

# PFSWEB INC

## FORM 10-K (Annual Report)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 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

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**PFSWEB, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

75-2837058  
(I.R.S. Employer  
Identification Number)

75013  
(Zip code)

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

Securities registered pursuant to Section 12(b) of the Act: None  
Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, par value \$.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2013 (based on the closing price as reported by the National Association of Securities Dealers Automated Quotation System) was \$ 51,189,540.

At March 2 6, 2014, there were 16,653,008 shares of the registrant's Common Stock issued, \$.001 par value.

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**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III of this Annual Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of shareholders, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Annual Report relates.

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*Unless otherwise indicated, all references to “PFSweb,” “the Company,” “we,” “us” and “our” refer to PFSweb, Inc., a Delaware corporation, and its subsidiaries; references to “PFS” refer to our wholly-owned subsidiaries, Priority Fulfillment Services, Inc., PFS Canada and PFS Europe; references to “Supplies Distributors” refer to our wholly-owned subsidiary Supplies Distributors, Inc. and its subsidiaries; and references to “Retail Connect” refers to our wholly-owned subsidiary PFSweb Retail Connect, Inc.*

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## PART I

### Item 1. Business

#### General

PFSweb is an international business process outsourcing provider of end-to-end eCommerce solutions and other services. PFSweb provides these solutions and services on a customized basis to major brand names and other companies seeking to optimize their supply chain and to enhance their traditional and online business channels and initiatives. We derive our revenues by providing a broad range of services as we facilitate and process individual business transactions on our clients' behalf. Marketed as *PFSweb's End2End eCommerce*® solution and PFSweb Infinite Commerce, or iCommerce, the services we offer are organized into the following categories:

- Digital Marketing
- eCommerce Technology
- Order Management & Omni-Channel Solutions
- Customer Care
- Logistics and Fulfillment
- Financial Management
- Professional Consulting

Our solutions support both direct-to-consumer (“DTC”) and business-to-business (“B2B”) sales channels. The majority of our clients are the merchants of record for the orders we process through our infrastructure on their behalf. For these clients, we do not own the inventory or the resulting accounts receivable, but provide ecommerce solutions and other services for these client-owned assets.

For some of our clients, we are the merchant of record for the orders we process through our infrastructure. Depending on the terms under these arrangements, we record either product revenue or service fee revenue, may own the accounts receivable and inventory and we may be compensated for all or a portion of our services through the resulting profit margin. In some cases, we purchase the inventory as the product is delivered to our facility. In other situations, the client retains ownership of inventory in our facility and we purchase the inventory immediately prior to each individual customer sales transaction. In all cases, we seek inventory financing from our clients in the form of extended terms, working capital programs or marketing funds to help offset the working capital requirements that follow accounts receivable and inventory ownership.

We are headquartered in Allen, Texas where our executive and administrative offices and our primary technology operations and hosting facilities are located. We operate state-of-the-art call centers from our U.S. facility located in Dallas, Texas and from our international facilities located in Richmond Hill, Ontario, Canada, Liège, Belgium and Manila, Philippines. We lease or manage warehouse facilities of approximately 1.6 million square feet, many containing highly automated and state of the art material handling and communications equipment in Memphis, Tennessee, Southaven, Mississippi, Grapevine, Texas, Richmond Hill, Ontario, Canada and Liège, Belgium, allowing us to provide global distribution solutions.

#### **PFSWEB'S END2END ECOMMERCE® SOLUTIONS**

PFSweb serves as the “brand behind the brand”® for companies seeking to increase efficiencies, enter new markets or launch optimized sales channels. As an eCommerce and business process outsourcer, we offer scalable and cost-effective solutions for brand manufacturers, online retailers, and distributors across a wide range of industry segments. We provide our clients with seamless and transparent solutions to support their business strategies, allowing them to focus on their core competencies. Leveraging PFSweb's technology, expertise and proven methodologies, we enable clients to develop and deploy new products and implement new business strategies or address new distribution channels rapidly and efficiently through our optimized solutions. Our clients engage us both as a consulting partner to assist them in the design of a business solution as well as a virtual and physical infrastructure partner to provide the mission critical operations required to build and manage their business solution. Together, we not only help our clients define new ways of doing business, but also provide them the technology, physical infrastructure and professional resources necessary to quickly implement their business model. We allow our clients to quickly and dramatically change how they “go-to-market.”

Each client has a unique business model and unique strategic objectives that often require highly customized solutions. PFSweb supports clients in a wide array of industries, including fashion apparel and accessories, fragrance and beauty products, consumer packaged goods, home furnishings and housewares, consumer electronics, office technology and network connectivity products and aviation spare parts. These clients turn to PFSweb for help in addressing a variety of business issues that include eCommerce,

customer satisfaction and retention, time-definite logistics, vendor managed inventory and integration, supply chain compression, cost model realignments, transportation management and international expansion, among others. We also act as a constructive agent of change, providing clients the ability to alter their current distribution model, establish direct relationships with end-customers, and reduce the overall time and costs associated with existing distribution channel strategies. Our clients are seeking solutions that will provide them with dynamic supply chain and multi-channel marketing efficiencies, while ultimately delivering a world-class customer service experience.

Our value proposition is to become a seamless, well integrated extension of our clients' enterprises by delivering superior solutions that drive optimal customer experiences. On behalf of the brands we serve, we strive to increase and enhance sales and market growth, bolster customer satisfaction and customer retention, and drive costs out of the business through operations and technology related efficiencies. As both a virtual and a physical infrastructure for our clients' businesses, we embrace their brand values and strategic objectives. By utilizing our services, our clients are able to:

*Quickly Capitalize on Market Opportunities.* Our solutions empower clients to rapidly implement their supply chain and eCommerce strategies and take advantage of opportunities without lengthy integration and implementation efforts. We have readily available advanced technology and physical infrastructure that is flexible in its design, which facilitates quick integration and implementation. The PFSweb solution is designed to allow our clients to deliver consistent quality service as transaction volumes grow and also to handle daily and seasonal peak periods. Through our international locations, our clients can sell their products throughout the world.

*Improve the Customer Experience.* We enable our clients to provide their customers with a high-touch, positive buying experience thereby maintaining and promoting brand loyalty. Through our use of advanced technology, we can respond directly to customer inquiries by e-mail, voice or data communication and assist them with online ordering and product information. We believe we offer our clients a "world-class" level of service, including 24-hour, seven-days-a-week, Web-enabled customer care service centers, detailed Customer Relationship Management ("CRM") reporting and exceptional order accuracy. We have significant experience in the development of eCommerce storefronts that allows us to recommend features and functions easily navigated and understood by our clients' customers. Our technology platform is designed to ensure high levels of reliability and fast response times for our clients' customers. Because of our technology, our clients benefit from being able to offer the latest in customer communication and response conveniences to their customers.

*Minimize Investment and Improve Operating Efficiencies.* One of the most significant benefits outsourcing provides is the ability to transform fixed costs into variable costs. By eliminating the need to invest in a fixed capital infrastructure, our clients' costs typically become more directly correlated with volume increases or declines. Further, as volume increases drive the demand for greater infrastructure or capacity, we are able to quickly deploy additional resources. We provide services to multiple clients, which enables us to offer our clients economies of scale, and resulting cost efficiency, that they may not have been able to obtain on their own. Additionally, because of the large number of daily transactions we process, we have been able to justify investments in levels of automation, security surveillance, quality control processes and transportation carrier interfaces that are typically outside the scale of investment that our clients might be able to cost justify on their own. These additional capabilities can provide our clients the benefits of enhanced operating performance and efficiency, reduced inventory shrinkage, and expanded customer service options.

*Access a Sophisticated Technology Infrastructure.* We provide our clients with ready access to a sophisticated technology infrastructure that is designed to interface seamlessly with their systems. We provide our clients with vital product and customer information that can be immediately available to them on their own systems or through web based graphic user interfaces for use in data mining, analyzing sales and marketing trends, monitoring inventory levels and performing other management functions.

