

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the Quarterly Period Ended June 30, 2013

OR

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

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

Commission File Number 000-28275

**PFSweb, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
(State of Incorporation)

505 Millennium Drive, Allen, Texas  
(Address of principal executive offices)

75-2837058  
(I.R.S. Employer  
I.D. No.)

75013  
(Zip Code)

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

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

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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

At August 12, 2013 there were 16,104,705 shares of registrant's common stock outstanding.

PFSWEB, INC. AND SUBSIDIARIES

Form 10-Q  
June 30, 2013

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

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

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 21,638	\$ 19,626
Restricted cash	457	283
Accounts receivable, net of allowance for doubtful accounts of \$391 and \$450 at June 30, 2013 and December 31, 2012, respectively	37,873	45,684
Inventories, net of reserves of \$1,753 and \$1,789 at June 30, 2013 and December 31, 2012, respectively	17,822	24,654
Other receivables	6,984	7,675
Prepaid expenses and other current assets	4,364	4,346
Total current assets	89,138	102,268
PROPERTY AND EQUIPMENT, net	26,611	27,917
OTHER ASSETS	2,887	3,286
Total assets	\$ 118,636	\$ 133,471
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt and capital lease obligations	\$ 8,940	\$ 16,660
Trade accounts payable	26,760	40,493
Deferred revenue	7,870	6,648
Accrued expenses	18,981	23,097
Total current liabilities	62,551	86,898
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	4,224	5,400
DEFERRED REVENUE	7,343	7,562
DEFERRED RENT	5,237	5,560
Total liabilities	79,355	105,420
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.001 par value; 35,000,000 shares authorized; 16,138,172 and 12,812,386 shares issued at June 30, 2013 and December 31, 2012, respectively; and 16,104,705 and 12,778,919 outstanding at June 30, 2013 and December 31, 2012, respectively	16	13
Additional paid-in capital	120,915	106,018
Accumulated deficit	(82,939)	(79,409)
Accumulated other comprehensive income	1,414	1,554
Treasury stock at cost, 33,467 shares	(125)	(125)
Total shareholders' equity	39,281	28,051
Total liabilities and shareholders' equity	\$ 118,636	\$ 133,471

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

**PFSWEB, INC. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In Thousands, Except Per Share Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>REVENUES:</b>				
Product revenue, net	\$ 22,985	\$ 29,423	\$ 48,467	\$ 63,974
Service fee revenue	26,496	28,384	54,498	56,762
Pass-through revenue	8,704	9,264	18,361	19,103
Total revenues	<u>58,185</u>	<u>67,071</u>	<u>121,326</u>	<u>139,839</u>
<b>COSTS OF REVENUES:</b>				
Cost of product revenue	21,479	27,263	44,994	58,945
Cost of service fee revenue	17,811	20,698	37,069	42,353
Cost of pass-through revenue	8,704	9,264	18,361	19,103
Total costs of revenues	<u>47,994</u>	<u>57,225</u>	<u>100,424</u>	<u>120,401</u>
Gross profit	10,191	9,846	20,902	19,438
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES,</b> including stock based compensation expense of \$282 and \$366 in the three months ended June 30, 2013 and 2012, respectively, and \$585 and \$706 in the six months ended June 30, 2013 and 2012, respectively.	<u>10,938</u>	<u>9,902</u>	<u>23,739</u>	<u>20,406</u>
Loss from operations	(747)	(56)	(2,837)	(968)
<b>INTEREST EXPENSE, net</b>	<u>184</u>	<u>258</u>	<u>402</u>	<u>522</u>
Loss from operations before income taxes	(931)	(314)	(3,239)	(1,490)
<b>INCOME TAX EXPENSE</b>	<u>24</u>	<u>194</u>	<u>291</u>	<u>303</u>
<b>NET LOSS</b>	<u>\$ (955)</u>	<u>\$ (508)</u>	<u>\$ (3,530)</u>	<u>\$ (1,793)</u>
<b>NET LOSS PER SHARE:</b>				
Basic	<u>\$ (0.07)</u>	<u>\$ (0.04)</u>	<u>\$ (0.26)</u>	<u>\$ (0.14)</u>
Diluted	<u>\$ (0.07)</u>	<u>\$ (0.04)</u>	<u>\$ (0.26)</u>	<u>\$ (0.14)</u>
<b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:</b>				
Basic	<u>14,525</u>	<u>12,783</u>	<u>13,661</u>	<u>12,774</u>
Diluted	<u>14,525</u>	<u>12,783</u>	<u>13,661</u>	<u>12,774</u>
<b>COMPREHENSIVE LOSS:</b>				
Net loss	\$ (955)	\$ (508)	\$ (3,530)	\$ (1,793)
Foreign currency translation adjustment	119	(496)	(140)	(221)
<b>TOTAL COMPREHENSIVE LOSS</b>	<u>\$ (836)</u>	<u>\$ (1,004)</u>	<u>\$ (3,670)</u>	<u>\$ (2,014)</u>

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

**PFSWEB, INC. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In Thousands)

	Six Months Ended June 30,	
	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (3,530)	\$ (1,793)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	5,096	4,332
Provision for doubtful accounts	35	21
Provision for excess and obsolete inventory	10	169
Deferred income taxes	24	(3)
Stock-based compensation expense	585	706
Changes in operating assets and liabilities:		
Restricted cash	18	(200)
Accounts receivable	7,670	13,310
Inventories	6,705	3,031
Prepaid expenses, other receivables and other assets	934	4,174
Deferred rent	(281)	5,306
Accounts payable, deferred revenue, accrued expenses and other liabilities	(16,509)	(12,938)
Net cash provided by operating activities	757	16,115
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(3,162)	(9,371)
Net cash used in investing activities	(3,162)	(9,371)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from issuance of common stock	14,312	48
Purchase of treasury stock	—	(12)
Decrease (increase) in restricted cash	(192)	299
Payments on capital lease obligations	(1,299)	(737)
Payments on long-term debt, net	(8,307)	(6,827)
Net cash provided by (used in) financing activities	4,514	(7,229)
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(97)	(103)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,012	(588)
CASH AND CASH EQUIVALENTS, beginning of period	19,626	17,695
CASH AND CASH EQUIVALENTS, end of period	\$ 21,638	\$ 17,107
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Non-cash investing and financing activities:		
Property and equipment acquired under long-term debt and capital leases	\$ 1,071	\$ 5,597

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

## Notes to Unaudited Consolidated Financial Statements

**1. OVERVIEW AND BASIS OF PRESENTATION**

PFSweb, Inc. and its subsidiaries are collectively referred to as the “Company;” “Supplies Distributors” refers to Supplies Distributors, Inc. and its subsidiaries; “Retail Connect” refers to PFSweb Retail Connect, Inc.; and “PFSweb” refers to PFSweb, Inc. and its subsidiaries and affiliates, excluding Supplies Distributors and Retail Connect.

***PFSweb Overview***

PFSweb is an international business process outsourcing provider of end-to-end eCommerce solutions to major brand name companies seeking to optimize their supply chain and to enhance their traditional and online business channels and initiatives in the United States, Canada, and Europe. PFSweb offers a broad range of service offerings that include digital marketing, eCommerce technologies, order management, customer care, logistics and fulfillment, financial management and professional consulting.

***Supplies Distributors Overview***

Supplies Distributors and PFSweb operate under distributor agreements with Ricoh Company Limited and Ricoh Production Print Solutions, a strategic business unit within the Ricoh Family Group of Companies, (collectively hereafter referred to as “RicoH”) under which Supplies Distributors acts as a distributor of various Ricoh products. Substantially all of Supplies Distributors’ revenue is generated by its sale of product purchased from Ricoh.

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

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

***Basis of Presentation***

The unaudited interim consolidated financial statements as of June 30, 2013, and for the three and six months ended June 30, 2013 and 2012, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and are unaudited. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) 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 consolidated financial statements of the Company include all adjustments necessary for a fair presentation of the Company’s financial position as of June 30, 2013, its results of operations for the three and six months ended June 30, 2013 and 2012 and its cash flows for the six months ended June 30, 2013 and 2012. Results of the Company’s operations for interim periods may not be indicative of results for the full fiscal year.

Certain prior period data on the income statement has been reclassified to conform to the current year presentation of a) product and pass-through revenues, b) cost of product, service fee and pass-through revenues and c) selling, general and administrative expenses, each of which was previously classified as a different component on the income statement. These reclassifications had no effect on previously reported net income (loss) or total shareholders’ equity.

**2. SIGNIFICANT ACCOUNTING POLICIES*****Principles of Consolidation***

All intercompany accounts and transactions have been eliminated in consolidation.

