well as capital expenditures. To offset these expenses, we will need to generate additional profitable business. If our revenue grows slower than either we anticipate or our clients' projections indicate, or if our operating and marketing expenses exceed our expectations, we may not generate sufficient revenue to be profitable or be able to sustain or increase profitability on a quarterly or an annual basis in the future. Additionally, if our revenue grows slower than either we anticipate or our clients' projections indicate, we may incur unnecessary or redundant costs and our operating results could be adversely affected.

Our operating results are materially impacted by our client mix and the seasonality of their business.

Our business is materially impacted by our client mix and the seasonality of their business. Based upon our current client mix and their current projected business volumes, we anticipate our service fee revenue business activity will be at its lowest in the first quarter of our fiscal year and that our product revenue business activity will be at its highest in the fourth quarter of our fiscal year. We believe results of operations for a quarterly period may not be indicative of the results for any other quarter or for the full year. We are unable to predict how the seasonality of future clients' business may affect our quarterly revenue and whether the seasonality may change due to modifications to a client's business. As such, 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.

Changes to financial accounting standards may affect our reported results of operations.

We prepare our financial statements to conform to generally accepted accounting principles, or GAAP. GAAP are subject to interpretation by the American Institute of Certified Public Accountants, the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results and may even affect our reporting of transactions which were completed before a change is announced. Accounting rules affecting many aspects of our business, including rules relating to accounting for asset impairments, revenue recognition, arrangements involving multiple deliverables, employee stock purchase plans and stock option grants, have recently been revised or are currently under review. Changes to those rules or current interpretation of those rules may have a material adverse effect on our reported financial results or on the way we conduct our business.

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

As of September 30, 2006, our total credit facilities outstanding, including debt, capital lease obligations and our vendor accounts payable related to financing of IBM product inventory, was approximately $69 million. Certain of the credit facilities have maturity dates in calendar year 2007 or after, but are classified as current liabilities in our consolidated financial statements. We cannot provide assurance that our credit facilities will be renewed by the lending parties. Additionally, these credit facilities include both financial and non-financial covenants, many of which also include cross default provisions applicable to other agreements. These covenants also restrict our ability to transfer funds among our various subsidiaries, which may adversely affect the ability of our subsidiaries to operate their businesses or comply with their respective loan covenants. We cannot provide assurance that we will be able to maintain compliance with these covenants. Any non-renewal or any default under any of our credit facilities would have a material adverse impact upon our business and financial condition. In addition we have provided $6.5 million of subordinated indebtedness to Supplies Distributors, the minimum level required under certain credit facilities as of September 30, 2006. The maximum level of this subordinated indebtedness to Supplies Distributors that may be provided without approval from our lenders is $8.0 million. The restrictions on increasing this amount without lender approval may limit our ability to comply with certain loan covenants or further grow and develop Supplies Distributors' business. We have guaranteed most of the indebtedness of Supplies Distributors. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors by its lenders to the extent Supplies Distributors is unable to do so. We have also guaranteed eCOST's $15 million credit line with Wachovia, as well as certain of its vendor trade payables. We currently expect that it may be necessary to provide additional guarantees of certain eCOST vendor trade payables in the future.

We are dependent on our key personnel, and we need to hire and retain skilled personnel to sustain our business.

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

We are subject to risks associated with our international operations.

We currently operate a 150,000 square foot distribution center in Liege, Belgium and a 13,000 square foot distribution center in Richmond Hill, Canada, near Toronto. We cannot assure you that we will be successful in expanding in these or any additional international markets. In addition to the uncertainty regarding our ability to generate revenue from foreign operations and expand our international presence, there are risks inherent in doing business internationally, including:

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

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

We are uncertain about our need for and the availability of additional funds.

Our future capital needs are difficult to predict. We may require additional capital to take advantage of unanticipated opportunities, including strategic alliances and acquisitions, or to respond to changing business conditions and unanticipated competitive pressures or to fund capital expenditures or unanticipated expenses, including litigation defense costs of current or future litigation. In addition, eCOST is now a wholly-owned subsidiary and is expected to need additional financing as well. We may also require additional funds to finance operating losses, including continuing operating losses currently anticipated to be incurred by eCOST. Should these circumstances arise, our existing cash balance and credit facilities may be insufficient and we may need to raise additional funds either by borrowing money or issuing additional equity. We cannot assure you that such resources will be adequate or available for all of our future financing needs. Our inability to finance our growth, either internally or externally, may limit our growth potential and our ability to execute our business strategy. If we are successful in completing an additional equity financing, this could result in further dilution to our stockholders or reduce the market value of our common stock.

We may engage in future strategic alliances or acquisitions that could dilute our existing stockholders, cause us to incur significant expenses or harm our business.

We may review strategic alliance or acquisition opportunities that would complement our current business or enhance our technological capabilities. Integrating any newly acquired businesses, technologies or services may be expensive and time-consuming. To finance any acquisitions, it may be necessary for us to raise additional funds through borrowing money or completing public or private financings. Additional funds may not be available on terms that are favorable to us and, in the case of equity financings, may result in dilution to our stockholders. We may not be able to operate any acquired businesses profitably or otherwise implement our growth strategy successfully. If we are unable to integrate any newly acquired entities or technologies effectively, our operating results could suffer. Future acquisitions could also result in incremental expenses and the incurrence of debt and contingent liabilities, any of which could harm our operating results.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders could lose confidence in our financial reporting, which could harm our business, and the trading price of our common stock.

We have begun a process to document and evaluate our internal controls over financial reporting to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors addressing these assessments. Based on the current requirements, and our current public float, we are not required to comply with Section 404. However, in this regard, our management has been dedicating internal resources, has engaged outside consultants and has begun to develop a detailed work plan to (i) assess and document the adequacy of internal controls over financial reporting, (ii) take steps to improve control processes, where appropriate, and (iii) validate through testing that controls are functioning as documented. If we fail to correct any issues in the design or operating effectiveness of internal controls over financial reporting or fail to prevent fraud, current and potential stockholders could lose confidence in our financial reporting, which could harm our business and the trading price of our common stock.

Our service fee revenue and gross margin is dependent upon our clients' business and transaction volumes and our costs; many of our client service agreements are terminable by the client at will; We may incur financial penalties if we fail to meet contractual service levels under certain client service agreements.

Our service fee revenue is primarily transaction based and fluctuates with the volume of transactions or level of sales of the products by our clients for whom we provide transaction management services. If we are unable to retain existing clients or attract new clients or if we dedicate significant resources to clients whose business does not generate sufficient revenue or whose products do not generate substantial customer sales, our business may be materially adversely affected. Moreover, our ability to estimate service fee revenue for future periods is substantially dependent upon our clients' and our own projections, the accuracy of which has been, and will continue to be, unpredictable. Therefore, our planning for client activity and targeted goals for service fee revenue and gross margin may be materially adversely affected by incomplete, delayed or inaccurate projections. In addition, many of our service agreements with our clients are terminable by the client at will. Therefore, we cannot assure you that any of our clients will continue to use our services for any period of time. The loss of a significant amount of service fee revenue due to client terminations could have a material adverse effect on our ability to cover our costs and thus on our profitability. Certain of our client service agreements contain minimum service level requirements and impose financial penalties if we fail to meet such requirements. The imposition of a substantial amount of such penalties could have a material adverse effect on our business and operations.

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

For the nine months ended September 30, 2006, the prime contractor to a U.S. government agency (for whom we are a subcontractor), a consumer products company and Xerox Corporation represented approximately 25%, 19% and 12%, respectively, of our total service fee revenue, net of pass-through revenue. The loss of, or non-payment of invoices by, any or all of such prime contractor to the U.S. agency, consumer products company or Xerox as clients would have a material adverse effect upon our business. In particular, the agreement under which we provide services to such clients are terminable at will upon notice by such clients.

Substantially all of our Supplies Distributors product revenue was generated by sales of product purchased under master distributor agreements with IBM and is dependent on IBM's business. Our Supplies Distributor product revenue business is dependent upon our master distributor relationship with IBM and the continuing market for IBM products. A termination of the relationship with IBM or a decline in customer demand for such products could have a material adverse effect on our business. Sales to three clients/customers accounted for approximately 30% of our consolidated product revenues for the nine months ended September 30, 2006. The loss of any one or more of such customers, or non-payment of any material amount by these or any other customer, would have a material adverse effect upon our business.

Our systems may not accommodate significant growth in our number of clients.

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

We may not be able to recover all or a portion of our start-up costs associated with one or more of our clients.

We generally incur start-up costs in connection with the planning and implementation of business process solutions for our clients. Although we generally attempt to recover these costs from the client in the early stages of the client relationship, or upon contract termination if the client terminates without cause prior to full amortization of these costs, there is a risk that the client contract may not fully cover the start-up costs. To the extent start-up costs exceed the start-up fees received, excess costs will be expensed as incurred. Additionally, in connection with new client contracts we generally incur capital expenditures associated with assets whose primary use is related to the client solution. There is a risk that the contract may end before expected and we may not recover the full amount of our capital costs.

Our revenue and margins may be materially impacted by client transaction volumes that differ from client projections and business assumptions.

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

We face competition from many sources that could adversely affect our business.

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

Our sales and implementation cycles are highly variable and our ability to finalize pending contracts may cause our operating results to vary widely.

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

We are subject to disputes with clients, customers and other authorities which, if not resolved in our favor, may materially adversely affect our results of operations.

In the ordinary course of our business, one or more of our clients or customers may dispute our invoices for services rendered or other charges. We also 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. We plan to dispute the notice, but if the dispute is not resolved favorably, additional taxes of approximately $1.5 million through September 30, 2006 could be assessed against us.

Our business could be adversely affected by a systems or equipment failure, whether that of us or our clients.

Our operations are dependent upon our ability to protect our distribution facilities, customer service centers, computer and telecommunications equipment and software systems against damage and failures. Damage or failures could result from fire, power loss, equipment malfunctions, system failures, natural disasters and other causes. If our business is interrupted either from accidents or the intentional acts of others, our business could be materially adversely affected. In addition, in the event of widespread damage or failures at our facilities, our short-term disaster recovery and contingency plans and insurance coverage may not be sufficient.

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

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

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

A breach of our e-commerce security measures could reduce demand for its services. Credit card fraud and other fraud could adversely affect our business.

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

We may be required to expend significant capital and other resources to protect against security breaches or to address any problem they may cause. Because our activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage its reputation, cause us to lose clients, impact our ability to attract new clients and we could be exposed to litigation and possible liability. Our security measures may not prevent security breaches, and failure to prevent security breaches may disrupt our operations. In certain circumstances, we do not carry insurance against the risk of credit card fraud and other fraud, so the failure to adequately control fraudulent transactions on our client's behalf could increase our expenses.

We may be a party to litigation involving our e-commerce intellectual property rights.

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

Risks Related to the Business Process Outsourcing Industry

If the trend toward outsourcing does not continue, our business will be adversely affected.

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

Our market is subject to rapid technological change and to compete we must continually enhance our systems to comply with evolving standards.

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

Risks Related to Our Stock

The market price of our common stock may be volatile. You may not be able to sell your shares at or above the price at which you purchased such shares.

The trading price of our common stock may be subject to wide fluctuations in response to quarter-to-quarter fluctuations in operating results, announcements of material adverse events, general conditions in our industry or the public marketplace and other events or factors. In addition, stock markets have experienced extreme price and trading volume volatility in recent years. This volatility has had a substantial effect on the market prices of securities of many technology related companies for reasons frequently unrelated to the operating performance of the specific companies. These broad market fluctuations may adversely affect the market price of our common stock. In addition, if our operating results differ from our announced guidance or the expectations of equity research analysts or investors, the price of our common stock could decrease significantly.

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

As of September 30, 2006, we had issued and outstanding 601,190 warrants to purchase common stock (having a weighted average exercise price of $2.29 per share). In addition, as of September 30, 2006, we have an aggregate of 5,940,810 stock options outstanding to employees, directors and others with a weighted average exercise price of $1.29 per share. The shares of common stock that may be issued upon exercise of these warrants and options may be resold into the public market. Sales of substantial amounts of common stock in the public market as a result of the exercise of these warrants or options, or the perception that future sales of these shares could occur, could reduce the market price of our common stock and make it more difficult to sell equity securities in the future.

Our common stock is at risk for delisting from the Nasdaq Capital Market. If it is delisted, our stock price and your liquidity may be impacted. We may implement a stock split in order to comply with Nasdaq listing requirements.

Our common stock is currently listed on the Nasdaq Capital Market. Nasdaq has requirements that a company must meet in order to remain listed on the Nasdaq Capital Market. These requirements include maintaining a minimum closing bid price of $1.00. On August 25, 2006, we received a Nasdaq Staff Deficiency Letter indicating that, based on a review of our closing bid price for the previous 30 business days, we were not in compliance with the minimum $1.00 minimum bid price requirement for continued listing on The Nasdaq Capital Market. We have been afforded a 180-day grace period to achieve compliance through achieving or exceeding the $1.00 minimum bid price requirement for 10 consecutive business days. If necessary to maintain our listing, we may effect a reverse stock split. As of November 14, 2006, we currently meet all the minimum continued listing requirements for the Nasdaq Capital Market except for the $1.00 minimum bid price.