We believe our highest value proposition is achieved when our clients engage our full suite of services from all of the categories included in PFSweb's End2End eCommerce® solutions. However, we provide our clients with the opportunity to customize their solution by selecting only certain services from our offering in à la carte fashion if they prefer. We believe this flexibility and willingness to create a customized solution for each client differentiates us from our competition.

## **Digital Marketing Services**

Our team has extensive experience partnering with our clients to help grow their business. We have expertise in developing strategies to attract new customers, converting website visitors into actual buyers, and nurturing the relationships with current customers to increase their lifetime value. We achieve this through the following services:

*Creative Services.* With a unique understanding of usability and user experience we can convey our clients' creative needs from concept to execution. Our creative solutions are in tune with our client's brand and effectively translate the clients' voice in the digital market while engaging customers at every digital touchpoint.

*Customer Experience.* We determine how to optimize the website to engage the customers with the brand, drive sales conversion, and offer an ideal customer shopping experience. Our team makes it their focus to understand the customer's needs and offer site usability assessments that will improve the customer experience, enhance the brand and support revenue goals.

*Digital Strategy.* We offer unique strategic insights and subject matter experts to make absolutely sure that our marketing approach yields the most effective results. Through the use of behavioral research and analysis, the strategy team helps our clients plan, build and execute a strategy that creates, sustains and nurtures a community of actively engaged customers.

*Search Engine Optimization (SEO).* We combine knowledge of SEO best practices with a detailed knowledge of the technology platform to maximize the programs' performance. Our subject matter experts achieve measurable results by using enterprise tools to identify keyword opportunities matched to optimal landing pages, scale SEO efforts, identify on-page and off-page optimization opportunities, monitor progress, and assess the competitive landscape. We provide both the strategies and the implementation to achieve top rankings in the search engines, increase visibility of the brand and drive sales results.

*Search Engine Marketing (SEM).* Our certified SEM strategists provide cost effective paid search marketing campaigns which are highly focused on increasing conversion and optimizing ad spend. SEM campaigns are designed to attract new visitors to the site through paid keyword advertising, display advertising, retargeting, product search and social media advertising. We develop and execute pay per click campaigns using tactics such as A/B testing of creative and landing page testing, along with bidding strategies and keyword targeting to optimize the results.

*Affiliate Marketing.* We seek the best affiliate partners that fit the brands, implement the program, and manage the ongoing relationships. We develop strategies for the programs and nurture the affiliate partnerships to ensure relevant traffic is driven to the website to convert into sales.

*Comparison Shopping Engines.* We have experience creating and managing comparison shopping feeds that will increase brand visibility in a competitive landscape while driving sales. We use the comparison shopping engine channel to enhance the search engine marketing initiatives and power mobile applications.

*Conversion Optimization.* We combine industry expertise with best-in-breed technology to increase conversion and increase average order size. Our team of experts offers services in on-site merchandising, recommendations, personalization, on-site search, and promotion management and support.

*Digital Analytics.* All of our interactive marketing services are data driven; we look at how the various marketing programs are performing and determine where investments need to be made. We turn data into knowledge and offer insight into the customers' behavior and create strategies to provide actionable results.

*Email Marketing.* We offer our clients a dynamic 1-to-1 email approach that enables sending engaging, personalized emails to each customer. Our email strategy and execution services are designed to build customer loyalty and generate revenue. We provide email delivery services to ensure email is reaching the inbox and have established methodologies to test content, design, and subject lines, as well as drive email strategy to engage and retain customers.

*Social Media.* We engineer social media strategies across multiple platforms to encourage interaction and build relationships, and raise overall brand awareness. Our strategists leverage innovative technologies to engage the customers through relevant content and connect the customer with the brand.

## **eCommerce Technology Services**

*Direct-to-Consumer eCommerce ("DTC").* PFSweb's End2End eCommerce<sup>®</sup> solution for the DTC online channel features Demandware eCommerce, a leading third party Software-as-a-Service ("SaaS") eCommerce platform. We have fully integrated Demandware with the rest of our world-class technology platform including other best-of-breed technology partners to create a PFSweb reference application that provides our clients with a very high-function DTC online store out-of-the-box. We are able to use the PFSweb reference application as a starting point to quickly create a completely customized online store for our DTC clients. Designed specifically for DTC brands, our comprehensive offering redefines end-to-end eCommerce by enabling retailers and branded consumer goods manufacturers with the ability to employ a total outsourcing solution customized to their particular eCommerce strategy, without the loss of site or brand control associated with earlier end-to-end outsourcing solutions.

*Business-to-Business eCommerce ("B2B").* PFSweb's End2End eCommerce<sup>®</sup> solution for the B2B online channel features our GlobalMerchant Commerceware<sup>®</sup> service that provides a complete eCommerce website solution for our B2B clients. We engage collaboratively with our clients to design, build, host, and manage fully branded, fully customized and fully integrated eCommerce

web applications for B2B channels. We offer a broad range of hosting and support plans that can be tailored to fit the needs of each client. Utilizing Microsoft's .NET Technologies and our proprietary GlobalMerchant Commerceware<sup>®</sup> platform, we maintain a robust hosting environment for our hosted client B2B web sites.

## **Order Management Services**

*Order Management Interfaces.* Our order management technology solutions provide interfaces that allow for real-time information retrieval, including information on inventory, sales orders, shipments, delivery, purchase orders, warehouse receipts, customer history, accounts receivable and credit lines. These solutions are seamlessly integrated with our web-enabled customer contact centers, allowing for the processing of orders through shopping cart, phone, fax, mail, email, web chat, and other order receipt methods. As the information backbone for our total supply chain solution, order management services can be used on a stand-alone basis or in conjunction with our other business infrastructure offerings, including customer contact, financial or distribution services. In addition, for the B2B market, our technology platform provides a variety of order receipt methods that facilitate commerce within various stages of the supply chain. Our systems provide the ability for both our clients and their customers to track the status of orders at any time. Our services are transparent to our clients' customers and are seamlessly integrated with our clients' internal system platforms and web sites. By synchronizing these activities, we can capture and provide critical customer information, including:

- Statistical measurements critical to creating a quality customer experience, containing real-time order status, order exceptions, back order tracking, allocation of product based on timing of online purchase and business rules, the ratio of customer inquiries to purchases, average order sizes and order response time;
- B2B supply chain management information critical to evaluating inventory positioning, for the purpose of improving inventory turns, and assessing product flow-through and end-user demand;
- Reverse logistics information, including customer response and reason for the return or rotation of product and desired customer action;
- Detailed marketing information about what was sold and to whom it was sold, by location and preference; and
- Web traffic reporting showing the number of visits ("hits") received, areas visited, and products and information requested.

*Technology Collaboration.* We have created a suite of technology services that enable buyers and suppliers to fully automate their business transactions within their supply chain using the order management interfaces. Our collaboration technologies operate in an open systems environment and feature the use of industry-standard XML and SOA web services, enabling customized eCommerce solutions with minimal changes to a client's systems or our Enterprise Resource Planning ("ERP") systems. The result is a faster implementation process. We also support information exchange methods such as AS2, FTP, SFTP, EDI, MQ Series, ALE, HTTP, and HTTPS.

*Information Management.* We have the ability to communicate with and transfer information to and from our clients through a wide variety of technology services, including real-time web service enabled data interfaces, file transfer methods and electronic data interchange. Our systems are designed to capture, store and electronically forward to our clients critical information regarding customer inquiries and orders, product shipments, inventory status (for example, levels of inventory on hand, on backorder, on purchase order and inventory due dates to our warehouse), product returns and other information. Our systems are capable of providing our clients with customer inventory and order information for use in analyzing sales and marketing trends and introducing new products. We also offer customized reports and data analyses based upon specific client needs to assist them in their budgeting and business decision process.

## **Customer Care Services**

*Customer Relationship Management.* Through our web enabled CRM platform, called iCommerce Agent ("iCA"), our unique technology leverages the client's website investment by wrapping CRM capabilities around the existing website. Through iCA, agents provide customer service functions, such as placing orders, checking order status, facilitating returns, gathering "voice of the customer" information, initiating upsell and cross sell, and managing escalations. iCA is fully integrated into the client's web front end and PFSweb's data analytics platform and order processing system, allowing full visibility into customer history and customer trends. Through each of our customer touch-points, information can be analyzed and processed for current or future use in business evaluation, product effectiveness and positioning, and supply chain planning. Through this fully integrated system, we are able to provide a complete customer care solution.