## Notes to Unaudited Consolidated Financial Statements

**Use of Estimates**

The preparation of consolidated financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The recognition and allocation of certain revenues and selling, general and administrative expenses in these consolidated financial statements also require management estimates and assumptions.

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as the operating environment changes. These changes have been included in the consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. These uncertainties are discussed in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 in the section entitled "Risk Factors." Based on a critical assessment of accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes the Company's consolidated financial statements are fairly stated in accordance with U.S. GAAP, and provide a fair presentation of the Company's financial position and results of operations.

**Investment in Affiliates**

Priority Fulfillment Services, Inc. ("PFS"), a wholly-owned subsidiary of PFSweb, Inc., has made advances to Supplies Distributors that are evidenced by a Subordinated Demand Note (the "Subordinated Note"). Under the terms of certain of the Company's debt facilities, the outstanding balance of the Subordinated Note cannot be increased to more than \$5.0 million or decreased to less than \$3.5 million without prior approval of certain of the Company's lenders. As of both June 30, 2013 and December 31, 2012, the outstanding balance of the Subordinated Note was \$3.5 million. The Subordinated Note is eliminated in the Company's consolidated financial statements.

PFS has also made advances to Retail Connect, which aggregated \$11.1 million at both June 30, 2013 and December 31, 2012. Certain terms of the Company's debt facilities provide that the total advances to Retail Connect may not be less than \$2.0 million without prior approval of Retail Connect's lender, if needed. PFS has received the approval of its lender to advance incremental amounts to certain of its subsidiaries and/or affiliates, including Retail Connect, if needed, subject to certain financial covenants, as defined. PFSweb, Inc. has also advanced to Retail Connect an additional \$8.5 million and \$8.2 million as of June 30, 2013 and December 31, 2012, respectively. All of these advances are eliminated upon consolidation. As of June 30, 2013, PFSweb, Inc. has approximately \$16.0 million available to be advanced to Retail Connect and/or other affiliates.

**Concentration of Business and Credit Risk**

No service fee client or product revenue customer represented more than 10% of the Company's consolidated total net revenue during the six months ended June 30, 2013 or accounts receivable as of June 30, 2013.

A summary of the nonaffiliated customer and client concentrations is as follows:

	Six Months Ended June 30,	
	2013	2012
Product Revenue (as a percentage of total Product Revenue):		
Customer 1	15%	14%
Customer 2	12%	10%
Service Fee Revenue (as a percentage of total Service Fee Revenue):		
Client 1	14%	15%
Client 2	9%	16%

The Company currently anticipates that its product revenue and service fee revenue from the customers and clients identified above will decline during the next twelve months and the contractual relationship with Client 1 will end during the quarter ended September 30, 2013.

Notes to Unaudited Consolidated Financial Statements

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

The Company has multiple arrangements with International Business Machines Corporation ("IBM") and Ricoh and is dependent upon the continuation of such arrangements. These arrangements, which are critical to the Company's ongoing operations, include Supplies Distributors' distributor agreements and certain of Supplies Distributors' working capital financing agreements. Substantially all of Supplies Distributors' revenue is generated by its sale of product purchased from Ricoh. Supplies Distributors also relies upon Ricoh's sales force and product demand generation activities and the discontinuance of such services would have a material impact upon Supplies Distributors' business. In addition, Supplies Distributors has product sales to IBM and Ricoh business affiliates.

As a result of certain operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues and profitability for Supplies Distributors in 2013 and beyond.

***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 declines in values due to inventories that are slow moving or obsolete, excess levels of inventory or values assessed at lower than cost.

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

***Operating Leases***

The Company leases certain real estate for its warehouse, call center and corporate offices, as well as certain equipment under non-cancelable operating leases that expire at various dates through 2022. Management expects that, in the normal course of business, leases that expire will be renewed or replaced by other similar leases. The Company recognizes escalating lease payments on a straight-line basis over the term of each respective lease with the difference between cash payments and rent expense recognized being recorded as deferred rent in the accompanying consolidated balance sheets.

***Property and Equipment***

The Company's property held under capital leases amounts to approximately \$4.8 million and \$5.1 million, net of accumulated amortization of approximately \$3.8 million and \$2.6 million, at June 30, 2013 and December 31, 2012, respectively. Depreciation and amortization expense related to capital leases during the six months ended June 30, 2013 and 2012 was \$1.3 million and \$1.0 million, respectively. In addition, during 2012, the Company incurred approximately \$6.0 million of leasehold improvements at certain of its leased facilities that are being amortized over the shorter of the asset's useful lives or the lease terms and were primarily financed via tenant allowances that are also being amortized over the lease terms.

***Income Taxes***

The Company records a tax provision primarily associated with state income taxes and its Supplies Distributors subsidiary's international operations. The Company has recorded a valuation allowance for the majority of its net deferred tax assets.

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

The Company made payments for interest of approximately \$0.4 million and \$0.5 million in the six months ended June 30, 2013 and 2012, respectively. Income taxes of approximately \$49,000 and \$0.3 million were paid by the Company during the six month periods ended June 30, 2013 and 2012, respectively.



## Notes to Unaudited Consolidated Financial Statements

**3. NET LOSS PER COMMON SHARE**

Basic and diluted net loss per share are computed by dividing net loss by the weighted-average number of common shares outstanding for the reporting period. Stock options not included in the calculation of diluted net loss per share for the six months ended June 30, 2013, and 2012 were 2.0 million and 2.1 million, respectively, as the effect would be anti-dilutive.

**4. STOCK AND STOCK OPTIONS**

In May 2013, the Company completed an equity offering pursuant to which the Company sold an aggregate of 3.2 million shares of common stock, par value \$0.001 per share, at \$4.57 per share, resulting in net proceeds, after deducting offering expenses, of approximately \$14.1 million.

On May 22, 2013, pursuant to the Company's 2005 Employee Stock and Incentive Plan, as amended and restated (the "Plan"), the Company issued Performance-Based Share Awards ("Performance Shares", as defined in the Plan) to certain of the Company's executives. The number of Performance Shares that each such individual may receive is subject to, and calculated by reference to, the achievement by the Company of certain 2013 financial targets. Based on the financial targets, the aggregate maximum number of Performance Shares that may be issued for 2013 is 0.7 million. The Performance Shares are subject to four year vesting based upon continued employment and the comparative performance (on an annual and cumulative basis) of the Company's common stock on NASDAQ compared to the Russell Micro Cap Index.

**5. VENDOR FINANCING**

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of Ricoh products in the United States, providing financing for eligible Ricoh inventory and certain receivables up to \$20.0 million. The agreement has no stated maturity date and provides either party the ability to exit the facility following a 90-day notice. Given the structure of this facility and as outstanding balances, which represent inventory purchases, are repaid within twelve months, the Company has classified the outstanding amounts under this facility, which were \$11.4 million and \$11.9 million as of June 30, 2013 and December 31, 2012, respectively, as accounts payable in the consolidated balance sheets. As of June 30, 2013, Supplies Distributors had \$2.1 million of available credit under this facility. The credit facility 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. The credit facility also contains 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 is 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 \$3.5 million and the Company is required to maintain a minimum shareholders' equity of \$18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5% (3.75% as of June 30, 2013). The facility also includes a monthly service fee.

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

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

	June 30, 2013	December 31, 2012
Loan and security agreements		
Supplies Distributors	\$ 4,647	\$ 3,264
PFS	2,026	11,077
Credit facility – Retail Connect	—	—
Master lease agreements	5,975	6,648
Other	516	1,071
Total	<u>13,164</u>	<u>22,060</u>
Less current portion of long-term debt	8,940	16,660
Long-term debt, less current portion	<u>\$ 4,224</u>	<u>\$ 5,400</u>

## Notes to Unaudited Consolidated Financial Statements

***Loan and Security Agreement – Supplies Distributors***

Supplies Distributors has a loan and security agreement with Wells Fargo Bank, National Association (“Wells Fargo”) to provide financing for up to \$25 million of eligible accounts receivable in the United States and Canada. As of June 30, 2013, Supplies Distributors had \$1.3 million of available credit under this agreement. The Wells Fargo facility expires on the earlier of March 2014 or the date on which the parties to the Ricoh distributor agreement no longer operate under the terms of such agreement and/or Ricoh no longer supplies products pursuant to such agreement. Borrowings under the Wells Fargo facility accrue interest at prime rate plus 0.25% to 0.75% (3.75% as of June 30, 2013) or Eurodollar rate plus 2.5% to 3.0%, dependent on excess availability and subject to a minimum of 3.0%, as defined. The interest rate as of June 30, 2013 was 3.75% for \$3.6 million of outstanding borrowings and 3.0% for \$1.0 million of outstanding borrowings. As of December 31, 2012, the interest rate was 3.75% for \$1.3 million of outstanding borrowings and 3.0% for \$2.0 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. This agreement also contains 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 \$3.5 million, may not maintain restricted cash of more than \$5.0 million and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and Wells Fargo pursuant to which a security interest was granted to Wells Fargo for all U.S. and Canadian customer remittances received in specified bank accounts. At June 30, 2013 and December 31, 2012, these bank accounts held \$0.4 million and \$0.2 million, respectively, which were restricted for payment to Wells Fargo.