If we fail to maintain the standards necessary to be quoted on the Nasdaq Capital Market and our common stock is delisted, trading in our common stock would be conducted on the OTC Bulletin Board as long as we continue to file reports required by the Securities and Exchange Commission. The OTC Bulletin Board is generally considered to be a less efficient market than the Nasdaq Capital Market, and our stock price, as well as the liquidity of our Common Stock, may be adversely impacted as a result.

Our certificate of incorporation, our bylaws, our shareholder rights plan and Delaware law make it difficult for a third party to acquire us, despite the possible benefit to our stockholders.

Provisions of our certificate of incorporation, our bylaws, our shareholder rights plan and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. For example, our certificate of incorporation provides for a classified board of directors, meaning that only approximately one-third of our directors may be subject to re-election at each annual stockholder meeting. Our certificate of incorporation also permits our Board of Directors to issue one or more series of preferred stock which may have rights and preferences superior to those of the common stock. The ability to issue preferred stock could have the effect of delaying or preventing a third party from acquiring us. We have also adopted a shareholder rights plan. These provisions could discourage takeover attempts and could materially adversely affect the price of our stock. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit large stockholders from consummating a merger with, or acquisition of us. These provisions may prevent a merger or acquisition that would be attractive to stockholders and could limit the price that investors would be willing to pay in the future for our common stock.

There are limitations on the liabilities of our directors and executive officers.

Pursuant to our bylaws and under Delaware law, our directors are not liable to us or our stockholders for monetary damages for breach of fiduciary duty, except for liability for breach of a director's duty of loyalty, acts or omissions by a director not in good faith or which involve intentional misconduct or a knowing violation of law, or any transaction in which a director has derived an improper personal benefit.

Risks Related to our Merger with eCOST

We may fail to realize the anticipated synergies, cost savings, growth opportunities and other benefits expected from the merger, which could adversely affect the value of our common stock.

We entered into a merger with eCOST with the expectation that the merger will result in synergies, cost savings, growth opportunities and other benefits to the combined company. However, the ability to realize these anticipated benefits of the merger will depend, in part, on our ability to integrate the business of eCOST with our business. The integration of two independent companies is a complex, costly and time-consuming process. It is possible that these integration efforts will not be completed as smoothly as planned or that these efforts will divert management attention for an extended period of time. Delays encountered in the integration process could have a material adverse effect on the revenues, expenses, operating results and financial condition for us. There can be no assurance that we will realize any of the anticipated benefits from our merger with eCOST.

Stockholders may receive a lower return on their investment after the merger.

Although we believe that the merger will create financial, operational and strategic benefits for the combined company and its stockholders, these benefits may not be achieved. The combination of our businesses, even if conducted in an efficient, effective and timely manner, may not result in combined financial performance that is better than what our company would have achieved independently if the merger had not occurred.

Uncertainty regarding the merger may cause clients, customers, suppliers and others to delay or defer decisions concerning us and eCOST, which may harm the results of operations of either or both companies.

In response to our completion of the merger, clients, customers and suppliers may delay or defer outsourcing, purchasing or supply decisions or otherwise alter existing relationships with us and eCOST. Prospective clients and customers could be reluctant to contract for the combined company's services or purchase the combined company's products due to uncertainty about the combined company's ability to efficiently provide products and services. In addition, clients, customers, suppliers and others may also seek to terminate or change existing agreements with us or eCOST as a result of the merger. These and other actions by clients, customers, suppliers and others could negatively affect the business of the combined company.

Uncertainties associated with the merger may cause us and eCOST to lose key personnel.

Our current and prospective employees and eCOST employees may experience uncertainty about their future roles with the combined company until or after strategies with regard to the combined company are announced or executed. In addition, eCOST does not have employment agreements with any of its key employees other than with its Chief Executive Officer, Adam Shaffer. These uncertainties may adversely affect PFSweb's and eCOST's ability to attract and retain key management, sales, marketing and technical personnel. If a substantial number of key employees leave as a result of the merger, or the combined company fails to attract key personnel, the combined company's business could be adversely affected.

eCOST may be required to indemnify PC Mall for taxes arising as a result of the merger.

In connection with the consummation of the merger, eCOST received a written opinion from its legal counsel to the effect that the merger should not cause Section 355(e) of the Internal Revenue Code to apply to the April 2005 spin-off of eCOST from its former parent, PC Mall. Such opinion was based on certain factual representations made by PC Mall and eCOST and certain factual and legal assumptions made by eCOST's legal counsel. Such opinion represented such legal counsel's best judgment regarding the application of the U.S. federal income tax laws, but is not binding on the IRS or the courts. No assurance can be given that the IRS will not assert a contrary position or that any such contrary position would not be sustained by a court. If the Merger does cause Section 355(e) to apply to the April 2005 spin-off of eCOST from PC Mall, eCOST must indemnify PC Mall for any resulting tax-related liabilities.

Risks Related to eCOST

eCOST may not be able to achieve or maintain profitability.

eCOST has incurred continuing operating losses and may not be able to achieve or maintain profitability on a quarterly or annual basis. eCOST's ability to achieve or maintain profitability depends on a number of factors, including its ability to:

- increase sales;
- maintain and expand vendor relationships;
- obtain additional and increase existing trade credit with key suppliers;
- generate sufficient gross profit; and
- control costs and generate the expected synergies applicable to the merger.

eCOST needs additional financing and may not be able to obtain additional financing on favorable terms or at all, which could increase its costs and limit its ability to grow.

eCOST needs to obtain additional financing and there can be no assurance that it will be able to obtain additional financing on commercially reasonable terms or at all. eCOST's failure to obtain additional financing or its inability to obtain financing on acceptable terms could materially adversely affect its ability to achieve profitability and grow its business.

eCOST's operating results are difficult to predict.

eCOST's operating results have fluctuated in the past and are likely to vary significantly in the future based upon a number of factors, many of which it cannot control. eCOST operates in a highly dynamic industry and future results could be subject to significant fluctuations. Revenue and expenses in future periods may be greater or less than revenue and expenses in the immediately preceding period or in the comparable period of the prior year. Therefore, period-to-period comparisons of eCOST operating results are not necessarily a good indication of its future performance. Some of the factors that could cause eCOST's operating results to fluctuate include:

- price competition that results in lower sales volumes, lower profit margins, or net losses;
- fluctuations in coupon redemption rates;
- the amount, timing and impact of advertising and marketing costs;
- eCOST's ability to successfully implement new technologies or software systems;
- eCOST's ability to obtain sufficient financing;
- changes in the number of visitors to the eCOST website or eCOST's inability to convert those visitors into customers;
- technical difficulties, including system or Internet failures;
- fluctuations in the demand for eCOST products or overstocking or understocking of products;
- fluctuations in revenues and shipping costs, particularly during the holiday season;
- economic conditions generally or economic conditions specific to the Internet, online commerce, the retail industry or the mail order industry;
- changes in the mix of products that eCOST sells; and
- fluctuations in levels of inventory theft, damage or obsolescence.

The failure of eCOST to improve its financial and operating performance may result in a failure of eCOST to comply with its financial covenants

In the event eCOST is unable to increase its revenue and/or gross profit from its present levels and does not achieve the operating efficiencies targeted to occur upon completion of its integration into our infrastructure, 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 payment under our parent guaranty.

If eCOST fails to accurately predict its inventory risk, its margins may decline as a result of write-downs of its inventory due to lower prices obtained from older or obsolete products.

Some of the products eCOST sells on its website are characterized by rapid technological change, obsolescence and price erosion (for example, computer hardware, software and consumer electronics), and because eCOST may sometimes stock large quantities of particular types of inventory, inventory reserves may be required or may subsequently prove insufficient, and additional inventory write-downs may be required.

Increased product returns or a failure to accurately predict product returns could decrease eCOST's revenues and impact profitability.

eCOST makes allowances for product returns in its financial statements based on historical return rates. eCOST is responsible for returns of certain products ordered through its website from its distribution center as well as products that are shipped to its customers directly from its vendors. If eCOST's actual product returns significantly exceed its allowances for returns, especially as eCOST expands into new product categories, its revenues and profitability could decrease. In addition, because eCOST's allowances are based on historical return rates, the introduction of new merchandise categories, new products, changes in its product mix, or other factors may cause actual returns to exceed return allowances, perhaps significantly. In addition, any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer repeat customers.

eCOST's ability to offer a broad selection of products at competitive prices is dependent on its ability to maintain existing and build new relationships with manufacturers and vendors. eCOST does not have long-term agreements with its manufacturers or vendors and some of its manufacturers and vendors compete directly with eCOST.

eCOST purchases products for resale both directly from manufacturers and indirectly through distributors and other sources, all of whom eCOST considers its vendors. eCOST offers products on its website from numerous third-party manufacturers. eCOST does not have any long-term agreements with any of these vendors. Any agreements with vendors governing eCOST's purchase of products are generally terminable by either party upon 30 days' notice or less. In general, eCOST agrees to offer products on its website and the vendors agree to provide eCOST with information about their products and honor eCOST customer service policies. If eCOST does not maintain relationships with vendors on acceptable terms, including favorable product pricing and vendor consideration, it may not be able to offer a broad selection of products or continue to offer products at competitive prices, and customers may choose not to shop at the eCOST website. In addition, some vendors may decide not to offer particular products for sale on the Internet, and others may avoid offering their new products to retailers such as eCOST who offer a mix of close-out and refurbished products in addition to new products. From time to time, vendors may terminate eCOST's right to sell some or all of their products, change the applicable terms and conditions of sale or reduce or discontinue the incentives or vendor consideration that they offer. Any such termination or the implementation of such changes could have a negative impact on eCOST's operating results. Additionally, some products are subject to manufacturer or distributor allocation, which limits the number of units of those products that are available to eCOST and other resellers.

eCOST's revenue is dependent in part on sales of HP and HP-related products, which represented 32% of eCOST's net sales for the nine months ended September 30, 2006.

eCOST is dependent on the success of its advertising and marketing efforts, which are costly and may not achieve desired results, and on its ability to attract customers on cost-effective terms.

eCOST's revenues depend on its ability to advertise and market its products effectively. Increases in the costs of advertising and marketing, including costs of online advertising, paper and postage costs, costs and fees of third-party service providers and the costs of complying with applicable regulations, may limit eCOST's ability to advertise and market its business without impacting its profitability. If eCOST's advertising and marketing efforts prove ineffective or do not produce a sufficient level of sales to cover their costs, or if eCOST decreases its advertising or marketing activities due to increased costs, restrictions enacted by regulatory agencies or for any other reason, eCOST's revenues and profit margins may decrease. eCOST's success depends on its ability to attract customers on cost-effective terms. eCOST has relationships with online services, search engines, shopping engines, directories and other websites and e-commerce businesses through which it provide advertising banners and other links that direct customers to the eCOST website. eCOST expects to rely on these relationships as significant sources of traffic to the eCOST website and to generate new customers. If eCOST is unable to develop or maintain these relationships on acceptable terms, its ability to attract new customers on a cost-effective basis could be harmed. In addition, certain of eCOST's existing online marketing agreements require it to pay fixed placement fees or fees for directing visits to the eCOST website, neither of which may convert into sales.

Because eCOST experiences seasonal fluctuations in its revenues, its quarterly results may fluctuate.

eCOST's 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 its revenues occur during the first and fourth fiscal quarters. eCOST believes that its historical revenue growth makes it difficult to predict the effect of seasonality on its future revenues and results of operations. In anticipation of increased sales activity during the first and fourth quarter, eCOST incurs additional expenses, including higher inventory and staffing costs. If sales for the first and fourth quarter do not meet anticipated levels, then increased expenses may not be offset which could decrease eCOST's profitability. If eCOST were to experience lower than expected sales during its first or fourth quarter, for any reason, it would decrease eCOST's profitability.

eCOST's business may be harmed by fraudulent activities on its website.

eCOST has received in the past, and anticipates that it will receive in the future, communications from customers due to purported fraudulent activities on the eCOST website. Negative publicity generated as a result of fraudulent conduct by third parties could damage eCOST's reputation and diminish the value of its brand name. Fraudulent activities on eCOST's website could also subject it to losses. eCOST expects to continue to receive requests from customers for reimbursement due to purportedly fraudulent activities or threats of legal action if no reimbursement is made.

eCOST's business could be subject to political, economic and other risks associated with the Philippines.

To reduce costs, eCOST is evaluating shifting certain of its operations to the Philippines, which would subject eCOST to political, economic and other uncertainties, including expropriation, nationalization, renegotiation, or nullification of existing contracts, currency exchange restrictions and international monetary fluctuations. Furthermore, the Philippines has experienced violence related to guerrilla activity.