*Customer Assistance.* An important feature of evolving commerce is the ability for the customer to speak with a live customer service representative. Our experience has been that many consumers tell us they visited the web location for information, but not all of those consumers chose to place their order online. Our customer care services utilize features that integrate voice, e-mail, standard

mail, fax, data and Internet chat communications to respond to and handle customer inquiries. Our customer care representatives answer various questions, acting as virtual representatives of our clients' organization, regarding order status, shipping, billing, returns and product information and availability as well as a variety of other questions. Our web-enabled customer care technology identifies each customer contact automatically and routes it to the appropriate customer care representative who is individually trained in the clients' business and products.

Our web-enabled customer care centers are flexibly designed so that our customer care representatives can handle either several different clients and products in a shared agent environment, thereby creating economy of scale benefits for our clients, or through a highly customized dedicated agent support model that provides the ultimate customer experience and brand reinforcement.

*Quality Monitoring.* Quality is essential in our client solutions. As representatives of our clients, our customer care representatives must adhere to the unique quality standards of each client. We continually monitor the quality of our customer care representatives against each client quality standard and use the results to provide agent-level feedback to continually improve the customer care experience. Clients may participate in the quality process by remotely listening to calls, assisting in the grading of recorded calls, and providing ongoing direction to improve quality standards.

*Customer Self-Help.* With the need for efficiency and cost optimization for many of our clients, we have integrated interactive voice response ("IVR") as another option for customer contacts. IVR creates an "electronic workforce" with virtual agents that can assist customers with vital information at any time of the day or night. IVR allows for our clients' customers to deal interactively with our system to handle basic customer inquiries, such as account balance, order status, shipment status, catalog requests, product and price inquiries, and routine order entry for established customers. The inclusion of IVR in our service offering allows us to offer a cost effective way to handle high volume, low complexity calls.

## **Logistics and Fulfillment Services**

*Advanced Distribution Facilities and Infrastructure.* An integral part of our solution is the warehousing and distribution of inventory either owned by our clients or owned by us. We currently have approximately 1.6 million square feet of leased or managed warehouse space domestically and internationally to store and process our own and our clients' inventory. We receive inventory in our distribution centers, verify shipment accuracy, unpack and audit packages (a process that includes spot-checking a percentage of the inventory to validate piece counts and check for damages that may have occurred during shipping, loading and unloading). Upon request, we inspect for other damages or defects, which may include checking fabric, stitching and zippers for soft goods, or 'testing' power-up capabilities for electronic items as well as product specifications. We generally stock for sale within one business day of unloading. We pick, pack and ship customer orders and can provide customized packaging, customized monogramming, personalized laser engraving, capabilities of high volume shrink packaging, inserts and promotional literature for distribution with customer orders. For many clients, we provide gift-wrapping services including line level gifting, customized gift-wrapping paper, ribbon, gift-box and gift-messaging.

Our distribution facilities contain computerized sortation equipment, highly mobile pick-to-light carts, powered material handling equipment, scanning and bar-coding systems and automated conveyors and in-line scales. Our distribution complexes include several advanced technology enhancements, such as radio frequency technology in product receiving processing to ensure accuracy, as well as an automated package routing and a pick-to-light paperless order fulfillment system. Our advanced distribution systems provide us with the capability to warehouse an extensive number of stock keeping units (SKUs), ranging from large high-end electronics to small cosmetic compacts. Our facilities are flexibly configured to process B2B and single pick DTC orders from the same central location.

In addition to our advanced distribution systems, our pick-to-light carts, stationary pick-to-light areas and conveyor system controls provide real time productivity reporting, thereby providing our management team with the tools to implement productivity standards. This combination of computer-controlled equipment provides the seamless integration of our pick-to-light systems and mass sortation capabilities. This unique combination of technologies ensures high order accuracy for each and every customer order.

We are able to take advantage of a variety of shipping and delivery options, which range from next day service to zone skipping, to optimize transportation costs. Our facilities and systems are equipped with multi-carrier functionality, allowing us to integrate with all leading package carriers and provide a comprehensive freight and transportation management offering. We offer reverse logistics management services, including issuing return authorizations, return carrier shipping labels, receipt of product, crediting customer accounts and disposition of returned product.

Our domestic facilities provide security trained law enforcement professionals from our security headquarters in Memphis, Tennessee and Southaven, Mississippi. Continual validation ensures that we employ the latest in security processes and procedures to further enhance our surveillance and detection capabilities.



*Facility Operations and Management.* Our facilities management service offering includes distribution facility design and optimization, business process reengineering and ongoing staffing and management. Along with our operations in Mississippi and Tennessee, we also manage facilities on behalf of two of our clients: an aircraft parts distribution center in Grapevine, Texas and a DTC facility in Memphis, Tennessee for a major retailer. Our expertise in supply chain management, logistics and customer-centric fulfillment operations extends through our management of client-owned facilities, resulting in cost reductions, process improvements and technology-driven efficiencies.

*Kitting and Assembly Services.* Our expanded kitting and assembly services enable our clients to reduce the time and costs associated with managing multiple suppliers, warehousing hubs, and light manufacturing partners. As a single source provider, we provide the advantage of convenience, accountability and speed. Our kitting and assembly services include light assembly, specialized kitting and supplier-consigned inventory hub either in our distribution facilities or co-located elsewhere. We also offer customized light manufacturing and supplier relationship management (“SRM”).

We will work with clients to re-sequence certain supply chain activities to aid in an inventory postponement strategy. We can provide kitting and assembly services and build-to-stock thousands of units daily to stock in a Just-in-Time (“JIT”) environment. This service, for example, can entail the procurement of packaging materials including retail boxes, foam inserts and anti-static bags. These raw material components may be shipped to us from domestic or overseas manufacturers, and we will build the finished SKUs to stock for the client. Also included is the custom configuration of high-end printers and servers. This strategy allows manufacturers to make a smaller investment in base unit inventory while meeting changing customer demand for highly customizable products.

Our standard capabilities include: build-to-order, build-to-stock, expedited orders, passive and active electrostatic discharge (“ESD”) controls, product labeling, serial number generation, marking and/or capture, lot number generation, asset tagging, bill of materials (“BOM”) or computer automated design (“CAD”) engineering change processing, SKU-level pricing and billing, manufacturing and metrics reporting, first article approval processes, and comprehensive quality controls.

Kitting and inventory hub services enable clients to collapse supply chains into the minimal steps necessary to prepare product for distribution to any channel, including wholesale, mass merchant retail, or direct to consumer. Clients no longer have to employ multiple providers or require suppliers to consign multiple inventory caches for each channel. We offer our clients the opportunity to consolidate operations from a channel standpoint, as well as from a geographic perspective. Our integrated, global information systems and international locations support business needs worldwide.

*Product Management and Inspection Services.* We also operate a coupon management system and product management program. Coupons are managed and activated by a unique serial number, thus significantly reducing fraudulent activity. Our capabilities also extend into salvage operations, allowing our clients to reclaim valuable raw materials and components from discontinued or obsolete inventory.

We operate a test and repair center where we visually inspect items for cosmetic defects. These items are put through rigorous testing that includes: functionality, durability, accessory inspection and packaging. Items that pass the testing are repackaged and resold with a noted exception of “open-box” merchandise. Items that fail the inspection are disassembled and working spare parts are saved for future use in repairs.

*High Compliance Distribution Related to Food and Cosmetic Products.* We also operate an American Institute of Bakers (“AIB”) and the Food and Drug Administration (“F.D.A.”) compliant facility, which adheres to the Consolidated Standards for Inspection along with regulatory developments required by the F.D.A. Food Safety Modernization Act and other industry best practices. Adherence to these standards resulted in the facility scoring a “Superior” rating from the AIB audit and inspection in 2013.