***Loan and Security Agreement – PFS***

PFS has a Loan and Security Agreement (“Comerica Agreement”) with Comerica Bank (“Comerica”). The Comerica Agreement provides for up to \$12.5 million (\$10.0 million during certain non-seasonal peak months) of eligible accounts receivable financing (“Working Capital Advances”) through March 2014. The Comerica Agreement also provided for up to \$3.0 million of eligible equipment purchases (“Equipment Advances”) through January 2013, with principal payments due through April 2015. As of June 30, 2013, PFS had \$9.9 million of available credit under the Working Capital Advance portion of this facility and no remaining availability for Equipment Advances. Borrowings under the Working Capital Advance portion of the Comerica Agreement accrue interest at prime rate plus 2% (5.25% at June 30, 2013) while the Equipment Advances accrues interest at prime rate plus 2.25% (5.5% at June 30, 2013). The Comerica Agreement contains cross default provisions and various restrictions upon PFS’ ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the Subordinated Note receivable from Supplies Distributors to a maximum of \$5.0 million. Comerica has provided approval for PFS to advance incremental amounts subject to certain financial covenants, as defined, to certain of its subsidiaries and/or affiliates, if needed. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc.

***Credit Facility – Retail Connect***

Retail Connect has an asset-based line of credit facility of up to \$2.0 million from Wells Fargo, through May 2014, which is collateralized by substantially all of Retail Connect’s assets. Borrowings under the facility are limited to a percentage of eligible accounts receivable and inventory, up to a specified amount. Outstanding borrowings under the facility bear interest at prime rate plus 1% or Eurodollar rate plus 3.5%. There were no outstanding borrowings as of June 30, 2013. As of June 30, 2013, Retail Connect had \$0.1 million of available credit under this facility. In connection with the line of credit, Retail Connect entered into a cash management arrangement whereby Retail Connect’s operating accounts are considered restricted and swept and used to repay outstanding amounts under the line of credit, if any. The credit facility restricts Retail Connect’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 for Retail Connect of \$0 million, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit.

## Notes to Unaudited Consolidated Financial Statements

**Factoring Agreement**

Supplies Distributors' European subsidiary has a factoring agreement with BNP Paribas Fortis Factor that provides factoring for up to 7.5 million euros (approximately \$9.8 million as of June 30, 2013) of eligible accounts receivable through March 2014. This factoring agreement is accounted for as a secured borrowing. As of June 30, 2013, Supplies Distributors' European subsidiary had approximately 1.0 million euros (approximately \$1.3 million) of available credit under this agreement. Borrowings accrue interest at Euribor plus 0.7% (0.8% at June 30, 2013).

**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, such as profitability and cash flow, and required level of shareholders' equity or net worth (as defined), the Company would be required to obtain a waiver from the lender or the lender would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral and enforcement of payment under the Company parent guarantee. Any acceleration of the repayment of the credit facilities may have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations. As of June 30, 2013, the Company was in compliance with all debt covenants.

**Master Lease Agreements**

The Company has various agreements that provide for leasing or financing transactions of equipment and other assets and will continue to enter into such arrangements as needed to finance the purchasing or leasing of certain equipment or other assets. Borrowings under these agreements, which generally have terms of three to five years, are generally secured by the related equipment, and in certain cases, by a Company parent guarantee.

**7. SEGMENT INFORMATION**

The Company is currently organized into two primary operating segments, which generally align with the corporate organization structure. In the first segment, PFSweb is an international provider of various business process outsourcing solutions and operates as a service fee business. In the second operating segment ("Business and Retail Connect"), subsidiaries of the Company purchase inventory from clients and resell the inventory to client customers. In this segment, the Company generally recognizes product revenue.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues (in thousands):				
PFSweb	\$ 35,922	\$ 38,772	\$ 74,375	\$ 78,451
Business and Retail Connect	24,613	29,557	52,018	64,282
Eliminations	(2,350)	(1,258)	(5,067)	(2,894)
	<u>\$ 58,185</u>	<u>\$ 67,071</u>	<u>\$ 121,326</u>	<u>\$ 139,839</u>
Income (loss) from operations (in thousands):				
PFSweb	\$ (783)	\$ (588)	\$ (3,330)	\$ (2,328)
Business and Retail Connect	36	532	493	1,360
	<u>\$ (747)</u>	<u>\$ (56)</u>	<u>\$ (2,837)</u>	<u>\$ (968)</u>
Depreciation and amortization (in thousands):				
PFSweb	\$ 2,649	\$ 2,166	\$ 5,018	\$ 4,292
Business and Retail Connect	39	24	78	40
	<u>\$ 2,688</u>	<u>\$ 2,190</u>	<u>\$ 5,096</u>	<u>\$ 4,332</u>
Capital expenditures (in thousands):				
PFSweb	\$ 1,558	\$ 1,797	\$ 3,146	\$ 9,282
Business and Retail Connect	—	14	16	89

## Notes to Unaudited Consolidated Financial Statements

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	\$	\$	\$	\$
	1,558	1,811	3,162	9,371
			June 30, 2013	December 31, 2012
Assets (in thousands):				
PFSweb			\$ 89,060	\$ 94,940
Business and Retail Connect			43,596	52,648
Eliminations			(14,020)	(14,117)
			\$ 118,636	\$ 133,471

**8. COMMITMENTS AND CONTINGENCIES**

In 2012, the Company incurred approximately \$6.0 million of leasehold improvements at certain of its leased facilities that are being amortized over the shorter of the assets lives or the lease terms and were primarily financed via tenant allowances that are also being amortized over the lease terms.

The Company received municipal tax abatements in certain locations. In prior years, the Company received notice from a municipality that it did not satisfy certain criteria necessary to maintain the abatements and that the municipal authority planned to make an adjustment to the Company's tax abatement. The Company disputed the adjustment and such dispute has been settled with the municipality. However, the amount of additional property taxes to be assessed against the Company and the timing of the related payments has not been finalized. As of June 30, 2013, the Company believes it has adequately accrued for the expected assessment.

In April 2010, a sales employee of eCOST (the former name of Retail Connect) was charged with violating various federal criminal statutes in connection with the sales of eCOST products to certain customers, and approximately \$620,000 held in an eCOST deposit account was seized and turned over to the Office of the U.S. Attorney in connection with such activity. The Company received subpoenas from the Office of the U.S. Attorney requesting information regarding the employee and other matters, and the Company has responded to the subpoenas and is fully cooperating with the Office of the U.S. Attorney. In August 2012, the employee pleaded guilty to a misdemeanor. Neither the Company nor eCOST have been charged with any criminal activity, and the Company intends to seek the recovery or reimbursement of the funds that are currently classified as other receivables on the June 30, 2013 financial statements. Based on the information available to date, the Company is unable to determine the amount of the loss, if any, relating to the seizure of such funds. No assurance can be given, however, that the seizure of such funds, or the inability of the Company to recover such funds or any significant portion thereof, or any costs and expenses incurred by the Company in connection with this matter will not have a material adverse effect upon the Company's financial condition or results of operations.

The Company is subject to claims in the ordinary course of business, including claims of alleged infringement by the Company or its subsidiaries of the patents, trademarks and other intellectual property rights of third parties. PFS is generally required to indemnify its service fee clients against any third party claims alleging infringement by PFS of the patents, trademarks and other intellectual property rights of third parties.