Delivery of eCOST's products could be delayed or disrupted by factors beyond its control, and it could lose customers as a result.

eCOST relies upon third party carriers for timely delivery of its product shipments. As a result, eCOST is subject to carrier disruptions and increased costs due to factors that are beyond its control, including employee strikes, inclement weather and increased fuel costs. Any failure to deliver products to customers in a timely and accurate manner may damage eCOST's reputation and brand and could cause it to lose customers. eCOST does not have a written long-term agreement with any of these third party carriers, and it cannot be sure that these relationships will continue on terms favorable to eCOST, if at all. If eCOST's relationship with any of these third party carriers is terminated or impaired or if any of these third parties is unable to deliver products, eCOST would be required to use alternative carriers for the shipment of products to customers. eCOST may be unable to engage alternative carriers on a timely basis or on favorable terms, if at all. Potential adverse consequences include:

- reduced visibility of order status and package tracking;
- delays in order processing and product delivery;
- increased cost of delivery, resulting in reduced margins; and
- reduced shipment quality, which may result in damaged products and customer dissatisfaction.

If eCOST does not successfully expand its website and processing systems to accommodate higher levels of traffic and changing customer demands, it could lose customers and its revenues could decline.

To remain competitive, eCOST must continue to enhance and improve the functionality and features of its website. If eCOST fails to upgrade its website in a timely manner to accommodate higher volumes of traffic, its website performance could suffer and eCOST may lose customers. The Internet and the e-commerce industry are subject to rapid technological change. If competitors introduce new features and website enhancements embodying new technologies, or if new industry standards and practices emerge, eCOST's existing website and systems may become obsolete or unattractive. Developing the eCOST website and other systems entails significant technical and business risks. eCOST may face material delays in introducing new services, products and enhancements. If this happens, customers may forgo the use of eCOST's website and use those of its competitors. eCOST may use new technologies ineffectively, or it may fail to adapt its website, transaction processing systems and computer network to meet customer requirements or emerging industry standards.

If eCOST fails to successfully expand its merchandise categories and product offerings in a cost-effective and timely manner, its reputation and the value of its new and existing brands could be harmed, customer demand for its products could decline and its profit margins could decrease.

eCOST has generated the substantial majority of its revenues during the past five years from the sale of computer hardware, software and accessories and consumer electronics products. In the past 18 months eCOST launched several new product categories, including digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. While its merchandising platform has been incorporated into and tested in the online computer and consumer electronics retail markets, eCOST cannot predict with certainty whether it can be successfully applied to other product categories. In addition, expansion of its business strategy into new product categories may require eCOST to incur significant marketing expenses, develop relationships with new vendors and comply with new regulations. eCOST may lack the necessary expertise in a new product category to realize the expected benefits of that new category. These requirements could strain managerial, financial and operational resources. Additional challenges that may affect eCOST's ability to expand into new product categories include its ability to:

- establish or increase awareness of new brands and product categories;
- acquire, attract and retain customers at a reasonable cost;
- achieve and maintain a critical mass of customers and orders across all product categories;
- attract a sufficient number of new customers to whom new product categories are targeted;
- successfully market new product offerings to existing customers;
- maintain or improve gross margins and fulfillment costs;
- attract and retain vendors to provide an expanded line of products to customers on terms that are acceptable; and
- manage inventory in new product categories.

eCOST cannot be certain that it will be able to successfully address any or all of these challenges in a manner that will enable it to expand its business into new product categories in a cost-effective or timely manner. If eCOST's new categories of products or services are not received favorably, or if its suppliers fail to meet eCOST's customers' expectations, eCOST's results of operations would suffer and its reputation and the value of the applicable new brand and other brands could be damaged. The lack of market acceptance of eCOST new product categories or inability to generate satisfactory revenues from any expanded product categories to offset their cost could harm eCOST's business.

If eCOST is unable to provide satisfactory customer service, it could lose customers.

eCOST's ability to provide satisfactory levels of customer service depends, to a large degree, on the efficient and uninterrupted operation of its customer service operations. Any material disruption or slowdown in its order processing systems resulting from labor disputes, telephone or Internet failures, power or service outages, natural disasters or other events could make it difficult or impossible to provide adequate customer service and support. If eCOST is unable to continually provide adequate staffing and training for its customer service operations, its reputation could be seriously harmed and eCOST could lose customers. Because eCOST's success depends in large part on keeping its customers satisfied, any failure to provide high levels of customer service would likely impair its reputation and decrease its revenues.

eCOST may not be able to compete successfully against existing or future competitors.

The market for online sales of the products eCOST offers is intensely competitive and rapidly evolving. eCOST principally competes with a variety of online retailers, specialty retailers and other businesses that offer products similar to or the same as eCOST's products. Increased competition is likely to result in price reductions, reduced revenue and gross margins and loss of market share. eCOST expects competition to intensify in the future because current and new competitors can enter the market with little difficulty and can launch new websites at a relatively low cost. In addition, some of eCOST's product vendors have sold, and continue to intensify their efforts to sell, their products directly to customers. eCOST currently or potentially competes with a variety of businesses, including:

- other multi-category online retailers such as Amazon.com and Buy.com;
- online discount retailers of computer and consumer electronics merchandise such as Computers4Sure, NewEgg and TigerDirect;
- liquidation e-tailers such as Overstock.com and SmartBargains.com;
- consumer electronics and office supply superstores such as Best Buy, Circuit City, CompUSA, Office Depot, OfficeMax and Staples; and
- manufacturers such as Apple, Dell, Gateway, Hewlett-Packard and IBM, that sell directly to customers.

Many of the current and potential competitors described above have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than eCOST. In addition, online retailers may be acquired by, receive investments from or enter into other commercial relationships with larger, well-established and well-financed companies. Some of eCOST's competitors may be able to secure products from manufacturers or vendors on more favorable terms, devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing or inventory availability policies and devote substantially more resources to website and systems development than eCOST is able to.

If the protection of eCOST's trademarks and proprietary rights is inadequate, its brand and reputation could be impaired and it could lose customers.

eCOST has six trademarks that it considers to be material to the successful operation of business: eCOST(R), eCOST.com(R), eCOST.com Bargain Countdown™, eCOST.com Your Online Discount Superstore!™, Bargain Countdown™ and Bargain Countdown Platinum Club™. eCOST currently uses all of these marks in connection with telephone, mail order, catalog and online retail services. eCOST also has several additional pending trademark applications. eCOST relies on trademark and copyright law, trade secret protection and confidentiality agreements with its employees, consultants, suppliers and others to protect its proprietary rights. eCOST's applications may not be granted, and eCOST may not be able to secure significant protection for its service marks or trademarks. eCOST's competitors or others could adopt trademarks or service marks similar to its marks, or try to prevent eCOST from using its marks, thereby impeding its ability to build brand identity and possibly leading to customer confusion. Any claim by another party against eCOST for customer confusion caused by use of eCOST's trademarks or service marks, or eCOST's failure to obtain registrations for its marks, could negatively affect its competitive position and could cause it to lose customers.

eCOST has also filed an application with the U.S. Patent and Trademark Office for patent protection for its proprietary Bargain Countdown™ technology. eCOST may not be granted a patent for this technology and may not be able to enforce its patent rights if its competitors or others use infringing technology. If this occurs, eCOST's competitive position, revenues and profitability could be negatively affected.

Effective trademark, service mark, patent, copyright and trade secret protection may not be available in every country in which eCOST will sell its products and offer its services. In addition, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. Therefore, eCOST may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of its trademarks and other proprietary rights. If eCOST is unable to protect or preserve the value of its trademarks, copyrights, trade secrets or other proprietary rights for any reason, eCOST's competitive position could be negatively affected and it could lose customers.

eCOST also relies on technologies that it licenses from related and third parties. These licenses may not continue to be available to eCOST on commercially reasonable terms, or at all, in the future. As a result, eCOST may be required to develop or obtain substitute technology of lower quality or at greater cost, which could negatively affect its competitive position, cause it to lose customers and decrease its profitability.

If third parties claim eCOST is infringing their intellectual property rights, eCOST could incur significant litigation costs, be required to pay damages, or change its business or incur licensing expenses.

Third parties have asserted, and may in the future assert, that eCOST's business or the technologies it uses infringe on their intellectual property rights. As a result, eCOST may be subject to intellectual property legal proceedings and claims in the ordinary course of business. eCOST cannot predict whether third parties will assert additional claims of infringement in the future or whether any future claims will prevent it from offering popular products or services.

If eCOST is forced to defend against third-party infringement claims, whether they are with or without merit or are determined in its favor, eCOST could face expensive and time-consuming litigation, which could result in the imposition of a preliminary injunction preventing it from continuing to operate its business as currently conducted throughout the duration of the litigation or distract eCOST's technical and management personnel. If eCOST is found to infringe, it may be required to pay monetary damages, which could include treble damages and attorneys' fees for any infringement that is found to be willful, and either be enjoined or required to pay ongoing royalties with respect to any technologies found to infringe. Further, as a result of infringement claims either against eCOST or against those who license technology to eCOST, eCOST may be required, or deem it advisable, to develop non-infringing technology, which could be costly and time consuming, or enter into costly royalty or licensing agreements. Such royalty or licensing agreements, if required, may be unavailable on terms that are acceptable, or at all. eCOST expects that participants in its market will be increasingly subject to infringement claims as the number of competitors in the industry grows. If a third party successfully asserts an infringement claim against eCOST and it is enjoined or required to pay monetary damages or royalties or eCOST is unable to develop suitable non-infringing alternatives or license the infringed or similar technology on reasonable terms on a timely basis, eCOST's business, results of operations and financial condition could be materially harmed.

eCOST may be liable for misappropriation of its customers' personal information.

Data security laws are becoming more stringent in the United States and abroad. Third parties are engaging in increased cyber attacks against companies doing business on the Internet and individuals are increasingly subjected to identity and credit card theft on the Internet. If third parties or unauthorized employees are able to penetrate eCOST's network security or otherwise misappropriate its customers' personal information or credit card information, or if eCOST gives third parties or its employees improper access to customers' personal information or credit card information, eCOST could be subject to liability. This liability could include claims for unauthorized purchases with credit card information, impersonation or other similar fraud claims. This liability could also include claims for other misuses of personal information, including unauthorized marketing purposes. Liability for misappropriation of this information could decrease eCOST's profitability. In such circumstances, eCOST also could be liable for failing to provide timely notice of a data security breach affecting certain types of personal information. In addition, the Federal Trade Commission and state agencies have brought numerous enforcement actions against Internet companies for alleged deficiencies in those companies' privacy and data security practices, and they may continue to bring such actions. eCOST could incur additional expenses if new regulations regarding the collection, use or storage of personal information are introduced or if government agencies investigate our privacy or security practices.

eCOST relies on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of sensitive customer information such as customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments may result in a compromise or breach of the algorithms that eCOST uses to protect customer transaction data. If any such compromise of security were to occur, it could subject eCOST to liability, damage its reputation and diminish the value of its brand-name. A party who is able to circumvent the security measures could misappropriate proprietary information or cause interruptions in operations. eCOST may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. eCOST's security measures are designed to prevent security breaches, but its failure to prevent such security breaches could subject eCOST to liability, damage its reputation and diminish the value of its brand-name.

Moreover, for the convenience of its customers, eCOST provides non-secured channels for customers to communicate. Despite the increased security risks, customers may use such channels to send personal information and other sensitive data. In addition, "phishing" incidents are on the rise. Phishing involves an online company's customers being tricked into providing their credit card numbers or account information to someone pretending to be the online company's representative. Such incidents have recently given rise to litigation against online companies for failing to take sufficient steps to police against such activities by third parties, and may discourage customers from using online services.

eCOST may be subject to product liability claims that could be costly and time consuming.

eCOST sells products manufactured and distributed by third parties, some of which may be defective. If any product that eCOST sells were to cause physical injury or damage to property, the injured party or parties could bring claims against eCOST as the retailer of the product. eCOST's insurance coverage may not be adequate to cover every claim that could be asserted. If a successful claim were brought against eCOST in excess of its insurance coverage, it could expose it to significant liability. Even unsuccessful claims could result in the expenditure of funds and management time and could decrease profitability.

Risks Related to eCOST's Industry

eCOST's success is tied to the continued use of the Internet and the adequacy of the Internet infrastructure.

eCOST's future revenues and profits, if any, substantially depend upon the continued widespread use of the Internet as an effective medium of business and communication. If use of the Internet declines or the Internet infrastructure becomes an ineffective medium for business transactions and communication, eCOST may not be able to effectively implement its growth strategy and it could lose customers. Widespread use of the Internet could decline as a result of disruptions, computer viruses or other damage to Internet servers or users' computers. Additionally, if the Internet's infrastructure does not expand fast enough to meet increasing levels of use, it may become a less effective medium of business transactions and communications.

The security risks of e-commerce may discourage customers from purchasing goods over the Internet.