## **Financial Management Services**

Our financial services are divided into two major areas: 1) billing, credit, collection and cash application services for B2B clients and 2) fraud review, chargeback management and processing and settlement credit card services for DTC clients.

*Business-to-Business Financial Management.* For B2B clients, we offer full-service accounts receivable management and collection capabilities, including the ability to generate customized computer-generated invoices in our clients’ names. We assist clients in reducing accounts receivable and days sales outstanding, while minimizing costs associated with maintaining an in-house collections staff. We offer electronic credit services in the format of EDI and XML communications direct from our clients to their vendors, suppliers and retailers.

*Direct-to-Consumer Financial Management.* For DTC clients, we offer secure credit card processing related services for orders made via a client web site or through our customer contact center. We offer manual credit card order review as an additional level of

fraud protection. We also calculate sales taxes, goods and services taxes or value added taxes, if applicable, for numerous taxing authorities and on a variety of products. Using third-party leading-edge fraud protection services and risk management systems, we can offer high levels of security and reduce the level of risk for client transactions.

### **Professional Consulting Services**

As part of the tailored solution for our clients, we offer a full team of experts specifically designated to focus on our clients' businesses. Team members play a consultative role, providing constructive evaluation, analysis and recommendations for the client's business. This team creates customized solutions and devises plans that will increase efficiencies and produce benefits for the client when implemented.

Comprised of industry experts from top-tier consulting firms and industry market leaders, our team of professional consultants provides client service focus and eCommerce, customer care, logistics and distribution expertise. They have built solutions for Fortune 1000 and Global 2000 market leaders in a wide range of industries, including multi-channel retailers, apparel, technology, telecommunications, cosmetics, aviation, housewares, high-value collectibles, sporting goods, pharmaceuticals and several more. Focusing on the evolving infrastructure needs of major corporations and their business initiatives, our team has a solid track record providing consulting services in the areas of interactive marketing eCommerce, supply chain management, distribution and fulfillment, technology interfacing, logistics and customer support.

### **SELLER SERVICES FINANCIAL MODELS**

#### **Service Fee Model**

We refer to the standard PFS seller services financial model as the "Service Fee" 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 provide eCommerce website services, inventory and order management, customer service, payment processing, and operations reports such as product sales, sales tax, and inventory management reports. In this model, we provide infrastructure and services and the clients are responsible for all financial operations and reporting related to the sales transactions.

The Service Fee model is designed to generate margins for our clients consistent with other retailers in our clients' product category and provide bottom line financial results for our clients similar to other retailers in their space. We report service fee revenues from clients in this model in our traditional PFSweb service fee segment.

#### **Agent (Flash) Financial Model**

As an additional service, we offer an "Agent" model, or "Flash" model, in which our clients maintain ownership of the product inventory stored at our locations. 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 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 as a component of service fee revenue in our consolidated statement of operations.

#### **Retail Financial Model**

In addition to the Service Fee and the Agent models, we also offer a "Retail" model. Under the Retail model, a PFSweb subsidiary purchases inventory from the client. In the Retail model, we place the initial and replenishment purchase orders with the client and take ownership of the product upon delivery to our facility.

Because we are the product owner as well as the merchant of record, we work closely with the client to plan sales and promotional activities. 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 as well as potential reimbursement for uncollectible customer accounts receivable balances. Since we purchase and own the inventory and accounts receivable, this business model may require significant working capital requirements for which we have credit available either through credit terms provided by our clients or under senior credit facilities. Depending on the terms of our client arrangements in the Retail model, we record either: 1) product revenue as a component of product revenue, or 2) product revenue net of cost of product revenue as a component of service fee revenue in our consolidated statement of operations.

The costs of all standard PFSweb services normally billed on a transaction basis under the Service Fee model, as well as certain credit risks, may be covered by the selling margin under the Retail model arrangement. The bottom line financial results for our client should be similar to the financial benefits from the retail channel, although unlike the traditional retail channel, our clients generally control the presentation and branding of the web site and own all the customer data from the eCommerce activities.

In general, we use our Retail model to enable our Supplies Distributors subsidiary to serve as a global distributor of printer supplies for Ricoh Infoprint Solutions Company (“IPS”), a wholly-owned subsidiary of Ricoh Company Ltd. (hereafter referred to collectively as “Ricoh”). In this model, the product revenues are reported in our Business and Retail Connect segment.

## **INDUSTRY INFORMATION AND COMPETITIVE LANDSCAPE**

### **Industry Overview**

Business activities in the public and private sectors continue to operate in an environment of rapid technological advancement, increasing competition and continuous pressure to improve operating and supply chain efficiency while decreasing costs. We currently see the following trends within the industry:

- Manufacturers strive to restructure their supply chains to maximize efficiency and reduce costs in both B2B and DTC markets, and to create a variable-cost supply chain able to support the multiple, unique needs of each of their initiatives, including traditional and electronic commerce.
- Companies in a variety of industries seek outsourcing as a method to address one or more business functions that are not within their core business competencies, to reduce operating costs or to improve the speed or cost of implementation.
- Retailers, both traditional and e-commerce only, partner with end to end providers to provide a turnkey solution to support their e-commerce channels. Providers with a global presence provide additional value to companies pursuing an international expansion strategy.

### **Supply Chain Management Trend**

As companies maintain focus on improving their businesses and balance sheet financial ratios, significant efforts and investments continue to be made identifying ways to maximize supply chain efficiency and extend supply chain processes. Working capital financing, vendor managed inventory, supply chain visibility software solutions, distribution channel skipping, direct to consumer eCommerce sales initiatives, and complex upstream supply chain collaborative technology are products that manufacturers seek to help them achieve greater supply chain efficiency.

A key business challenge facing many manufacturers and retailers as they evaluate their supply chain efficiency is in determining how the trend toward increased direct-to-customer business activity will impact their traditional B2B and DTC commerce business models. Order management and small package fulfillment and distribution capabilities are becoming increasingly important processes as this trend evolves. We believe manufacturers will look to outsource their non-core competency functions to support this modified business model. We believe companies will continue to strategically plan for the impact that eCommerce and other new technology advancements will have on their traditional commerce business models and their existing technology and infrastructure capabilities.

Manufacturers, as buyers of materials, are also imposing new business practices and policies on their supplier partners to shift the normal supply chain costs and risks associated with inventory ownership away from their own balance sheets. Through techniques like Vendor Managed Inventory or Consigned Inventory Programs (“CIP”), manufacturers are asking their suppliers, as a part of the supplier selection process, to provide capabilities where the manufacturer need not own, or even possess, inventory prior to the exact moment that unit of inventory is required as a raw material component or for shipping to a customer. To be successful for all parties, business models such as these often require a sophisticated collection of technological capabilities that allow for complete integration and collaboration of the information technology environments of both the buyer and supplier. For example, for an inventory unit to arrive at the precise required moment in the manufacturing facility, it is necessary for the Manufacturing Resource Planning systems of the manufacturer to integrate with the CRM systems of the supplier. When hundreds of supplier partners are involved, this process can become quite complex and technologically challenging. Buyers and suppliers are seeking solutions that utilize XML based protocols and traditional EDI standards to ensure an open systems platform that promote easier technology integration in these collaborative solutions.

## Outsourcing Trend

In response to growing competitive pressures and technological innovations, we believe many companies, both large and small, are focusing their critical resources on the core competencies of their business and utilizing eCommerce and business process outsourcing to accelerate their business plans in a cost-effective manner and perform non-core business functions. Outsourcing can provide many key benefits, including the ability to:

- Enter new business markets or geographic areas rapidly;
- Increase flexibility to meet changing business conditions and demand for products and services;
- Enhance customer satisfaction and gain competitive advantage;
- Reduce capital and personnel investments and convert fixed investments to variable costs;
- Improve operating performance and efficiency; and
- Capitalize on skills, expertise and technology infrastructure that would otherwise be unavailable or expensive given the scale of the business.