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

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

### Forward-Looking Information

We have made forward-looking statements in this Report on Form 10-Q. These statements are subject to risks and uncertainties, and there can be no guarantee that these statements will prove to be correct. Forward-looking statements include assumptions as to how we may perform in the future. When we use words like "seek," "strive," "believe," "expect," "anticipate," "predict," "potential," "continue," "will," "may," "could," "intend," "plan," "target" and "estimate" or similar expressions, we are making forward-looking statements. You should understand that the following important factors, in addition to those set forth above or elsewhere in this Report on Form 10-Q and our Form 10-K for the year ended December 31, 2012, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

- our ability to retain and expand relationships with existing clients and attract and implement new clients;
- our reliance on the fees generated by the transaction volume or product sales of our clients;
- our reliance on our clients' projections or transaction volume or product sales;
- our dependence upon our agreements with International Business Machines Corporation ("IBM") and Ricoh Company Limited and Ricoh Production Print Solutions, a strategic business unit within the Ricoh Family Group of Companies, (collectively hereafter referred to as "Ricoh");
- our dependence upon our agreements with our major clients;
- our client mix, their business volumes and the seasonality of their business;
- our ability to finalize pending contracts;
- the impact of strategic alliances and acquisitions;
- trends in e-commerce, outsourcing, government regulation, both foreign and domestic, and the market for our services;
- whether we can continue and manage growth;
- increased competition;
- our ability to generate more revenue and achieve sustainable profitability;
- effects of changes in profit margins;
- the customer and supplier concentration of our business;
- the reliance on third-party subcontracted services;
- the unknown effects of possible system failures and rapid changes in technology;
- foreign currency risks and other risks of operating in foreign countries;
- potential litigation;
- our dependency upon key personnel;
- the impact of new accounting standards, and changes in existing accounting rules or the interpretations of those rules;
- our ability to raise additional capital or obtain additional financing;
- our ability, and the ability of our subsidiaries, to borrow under current financing arrangements and maintain compliance with debt covenants;
- relationship with, and our guarantees of, certain of the liabilities and indebtedness of our subsidiaries; and
- taxation on the sale of our products.

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 these expectations actually will be achieved. In addition, some forward-looking statements are based upon assumptions as to future events that may not prove to be accurate. Therefore, actual outcomes and results may differ materially from what is expected or forecasted in such forward-looking statements.

We undertake no obligation to update publicly any forward-looking statement for any reason, even if new information becomes available or other events occur in the future.

## Overview

We are an international business process outsourcing provider of end-to-end eCommerce solutions. We provide these solutions to major brand name companies seeking to optimize their supply chain and to enhance their traditional and online business channels and initiatives. We derive our revenues from providing a broad range of services as we process individual business transactions on our clients' behalf using three different seller services financial models: 1) the Enablement model, 2) the Agent (or Flash) model and 3) the Retail model.

We refer to the standard PFSweb seller services financial model as the Enablement model. In this model, our clients own the inventory and are the merchants of record and engage us to provide various business outsourcing services in support of their business operations. We derive our service fee revenues from a broad range of service offerings that include digital marketing, eCommerce technologies, order management, customer care, logistics and fulfillment, financial management and professional consulting. 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 we lease or manage. We currently provide infrastructure and distribution solutions to clients that operate in a range of vertical markets, including technology manufacturing, computer products, cosmetics, fragile goods, contemporary home furnishings, apparel, aviation, telecommunications, consumer electronics and consumer packaged goods, among others.

In this model, we typically charge for our services on a cost-plus basis, a percent of shipped revenue basis or a per-transaction basis, such as a per-labor hour 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 costs and other 'out-of-pocket' expenses include travel, shipping and handling costs and telecommunication charges and are included in pass-through revenue.

As an additional service, we offer our second model, the Agent, or Flash, financial model, in which our clients maintain ownership of the product inventory stored at our locations as in the Enablement model. When a customer orders the product from our clients, a "flash" sale transaction passes product ownership to us for each order and we in turn immediately re-sell the product to the customer. The "flash" ownership exchange establishes us as the merchant of record, which enables us to use our existing merchant infrastructure to process sales to end customers, removing the need for the clients to establish these business processes internally, but permitting them to control the sales process to end customers. In this model, based on the terms of our current client arrangements, we record product revenue net of cost of product revenue.

Finally, our Retail model allows us to purchase inventory from the client just as any other client reseller partner. In this model, we place the initial and replenishment purchase orders with the client and take ownership of the product upon delivery to our facility. Consequently, in this model, we generate product revenue, as we own the inventory and the accounts receivable arising from our product sales. Under the Retail model, depending upon the product category and sales characteristics, we may require the client to provide product price protection as well as product purchase payment terms, right of return, and obsolescence protection appropriate to the product sales profile. In this model we recognize product revenue for customer sales. Freight costs billed to customers are reflected as components of product revenue. This business model generally requires significant working capital, for which we have credit available either through credit terms provided by our client or under senior credit facilities.

In general, we provide the Enablement and Agent (or Flash) models through our PFS and Supplies Distributors subsidiaries and the Retail model through our Supplies Distributors and PFSweb Retail Connect subsidiaries.

Growth is a key element to achieving our future goals, including achieving and maintaining sustainable profitability. Growth in our Enablement and Agent models is driven by two main elements: new client relationships and organic growth from existing clients. We focus our sales efforts on larger contracts with brand-name companies within two primary target markets, online brands and retailers and technology manufacturers, which, by nature, require a longer duration to close but also have the potential to be higher-quality and longer duration engagements.

Currently, any growth within our Retail model would be primarily driven by our ability to attract new distributor arrangements with Ricoh or other manufacturers and the sales and marketing efforts of the manufacturers and third party sales partners. As a result of certain operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale

and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues and profitability under our Retail model in 2013 and beyond.

We continue to monitor and control our costs to focus on profitability. While we are targeting our new service fee contracts to yield incremental gross profit, we also expect to incur incremental investments in technology development, operational and support management and sales and marketing expenses.

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 expenses.

*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 distributor agreements.

*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.

*Selling, General and Administrative expenses* - consist of expenses such as compensation and related expenses for sales and marketing staff, distribution costs (excluding freight) applicable to the Supplies Distributors business and the Retail model, 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 and our expenses 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. To improve our cash and liquidity position, in May 2013, we sold an aggregate of 3.2 million shares of our Common Stock at \$4.57 per share, resulting in net proceeds of \$14.1 million.

## Results of Operations For the Interim Periods Ended June 30, 2013 and 2012

The following table discloses certain financial information for the periods presented, expressed in terms of dollars, dollar change, percentage change and as a percentage of total revenue (in millions):

	Three Months Ended June 30,					Six Months Ended June 30,				
	2013	2012	Change	% of Net Revenues		2013	2012	Change	% of Net Revenues	
				2013	2012				2013	2012
<b>Revenues</b>										
Product revenue, net	\$ 23.0	\$ 29.4	\$ (6.4)	39.5%	43.9%	\$ 48.4	\$ 64.0	\$ (15.6)	9%	45.7%
Service fee revenue	26.5	28.3	(1.8)	45.5%	42.3%	54.5	56.8	(2.3)	44.9%	40.6%
Pass-through revenue	8.7	9.3	(0.6)	15.0%	13.8%	18.4	19.1	(0.7)	15.2%	13.7%
Total net revenues	58.2	67.0	(8.8)	100.0%	100.0%	121.3	139.9	(18.6)	100.0%	100.0%
<b>Cost of Revenues</b>										
Cost of product revenue (1)	21.5	27.2	(5.7)	93.4%	92.7%	44.9	59.0	(14.1)	92.8%	92.1%
Cost of service fee revenue (2)	17.8	20.7	(2.9)	67.2%	72.9%	37.1	42.4	(5.3)	68.0%	74.6%
Pass-through cost of revenue (3)	8.7	9.3	(0.6)	100.0%	100.0%	18.4	19.1	(0.7)	100.0%	100.0%
Total cost of revenues	48.0	57.2	(9.2)	82.5%	85.3%	100.4	120.5	(20.1)	82.8%	86.1%
Product revenue gross profit	1.5	2.2	(0.7)	6.6%	7.3%	3.5	5.0	(1.5)	7.2%	7.9%
Service fee gross profit	8.7	7.6	1.1	32.8%	27.1%	17.4	14.4	3.0	32.0%	25.4%
Pass-through gross profit	—	—	—	— %	— %	—	—	—	— %	— %
Total gross profit	10.2	9.8	0.4	17.5%	14.7%	20.9	19.4	1.5	17.2%	13.9%
Selling General and Administrative expense	10.9	9.9	1.0	18.8%	14.8%	23.7	20.4	3.3	19.6%	14.6%
Loss from operations	(0.7)	(0.1)	(0.6)	(1.3)%	(0.1)%	(2.8)	(1.0)	(1.8)	(2.4)%	(0.7)%
Interest expense, net	0.2	0.2	—	0.3%	0.4%	0.4	0.5	(0.1)	0.3%	0.4%
Loss before income taxes	(0.9)	(0.3)	(0.6)	(1.6)%	(0.5)%	(3.2)	(1.5)	(1.7)	(2.7)%	(1.1)%
Income tax expense, net	—	0.2	0.2	— %	0.3%	0.3	0.3	—	0.2%	0.2%
Net loss	<u>\$ (0.9)</u>	<u>\$ (0.5)</u>	<u>\$ 0.4</u>	(1.6)%	(0.8)%	<u>\$ (3.5)</u>	<u>\$ (1.8)</u>	<u>\$ (1.7)</u>	(2.9)%	(1.3)%

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



*Product Revenue, net.* Product revenue was \$23.0 million for the three months ended June 30, 2013, which represents a decrease of \$6.4 million or 21.9% as compared to the same quarter of the prior year. In the six months ended June 30, 2013, product revenue was \$48.4 million, which represented a decrease of \$15.6 million or 24.2% compared to the same period of the prior year. This reduction in revenue is primarily due to the operational restructuring by Ricoh of its business, which has resulted, and will continue to result, in changes in the sale and distribution of Ricoh products and lower product revenue. We currently expect product revenue to be approximately \$90 million to \$100 million in 2013.