In order for the e-commerce market to develop successfully, eCOST and other market participants must be able to transmit confidential information securely over public networks. Third parties may have the technology or know-how to breach the security of customer transaction data. Any breach could cause customers to lose confidence in the security of eCOST's website and choose not to purchase from the website. If someone is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt operations. Concerns about the security and privacy of transactions over the Internet could inhibit the growth of the Internet and e-commerce. Security measures may not effectively prohibit others from obtaining improper access to information. Any security breach could expose eCOST to risks of loss, litigation and liability and could seriously disrupt its operations.

Credit card fraud could decrease eCOST's revenues and profitability.

eCOST does not currently carry insurance against the risk of credit card fraud, so the failure to adequately control fraudulent credit card transactions could reduce its revenues and gross margin. eCOST has and may in the future suffer losses as a result of orders placed with fraudulent credit card data even though the associated financial institution approved payment of the orders. Under current credit card practices, eCOST may be liable for fraudulent credit card transactions because it did not obtain a cardholder's signature. If eCOST is unable to detect or control credit card fraud, or if credit card companies require more burdensome terms or refuse to accept credit card charges, eCOST's revenues and profitability could decrease.

Additional sales and use taxes could be imposed on past or future sales of eCOST's products or other products sold on eCOST's website, which could adversely affect eCOST's revenues and profitability.

In accordance with current industry practice and eCOST's interpretation of applicable law, eCOST collects and remits sales taxes only with respect to physical shipments of goods into states where eCOST has a physical presence. If any state or other jurisdiction successfully challenges this practice and imposes sales and use taxes on orders on which eCOST does not collect and remit sales taxes, eCOST could be exposed to substantial tax liabilities for past sales and could suffer decreased sales in that state or jurisdiction in the future. In addition, a number of states, as well as the U.S. Congress, have been considering various legislative initiatives that could result in the imposition of additional sales and use taxes on Internet sales. If any of these initiatives are enacted, eCOST could be required to collect sales and use taxes in states where eCOST does not have a physical presence. Future changes in the operation of eCOST's business also could result in the imposition of additional sales and use tax obligations. The imposition of additional sales and use taxes on past or future sales could adversely affect eCOST's revenues and profitability.

Existing or future government regulation could expose eCOST to liabilities and costly changes in its business operations, and could reduce customer demand for its products.

eCOST is subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet and e-commerce. Such existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, user privacy, marketing and promotional practices, database protection, pricing, content, copyrights, distribution, electronic contracts, email and other communications, consumer protection, product safety, the provision of online payment services, intellectual property rights, unauthorized access (including the Computer Fraud and Abuse Act), and the characteristics and quality of products and services. It is unclear how existing laws governing issues such as property ownership, sales and other taxes, libel, trespass, data mining and collection, and personal privacy apply to the Internet and e-commerce. Unfavorable resolution of these issues may expose eCOST to liabilities and costly changes in its business operations, and could reduce customer demand. The growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens on online companies. For example, California law requires notice to California customers if certain personal information about them is obtained by an unauthorized person, such as a computer hacker. These consumer protection laws could result in substantial compliance costs and could decrease profitability.

Laws or regulations relating to privacy and data protection may adversely affect the growth of eCOST's Internet business or its marketing efforts.

eCOST is subject to increasing regulation relating to privacy and the use of personal user information. For example, eCOST is subject to various telemarketing and anti-spam laws that regulate the manner in which it may solicit future suppliers and customers. Such regulations, along with increased governmental or private enforcement, may increase the cost of growing the business. In addition, several jurisdictions, including California, have adopted legislation limiting the uses of personal user information gathered online or require online services to establish privacy policies. Pursuant to the Children's Online Privacy Protection Act, the Federal Trade Commission has adopted regulations regarding the collection and use of personal identifying information obtained from children under 13 years of age. Increasingly, federal, state and foreign laws and regulations extend online privacy protection to adults. Moreover, in jurisdictions where eCOST does business, there is a trend toward requiring companies to establish procedures to notify users of privacy and security policies, to obtain prior consent from users for the collection, use and disclosure of personal information (even disclosure to affiliates), and to provide users with the ability to access, correct and delete personal information stored by companies. These data protection regulations and enforcement efforts may restrict eCOST's ability to collect, use or transfer demographic and personal information from users, which could be costly or harm marketing efforts. Further, any violation of privacy or data protection laws and regulations may subject eCOST to fines, penalties and damages, as well as harm to its reputation, which could decrease its revenues and profitability.

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

None

ITEM 5. Other Information

None.

ITEM 6. Exhibits

a) Exhibits:

Exhibit No.	Description of Exhibits
3.1(1)	Amended and Restated Certificate of Incorporation
3.2(1)	Amended and Restated Bylaws
10.1*	Tenth Amendment to Lease Agreement by and between Plano Atrium, LLC and Priority Fulfillment Services, Inc.
31.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(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

Table of Contents

SIGNATURES

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

Date: November 14, 2006

PFSweb, Inc.

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

INDEX TO EXHIBITS

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* Filed herewith

TENTH AMENDMENT TO OFFICE LEASE

THIS TENTH AMENDMENT TO LEASE AGREEMENT (this "Amendment") is entered into as of the 24th day of August, 2006 (the "Effective Date"), by and between Plano Atrium, LLC, a Delaware limited liability company ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation ("Tenant").

WITNESSETH:

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

WHEREAS, AmWest and Daisytek entered into that certain Modification and Ratification of Lease (the "First Amendment") dated January 7, 1992, pursuant to which AmWest leased to Daisytek, a certain 820 rentable square feet of storage space located in the basement of the Building and is herein referred to as the ("Storage Space");

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

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

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

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

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

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

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

WHEREAS, Atrium and Daisytek entered into that certain Eighth Amendment to Lease (the "Eighth Amendment") dated effective as of February 20, 1998;

WHEREAS, Atrium sold the Building to AGBRI Atrium, L.P., and assigned all of its rights under the Lease Agreement;

WHEREAS, Daisytek assigned its rights under Lease to Tenant pursuant to that certain Assignment of Lease dated February 1, 2000, and, in connection therewith, AGBRI Atrium, L.P., Tenant and Daisytek entered into that certain Consent Assignment which was attached to such Assignment.

WHEREAS, AGBRI Atrium, L.P. and Tenant entered into that certain Ninth Amendment to Lease (the "Ninth Amendment") dated effectively November 13, 2001 (the First Amendment, the Second Amendment, the Third Amendment, the Fourth Amendment, the Fifth Amendment, the Sixth Amendment, the Seventh Amendment, the Eighth Amendment and the Ninth

Amendment are herein collectively called the "Amendments" and the Original Lease, as amended by the Amendments, is herein called the ("Lease");

WHEREAS, Plano Atrium, LLC ("Landlord") has purchased Building from AGBRI Atrium, L.P.;

WHEREAS, the lease currently covers approximately 66,239 rentable square feet of space (the "Current Premises");

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

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

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

2. Extension of the Term of the Lease. Beginning March 16, 2007 (the "2007 Renewal Term Commencement Date") the term of the Lease is hereby extended until, and the Lease is hereby renewed through March 31, 2012 (such date of expiration is herein referred to as the "2007 Renewal Term Expiration Date"**)**. As used in the Lease and all exhibits attached thereto, the phrase "the term of this Lease" and the term "Lease Term" shall mean the period beginning December 16, 1991 and ending on the 2007 Renewal Term Expiration Date unless sooner terminated in accordance with the Lease or this Amendment.

3. Current Premises. The **"Current Premises"** contains approximately 66,239 rentable square feet located in the following: the First Floor Premises, located in Suite 125 and containing approximately 13,056 rentable square feet; the "Fifth Floor Premises" located in Suite 500 and containing approximately 52,363 rentable square feet; and the Storage Space, located in the basement level and containing approximately 820 rentable square feet.

4. Give-Back Premises. Tenant intends to give-back to Landlord the First Floor Premises containing approximately 13,056 rentable square feet, (the **"**Give-Back Premises") depicted in Exhibit A-1 attached hereto. The "Give-Back Premises Termination Date" shall mean the same date as the Expansion Premises Commencement Date (defined below in Paragraph 5). Tenant's obligation to continue to pay future Base Rent for the Give-Back Premises shall terminate on the Give-Back Premises Termination Date. Tenant agrees to vacate the Give-Back Premises within seven days following the Give-Back Premises Termination Date.

5. Expansion Premises. The term "Expansion Premises" shall mean approximately 20,208 rentable square foot space located in Suite 450 on the fourth floor of the Building and depicted in Exhibit A-2 attached hereto. The term "Expansion Premises Target Commencement Date" shall mean November 1, 2006. Landlord's failure to Substantially Complete the Landlord Work by the Expansion Premises Target Commencement Date shall not be a default by Landlord or otherwise render Landlord liable for damages; however, Landlord agrees to make commercially reasonable efforts to complete the Landlord Work by the Expansion Premises Target Commencement Date provided this Amendment is executed by August 15**,** 2006. The term "Expansion Premises Commencement Date" shall mean the date following exactly seven days after "Substantial Completion" of improvements as defined in Exhibit B-2**.** From and after the Expansion Premises Commencement Date, references to the "Premises" in this Amendment and the Lease shall mean approximately 73,391 rentable square feet (and shall include: the Fifth Floor Premises, the Expansion Premises, and the Basement Space; and shall no longer include: the Give-Back Premises).

6. Base Rent: Tenant shall pay Landlord as Base Rent for the Premises in lawful money of the United States of America, at PLANO ATRIUM, LLC, Dept. 6077, Los Angeles, CA 90084-6077, or at such other place as Landlord shall designate in writing from time to time, as follows:

(a) Fifth Floor Premises:

(i) Prior to August 1, 2006, Tenant shall pay Base Rent for Current Premises as required by the Lease; and

(ii) Commencing August 1, 2006 through March 31, 2008, Tenant shall pay $76,362.71 per month for the Fifth Floor Premises (i.e. $17.50 per rentable square foot on an annual basis for the Fifth Floor Premises);

(iii) Commencing April 1, 2008 through March 31, 2009, Tenant shall pay $78,544.50 per month for the Fifth Floor Premises (i.e. $18.00 per rentable square foot on an annual basis for the Fifth Floor Premises);

(iv) Commencing April 1, 2009 through March 31, 2010, Tenant shall pay $80,726.29 per month for the Fifth Floor Premises (i.e. $18.50 per rentable square foot on an annual basis for the Fifth Floor Premises);

(v) Commencing April 1, 2010 through March 31, 2011, Tenant shall pay $82,908.08 per month for the Fifth Floor Premises (i.e. $19.00 per rentable square foot on an annual basis for the Fifth Floor Premises);

(vi) Commencing April 1, 2011 through the Renewal Term Expiration Date, Tenant shall pay $85,089.88 per month for the Fifth Floor Premises (i.e. $19.50 per rentable square foot on an annual basis for the Fifth Floor Premises);

(b) Expansion Premises:

(i) Commencing on the Expansion Premises Commencement Date through March 31, 2008, Tenant shall pay $29,470.00 per month for the Expansion Premises (i.e. $17.50 per rentable square foot on an annual basis for the Expansion Premises);

(ii) Commencing April 1, 2008 through March 31, 2009, Tenant shall pay $30,312.00 per month for the Expansion Premises (i.e. $18.00 per rentable square foot on an annual basis for the Expansion Premises);

(iii) Commencing April 1, 2009 through March 31, 2010, Tenant shall pay $31,154.00 per month for the Expansion Premises (i.e. $18.50 per rentable square foot on an annual basis for the Expansion Premises);

(iv) Commencing April 1, 2010 through March 31, 2011, Tenant shall pay $31,996.00 per month for the Expansion Premises (i.e. $19.00 per rentable square foot on an annual basis for the Expansion Premises);

(v) Commencing April 1, 2011 through March 31, 2012, Tenant shall pay $32,838.00 per month for the Expansion Premises (i.e. $19.50 per rentable square foot on an annual basis for the Expansion Premises);

(c) Give-Back Premises:

(i) Prior to August 1, 2006 Tenant shall pay Base Rent for Current Premises as required by the Lease; and

(ii) Commencing on August 1, 2006 through the Give-Back Premises Termination Date, Tenant shall pay $19,040.00 per month for the Give- Back Premises (i.e. $17.50 per rentable square foot on an annual basis for the Give-Back Premises);

(d) Storage Space:

(i) Prior to April 1, 2007, Tenant shall pay Base Rent for Storage Space as required by the Lease; and

(ii) Commencing on the April 1, 2007 through the 2007 Renewal Term Expiration Date, Tenant shall pay $478.33 per month for the Storage Space (i.e. $7.00 per rentable square foot on an annual basis for the Storage Space);

7. Base Rental Amount Adjustments. Commencing on the 2007 Renewal Term Commencement Date, the following base rental adjustments are herein amended. Base Rent payable for the Premises will continue to be so adjusted, but the Base Expense Amount shall be the actual Operating Costs paid or incurred in the calendar year 2007.

8. Leasehold Improvements. Various agreements of the parties to this Amendment regarding improvements and payments to be made to the Premises are set forth in Exhibit B-1, Exhibit B-2, Exhibit B-3, and Exhibit B-4 attached hereto.