Typically, many outsourcing service providers are focused on a single function, such as information technology, call center management, credit card processing, warehousing or package delivery. This focus creates several challenges for companies looking to outsource more than one of these functions, including the need to manage multiple outsourcing service providers, to share information with service providers and to integrate that information into their internal systems. Additionally, the delivery of these multiple services must be transparent to the customer and enable the client to maintain brand recognition and customer loyalty. Furthermore, traditional commerce outsourcers are frequently providers of domestic-only services versus international solutions. As a result, companies requiring global solutions must establish additional relationships with other outsourcing parties.

Another vital point for major brand name companies seeking to outsource is the protection of their brand. When looking for an outsourcing partner to provide infrastructure solutions, brand name companies must find a company that can provide the same quality performance and superior experience their customers expect from their brands. Working with an outsourcing partner requires finding a partner that can maintain the consistency of their brand image, which is one of the most valuable intangible assets that recognized brand name companies possess.

## Competition

We face competition from many different sources depending upon the type and range of services requested by a potential client. Many other companies offer one or more of the same services we provide on an individual basis. Our competitors include vertical outsourcers, which are companies that offer a single function solution, such as call centers, public warehouses or credit card processors. We occasionally compete with transportation logistics providers, known in the industry as 3PL's and 4PL's (third or fourth party logistics providers), who offer product management functions as an ancillary service to their primary transportation services. We also compete against other eCommerce and business process outsourcing providers, who perform various services similar to our solution offerings. Additionally, as our Digital Marketing Services solution continues to grow, we see competition from agencies providing commerce strategy and system integration services.

In many instances, we compete with the in-house operations of our potential clients themselves. Occasionally, the operations departments of potential clients believe they can perform the same services we do, at similar quality levels and costs, while others are reluctant to outsource business functions that involve direct customer contact. We cannot be certain we will be able to compete successfully against these or other competitors in the future.

Although many of our competitors offer one or more of our services, we believe our primary competitive advantage is our ability to offer a full array of customized services marketed as *PFSweb's End2End eCommerce*® solutions, thereby eliminating any need for our clients to coordinate these services from many different providers. We believe we can differentiate ourselves by offering our clients a very broad range of eCommerce and business process services that address, in many cases, the entire value chain, from demand to delivery.

We also compete on the basis of many other important additional factors, including:

- operating performance and reliability;
- ease of implementation and integration;
- experience of the people required to successfully and efficiently design and implement solutions;
- experience operating similar solutions dynamically;
- leading edge technology capabilities;
- global reach; and
- price.

We believe we can compete favorably with respect to many of these factors. However, the market for our services is competitive and continually evolving, and we may not be able to compete successfully against current and future competitors.

## **COMPANY INFORMATION**

### **Clients and Marketing**

Our target clients include traditional retailers, online retailers and leading technology and consumer goods brands looking to quickly and efficiently implement or enhance business initiatives, adapt their go-to-market strategies, or introduce new products, programs or geographies, without the burden of modifying or expanding their technology, customer care, supply chain and logistics infrastructure. Our solutions are applicable to a multitude of industries and company types and we have provided solutions for such companies as:

Procter & Gamble (consumer packaged goods), L'Oréal (health & beauty), LEGO Brand Retail (toys), T.J. Maxx (apparel and home fashion), Columbia Sportswear (active outdoor apparel), Diageo (premium beverages), Roots Canada Ltd. (apparel), BCBGMAXAZRIA (high fashion), Ricoh (printer supplies), Xerox (printers and printer supplies), Hawker Beechcraft Corp. (facilities management and time-definite logistics supporting parts distribution) among many others.

We target potential clients through an extensive integrated marketing program comprised of a variety of direct marketing techniques, email marketing initiatives, trade event participation, search engine marketing, public relations, social media and a sophisticated outbound tele-sales lead generation model. We have also developed global business development methodology which allows us to effectively showcase our various eCommerce and business process outsourcing solutions and products. We also pursue strategic marketing alliances with consulting firms, software manufacturers and other logistics providers to increase market awareness and generate referrals and customer leads.

Because of the highly complex nature of the solutions we provide, our clients demand significant competence and experience from a variety of different business disciplines during the sales cycle. As such, we utilize a selected member of our senior executive team to lead the design and proposal development of each potential new client we choose to pursue. The senior executive is supported by a select group of highly experienced individuals from our professional services group with specific industry knowledge of, or experience with, the solutions development process. We employ a team of highly trained implementation managers whose responsibilities include the oversight and supervision of client projects and maintaining high levels of client satisfaction during the transition process between the various stages of the sales cycle and steady state operations.

### **Technology**

We maintain advanced management information systems and have automated key business functions using online, real-time or batch systems. These systems enable us to provide information concerning sales, inventory status, customer payments and other operations essential for us and our clients to efficiently manage electronic commerce and supply chain business programs. Our systems are designed to scale rapidly to handle the transaction processing demands of our clients and our growth.

We employ technology from a select group of vendors. For example, we deploy IBM e-servers and network printers in appropriate models to run web site functions as well as order management and distribution functions. Our network backbone is powered by Cisco, who provides network connectivity and network security solutions for our worldwide locations. We utilize Avaya Communication for telephone switch and call center management functions, and to interact with customers via voice, e-mail or chat. Avaya Communication technology also allows us to share web pages between customers and our service representatives. We have the ability to transmit and receive voice, data and video simultaneously on a single network connection to a customer to more effectively serve that customer for our client. Clients' interest in using this technology stems from its ability to allow shoppers to consult with

known experts in a way the customer chooses prior to purchasing. Our sophisticated computer-telephony integration has been accomplished by combining systems software from IBM and Avaya Communication together with our own application development. We use Verizon Business for our private enterprise network and AT&T as our long distance carrier. We use Oracle's J.D. Edwards as the software provider for the primary ERP applications used in our operational areas and financial areas. We use Dematic Materials Handling Automation for our automated order selection, automated conveyor and "pick-to-light" (inventory retrieval) systems, and wireless scanner guns for our warehouse radio frequency applications. Our Warehouse Management System ("WMS") and Distribution Requirements Planning ("DRP") system have been developed in-house to meet the varied unique requirements of our vertical markets. Both the WMS and DRP are tightly integrated to both the North American and European deployments of our J.D. Edwards' system.

Many internal infrastructures are not sufficient to support the explosive growth in e-business, e-marketplaces, supply chain compression, distribution channel realignment and the corresponding demand for real-time information necessary for strategic decision-making and product fulfillment. To address this need, we have created *PFSweb's End2End eCommerce*® platform to enable companies with little or no eCommerce infrastructure to speed their time to market and minimize resource investment and risk, and to allow all companies involved to improve the efficiency of their supply chain.

Using the various components of our collaboration technology suite, we can assist our clients in easily integrating their web sites or ERP systems to our systems for real-time web service enabled transaction processing without regard for their hardware platform or operating system. This high-level of systems integration allows our clients to automatically process orders, customer data and other eCommerce information. We also can track information sent to us by the client as it moves through our systems in the same manner a carrier would track a package throughout the delivery process. Our systems enable us to track, at a detailed level, information received, transmission timing, any errors or special processing required and information sent back to the client.

We provide technology interfaces to our back-office applications including our customized Oracle J.D. Edwards order management and fulfillment application. We utilize IBM® Sterling B2B Integrator ("SI") as our technology platform for Enterprise Application Integration with our clients and clients' trading partners. With SI, we have greatly increased our ability to quickly design and deploy customized B2B and DTC eCommerce solutions for our clients by utilizing a robust business process modeling tool and a highly scalable operating infrastructure. This platform facilitates the efficient and secure exchange of electronic business transactions/documents in a wide variety of formats (i.e. XML, X.12 EDI, delimited text, IDOCS) and communication protocols (i.e. FTP/SFTP, AS2/HTTP/HTTPS, AS1 SMTP, MQ Series and SOA Web Services).

We have invested in advanced telecommunications, computer telephony, electronic mail and messaging, automated fax technology, IVR technology, barcode scanning, wireless technology, fiber optic network communications and automated inventory management systems. We have also developed and utilize telecommunications technology that provides for automatic customer call recognition and customer profile recall for inbound customer service representatives.