*Service Fee Revenue.* The decrease in service fee revenue for the three and six months ended June 30, 2013 as compared to the same period of the prior year was primarily due to decreased service fees from both existing and terminated client relationships, partially offset by the impact of new client relationships that began in 2012 and early 2013.

The change in service fee revenue, excluding pass-through revenue, is shown below (\$ millions):

	<u>Three Months</u>	<u>Six Months</u>
Period ended June 30, 2012	\$ 28.3	\$ 56.8
New service contract relationships	3.4	5.8
Change in existing client service fees	(2.0)	(7.8)
Terminated clients not included in 2013 revenue	<u>(3.2)</u>	<u>(0.3)</u>
Period ended June 30, 2013	<u>\$ 26.5</u>	<u>\$ 54.5</u>

Our service fee revenue has been negatively impacted, and will continue to be negatively impacted, in 2013 by the conclusion or anticipated reduction of operations of certain client programs. Based on current client projections for fiscal year 2013, we currently expect the reduction in revenue derived from these client programs to be offset in part, but not in whole, by new or expanded client opportunities.

*Cost of Product Revenue.* The cost of product revenue decreased by \$5.7 million, or 21.2%, to \$21.5 million in the three months ended June 30, 2013. The resulting gross profit margin was \$1.5 million, or 6.6% of product revenue, for the three months ended June 30, 2013 and \$2.2 million, or 7.3% of product revenue, for the comparable 2012 period. The cost of product revenue decreased by \$14.1 million, or 23.7%, to \$44.9 million in the six months ended June 30, 2013. The resulting gross profit margin was \$3.5 million, or 7.2% of product revenue, for the six months ended June 30, 2013 and \$5.0 million, or 7.9% of product revenue, for the comparable 2012 period. The gross profit was negatively impacted by reduced product revenue primarily attributable to the Ricoh restructuring activities, which we expect to continue in 2013. The gross profit margin for 2013 and 2012 includes the impact of incremental gross margin earned on product sales resulting from certain product price increases and the impact of certain incremental inventory cost reductions.

*Cost of Service Fee Revenue.* Gross profit as a percentage of service fees was 32.8% in three month period ended June 30, 2013 and 27.1% in the same period of 2012. In the six month period ended June 30, 2013, gross profit, as a percentage of service fees was 32.0% as compared to 25.4% in the comparable 2012 period. The gross profit percentage increase resulted from a change in the client mix, improved operating efficiencies and an increased level of higher margin client project activity. Additionally, the three and six months ended June 30, 2013 included an incremental benefit of \$0.4 million and \$1.0 million, respectively, applicable to certain client transition related agreements, which we expect to continue into the quarter ended September 30, 2013 although at a lower amount.

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

*Selling, General and Administrative Expenses.* Selling, General and Administrative expenses for the three months ended June 30, 2013 and 2012 were \$10.9 million and \$9.9 million, respectively. As a percentage of total net revenue, selling, general and administrative expenses were 18.8% in the three months ended June 30, 2013 and 14.8% in the prior year period. In the six months ended June 30, 2013, selling, general and administrative expenses were \$23.7 million, or 19.6% of total net revenue, as compared to \$20.4 million, or 14.6% of total net revenue in the comparable period of 2012. The increase in costs in the three and six months ended June 30, 2013 is primarily related to certain restructuring related charges of approximately \$0.3 million and \$2.5 million, respectively and an increase in personnel related costs and depreciation and amortization expense in the three and six months ended June 30, 2013. The prior year three month period ended June 30, 2012 included approximately \$0.3 million of relocation costs relating to our facility relocations and expansions in 2012. The six month period ended June 30, 2012 included \$0.5 million of lease termination costs and \$0.9 million of relocation related costs relating to our facility relocations and expansions in 2012. Excluding the restructuring related charges, lease termination costs and relocation related costs in both 2013 and 2012, as a percent of total net revenue, selling, general and administrative expenses were 18.3% and 17.5% in the three and six months ended June 30, 2013, respectively, and 14.3% and

13.7% in the comparable three and six months of the prior year period, respectively. As a result of our restructuring efforts and our ongoing focus on cost controls, we currently expect reductions in selling, general and administrative costs during the remainder of calendar year 2013 as compared to the June 30, 2013 quarter.

*Income Taxes.* We recorded a tax provision associated primarily with state income taxes, our subsidiary Supplies Distributors' Canadian and European operations and our Philippines operations. A valuation allowance has been provided for the majority of our net deferred tax assets, which are primarily related to our net operating loss carryforwards and certain foreign deferred tax assets. We expect we will continue to record an income tax provision associated with state income taxes, Supplies Distributors' Canadian and European results of operations and our Philippines operations.

## **Liquidity and Capital Resources**

During the six months ended June 30, 2013, we generated \$0.8 million of cash from operating activities primarily due to a \$7.7 million decrease in accounts receivable mostly applicable to our services business following the holiday seasonal peak period, a \$6.7 million reduction in inventories related to reduced product revenue and a \$0.9 decrease in prepaid expenses, other receivable and other assets primarily related to timing of receipts. Included in our cash flows from operating activities is also \$2.2 million of cash income from operations before working capital changes. The increase in cash was partially offset by a \$16.5 million decrease in accounts payable, deferred revenue, accrued expenses and other liabilities related to reduced inventory purchases as a result of a reduction in product revenue, reduced service fee business payables and accrual levels and a reduction related to timing of various vendor and client reimbursable payments.

During the six months ended June 30, 2012, we generated \$16.1 million of cash from operating activities primarily due to a \$13.3 million decrease in accounts receivable mostly applicable to our services business following the holiday seasonal peak period, a \$5.3 million increase in deferred rent related to tenant allowance improvements at certain new facilities, a \$4.2 million decrease in prepaid expenses, other receivables and other assets primarily related to a timing of receipts and a reduction of value-added tax receivable at our European subsidiary and a \$3.0 million reduction in inventories related to reduced product revenue. Included in our cash flows from operating activities is also \$3.4 million of cash income from operations before working capital changes. These inflows were partially offset by a \$12.9 million decrease in accounts payable, deferred revenue, accrued expenses and other liabilities following the timing of payments we make for products and services, payment processing and related transactions costs.

In the six months ended June 30, 2013, we incurred capital expenditures of \$3.2 million, net of \$1.1 million of property and equipment acquired under debt and capital lease financing, which consisted primarily of payments for internally developed software and capital leases on equipment. Net proceeds of \$14.3 million from the issuance of common stock, including an equity offering in May, were partially offset by payments on debt and capital leases, net of any proceeds from debt and an increase in restricted cash of \$9.7 million in the six months ended June 30, 2013.

In the six months ended June 30, 2012, we incurred capital expenditures of \$9.4 million, exclusive of \$5.6 million of property and equipment acquired under debt and capital lease financing. This included capital expenditures related to our new corporate headquarters and call center facility, which were financed by the landlords through tenant allowances. Cash used for payments on debt and capital leases, net of any proceeds from debt and a decrease in restricted cash, was \$7.2 million in the six months ended June 30, 2012.

Capital expenditures have historically consisted of additions to upgrade our management information systems, development of customized technology solutions to support and integrate with our service fee clients and general expansion and upgrades to our facilities, both domestic and foreign. We expect to incur capital expenditures to support new contracts and anticipated future growth opportunities. Based on our current client business activity and our targeted growth plans, we anticipate our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months, including costs to implement new clients, will be approximately \$9 million to \$11 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients. To maintain our current operating cash position, a portion of these expenditures may be financed through client reimbursements, debt, operating or capital leases or additional equity. We may elect to modify or defer a portion of such anticipated investments in the event we do not obtain the financing or achieve the financial results necessary to support such investments.