9. Renewal Option. Tenant shall have the renewal option rights set forth in the Exhibit D attached hereto.

10. Right of First Refusal Option. Tenant shall have the Right of First Refusal as set forth in Exhibit E attached hereto.

11. Expansion Option. Tenant shall have the expansion rights set forth in the Exhibit F attached hereto.

12. Brokers. Tenant represents and warrants to Landlord that it has dealt directly with (and only with) Cushman & Wakefield (Tenant's Broker) and Jamison Properties, Inc. (Landlord's Broker) in connection with this Amendment, and that insofar as Tenant knows, no other broker negotiated or participated on its behalf in the negotiations of this Amendment, or is entitled to any commission in connection therewith. Tenant hereby agrees to indemnify, save and hold Landlord and all Landlord Indemnitees harmless from and against any and all claims or demands made upon Landlord for any commissions, fees or other compensation by any other broker, agent or salesman acting on behalf of Tenant in connection with this Amendment. Landlord hereby agrees to indemnify, save and hold Tenant harmless from and against any and all claims or demands made upon Tenant for any commissions, fees or other compensation by Landlord's Broker or Tenant's Broker. The provisions of this paragraph shall survive the expiration or any earlier termination of the Lease.

13. Tenant Certification. By its execution of this Amendment, each party hereby certifies that as of the date of such execution, and to the best of its knowledge, the other party is not in default of the performance of its obligations pursuant to the Lease. Tenant further certifies that, to the best of its knowledge, it has no offsets, claims against Landlord or the rent payable by Tenant under the Lease and no defenses with respect to the Lease.

14. Continuing Effect; Gender and Number. The Lease, as amended herein, is hereby ratified and confirmed and shall continue in full force and effect. Singular words shall connote the plural number as well as singular and vice versa, and the masculine shall include the feminine and the neuter.

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

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

17. Conflicts; Incorporation by Reference. In the event of any conflict between the terms of this Amendment and the Lease, the terms of this Amendment shall control. All of the exhibits attached to this Amendment are by this reference incorporated herein and made a part hereof for all purposes.

18. Prior Agreements; Amendments. This Amendment and the Lease, including the exhibits attached hereto, contain all of the covenants, provisions, agreements, conditions and

understandings between Landlord and Tenant concerning the Expansion Premises and any other matter covered or mentioned herein or therein, and no prior agreement or understanding, oral or written, express or implied, pertaining to the Expansion Premises or any such other matter shall be effective for any purpose. No provision of this Amendment may be amended or added to except by an agreement in writing signed by the parties hereto or their respective successors in interest. The parties hereto acknowledge and agree that all prior agreements, representations, negotiations and understandings pertaining to the Expansion Premises are deemed superseded by the execution of this Amendment to the extent that they are not expressly incorporated herein.

19. Tenant Not a Restricted Entity. Tenant represents and warrants that Tenant is not, and shall not become, a person or entity with whom Landlord is restricted from doing business with under regulations of the Office of Foreign Asset Control ("OFAC") of the Department of the Treasury (including, but not limited to, those named on OFAC's Specially Designated and Blocked Persons list) or under any statute, executive order (including, but not limited to, the September 24, 2001 Executive Order Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit, or Support Terrorism), or other action of any Governmental Authority and is not and shall not engage in any dealings or transactions or be otherwise associated with such persons or entities.

20. Charges and Computations. Landlord and Tenant agree that each provision of the Lease and this Amendment for determining charges, amounts and additional rent payable by Tenant is commercially reasonable and, as to each such charge or amount, constitutes a "method by which the charge is to be computed" for purposes of Section **93.012** of the Texas Property Code, as enacted by House Bill 2186, 77th Legislature. **ACCORDINGLY, TENANT VOLUNTARILY AND KNOWINGLY WAIVES ALL RIGHTS AND BENEFITS, IF ANY, AVAILABLE TO TENANT UNDER SECTION 93.012 OF THE TEXAS PROPERTY CODE, AS ENACTED BY HOUSE BILL 2186, 77TH LEGISLATURE, AS SUCH SECTION NOW EXISTS OR AS IT MAY BE HEREAFTER AMENDED OR SUCCEEDED.**

21. Effect of Submission. This Amendment shall become effective only upon the execution and delivery by both Landlord and Tenant.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment as of the date or dates set forth below but effective for all purposes as of the Effective Date.

LANDLORD:

PLANO ATRIUM, LLC, a Delaware
limited liability company

By: PLANO ATRIUM2, LLC, a
Delaware limited liability company, its
sole member

By: JAMISON PLANO ATRIUM, INC., a
Delaware corporation, its Managing Member

By: ______________________________
Name: ______________________________
Title: ______________________________

TENANT:

PRIORITY FULFILLMENT SERVICES, INC., a
Delaware corporation

By: ______________________________
Name: ______________________________
Title: ______________________________

EXHIBIT A-1

Give-Back Premises

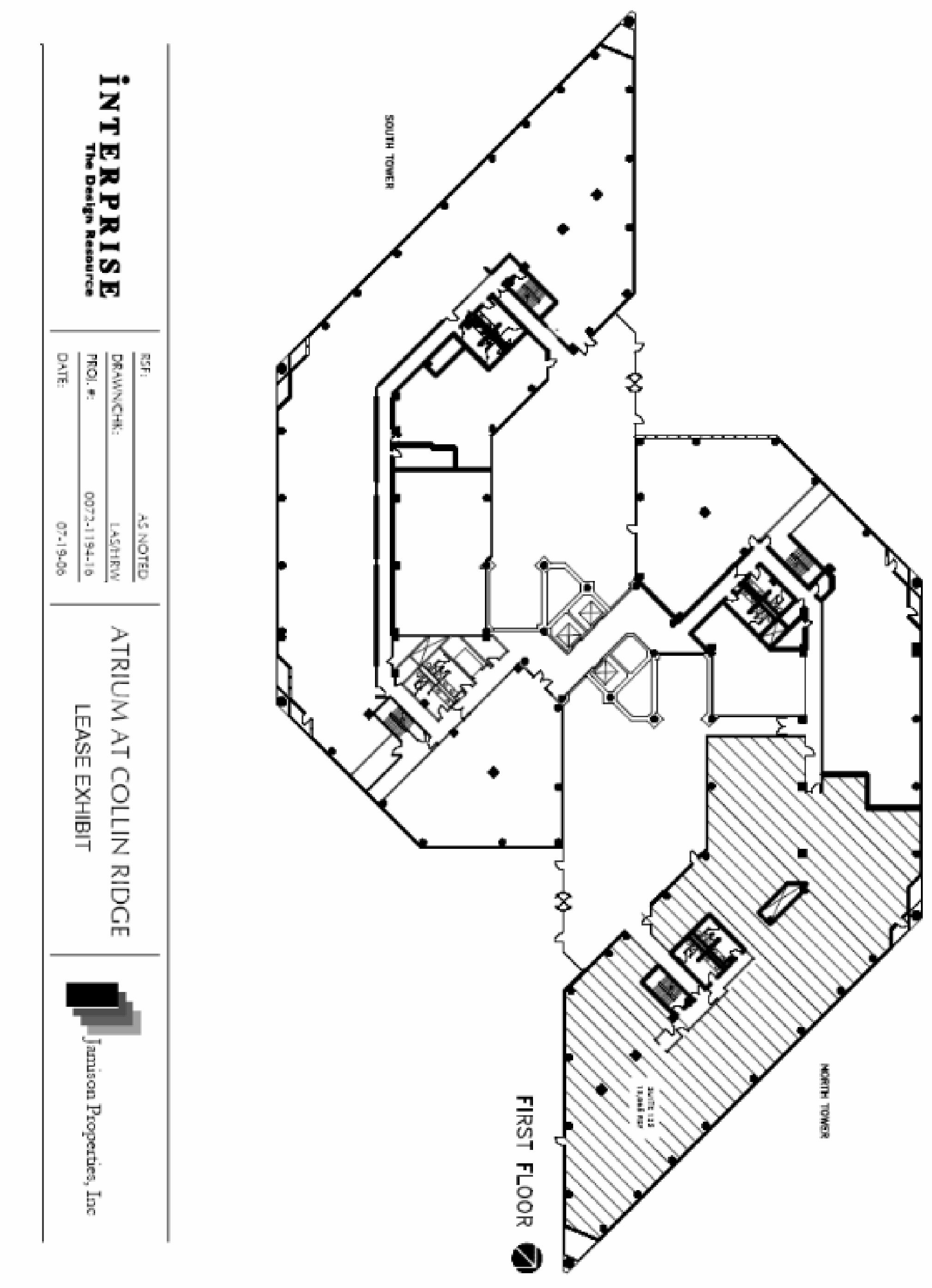

EXHIBIT A-2

Expansion Premises

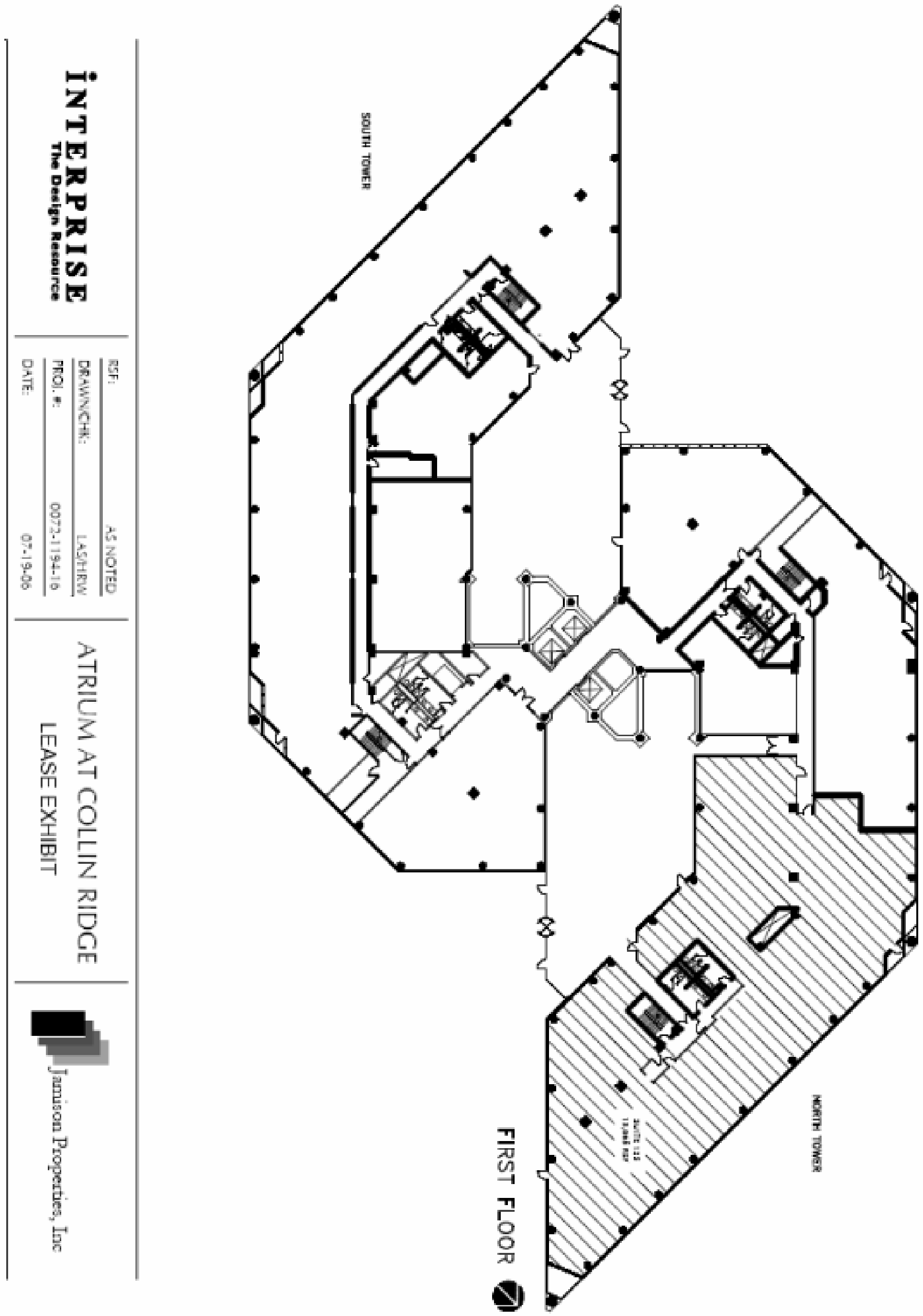

EXHIBIT B-1

TENANT IMPROVEMENT WORK AGREEMENT

5TH FLOOR REFURBISHMENT

PLANO ATRIUM, LLC, a Delaware limited liability company ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation ("Tenant"), entered into that certain Tenth Amendment to Office Lease (the "Amendment") dated as of August ___, 2006, for the lease of certain space at Atrium at Collin Ridge located in Plano County, Texas. This Exhibit B-1 (this "Exhibit") is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment. Landlord and Tenant mutually agree as follows:

1. Tenant shall accept the Fifth Floor Premises in its "AS-IS" condition, and Landlord shall have no obligation to perform any work therein except as outlined in this Exhibit (including, without limitation, demolition of any improvements existing therein or construction of any tenant finish-work or other improvements therein except as set forth in this Exhibit).