The primary responsibility of our systems development team of IT professionals is directed at implementing custom solutions for new clients and maintaining existing client relationships. Our development team can also produce proprietary systems infrastructure to expand our capabilities in circumstances where we cannot purchase standard solutions from commercial providers. We also utilize temporary and/or contract resources when needed for additional capacity.

Our information technology operations and infrastructure are built on the premise of reliability and scalability. We maintain diesel generators and un-interruptible power supply equipment to provide constant availability to computer rooms, call centers and warehouses. Multiple internet service providers and redundant web servers provide for a high degree of availability to web sites that interface with our systems. Capacity planning and upgrading is performed regularly to allow for quick implementation of new clients and avoid time-consuming infrastructure upgrades that could slow growth rates. In the event of a disastrous situation, we also have a disaster recovery plan that provides geographically separated and comparably equipped data centers that are able to recover stored data in a reasonable and effective manner.

## **Employees**

As of December 31, 2013, we had approximately 1,300 employees, of which approximately 970 were located in the United States. We have never suffered an interruption of business as a result of a labor dispute. We consider our relationship with our employees to be good. In the U.S., Canada and Philippines, we are not a party to any collective bargaining agreements and while our European subsidiaries are not a party to a collective-bargaining agreement, they are required to comply with certain rules agreed upon by representatives of their industry (logistics) and unions.

Our success in recruiting, hiring and training large numbers of skilled employees and obtaining large numbers of hourly employees and temporary staff during peak periods for distribution and call center operations is critical to our ability to provide high quality distribution and support services. Call center representatives and distribution personnel receive feedback on their performance

on a regular basis and, as appropriate, are recognized for superior performance or given additional training. Generally, our clients provide specific product training for our customer service representatives and, in certain instances, on-site client personnel to provide specific technical support. To maintain good employee relations and to minimize employee turnover, we strive to offer competitive pay, hire primarily full-time employees who are eligible to receive a full range of employee benefits, and provide employees with clear, visible career paths.

### **Internet Access to Reports**

We maintain an Internet website, [www.pfsweb.com](http://www.pfsweb.com). Our annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K (and amendments, if any, to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934) are made available, free of charge, through the investor relations section of this website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. The information on this website is not incorporated in this report.

### **Government Regulation**

We are subject to federal, state, local and foreign consumer protection laws, including laws protecting the privacy of our customers' personally identifiable information and other non-public information and regulations prohibiting unfair and deceptive trade practices. Furthermore, the growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens and greater penalties on online companies. Moreover, there is a trend toward regulations requiring companies to provide consumers with greater information regarding, and greater control over, how their personal data is used, and requiring notification when unauthorized access to such data occurs. For example, many states currently require us to notify each of our customers who are affected by any data security breach in which an unauthorized person, such as a computer hacker, obtains such customer's name and one or more of the customer's social security number, driver's license number, credit or debit card number or other similar personal information. In addition, several jurisdictions, including foreign countries, have adopted privacy-related laws that restrict or prohibit unsolicited email promotions, commonly known as "spam," and that impose significant monetary and other penalties for violations. One such law, the CAN-SPAM Act of 2003 and the recent anti-spam legislation passed in Canada impose complex, burdensome and often ambiguous requirements in connection with our sending commercial email to our customers and potential customers. Moreover, in an effort to comply with these laws, Internet service providers may increasingly block legitimate marketing emails. These consumer protection laws may become more stringent in the future and could result in substantial compliance costs and could interfere with the conduct of our business.

## **Item 1A. RISK FACTORS**

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

### **General Risks Related to Our Business**

***Our business and future growth depend on our continued access to bank and commercial financing. An uncertain or recessed economy may negatively impact our business, results of operations, financial condition or liquidity.***

Our business and future growth currently depend on our ability to access bank, vendor and commercial lines of credit. We currently depend on line of credit facilities provided by various banks and commercial lenders that provided for an aggregate of up to approximately \$73 million in available financing as of December 31, 2013. These lines of credit currently mature at various dates through March 2016 and are secured by substantially all our assets. Our ability to renew our lines of credit depends upon various factors, including the availability of bank loans and commercial credit in general, as well as our financial condition and prospects. Therefore, we cannot guarantee that these credit facilities will continue to be available beyond their current maturities on reasonable terms or at all. Our inability to renew or replace our credit facilities or find alternative financing would materially adversely affect our business, financial condition, operating results and cash flow. An uncertain or recessed economy could also adversely impact our customers' operations or ability to maintain liquidity, which may negatively impact our business and results of operations.

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

To reach our business growth objectives, we may increase our operating and marketing expenses, as well as capital expenditures. To offset these expenses, we will need to generate additional profitable business. If our revenue grows slower than either we anticipate or our clients' projections indicate, or declines, or if our operating and marketing expenses exceed our expectations or cannot be reduced to an appropriate level, we may not generate sufficient revenue to be profitable or be able to sustain or increase

profitability on a quarterly or annual basis in the future. Additionally, if our revenue grows slower than either we anticipate or our clients' projections indicate, we may incur unnecessary or redundant costs and our operating results could be adversely affected.

***We have a large investment in fulfillment and computer technology equipment as well as long term building leases. A reduction in our clients' ecommerce business or our inability to increase service fee revenue from new or existing clients could negatively impact our operating results.***

We seek to maintain sufficient capacity in our fulfillment operations and computer technology systems to support growth in our clients' business and service those clients during seasonal volume increases. A reduction in our clients' business or our inability to increase service fee revenue from new or existing clients could result in an underutilization in our invested assets. Furthermore, we have three building leases with lease terms long enough to secure competitive lease rates, but which require early termination payments in the event we elect to terminate the leases prior to their scheduled expiration, thus limiting our flexibility to reduce fixed capacity in response to reduced revenue.

***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.***

As of December 31, 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 \$21 million. Certain of the credit facilities have maturity dates in calendar year 2015 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. A non-renewal, default under or acceleration of any of our credit facilities could 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 December 31, 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 further grow and develop Supplies Distributors' business. We have guaranteed most of the indebtedness of Supplies Distributors. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors by its lenders to the extent Supplies Distributors is unable to do so. We have also guaranteed Retail Connect's \$2.0 million credit line, as well as certain of its vendor trade payables.

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

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



***We are subject to risks associated with our international operations.***

We currently operate a distribution complex in Liège, Belgium with approximately 200,000 square feet, and a distribution center in Richmond Hill, Ontario, Canada with approximately 34,000 square feet. We also operate a facility in the Philippines with approximately 7,000 square feet to provide technology development and administrative support. We cannot assure you we will be successful in expanding in these or any additional international markets. In addition to the uncertainty regarding our ability to generate revenue from foreign operations and expand our international presence, there are risks inherent in doing business internationally, including:

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

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

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

Our future capital needs are difficult to predict. We may require additional capital to take advantage of opportunities, including strategic alliances and acquisitions, and to fund capital expenditures, or to respond to changing business conditions and unanticipated competitive pressures. We may also require additional funds to finance operating losses. Should these circumstances arise, our existing cash balance and credit facilities may be insufficient and we may need to raise additional funds either by borrowing money or issuing additional equity or both. We cannot assure you that such resources will be adequate or available for all of our future financing needs. Our inability to finance our growth, either internally or externally, may limit our growth potential and our ability to execute our business strategy. If we are successful in completing an additional equity financing, this could result in further dilution to our shareholders' ownership or reduce the market value of our common stock.

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

We may review strategic alliance or acquisition opportunities that would complement our current business or enhance our technological capabilities. Integrating any newly acquired businesses, technologies or services may be expensive and time-consuming. To finance any acquisitions, it may be necessary for us to raise additional funds through borrowing money or completing public or private financings. Additional funds may not be available on terms that are favorable to us and, in the case of equity financings, may result in dilution to our shareholders' ownership. We may not be able to operate any acquired businesses profitably or otherwise implement our growth strategy successfully. If we are unable to integrate any newly acquired entities or technologies effectively, our operating results could suffer. Future acquisitions could also result in incremental expenses and the incurrence of debt and contingent liabilities, any of which could harm our operating results. We may also incur costs in connection with potential strategic opportunities that are not consummated. Although we require potential strategic partners to agree to confidentiality and nondisclosure provisions, the use or disclosure of our confidential or proprietary information by such parties in violation of their confidentiality and nondisclosure obligations could harm our business.