During the six months ended June 30, 2013, our working capital increased to \$26.5 million from \$15.4 million at December 31, 2012 primarily due to net proceeds of \$14.1 million from an equity offering in May 2013 partially offset by the paydown of debt facilities, capital expenditures and the impact of certain restructuring related accruals. 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 or entering into new debt agreements. No assurances can be given we will be successful in obtaining any additional financing or the terms thereof. We currently believe our cash position, financing available under our credit facilities and funds generated from operations will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our current debt and lease obligations, and additional loans to

our subsidiaries, if necessary, for at least the next twelve months.

In support of certain debt instruments and leases, as of June 30, 2013, we had \$0.5 million of cash restricted for repayment to lenders. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain of our subsidiaries' credit facilities. Many of these facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other credit facilities and agreements. These covenants include, among others, minimum levels of net worth, profitability and cash flow (as defined) and restrictions on the ability of the borrower subsidiaries to advance funds to other borrower subsidiaries. As a result, it is possible for one or more of these borrower subsidiaries to fail to meet their respective covenants even if another borrower subsidiary otherwise has available excess funds, which, if not restricted, could be used to cure the default. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders' equity, and we are not able to obtain a waiver, the lenders would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral and enforcement of payment under our parent guarantee. A requirement to accelerate the repayment of the credit facility obligations may have a material adverse impact on our financial condition and results of operations. We can provide no assurance we will have the financial ability to repay all such obligations. As of June 30, 2013, we were in compliance with all debt covenants. Further, non-renewal of any of our credit facilities may have a material adverse impact on our business and financial condition. 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.

We receive municipal tax abatements in certain locations. In prior years, we received notice from a municipality that we did not satisfy certain criteria necessary to maintain the abatements and that the municipal authority planned to make an adjustment to our tax abatement. We disputed the adjustment and such dispute has been settled with the municipality. However, the amount of additional property taxes to be assessed against us and the timing of the related payments has not been finalized. As of June 30, 2013, we believe we have adequately accrued for the expected assessment.

In April 2010, a sales employee of eCOST (the former name of Retail Connect) was charged with violating various federal criminal statutes in connection with the sales of eCOST products to certain customers, and approximately \$620,000 held in an eCOST deposit account was seized and turned over to the Office of the U.S. Attorney in connection with such activity. We received subpoenas from the Office of the U.S. Attorney requesting information regarding the employee and other matters, and have responded to such subpoenas and are fully cooperating with the Office of the U.S. Attorney. In August 2012, the employee pleaded guilty to a misdemeanor. Neither the Company nor eCOST have been charged with any criminal activity, and we intend to seek the recovery or reimbursement of such funds, that are currently classified as other receivables in the June 30, 2013 financial statements. Based on the information available to date, we are unable to determine the amount of the loss, if any, relating to the seizure of such funds. No assurance can be given, however, that the seizure of such funds, or our inability to recover such funds or any significant portion thereof, or any costs and expenses we may incur in connection with such matter will not have a material adverse effect upon our financial condition or results of operations.

#### **Supplies Distributors Financing**

To finance its distribution of Ricoh products in the U.S., Supplies Distributors has a short-term credit facility with IBM Credit LLC ("IBM Credit") that provides financing for up to \$20.0 million. We have provided a collateralized guarantee to secure the repayment of this credit facility. The IBM Credit facility does not have a stated maturity and both parties have the ability to exit the facility following a 90-day notice. The Company has direct vendor credit terms with Ricoh to finance Supplies Distributors European subsidiary's inventory purchases.

Supplies Distributors also has a loan and security agreement with Wells Fargo Bank, National Association ("Wells Fargo") to provide financing for up to \$25.0 million of eligible accounts receivables in the United States and Canada. The Wells Fargo facility expires on the earlier of March 2014 or the date on which the parties to the Ricoh distributor agreement no longer operate under the terms of such agreement and/or Ricoh no longer supplies products pursuant to such agreement.

Supplies Distributors' European subsidiary has a factoring agreement with BNP Paribas Fortis Factor ("BNP Paribas") to provide factoring for up to 7.5 million Euros (approximately \$9.8 million at June 30, 2013) of eligible accounts receivables through March 2014.

These credit facilities contain cross default provisions, various restrictions upon the ability of Supplies Distributors and its subsidiaries to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to related parties (including entities directly or indirectly owned by PFSweb), 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 \$3.5 million, not maintain restricted cash of more than \$5.0 million, are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure and a minimum shareholders' equity of at least \$18.0 million. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries under these facilities if they are unable to do so. We have also provided a guarantee of substantially all of the obligations of Supplies Distributors and its subsidiaries to IBM and Ricoh.

### **PFS Financing**

Our PFS subsidiary has a Loan and Security Agreement ("Comerica Agreement") with Comerica Bank, which provides for up to \$12.5 million (\$10.0 million during certain non-seasonal peak-months) of eligible accounts receivable financing through March 2014. The Comerica Agreement also provided for up to \$3.0 million of eligible equipment financing ("Equipment Advances"). Outstanding Equipment Advances have a final maturity date of April 15, 2015. We entered into this Comerica Agreement to supplement our existing cash position and provide funding for our current and future operations, including our targeted growth. The Comerica 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), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20.0 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 also limits PFS' ability to increase the subordinated loan to Supplies Distributors to more than \$5.0 million and permits PFS to advance incremental amounts to certain of its subsidiaries and/or affiliates subject to certain financial covenants, as defined. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb.

### **Retail Connect Financing**

Retail Connect has an asset-based line of credit facility for up to \$2.0 million of eligible financing with Wells Fargo, which is collateralized by substantially all of Retail Connect's assets and expires in May 2014. Borrowings under the facility and letter of credit availability are limited to a percentage of accounts receivable and inventory, up to specified amounts. As of June 30, 2013, Retail Connect had \$0.1 million of available credit under this facility. The credit facility restricts Retail Connect's ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to subsidiaries, affiliates and related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as a minimum tangible net worth for Retail Connect of \$0 million, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit.

### **Equity Offering**

In May 2013, we sold 3.2 million shares of our common stock in a private transaction at \$4.57 per share, resulting in net proceeds of approximately \$14.1 million after deducting expenses.

### **Seasonality**

The seasonality of our service fee business is dependent upon the seasonality of our clients' business and sales of their products. Accordingly, we 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 run rate service fee business activity, which is dependent upon the business volume of our clients, will generally be lower in the first three quarters of the calendar year, and highest in the quarter ended December 31. We anticipate our product revenue will be generally highest during the quarter ended December 31. We believe our historical revenue pattern makes it difficult to predict the effect of seasonality on our future revenues and results of operations.

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.

## **Inflation**

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

## **Critical Accounting Policies**

A description of our critical accounting policies is included in Note 2 of the consolidated financial statements in our December 31, 2012 Annual Report on Form 10-K.

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

Not applicable.

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

### *Disclosure Controls and Procedures*

We maintain a comprehensive set of disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (“Exchange Act”). As of June 30, 2013, an evaluation of the effectiveness of our disclosure controls and procedures was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, these disclosure controls and procedures were effective.

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

During the period that ended on June 30, 2013, there was no change in internal control over financial reporting (as defined in Rule 13a-15(f) or Rule 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

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

None

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

In addition to the risk factors set forth in Part I, Item 1A of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed with the Securities and Exchange Commission on April 1, 2013, our business, financial condition and operating results could be adversely affected by any or all of the following factors.

#### **General Risks Related to 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 PFS, Supplies Distributors and Retail Connect.***

As of June 30, 2013, our total credit facilities outstanding, including debt, capital lease obligations and our vendor accounts payable related to financing of Ricoh product inventory, was approximately \$25 million. Certain of the credit facilities have maturity dates in calendar year 2014 or beyond, but are classified as current liabilities in our consolidated financial statements given the underlying nature of the credit facility. 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, default under or acceleration of any of our credit facilities may have a material adverse impact upon our business and financial condition. In addition we have provided \$3.5 million of subordinated indebtedness to Supplies Distributors as of June 30, 2013. The maximum level of this subordinated indebtedness to Supplies Distributors that may be provided without approval from our lenders is \$5.0 million. The restrictions on increasing this amount without lender approval may limit our ability to comply with certain loan covenants or grow and support 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 Retail Connect's \$2.0 million credit line, as well as certain of its vendor trade payables.

### **Specific Risks Related to Our Business Process Outsourcing Business**

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

For the six months ended June 30, 2013, two clients represented approximately 23% of service fee revenue (excluding pass-through revenue) and approximately 13% of consolidated revenue. We currently anticipate that both of these clients and other clients will reduce the level of services or terminate their relationship with us so that, unless we are able to increase our service fee revenue from other existing or new clients or adjust our operating costs, such reduction or termination of services would have a material adverse effect upon our business, results of operation and financial condition.