Landlord shall provide Tenant with an allowance not to exceed an amount of Three Hundred Fifty Thousand Forty-Four dollars ($350,044), the "5th Floor Refurbishment Allowance", as outlined below:

(a) Fifth Floor Refurbishment Allowance. Landlord agrees to provide Tenant an allowance not to exceed Two Hundred Forty Thousand Forty-Two Dollars ($240,042.00) (i.e. $5.00 per usable square foot) for improvements to the Fifth Floor Premises to be performed by Tenant. This allowance will be paid by Landlord to Tenant, from time to time, upon presentation by Tenant of invoices reflecting the cost of refurbishment and other improvements to the Fifth Floor Premises incurred by Tenant. Tenant shall complete such refurbishment and other improvements to the Fifth Floor Premises within six months of the 2007 Renewal Term Commencement Date. All such refurbishments and improvements shall be in compliance with the applicable provisions of the Lease and all applicable governmental laws, codes, rules and regulations. Any portion of this allowance not used (the "Unused Allowance") may be applied by Tenant to any Excess incurred in connection with the Expansion Premises as provided in Exhibit B-2.

(b) Restroom Upgrade Allowance. Landlord agrees to upgrade the Fifth Floor Restrooms based on an allowance of Eighty Thousand Dollars ($80,000.00). Landlord represents that such allowance is sufficient for such purpose and all improvements shall be in compliance with all applicable governmental laws, codes, rules and regulations including ADA/TAS. Landlord will use its best effort to minimize disruption caused to Tenant and will work around the time of day or night most convenient to the Tenant.

(c) Lighting Retrofit. Landlord agrees to install at its expense, and in an amount not to exceed Thirty Thousand Dollars ($30,000.00) improvements to retrofit the Building Standard lighting on the Fifth Floor Premises. Landlord agrees to install new Building Standard T-8 lamps and electronic ballasts in Tenant's existing Building Standard lighting fixtures. Landlord represents that such allowance is sufficient for such purpose and all improvements shall be in compliance with all applicable governmental laws, codes, rules and regulations. Landlord will use its best effort to minimize disruption caused to Tenant and will work around the time of day or night most convenient to the Tenant.

Landlord shall use its best efforts to complete such upgrades and retrofit as soon as reasonably feasible following the date hereof and prior to the 2007 Renewal Term Commencement Date.

2. ADDITIONAL WORK

Except to the extent described herein, Landlord has no obligation to do or pay for any work to the Fifth Floor Premises (or any plans or specifications relating thereto).

3. MISCELLANEOUS

(a) The terms and provisions of this Exhibit are intended to supplement and are specifically subject to all the terms and provisions of the Amendment and the Lease.

(b) This Exhibit may not be amended or modified other than by supplemental written agreement executed by authorized representatives of the parties hereto. Singular words shall connote the plural number as well as the singular and vice versa, and the masculine shall include the feminine and the neuter.

(c) The size and location of all of Tenant's wire, cable, condenser water piping and power conduit shall be subject to Landlord's prior written approval which shall not be unreasonably withheld.

EXHIBIT B-2

TENANT IMPROVEMENT WORK AGREEMENT

4TH FLOOR EXPANSION

PLANO ATRIUM, LLC, a Delaware limited liability company ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation ("Tenant"), entered into that certain Tenth Amendment to Office Lease (the "Amendment") dated as of August ___, 2006, for the lease of certain space at Atrium at Collin Ridge located in Plano, Texas. This Exhibit B-2 (this "Exhibit") is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment. Landlord and Tenant mutually agree as follows:

1. Except as set forth in this Exhibit, Tenant accepts the Expansion Premises in its "**As Is**" condition on the date that this Lease is entered into.

2. In addition to the improvements listed in the following paragraphs, Landlord agrees to provide the following improvement allowances.

(a) Moving Allowance. Landlord agrees to provide Tenant with an allowance (the "Moving Allowance") in an amount not to exceed seventeen thousand dollars ($17,000.00) (i.e. $1.00 per usable square foot for the Expansion Premises) for costs associated with moving Tenant's furniture and personal property to the Expansion Premises. Tenant agrees to provide Landlord with documentation of expenses for costs incurred by Tenant for the moving expense. Landlord shall reimburse Tenant in cash or its equivalent within 30 days of receipt of the documentation of expenses. Any portion of the Moving Allowance not so used may, at Tenant's option, be applied as a credit to the next Base Rental then due or to any Excess (as defined below).

(b) Amortized Excess Allowance. Tenant may request an additional allowance (the "Amortized Excess Allowance") in an amount not to exceed eighty-four thousand nine hundred ninety-five dollars ($84,995.00) (i.e. $5.00 per usable square foot for the Expansion Premises). The Amortized Excess Allowance may be used for Tenant Improvements (including changes orders or Above Standard Charges on Expansion Premises or for additional allowance for the 5th Floor Refurbishment), as well as for furniture, fixtures, and/or telecommunications. Tenant and Landlord agree to promptly enter into a lease amendment whereby Landlord agrees to bear the Amortized Excess Allowance costs to complete the Improvements or such other foregoing uses. Tenant agrees to pay to Landlord the Amortized Excess Allowance as an adjustment of Base Rental for the Expansion Premises (the "Amortized Excess Payment) to Landlord as follows:

The monthly installments of Base Rent payable by Tenant to Landlord under the Lease shall be increased by an amount sufficient to fully amortize in equal monthly installments over the period beginning on the Expansion Premises Commencement Date and ending on the 2007 Renewal Term Expiration Date the balance of the Amortized Excess Allowance, plus interest thereon at a fixed rate of ten percent (10%) per annum (the "Amortized Excess Portion"). The Amortized Excess Portion shall be payable to Landlord beginning on the first day of the First (1st) full month following the Expansion Premises Commencement Date and continuing regularly monthly thereafter through and including the 2007 Renewal Term Expiration Date**.**

3. Landlord agrees to "turn-key" the Improvements to the Expansion Premises using Building Standard materials based on the Space Plan approved by Landlord and Tenant and prepared by Interprise Design and dated August 8, 2006, a copy of which is attached hereto as Exhibit B-3 (the "Plans"). Landlord further agrees to provide the following improvements

a. One coffee bar with base cabinet including sink and over head storage cabinets

b. Power Connections for each work station

c. Wall finishes and carpet squares to match the fifth floor customer service center

d. Signage Costs

e. Carpet stairwell between 4th and 5th floors.

f. Landlord shall provide an allowance an amount not to exceed $5,000.00 for an access card reader to be added to the Building's main east entrance glass door (the "Building Access Allowance"). Such costs shall be limited to the access card reader, magnetic locking device, and connection to the Building's fire panel. In the event that Tenant chooses to use the Building's access system, Tenant may use the allowance for the costs of purchasing the Building's access cards from Landlord.

All improvements shall be in compliance with all applicable governmental laws, codes, rules and regulations including ADA/TAS.

4. Notwithstanding anything to the contrary contained herein, so long as Tenant does not request any changes to the Plans, as set forth above, no Excess (as defined herein) shall be charged to or payable by Tenant in connection with the construction of the Improvements to the Expansion Premises.

5. Landlord shall construct the tenant improvements contemplated hereby in accordance with the Plans (collectively, the "Improvements"). The cost of the Improvements for the purpose of billing shall equal the cost of planning, designing and constructing such Improvements (including any contractor's fee and Landlord's cost of supervision and coordination of the work in an amount equal to three percent (3%) of the actual cost to Landlord of the construction). All Improvements will be constructed with Building Standard materials with the exception of Improvements noted in Section 3 above. Any above standard improvements shall be considered Excess (defined below).

6. All costs and expenses incurred in the design and construction of the Improvements shall be borne by Landlord; provided, however, that any costs and expenses (the "Excess") incurred as a result of changes to the Plans requested by Tenant, change orders requested by Tenant, and/or Above Standard Improvements requested by Tenant (collectively, a "Tenant Change") shall be paid by Tenant, and shall be payable, at Tenant's option, as follows: (a) (i) Tenant shall pay, within ten (10) days from delivery of Landlord's invoice to Tenant therefor, to Landlord prior to the commencement of construction of the Tenant Change, an amount equal to one hundred percent (100%) of such Excess (as then estimated by Landlord), or (ii) Tenant may utilize the Amortized Excess Allowance or Unused Allowance (as defined above). Any costsExcess that exceed the Amortized Excess Allowance or Unused Allowance shall be paid by Tenant as outlined above; and (b) As soon as the final accounting is prepared and submitted to Tenant, and following the completion of all "punch list" items Tenant shall pay to Landlord, within twenty (20) days from delivery of Landlord's invoice to Tenant therefor, the entire unpaid balance, if any, of the actual Excess based on the final costs to Landlord and failure to make any such payments when due shall constitute an event of default under the Lease, entitling Landlord to all of its remedies thereunder as well as all remedies otherwise available to Landlord.

7. If Tenant requests any changes in the Plans, Tenant shall present Landlord with revised drawings and specifications for Landlord's approval, which approval will not be unreasonably withheld (but may be withheld if Landlord believes that any changes could substantially delay the construction of the Improvements). If Landlord approves such changes, Landlord shall incorporate such changes in the Improvements following Landlord's receipt of a change order therefor executed by Tenant.

8. Landlord hereby agrees that to the extent it acts as contractor hereunder, Landlord will commence or cause the commencement of the construction of the Improvements as promptly as is reasonably possible and will proceed with due diligence to perform or cause such work to be performed in a good and workmanlike manner. Landlord warrants to Tenant that all materials and equipment furnished in constructing the portion of the Improvements constructed by Landlord will be of good quality, free from faults and defects; provided, however, that Tenant's sole remedy for breach of such warranty shall be that Landlord, for a period of twelve (12) months after substantial completion of such work, at its sole cost and expense, will make all necessary repairs, replacements, and corrections of any nature or description as may become necessary by reason of faulty construction, labor or materials in the portion of the Improvements constructed by Landlord.

9. For the purposes of this Exhibit, the term "Substantial Completion" of the Improvements shall mean the completion of such Improvements in accordance with the Plans in all material respects excepting only minor "punch list" finish and touch-up work which does not interfere with the occupancy of the Leased Premises by Tenant, and the issuance of a certificate of occupancy and all other municipal permits necessary for Tenant to lawfully occupy and use the Expansion Premises under the Lease. Tenant shall submit a "punch list" to Landlord promptly following Substantial Completion of the Expansion Premises, and all such "punch list" items will be completed by Landlord within thirty (30) days of its receipt of such list.

10. Landlord agrees to allow Tenant or its representative to provide a list of approved general contractors that Landlord may consider. Final selection of these trades shall be at Landlord's sole discretion.

11. Unless otherwise specified, the Expansion Premises are to be painted and carpeted using Building Standard colors and finish materials. The Building Standard Grid consists of 2' x 4' ceiling tiles. Landlord shall provide ceiling grid in good condition and will replace any damaged or stained. tiles. All ceiling tiles should be clean, uniform, and free of cracks, its, or bending (warping). Parabolic light fixtures shall be installed and wired per the Plans, including air return and supply capability. Fixtures shall include new T8 lamps and electronic ballasts. Refer to I.E.S. Lighting Handbook for specific light levels -1/60 square feet.

12. Building sprinkler system shall be installed in accordance with the Plans (allow one sprinkler head per 150-170 RSF as specified in Tenant's drawings). Landlord warrants that the Expansion Premises sprinkler system currently meets required building codes. Any pre-existing damaged or missing components shall be replaced at Landlord's cost. Costs resulting from the modifications to the Expansion Premises for the addition or relocation of sprinkler system components shall be part of the Improvements.

13. Landlord shall provide Building Standard HVAC services. Landlord warrants that the Expansion Premises HVAC mechanical system currently meets Building Standard requirements. Costs resulting upon the modifications of the Expansion Premises for the addition or relocation of HVAC system components shall be part of the Improvements. The HVAC system shall be tested, adjusted, and balanced to Tenant's requirements by a NEBB certified balancing firm.

14. Building fire alarm, enunciators, fire extinguishers, smoke detectors, exit fights and ADA complying strobes shall be installed per code and occupancy requirements. Landlord warrants that the Expansion Premises fire safety system currently meets required building codes. Any pre-existing damaged or missing components shall be replaced at Landlord's cost. Costs resulting from the modifications to the Expansion Premises for the addition or relocation of fire safety components shall be part of the Improvements.

15. Electrical distribution shall be modified in accordance with the Plans. Tenant requires 8 watts per square foot capacity (demand) (separate from base building HVAC systems) and lighting for the Expansion Premises. Landlord warrants that the Expansion Premises electrical system currently meets Building Standard requirements. Costs resulting from the modifications to the Expansion Premises for the addition or relocation of electrical outlets or components shall be part of the Improvements.