***Delivery of our and our clients' products could be delayed or disrupted by factors beyond our control, and we could lose customers and clients as a result.***

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

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

***Our profitability could be adversely affected if the operation of our facilities were interrupted or shut down as the result of a natural disaster.***

We operate a majority of our distribution facilities in and around the Memphis, Tennessee area and our headquarters and call center operations are centered in the Dallas, Texas area. We also maintain facilities in Canada, Europe and the Philippines. Any natural disaster or other serious disruption to our facilities due to fire, tornado, flood or any other cause would substantially disrupt our operations and would impair our ability to adequately service our customers. In addition, we could incur significantly higher costs during the time it takes for us to reopen or replace any one or more of our facilities, which may or may not be reimbursed by insurance. As a result, disruption at one or more of our facilities could adversely affect our profitability.

***A breach of our eCommerce security measures could reduce demand for our services. Credit card fraud and other fraud could adversely affect our business.***

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

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

***We may be liable for misappropriation of our customers' and our clients' customers' personal information.***

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

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

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

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

***Our service fee revenue and gross margin is dependent upon our clients’ business and transaction volumes and our costs; we may incur financial penalties if we fail to meet contractual service levels under certain client service agreements.***

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

***We or our clients may be a party to litigation involving our eCommerce intellectual property rights. If third parties claim we or our clients are infringing their intellectual property rights, we could incur significant litigation costs, be required to pay damages, or change our business or incur licensing expenses.***

Third parties have asserted, and may in the future assert, that our business or the technologies we use infringe on their intellectual property rights. As a result, we or our clients may be subject to intellectual property legal proceedings and claims in the ordinary course of business. We cannot predict whether third parties will assert claims of infringement in the future or whether any future claims will prevent us from offering popular products or services. If we or our clients are found to infringe, we may be required to pay monetary damages, which could include treble damages and attorneys’ fees for any infringement that is found to be willful, and either be enjoined or required to pay ongoing royalties with respect to any technologies found to infringe. Further, as a result of infringement claims either against us or our clients, we may be required, or deem it advisable, to develop non-infringing technology, which could be costly and time consuming, or enter into costly royalty or licensing agreements. Such royalty or licensing agreements, if required, may be unavailable on terms that are acceptable, or at all. If a third party successfully asserts an infringement claim against us or our clients and we are enjoined or required to pay monetary damages or royalties or we are unable to develop suitable non-infringing alternatives or license the infringed or similar technology on reasonable terms on a timely basis, our business, results of operations and financial condition could be materially harmed.

***We rely on third party providers for a portion of our client services, and we are subject to various risks and liabilities if we are unable to continue our relationship with such providers, such providers do not provide the third party services or provide them in a manner that does not meet required service levels.***

We currently, and may in the future, rely on third party providers to provide a portion of our end-to-end solution service offering. Generally, under the terms of our contracts with our end-to-end solution service clients, we remain liable to provide such third party services and may be liable for the actions and omissions of such third party providers. In certain instances, our end-to-end

solution service clients prepay in advance a portion of the service fees payable in respect of the third party services, and, under certain circumstances, including our breach or the breach by our third party provider of our or their respective obligations, we are liable to refund all or a portion of such prepaid fees. Consequently, in the event our third party provider fails to provide the third party services in compliance with required services levels, or otherwise breaches its obligations, or discontinues its business, whether as the result of bankruptcy, insolvency or otherwise, we may be required to provide such services at a higher cost to us and may otherwise be liable for various costs and expenses related to such event. In addition, any such failure may damage our reputation and otherwise result in a material adverse affect upon our business and financial condition.

***We may incur liability for indemnification obligations under our contracts with our clients and business partners which may have a material adverse effect upon our business, results of operations and financial condition.***

We include indemnification provisions in the contracts we enter into with our clients and business partners. Generally, the provisions require us to defend claims arising out of our infringement of third-party intellectual property rights, breach of contractual obligations and/or unlawful or otherwise culpable conduct, including breach of data security. The indemnity obligations generally cover damages, costs and attorneys' fees arising out of such claims. In many instances, our indemnification obligations to our clients include the actions or omissions of our third-party service providers. Although we seek to limit our total liability under such provisions to either a portion of the value of the contract or a specified, agreed-upon amount, in some cases our total liability under such provisions is unlimited. Although in most cases our third party service providers indemnify us for their actions and omissions, such providers may dispute or be unable to satisfy their indemnification obligation to us. In addition, our indemnification obligation to our clients may be broader in scope, or may be subject to larger limitations of liability, than the indemnification obligation of our third party service providers to us. In most cases, the term of the indemnity provision is perpetual. If we are required to indemnify a claim in a material amount, or if a series of indemnification claims are in the aggregate a material amount, we may be required to expend significant resources to defend the claims, which may have a material adverse effect upon our business, results of operations and financial condition.

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

For 2013, two clients in the aggregate represented approximately 14% of our service fee revenue (excluding pass-through revenue) and 8% of consolidated revenue. We currently anticipate that both of these clients and other clients will reduce the level of services or have terminated 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 will 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 2012 and 2013. Further reduction in the Ricoh business may have a material adverse effect on Supplies Distributors' business and may adversely affect our overall financial condition.

Sales by Supplies Distributors to two customers in the aggregate accounted for approximately 28% of Supplies Distributors' total product revenue for the year ended December 31, 2013 and 10% of consolidated net revenue. 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.

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

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

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

Our success depends on our ability to handle a large number of transactions for many different clients in various product categories. We expect the volume of transactions will increase significantly as we expand our operations. In addition, client marketing

programs, such as “secret sales”, “flash sales” or holiday related promotions often result in significant short-term spikes in transaction volumes. When this occurs, additional stress is placed upon our network hardware and software and our ability to efficiently manage our operations, and we cannot assure you of our ability to efficiently manage a large number of transactions. If we are not able to maintain an appropriate level of operating performance, we may be in breach of our client contractual obligations, develop a negative reputation, and impair existing and prospective client relationships and our business would be materially adversely affected.

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

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

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

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

***We face competition from many sources that could adversely affect our business; growth in our clients' ecommerce business may make it more efficient for the client to perform our services themselves.***

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

In addition, growth in our clients' ecommerce businesses may cause a client to consider making the necessary investments to process their ecommerce operations in-house. In such event, unless we can provide a more cost-effective solution to the client, the client may choose to terminate our services. There is no assurance that we will be able to provide a more cost-effective solution, or that any such solution will not reduce our profitability or be accepted by the client.

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

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

***Our business could be adversely affected by a systems or equipment failure, whether ours or our clients.***

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

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

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

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

***We may be subject to sales tax in one or more jurisdictions which adversely affect our business.***

We collect sales or other similar taxes for shipments of goods in certain states and jurisdictions. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us and other out-of-state companies that engage in online commerce. If sales tax obligations are successfully imposed upon us by a state or other jurisdiction, we could be exposed to substantial tax liabilities for past sales and fines and penalties for failure to collect sales taxes and we could suffer decreased sales in that state or jurisdiction as the effective cost of purchasing goods from us increases for those residing in that state or jurisdiction. In addition, new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of existing laws and regulations to the Internet and commercial online services could result in significant additional taxes or regulatory restrictions on our business. These taxes could have an adverse effect on our cash flows and results of operations. Furthermore, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements.

**Risks Related to the Business Process Outsourcing Industry**

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

Our business could be materially adversely affected if the trend toward outsourcing declines or reverses, or if corporations bring previously outsourced functions back in-house. Particularly during general economic downturns, businesses may bring in-house previously outsourced functions to avoid or delay layoffs.