The majority of our Supplies Distributors product revenue is generated by sales of product purchased under distributor agreements with Ricoh. These agreements are terminable at will and no assurance can be given that Ricoh will continue the distributor agreements with Supplies Distributors. Supplies Distributors does not have its own sales force and relies upon Ricoh's sales force and product demand generation activities for its sale of Ricoh product. As a result of certain operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues and profitability for Supplies Distributors in 2013 and beyond. Further reduction in the Ricoh business may have a material adverse effect on Supplies Distributors' business and our overall financial condition.

Sales by Supplies Distributors to two customers in the aggregate accounted for approximately 27% of Supplies Distributors' total product revenue and 11% of consolidated net revenues in the six month period ended June 30, 2013. The loss of one or both of such customers, or non-payment of any material amount by these or any other customer would have a material adverse effect upon Supplies Distributors' business results of operations and financial condition.

### **Risks Related to Our Stock**

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

As of June 30, 2013, we have an aggregate of 2.0 million stock options outstanding to employees, directors and others with a weighted average exercise price of \$4.66 per share. The shares of common stock that may be issued upon exercise of these 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 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.

### **ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On May 15, 2013, the Company sold 3,214,369 shares of its Common Stock in a private transaction at \$4.57 per share, resulting in gross proceeds of \$14.7 million. Reference is made to the Current Report on Form 8-K filed by the Company on May 15, 2013 for further information.

### **ITEM 3. Defaults Upon Senior Securities**

None

### **ITEM 4. Mine Safety Disclosure**

Not applicable

### **ITEM 5. Other Information**

None

**ITEM 6. Exhibits**

## a) Exhibits:

<b>Exhibit No.</b>	<b>Description of Exhibits</b>
3.1(1)	Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.1.1(2)	Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.1.2(4)	Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.
3.1.3(5)	Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.1.4(8)	Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.2(1)	Amended and Restated By-Laws
3.2.1(3)	Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
3.2.2(6)	Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
3.2.3(8)	Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
10.1(7)	Form of Performance-Based Cash Award Agreement
10.2(7)	Form of Performance Shares Award Agreement
10.3**	Ninth Amendment to Loan and Security Agreement dated May 31, 2013, by and between Wells Fargo Bank, National Association and PFSweb Retail Connect, 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
101.INS**	XBRL Instance Document.
101.SCH**	XBRL Taxonomy Extension Schema.
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF**	XBRL Taxonomy Extension Definition Linkbase.
101.LAB**	XBRL Taxonomy Extension Label Linkbase.
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase.
(1)	Incorporated by reference from PFSweb, Inc. Registration Statement on Form S-1 (Commission File No. 333-87657).
(2)	Incorporated by reference from PFSweb, Inc. Form 10-K for the fiscal year ended December 31, 2005 filed on March 31, 2006.
(3)	Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on November 13, 2007.
(4)	Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 2, 2008.
(5)	Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 14, 2009.
(6)	Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 2, 2010.
(7)	Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 29, 2013.
(8)	Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 18, 2013.

\*Filed Herewith

\*\*Furnished Herewith

## SIGNATURES

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

Date: August 14, 2013

PFSweb, Inc.

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



**NINTH AMENDMENT TO  
LOAN AND SECURITY AGREEMENT**

**THIS NINTH AMENDMENT TO LOAN AND SECURITY AGREEMENT** (this "Amendment"), is dated as of May 31, 2013, by and between **WELLS FARGO BANK, NATIONAL ASSOCIATION**, acting through its Wells Fargo Business Credit operating division (as successor to Wachovia Bank, National Association which, in turn, was successor to Congress Financial Corporation (Western)) ("Lender"), and **PFSWEB RETAIL CONNECT, INC.**, a Delaware corporation formerly known as eCOST.com, Inc. ("Borrower").

**WITNESSETH:**

**WHEREAS**, Borrower and Lender entered into that certain Loan and Security Agreement, dated as of August 3, 2004 (as amended by (i) that certain First Amendment to Loan and Security Agreement, by and between Borrower and Lender; (ii) that certain Second Amendment to Loan and Security Agreement, by and between Borrower and Lender; (iii) that certain Third Amendment to Loan and Security Agreement, by and between Borrower and Lender; (iv) that certain Fourth Amendment to Loan and Security Agreement, dated as of March 28, 2007, by and between Borrower and Lender; (v) that certain Fifth Amendment to Loan and Security Agreement, dated as of January 6, 2009; (vi) that certain Sixth Amendment to Loan and Security Agreement, dated as of May 5, 2010, and as modified by that certain letter agreement dated as of November 29, 2005, (vii) that certain Seventh Amendment to Loan and Security Agreement, dated as of May 31, 2011, and (viii) that certain Eighth Amendment to Loan and Security Agreement, dated as of April 30, 2012 (as further amended, restated, supplemented or otherwise modified through the date hereof, the "Loan Agreement"), whereunder Lender agreed to make extensions of credit from time to time to, or for the account of, Borrower;

**WHEREAS**, the parties hereto desire to make certain amendments to the Loan Agreement, subject to the terms hereof;

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

**SECTION 1. Defined Terms.** Unless otherwise defined herein, all capitalized terms used herein have the meanings assigned to such terms in the Loan Agreement, as amended hereby.

**SECTION 2. Amendments.** Upon the Amendment Effective Date (as hereinafter defined), the Loan Agreement shall be amended as follows:

(a) Section 1.67 of the Loan Agreement is hereby deleted in its entirety and replaced with the following:

"**1.67 Revolving Loan Limit** shall mean Two Million Dollars (\$2,000,000)."

(b) Section 3.5 of the Loan Agreement is hereby deleted in its entirety and replaced with the following:

"**3.5 Unused Line Fee.** Borrower shall pay to Lender, on a monthly basis, an unused line fee at a rate equal to three-eighths of one percent (0.375%) per annum calculated upon the amount by which Revolving Loan Limit exceeds the average daily principal balance of the outstanding Revolving Loans and Letter of Credit Accommodations during the immediately preceding month (or part thereof) while this Agreement is in effect and for so long thereafter as any of the Obligations are outstanding, which fee shall be due and payable to Lender on the first day of each month, in arrears."

(c) The "Maturity Date" referenced in the first sentence of Section 12.1(a) of the Loan Agreement is hereby changed to "May 31, 2014".

**SECTION 3. Amendment Fee.** Borrower shall pay Lender an amendment fee in the amount of \$2,000, which shall be due and payable in full, and fully earned by Lender, on the Amendment Effective Date.

**SECTION 4. Representations, Warranties and Covenants of Borrower.** Borrower represents and warrants to Lender, and agrees that:

(a) the representations and warranties contained in the Loan Agreement (as amended hereby) and the other outstanding Financing Agreements are true and correct in all material respects at and as of the date hereof as though made on and as of the date hereof, except (i) to the extent specifically made with regard to a particular date and (ii) for such changes as are a result of any act or omission specifically permitted under the Loan Agreement (or under any Loan Document), or as otherwise specifically permitted by Lender;

(b) on the Amendment Effective Date, after giving effect to this Amendment, no Default or Event of Default will have occurred and be continuing;

(c) the execution, delivery and performance of this Amendment have been duly authorized by all necessary action on the part of, and duly executed and delivered by, Borrower, and this Amendment is a legal, valid and binding obligation of Borrower, enforceable against Borrower in accordance with its terms, except as the enforcement thereof may be subject to the effect of any applicable bankruptcy, insolvency, reorganization, moratorium, or similar laws affecting creditors' rights generally and general principles of equity (regardless of whether such enforcement is sought in a proceeding in equity or at law); and

(d) the execution, delivery and performance of this Amendment do not conflict with or result in a breach by Borrower of any term of any material contract, loan agreement, indenture or other agreement or instrument to which Borrower is a party or is subject.

**SECTION 5. Conditions Precedent to Effectiveness of Amendment.** This Amendment shall become effective (the "Amendment Effective Date") upon satisfaction of each of the following conditions:

(a) Each of Borrower and Lender shall have executed and delivered to Lender this Amendment, and such other documents as Lender may reasonably request;

(b) PFSweb, Inc. shall have executed and delivered a Reaffirmation of Guaranty in the form attached to this Amendment;

(c) No Default or Event of Default shall have occurred and be continuing; and

(d) All legal matters incident to the transactions contemplated hereby shall be reasonably satisfactory to counsel for Lender.