16. All baffling and sound insulation/isolation requirements installed for base building mechanical equipment will be provided and installed by Landlord to meet minimum requirements.

17. Building standard window covering shall be installed as a part of the Improvements.

18. Landlord shall, at Landlord's expense, level and smooth all floors within the Expansion Premises with no more than 1/4 inch level variance in any 10 foot radius and with no more than overall one (1) inch leveling variance between any two locations on any one floor of the Expansion Premises. The specifications for any materials used in such leveling shall be reasonably acceptable to Tenant.

19. All building columns and the core wall drywalled, taped and bedded.

20. Any wall surface beneath or above exterior windows to be furred, drywalled, taped and bedded and insulated.

21. Landlord represents that the Expansion Premises and related common areas will conform with all applicable regulatory codes including ADA/TAS. Such areas shall include but not be limited to restrooms, path of travel through the building, garages, elevator cabs, lobbies, and site work etc. In addition, all building safety and regulatory inspections are the responsibility of the Landlord and all records should be made available for review by Tenant.

22. Cabling rooms and cable risers shall be available for installation of telephones and computer network. Landlord, with its reasonable approval, shall provide building cable entrance, facilities and vertical risers of sufficient quantities to support Tenant's internally operated telephone and data communications system.

23. Landlord is responsible for the cost of removing any and all abandoned communications cable from the building's riser system (vertical pathways) serving the Expansion Premises and above the ceiling grid (horizontal pathways) in the Expansion Premises. Abandoned communications cable shall be defined as all communications cabling (copper or fiber) that is not terminated at both ends on a connector or other equipment and not identified "For Future Use" with a tag.

24. Landlord shall comply with ASHRE 6289 which addresses building air change requirements.

25. Tenant shall have the right to install secured conduit(s) in the riser space for its exclusive use upon written approval. of Landlord. Access to this riser space shall be free and shall be reasonably accessible during the Lease term and all extensions thereof.

26. Upon termination or expiration of the Lease term, and any renewal thereof, Tenant shall return the Expansion Premises in accordance with the provisions of the Lease, but shall have no obligation to remove the Improvements or otherwise restore the Expansion Premises.

27. COMMENCEMENT OF RENT

Tenant's obligation to pay Base Rent for the Expansion Premises shall not commence until the Expansion Premises Commencement Date; provided, however, that if the Substantial Completion of Improvements is delayed as a result of any one or more of the following (each referred to as a "Tenant Delay"):

(a) Tenant's request for materials, finishes and installations which require unusual lead time to order or unusual time to install; or

(b) Tenant's changes in the Improvements or in the Plans relating thereto (notwithstanding Landlord's approval of any such changes); or

(c) If the performance of any material portion of the Improvements depends on the prior or simultaneous performance of work by Tenant or any of Tenant's contractors, any delay by Tenant or Tenant's contractors in the completion of such work;

then and in any such event, Tenant's obligation to commence the payment of Base Rent for the Expansion Premises on the date provided for in the Amendment shall not be affected or deferred on account of such delay.

28. ACCESS BY TENANT PRIOR TO COMMENCEMENT OF TERM

If Tenant should desire to enter the Expansion Premises or authorize its employees, architects, space planners, consultants, contractors, engineers, suppliers and other representatives, as applicable, to do so prior to the Expansion Premises Commencement Date to (i) perform approved work not requested of Landlord, (ii) assist in the preparation of the Plans and/or to monitor the progress of the construction of the Improvements and/or (iii) install furniture, fixtures, equipment, telecommunications equipment or other equipment**,** Landlord shall permit such entry if: (**1**) Tenant shall use only such contractors which Landlord shall approve in its reasonable discretion and Landlord shall have approved the plans for such approved work to be utilized by Tenant, which approval will not be unreasonably withheld; (2) Tenant, its employees, architects, consultants, contractors, workmen, mechanics, engineers, space planners or such others as may enter the Premises (collectively, "Tenant's Contractors"), work in harmony with and do not in any way disturb or interfere with Landlord's Space Planner, architects, engineers, contractors, workmen, mechanics or other agents or independent contractors in the performance of their work (collectively, "Landlord's Contractors"), it being understood and agreed that if entry of Tenant or Tenant's Contractors would cause, has caused or is causing a material disturbance to Landlord or Landlord's Contractors, then Landlord may, with notice, refuse admittance to Tenant or Tenant's Contractors causing such disturbance; (3) Tenant, Tenant's Contractors and other agents shall provide Landlord with sufficient evidence that each is covered under such workers' compensation, employer's liability, commercial general liability and property damage insurance as Landlord may reasonably request for its protection and the protection of its agents and mortgagees; (4) such work shall be constructed/performed in accordance with the Lease; and (5) Tenant shall not then be in default of any of its obligations under the Lease and/or the Amendment. Tenant shall give Landlord's project manager reasonable advance notice of any entry permitted by this Exhibit and Landlord shall have the right to require that a representative and/or agent of Landlord accompany the person or persons so entering the Expansion Premises. Landlord shall not be liable for any injury, loss or damage to any of Tenant's installations or decorations made prior to the on Expansion Premises Commencement Date and not installed by Landlord. Tenant shall protect, defend, indemnify and hold harmless Landlord and all Landlord Indemnitees exempt and harmless from and against any and all Claims arising out of or in connection with work performed in any portion of the Expansion Premises by or on behalf of Tenant (but excluding work performed by Landlord or Landlord's Contractors) or otherwise arising out of or connected with the activities of Tenant or its agents, servants, officers, employees, contractors, suppliers or workmen in or about any portion of the Expansion Premises, the Building and/or the Complex, **SPECIFICALLY INCLUDING, WITHOUT LIMITATION, SUCH LIABILITIES, COSTS, DAMAGES, FEES** AND **EXPENSES ARISING OUT OF OR CONNECTED WITH THE NEGLIGENCE OF LANDLORD OR** ANY **LANDLORD INDEMNITEES,** but excluding any such liabilities, costs, damages, fees and expenses caused by or resulting from the sole or gross negligence or willful misconduct of Landlord or any Landlord Indemnitees. Landlord is not responsible for the function and maintenance of the improvements**,** equipment, cabinets or fixtures not installed by Landlord, except as otherwise provided herein**.** Such entry by Tenant and Tenant's Contractors pursuant to this Exhibit shall be deemed to be under all of the terms, covenants, provisions and conditions of the Lease and the Amendment except the covenant to pay Rent.

29. MISCELLANEOUS

(a) The terms and provisions of this Exhibit are intended to supplement and are specifically subject to all the terms and provisions of the Lease.

(b) This Exhibit may not be amended or modified other than by supplemental written agreement executed by authorized representatives of the parties hereto. Singular words shall connote the plural number as well as the singular and vice versa, and the masculine shall include the feminine and the neuter.

(c) If any re-drawing or re-drafting of the Plans is necessitated by any requested changes thereto by Tenant (all of which shall be subject to Landlord's approval), the expense of any such re-drawing or re-drafting will be charged to Tenant.

(d) The Excess and any other sums payable by Tenant to Landlord under this Exhibit shall constitute rent due under the Lease. In no event shall any termination of the Lease by Landlord relieve Tenant of Tenant's obligation to pay Landlord the Excess or any other sums payable by Tenant under this Exhibit.

EXHIBIT B-3

Expansion Premises Space Plan

EXHIBIT B-4

BUILDING IMPROVEMENTS

PLANO ATRIUM, LLC, a Delaware limited liability company (“Landlord”), and PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation (“Tenant”), entered into that certain Tenth Amendment to Office Lease (the “Amendment”) dated as of August ___, 2006, for the lease of certain space at Atrium at Collin Ridge located in Plano, Texas. This Exhibit B-4 (this “Exhibit”) is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment. Landlord and Tenant mutually agree as follows:

JANITORIAL:

Landlord shall establish and maintain a plan to improve the standards in the Building that will provide a first class business environment. In particular, Landlord agrees:

- to sweep architectural beams :tree of dust and debris on a quarterly basis. All Atrium balconies shall be kept clean of trash or furniture. The balconies shall be cleaned on a weekly basis.
- to use its reasonable efforts to remove unsightly storage of boxes in other tenant spaces visible through the atrium windows by inspecting weekly for unsightly boxes visible from the atrium and ordering its removal or the closing of blinds.
- to repaint any visible water stains on the Atrium ceiling.
- to maintain proper care of the water fountain so as to prevent algae growth in the water and on the water fountain walls and re-paint the water fountain (estimated at $2,000) and clean the fountain on a weekly basis.

ELEVATOR SERVICE:

Landlord will use its best effort to improve elevator downtime. Landlord represents that a new contract has been negotiated which includes faster response times on repairs and increased amount of preventative maintenance to the elevators. In addition, Landlord is installing infrared sensors on all elevator doors to improve safety. (The cost of the upgrade is estimated at $6,000)

BUILDING LOBBY:

Landlord agrees to furnish building lobby with new furniture. Landlord will spend up to $7,000.

SECURITY/LIFE SAFETY:

Landlord agrees to install a video surveillance system at the Building to monitor entrances and parking areas. Landlord agrees to spend up to $8,000 on surveillance system. In addition, Landlord will re-evaluate security procedures and patrols to deter automobile burglaries.

EXHIBIT C

PLANO ATRIUM, LLC, a Delaware limited liability company ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC. ("Tenant"), entered into that certain Tenth Amendment to Office Lease (the "Amendment") dated as of August ___, 2006, for the lease of certain space at Atrium at Collin Ridge located in Plano, Texas. This Exhibit C (this "Exhibit") is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment. Landlord and Tenant mutually agree as follows:

W I T N E S S E T H

1. The Expansion Premises have been delivered to, and accepted by, Tenant.
2. Substantial Completion of the Expansion Premises is ___________, 2006 and the Expansion Premises Commencement Date is ___________, 2006.
3. The Expansion Premises consists of 20,208 rentable square feet of floor area in the Building.
4. Base Rent is to calculated, determined and paid in the amounts and on the dates provided in Paragraph 6 of the Amendment.

IN WITNESS WHEROF, this instrument has been duly executed by Landlord and Tenant as of the date first written above.

LANDLORD:

PLANO ATRIUM, LLC, a Delaware
limited liability company

By: PLANO ATRIUM2, LLC, a
Delaware limited liability company, its
sole member

By: JAMISON PLANO ATRIUM, INC., a
Delaware corporation, its Managing Member

By: ______________________________
Name: ______________________________
Title: ______________________________

TENANT:

PRIORITY FULFILLMENT SERVICES, INC., a
Delaware corporation

By: ______________________________
Name: ______________________________
Title: ______________________________

EXHIBIT D

RENEWAL OPTION

PLANO ATRIUM, LLC, a Delaware limited liability company ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC. ("Tenant"), entered into that certain Tenth Amendment to Office Lease (the "Amendment") dated as of August ___, 2006, for the lease of certain space at Atrium at Collin Ridge located in Plano County, Texas. This Exhibit D (this "Exhibit") is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment. Landlord and Tenant mutually agree as follows:

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

2. Tenant shall have two (2) options (the "Renewal Option") to extend the Lease Term beyond the 2007 Renewal Term Expiration Date (such date and the last day of each Extension Term, if any, being herein referred to as a "Scheduled Expiration Date") for a period (the "Extension Term") of five (5) years, commencing upon the then-current Scheduled Expiration Date upon the same terms and conditions previously applicable, except for the grant of the exercised Renewal Option and the amount of Base Rental payable under the Lease (which amount shall be determined as set forth below). Not earlier than twelve (12) months or later than nine (9) months prior to the expiration of the 2007 Renewal Term, Tenant shall have the right to deliver to Landlord written notice (a "Notice of Intent to Renew") of Tenant's intent to extend the 2007 Renewal Term on the terms and conditions set forth herein. In such event, Landlord shall, within ninety (90) days after its receipt of a Notice of Intent to Renew, notify Tenant in writing of the Fair Market Value Rate (as defined in Paragraph 5 below) as determined by Landlord for Premises during the Extension Term (such determination is herein referred to as the ("Landlord's Assessment"). Landlord's Assessment shall reflect the fact that Landlord will provide to Tenant in connection with Tenant's exercise of the Renewal Option a refurbishment allowance (the "Refurbishment Allowance") in an amount equal to $7.00 per usable square foot of space then comprising the Premises. Tenant shall have the right, within fifteen (15) days after its receipt of written notice of the Landlord's Assessment, to either (i) accept in writing such Landlord's Assessment and exercise the Renewal Option (the "Notice of Exercise"), or (ii) reject such Landlord's Assessment but nevertheless elect to exercise the applicable Renewal Option by, in either instance, delivering written notice thereof to Landlord within such fifteen (15) day period; provided, however, that the Renewal Option may be validly exercised only if no uncured Tenant default exists as of the date of exercise. If Tenant timely delivers to Landlord written notice that Tenant is exercising the Renewal Option but that Tenant does not accept Landlord's Assessment ("Tenant's Objection Notice"), the Fair Market Value Rate shall be determined as provided in Paragraph 6 below. Tenant's Objection Notice must identify Tenant's determination of the Fair Market Value Rate ("Tenant's Assessment") to trigger the appraisal process set forth in Paragraph 6 below.

3. If Tenant does not either timely (i) accept Landlord's Assessment, or (ii) deliver to Landlord Tenant's Objection Notice, Tenant will be deemed to have elected to not exercise the Renewal Option. In no event shall Landlord have any obligation to provide Tenant with the Refurbishment Allowance in the event Tenant elects not to exercise of the renewal option or is deemed to have elected not to exercise the Renewal Option. The Extension Term shall commence immediately upon the expiration of the 2007 Renewal Term, and upon Tenant's exercise of the renewal option set forth in this Exhibit, the date of expiration of the 2007 Renewal Term shall automatically become the last day of the Extension Term.

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

strict accordance with the provisions of this Exhibit shall conclusively be deemed a waiver of the same.

5. Base Rental for the Extension Term shall be equal to 100% of either (y) the product of the Landlord's Assessment received by Tenant prior to Tenant's exercise of the Renewal Option multiplied by the number of rentable square feet of space then comprising the Premises if Tenant has accepted such Landlord's Assessment, or (z) if Tenant has timely delivered to Landlord Tenant's Objection Notice in which Tenant's Assessments has been identified, the product of the Fair Market Value Rate determined as provided in Paragraph 6 below multiplied by the number of rentable square feet of space comprising the Premises. As used herein, the term "Fair Market Value Rate" shall mean the base rent payable during the applicable lease period to a willing landlord by a willing tenant (neither having a compulsion to lease and Landlord having sufficient time to locate a replacement tenant), for the lease of non-sublease, non equity and renewal space in an office building comparable in quality to the Building, which space is of like size to the Premises, of like and comparable quality to the Premises, and which comparable office building is located in the Richardson/ Plano Telecom Corridor (as hereinafter defined), taking into consideration the terms of the Lease (including, without limitation, the available parking being make available to Tenant) and, as applicable, the following: (1) the location and floor level within the Building; (2) the condition of the existing improvements in the Premises and the premises covered by such renewed leases; (3) parking charges or the inclusion of the same in rental; (4) the extent of services to be provided by Landlord to Tenant and such renewal tenants; (5) the base year or dollar amount, if any, for escalation purposes; (6) credit rating and financial condition and stature of such renewal tenants as of the date of the exercise of the applicable lease renewal, and the credit rating and financial condition and stature of Tenant as of the date of the Landlord's Assessment; (7) the length of the lease renewal; (8) whether any broker's commission is payable; (9) the date on which the Extension Term will commence; and (10) any other appropriate term or condition. Notwithstanding and foregoing, in calculating the Fair Market Value Rate, no consideration shall be given to (i) any period of rental abatement, if any, granted to tenants in comparable property, and (ii) any portion of leasehold improvement allowances in excess of the Refurbishment Allowance. As used herein, the term "Richardson/Plano Telecom Corridor" shall mean the area located within portions of the Cities of Richardson and Plano, Texas generally recognized by real estate professionals as the "Telecom Corridor".

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

Market Value Rate for the Extension Term shall be the Fair Market Value Rate submitted to the Appraiser by the party that has submitted to the Appraiser its assessment of the Fair Market Value Rate and the applicable supporting data. The entire cost for the Appraiser's services shall be borne equally by Landlord and Tenant.

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

8. Once Fair Market Value Rate for the Extension Term has been established following a valid exercise by Tenant of the Renewal Option, Landlord and Tenant will, within fifteen (15) days thereafter, enter into an amendment (the "Lease Amendment") to the Lease reflecting (i) the extension of the 2007 Renewal Term, (ii) any change in Base Rental payable by Tenant as provided by this Exhibit, (iii) any change in the Base Year operation expenses, and (iv) such other amendments to the Lease as are necessary. Notwithstanding Landlord's and Tenant's obligation to execute and deliver the Lease Amendment within the time period provided above, Tenant's leasing of the Premises during the Extension Term is not conditioned on any such execution and delivery as the Lease Amendment is being executed merely to memorialize the terms and conditions of Tenant's leasing of the Premises during the Extension Term pursuant to this Exhibit after Landlord's receipt of the Notice of Exercise or Tenant's Objection Notice, as applicable.

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

EXHIBIT E

RIGHT OF FIRST REFUSAL

PLANO ATRIUM, LLC, a Delaware limited liability company ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC. ("Tenant"), entered into that certain Tenth Amendment to Office Lease (the "Amendment") dated as of August ___, 2006, for the lease of certain space at Atrium at Collin Ridge located in Plano, Texas. This Exhibit E (this "Exhibit") is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment. Landlord and Tenant mutually agree as follows:

1. Provided no Major Default has occurred and is continuing, Landlord shall, during the term of the Lease and prior to leasing the ROFR Space (as hereinafter defined), provide Tenant with the first refusal rights (the "ROFR Option") as set forth below. As used herein, the term "ROFR Space" shall mean any of the following: (a) any space located on the Fourth Floor of the Building and (b) any space of at least 7,000 rentable square feet in the Building Tenant shall have an ongoing ROFR Option subject to Existing Rights of Other Tenants (as defined in Paragraph 6 of this Exhibit), unless the applicable Existing Rights of Tenants have been waived or deemed waived by the party owning such rights or such rights have not been exercised in a timely manner and are no longer in effect with respect to the applicable ROFR Space.

2. Landlord shall, prior to leasing all or any portion of the ROFR Space, deliver to Tenant a written statement (the "ROFR Statement") which shall reflect Landlord's and the prospective tenant's non-binding agreement with respect to rent, term, finish allowances and other tenant inducements, and other matters related to the leasing of the applicable portion(s) of the ROFR Space (the "Offered Space"). Tenant shall have five (5) business days after its receipt of an ROFR Statement within which to notify Landlord in writing that it will exercise its ROFR Option and lease the Offered Space either, at Tenant's option (i) upon the same rent, term, finish allowances, and other tenant inducements, if any, contained in the ROFR Statement or (ii) if the date of the ROFR Statement is prior to September 1, 2008, upon the terms set forth in **Exhibit F**. Failure by Tenant to notify Landlord within such five (5) business day period shall be deemed an election by Tenant not to exercise its ROFR Option as to the Offered Space and Landlord shall have the right to lease such space to the prospective tenant upon substantially the same terms and conditions contained in the applicable ROFR Statement. If Landlord does not lease the Offered Space to such prospective tenant, upon such terms within 180 days of Tenant's election (or deemed election) not to exercise its ROFR Option as to such Offered Space, Tenant's ROFR Option for such Offered Space shall be reinstated. Tenant agrees that if it exercises its ROFR Option for any Offered Space, it must lease all of the Offered Space described in the applicable ROFR Statement.

3. Within fifteen (15) business days after the date of Landlord's receipt of Tenant's written notice that it will lease the Offered Space described in the applicable ROFR Statement, Landlord and Tenant will enter into an amendment to the Lease reflecting (i) the addition of such Offered Space to the Premises, (ii) the Base Rent payable under the Lease as provided by this Exhibit, (iii) Tenant's proportionate share of the Building, and (iv) such other amendments to the Lease as are necessary due to the addition of such Offered Space to the Premises.

4. Tenant's rights under this Exhibit shall terminate following the occurrence of the following events: (1) a termination of Tenant's right to possess all or any portion of the Premises following the occurrence of an Event of Default; (2) assignment of the Lease to a third party; (3) Tenant subleases more than twenty-five percent (25%) of the Premises; and/or (4) the expiration or earlier termination of the Lease.

5. Tenant's rights of first refusal under this Exhibit with respect to ROFR Space are subject to all rights of first refusal, rights of first opportunity, renewal rights, expansion options and any other rights of current tenants which exist as of the date hereof with respect to all or any portion of the ROFR Space (all of the foregoing rights and/or options are herein collectively called the "Existing Rights of Tenants"). Landlord's obligation to lease to Tenant all or any portion of the ROFR Space is contingent upon none of the Existing Rights of Tenants applicable to such ROFR Space being exercised either before or after Tenant's receipt of a ROFR Statement.

EXHIBIT F

EXPANSION OPTION

PLANO ATRIUM, LLC, a Delaware limited liability company ("Landlord"), and PRIORITY FULFILLMENT SERVICES, INC. ("Tenant"), entered into that certain Tenth Amendment to Office Lease (the "Amendment") dated as of August ___, 2006, for the lease of certain space at Atrium at Collin Ridge located in Plano, Texas. This Exhibit F (this "Exhibit") is attached to the Amendment. Except to the extent otherwise indicated herein, the initially capitalized terms used in this Exhibit shall have the meanings assigned to them in the Amendment. Landlord and Tenant mutually agree as follows:

1. Provided no Major Default has occurred and is continuing, Tenant shall have during the term of the Lease the following ongoing expansion rights (the "Expansion Option") as set forth below. As used herein, the term "Available Space" shall mean (a) any space located on the Fourth Floor of the Building and (b) any space of at least 7,000 rentable square feet in the Building, subject, however, to Other Building Tenants' Rights (defined below) unless the applicable Existing Rights of Tenants have been waived or deemed waived by the party owning such rights or such rights have not been exercised in a timely manner and are no longer in effect with respect to the applicable Available Space. Other Building Tenants' rights shall mean all rights of first refusal, rights of first opportunity, renewal rights, expansion options and any other rights of current tenants which exist as of the date hereof with respect to all or any portion of the Available Space.

If Tenant requests to sub-divide the Available Space, Landlord shall have the exclusive right to reject such sub-division of space, if such sub-division creates the following difficulties to the Landlord: (a) If, in Landlord's sole discretion, the sub-division of space leaves the leftover space unleasable or significantly reduces the Landlord's ability to lease such leftover space or (b) such sub-division of space creates any possible violations of an governing agencies' building codes, restrictions, or laws.

2. At such time as any Available Space is not subject to any Other Building Tenants' Rights, Landlord shall so notify Tenant, which notice ("Landlord's Expansion Notice") shall describe in reasonable detail the applicable Available Space (the "Expansion Space"). If Tenant wishes to exercise its Expansion Option as to such Expansion Space, Tenant shall, within ten (10) days of its receipt of Landlord's Expansion Notice deliver to Landlord a written letter of intent (the "Expansion Letter") describing Tenant's intention to lease such "Expansion Space"). The "Expansion Letter Delivery Date" shall be herein defined as the date of Landlord's receipt of such Expansion Letter. Landlord and Tenant agree to diligently proceed in executing a lease amendment for such Expansion Space within fifteen (15) business days of the Expansion Letter Delivery Date under the following terms and conditions:

(a) If the Expansion Letter Delivery Date is on or before September 1, 2008, Base Rent for the Expansion Space shall commence on the Expansion Space Commencement Date (as defined below) and shall be the then prevailing amount per rentable square foot as outlined in Section 6(a) of the Amendment. Landlord shall also provide Tenant with a Tenant Improvement Allowance which shall be at the prevailing market allowance for similar expansion space.

(b) If the Expansion Letter Delivery Date is after September 1, 2008, the Base rental rate shall be at the prevailing Fair Market Value, as mutually agreed by Landlord and Tenant. If the parties cannot agree, Fair Market Value shall be determined in accordance with the procedures set forth in Exhibit D. Landlord shall also provide Tenant with a Tenant Improvements Allowance which shall be at the prevailing market allowance for similar expansion space.

(c) Upon Substantial Completion of the Expansion Space, Landlord shall deliver the Expansion Space to Tenant (the "Expansion Space Commencement Date") and Tenant shall commence paying Base Rent, the Base Rent adjustments and any other costs or amounts payable by Tenant with respect to the Expansion Space as provided in the Lease Amendment for such space. The Expansion Space shall be taken in its "As Is" condition and Landlord shall have no obligations to construct any leasehold improvements therein nor make any alterations thereto nor provide any allowance for tenant improvements except for as outlined in section 2(a) or 2(b) of this Exhibit. The leasing of the Expansion Space shall be upon the same terms and conditions as the leasing of the Premises and shall upon and subject to all of the provisions of the Lease.

3. Tenant’s rights under this Exhibit shall terminate following the occurrence of the following events: (1) a termination of Tenant’s right to possess all or any portion of the Premises following the occurrence of an Event of Default; (2) assignment of the Lease to a third party; (3) Tenant subleases more than twenty-five percent (25%) of the Premises; and/or (4) the expiration or earlier termination of the Lease.

EXHIBIT 31.1

CERTIFICATIONS OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

I, Mark Layton, certify that:

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

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

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

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

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

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

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

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

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

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

Date: November 14, 2006

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

EXHIBIT 31.2

CERTIFICATIONS OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

I, Tom Madden, certify that:

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

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

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

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

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

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

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

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

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

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

Date: November 14, 2006

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

EXHIBIT 32.1

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

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

The Quarterly Report on Form 10-Q for the period ended June 30, 2006 (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.

November 14, 2006	/s/ Mark C. Layton Mark C. Layton Chief Executive Officer
November 14, 2006	/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.