**SECTION 6. Execution in Counterparts.** This Amendment may be executed in counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same instrument. Delivery of an executed counterpart of this Amendment by telefacsimile, ".pdf file" or other electronic method of transmission shall be equally as effective as delivery of an originally executed counterpart of this Amendment. Any party delivering an executed counterpart of this Amendment by telefacsimile, ".pdf file" or other electronic method of transmission also shall deliver an originally executed counterpart of this Amendment but the failure to deliver an originally executed counterpart shall not affect the validity, enforceability, and binding effect of this Amendment.

**SECTION 7. Costs and Expenses.** Borrower hereby affirms its obligation under Section 9.20 of the Loan Agreement to reimburse Lender for all expenses (including reasonable attorneys' fees) paid or incurred by Lender in connection with the preparation, negotiation, execution and delivery of this Amendment.

**SECTION 8. GOVERNING LAW.** THIS AMENDMENT SHALL BE GOVERNED BY, AND CONSTRUED AND INTERPRETED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF TEXAS, WITHOUT REGARD TO THE INTERNAL CONFLICTS OF LAWS PROVISIONS THEREOF.

**SECTION 9. Successors and Assigns.** This Amendment shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns.

**SECTION 10. Effect of Amendment; Reaffirmation of Financing Agreements.** The parties hereto agree and acknowledge that (a) nothing contained in this Amendment in any manner or respect limits or terminates any of the provisions of the Loan Agreement or the other outstanding Financing Agreements other than as expressly set forth herein and (b) the Loan Agreement (as amended hereby) and each of the other outstanding Financing Agreements remain and continue in full force and effect and are hereby ratified and reaffirmed in all respects. Upon the effectiveness of this Amendment, each reference in the Loan Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of similar import shall mean and be a reference to the Loan Agreement, as amended hereby.

**SECTION 11. Headings.** Section headings in this Amendment are included herein for convenience of any reference only and shall not constitute a part of this Amendment for any other purposes.

**SECTION 12. Release. BORROWER HEREBY ACKNOWLEDGES THAT AS OF THE DATE HEREOF IT HAS NO DEFENSE, COUNTERCLAIM, OFFSET, CROSS-COMPLAINT, CLAIM OR DEMAND OF ANY KIND OR NATURE WHATSOEVER THAT CAN BE ASSERTED TO REDUCE OR ELIMINATE ALL OR ANY PART OF ITS LIABILITY TO REPAY THE OBLIGATIONS OR TO SEEK AFFIRMATIVE RELIEF OR DAMAGES OF ANY KIND OR NATURE FROM LENDER, ITS AFFILIATES AND PARTICIPANTS, OR ANY OF THEIR RESPECTIVE DIRECTORS, OFFICERS, AGENTS, EMPLOYEES OR ATTORNEYS. BORROWER HEREBY VOLUNTARILY AND KNOWINGLY RELEASES AND FOREVER DISCHARGES LENDER, ITS AFFILIATES AND PARTICIPANTS, AND THEIR RESPECTIVE PREDECESSORS, AGENTS, OFFICERS, DIRECTORS, EMPLOYEES, SUCCESSORS AND ASSIGNS, FROM ALL POSSIBLE CLAIMS, DEMANDS, ACTIONS, CAUSES OF ACTION, DAMAGES, COSTS, EXPENSES, AND LIABILITIES WHATSOEVER, KNOWN OR UNKNOWN, ANTICIPATED OR UNANTICIPATED, SUSPECTED OR UNSUSPECTED, FIXED, CONTINGENT, OR CONDITIONAL, AT LAW OR IN EQUITY, ORIGINATING IN WHOLE OR IN PART ON OR BEFORE THE DATE THIS AMENDMENT IS EXECUTED, WHICH BORROWER MAY NOW OR HEREAFTER HAVE AGAINST LENDER AND ITS PREDECESSORS, AGENTS, OFFICERS, DIRECTORS, EMPLOYEES, SUCCESSORS AND ASSIGNS, IF ANY, AND IRRESPECTIVE OF WHETHER ANY SUCH CLAIMS ARISE OUT OF CONTRACT, TORT, VIOLATION OF LAW OR REGULATIONS, OR OTHERWISE, AND ARISING FROM THE LIABILITIES, THE EXERCISE OF ANY RIGHTS AND REMEDIES UNDER THE LOAN AGREEMENT OR OTHER FINANCING AGREEMENTS, AND NEGOTIATION FOR AND EXECUTION OF THIS AMENDMENT. BORROWER HEREBY COVENANTS AND AGREES NEVER TO INSTITUTE ANY ACTION OR SUIT AT LAW OR IN EQUITY, NOR INSTITUTE, PROSECUTE, OR IN ANY WAY AID IN THE INSTITUTION OR PROSECUTION OF ANY CLAIM, ACTION OR CAUSE OF ACTION, RIGHTS TO RECOVER DEBTS OR DEMANDS OF ANY NATURE AGAINST LENDER, ITS AFFILIATES AND PARTICIPANTS, OR THEIR RESPECTIVE SUCCESSORS, AGENTS, ATTORNEYS, OFFICERS, DIRECTORS, EMPLOYEES, AND PERSONAL AND LEGAL REPRESENTATIVES ARISING ON OR BEFORE THE DATE HEREOF OUT OF OR RELATED TO LENDER'S ACTIONS, OMISSIONS, STATEMENTS, REQUESTS OR DEMANDS IN ADMINISTERING, ENFORCING, MONITORING, COLLECTING OR ATTEMPTING TO COLLECT THE OBLIGATIONS OF BORROWER TO LENDER, WHICH OBLIGATIONS WERE EVIDENCED BY THE LOAN AGREEMENT AND THE OTHER FINANCING AGREEMENTS.**

**[Signature page follows]**

**IN WITNESS WHEREOF**, the parties hereto have caused this Amendment to be executed and delivered as of the date first above written.

**PFSWEB RETAIL CONNECT, INC.**, a Delaware corporation formerly known as eCOST.com, Inc., as Borrower

By: /s/ Thomas J. Madden

Name: Thomas Madden

Title: CFO

**WELLS FARGO BANK, NATIONAL ASSOCIATION**, acting through its Wells Fargo Business Credit operating division (as successor to Wachovia Bank, National Association which, in turn, was successor to Congress Financial Corporation (Western)), as Lender

By: /s/ Paul Traux

Name: Paul Traux

Title: Vice President

SIGNATURE PAGE TO NINTH AMENDMENT TO  
LOAN AND SECURITY AGREEMENT

DA-3289984 v2 1284274-00028

## **Reaffirmation of Guaranty**

The undersigned hereby (i) consents and agrees to the terms and provisions of the foregoing Amendment and each of the transactions contemplated thereby, and confirms and agrees that all references in the Financing Agreements to the "Loan Agreement" shall mean the Loan Agreement as amended by the foregoing Amendment, and (ii) agrees that that certain Guaranty, dated as of March 31, 2006 (the "Guaranty"), executed by the undersigned, in favor of Lender, remains in full force and effect and continues to be the legal, valid and binding obligation of the undersigned enforceable against the undersigned in accordance with its terms.

Furthermore, the undersigned hereby agrees and acknowledges that (a) the Guaranty executed by the undersigned is not subject to any claims, defenses or offsets, (b) nothing contained in the foregoing Amendment shall adversely affect any right or remedy of Lender under the Guaranty executed by the undersigned or any other agreement executed by the undersigned in connection therewith, (c) the execution and delivery of the foregoing Amendment or any agreement entered into by Lender in connection therewith shall in no way reduce, impair or discharge any obligations of the undersigned pursuant to the Guaranty executed by the undersigned, and shall not constitute a waiver by Lender of Lender's rights against the undersigned under the Guaranty executed by the undersigned, (d) the consent of the undersigned is not required to the effectiveness of the foregoing Amendment and (e) no consent by the undersigned is required for the effectiveness of any future amendment, modification, forbearance or other action with respect to the Loan Agreement or any present or future Financing Agreement (other than the Guaranty executed by the undersigned).

**PFSWEB, INC.**

By: /s/ Thomas J. Madden \_\_\_\_\_

Name: Thomas Madden

Title: CFO

**REAFFIRMATION OF GUARANTY**

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

I, Michael Willoughby, certify that:

1. I have reviewed this quarterly 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 period 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 operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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;
  - d) 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; and
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 the registrant's board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2013

By: /s/ Michael Willoughby  
Chief Executive Officer

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

I, Tom Madden, certify that:

1. I have reviewed this quarterly 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 period 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 operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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;
  - d) 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; and
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 the registrant's board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2013

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

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

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

The Quarterly Report on Form 10-Q for the period ended June 30, 2013 (the "Form 10-Q") of the Company fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Form 10-Q.

August 14, 2013

/s/ Michael Willoughby

Michael Willoughby  
Chief Executive Officer

August 14, 2013

/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.