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

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

## **Risks Related to Our Stock**

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

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

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

As of December 31, 2013, we have an aggregate of 1.8 million stock options outstanding to employees, directors and others with a weighted average exercise price of \$4.90 per share. The shares of common stock that may be issued upon exercise of these options may be resold into the public market. In addition, based on the Company's 2013 financial results, the aggregate maximum number of common stock that may be issued for 2013 under our executive long-term incentive plan is approximately 598,000, of which approximately 150,000 are fully vested. We have issued an aggregate of approximately 8,300 deferred stock units to members of our Board of Directors under our outside director compensation program. Sales of substantial amounts of common stock in the public market as a result of these issuances, or the perception that future sales of these shares could occur, could reduce the market price of our common stock and make it more difficult to sell equity securities in the future.

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

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

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

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

### **Item 1B. *Unresolved Staff Comments***

None.

### **Item 2. *Properties***

Our headquarters are located in Allen, Texas, a Dallas suburb.

In the U.S., we operate a distribution facility in Memphis, Tennessee, with aggregate space of more than 440,000 square feet. We also operate two additional distribution facilities totaling an aggregate of approximately 540,000 square feet in Southaven, Mississippi. These facilities are located approximately ten miles from the Memphis International Airport. We also manage two other facilities: a distribution facility in Grapevine, Texas with approximately 200,000 square feet and a DTC facility in Memphis, Tennessee with approximately 205,000 square feet.

Internationally, we operate a distribution complex in Liège, Belgium with approximately 200,000 square feet, which contains advanced distribution systems and equipment. We operate a distribution center in Richmond Hill, Ontario, Canada with approximately 34,000 square feet. We also operate a facility in the Philippines with approximately 7,000 square feet to provide primarily technology development and administrative support.

Except for the Grapevine, Texas facility and the DTC facility in Memphis, Tennessee, which we manage on our clients' behalf, all of our facilities are leased and the lease agreements generally contain one or more renewal options.

We operate customer service centers in our facilities in Dallas, Texas, Belgium, Canada and the Philippines. Our call center technology permits the automatic routing of calls to available customer service representatives in several of our call centers.

**Item 3.      *Legal Proceedings***

We are not party to any legal proceedings other than routine claims and lawsuits arising in the ordinary course of our business. We do not believe such claims and lawsuits, individually or in the aggregate, will have a material adverse effect on our business.

**Item 4.      *Mine Safety Disclosures***

Not Applicable



## PART II

### Item 5. *Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities*

Our common stock is listed, and currently trades, on the NASDAQ Capital Market under the symbol "PFSW." The following table sets forth for the period indicated the high and low sale price for the common stock as reported by NASDAQ:

	Price	
	High	Low
Year Ended December 31, 2012		
First Quarter	\$ 4.37	\$ 2.46
Second Quarter	\$ 4.40	\$ 2.31
Third Quarter	\$ 3.20	\$ 2.30
Fourth Quarter	\$ 3.27	\$ 2.14
Year Ended December 31, 2013		
First Quarter	\$ 4.24	\$ 2.73
Second Quarter	\$ 4.65	\$ 3.40
Third Quarter	\$ 6.10	\$ 3.91
Fourth Quarter	\$ 9.35	\$ 5.91

As of March 5, 2014, there were approximately 3,200 shareholders, of which 128 were record holders of the common stock.

We have never declared or paid cash dividends on our common stock and do not anticipate the payment of cash dividends on our common stock in the foreseeable future. We are also restricted from paying dividends under our debt agreements without the prior approval of our lenders. The payment of any future cash dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, operations, capital requirements, the general financial condition of the Company and general business conditions and the approval of our lenders. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

The following table summarizes information with respect to equity compensation plans under which equity securities of the Company are authorized for issuance as of December 31, 2013:

<u>Plan category (1)</u>	<u>Number of securities to be issued upon exercise of outstanding options</u>	<u>Weighted-average exercise price of outstanding options</u>	<u>Number of securities remaining available for future issuance</u>
Equity compensation plans approved by shareholders	1,818,592	\$ 4.90	1,174,674

(1) See Note 5 to the Consolidated Financial Statements for more detailed information regarding the Company's equity compensation plans.

### Item 6. *Selected Consolidated Financial Data*

None

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*We believe the following discussion and analysis provides information that is relevant to an assessment and understanding of our consolidated results of operations and financial condition. The discussion and analysis should be read in conjunction with the consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-K. This Management's Discussion and Analysis will help you understand:*

- The impact of forward looking statements;
- Our financial structure, including our historical financial presentation;
- Our results of operations for the previous two years as well as certain projections for the future;
- Certain of our relationships with our subsidiaries;
- Our liquidity and capital resources;
- The impact of seasonality, inflation and recently issued accounting standards on our financial statements; and
- Our critical accounting policies and estimates.

**Forward-Looking Information**

We have made forward-looking statements in this Report on Form 10-K. 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 the Risk Factors set forth above or elsewhere in this Report on Form 10-K, 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, transaction volume or product sales;
- our dependence upon our agreements with International Business Machines Corporation ("IBM") and 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 client and customer contracts;
- the impact of strategic alliances and acquisitions;
- trends in eCommerce, 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 dependence 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;
- our relationship with, and our guarantees of, certain of the liabilities and indebtedness of our subsidiaries; and
- taxation on the sale of our products and provision of our services.

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

## Overview

We are an international business process outsourcing provider of end-to-end eCommerce solutions. We provide these solutions to major brand name companies and others 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 Service Fee model, 2) the Agent (or Flash) model and 3) the Retail model.

We refer to the standard PFSweb seller services financial model as the Service Fee model. In this model, our clients own the inventory and are the merchants of record and engage us to provide various business process outsourcing services in support of their business operations. We derive our service fee revenues by providing 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. 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 Service Fee 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 as a component of service fee revenue in our consolidated statement of operations.

Finally, our Retail model allows us to purchase inventory from the client. 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. In this model, depending on the terms of our client arrangements, we may 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. Depending on the terms of our client arrangements in the Retail model, we record either: 1) product revenue as a component of product revenue, or 2) product revenue net of cost of product revenue as a component of service fee revenue in our consolidated statement of operations. 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 clients or under senior credit facilities.

In general, we provide the Service Fee 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 Service Fee 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 four primary target markets, health and beauty, home goods and collectibles, fashion and consumer packaged goods, which, by nature, require a longer duration to close but also have the potential to be higher quality and longer duration engagements.

Currently, we anticipate any growth within our Retail model would be through relationships with clients whereby the terms would allow us to record service fee revenue (product revenue net of product cost of revenue) in our consolidated statement of operations. These relationships are often driven by 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 product revenues and profitability under our Retail model in 2013 and beyond as compared to prior years.

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 to help generate growth.

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

### Year Ended December 31, 2013 Compared to Year Ended December 31, 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).

			Change		% of Total Revenue	
	2013	2012	\$	%	2013	2012
<b>Revenues:</b>						
Product revenue, net	\$ 91.0	\$ 119.7	\$ (28.7)	(24.0)%	37.7%	42.5%
Service fee revenue	113.0	120.4	(7.4)	(6.2)%	46.8%	42.8%
Pass-through revenue	37.6	41.4	(3.8)	(9.1)%	15.5%	14.7%
Total net revenues	241.6	281.5	(39.9)	(14.2)%	100.0%	100.0%
<b>Cost of Revenues</b>						
Cost of product revenue	85.3	110.2	(24.9)	(22.6)%	93.7%(1)	92.0%
Cost of service fee revenue	77.2	89.2	(12.0)	(13.5)%	68.3%(2)	74.1%
Pass-through cost of revenue	37.6	41.4	(3.8)	(9.1)%	100.0%(3)	100.0%
Total cost of revenues	200.1	240.8	(40.7)	(16.9)%	82.8%	85.5%
Product revenue gross profit	5.7	9.5	(3.8)	(39.9)%	6.3%(1)	8.0%
Service fee gross profit	35.8	31.2	4.6	14.9%	31.7%(2)	25.9%
Pass-through gross profit	—	—	—	—	—	—
Total gross profit	41.5	40.7	0.8	2.0%	17.2%	14.5%
<b>Selling, General and Administrative Expenses</b>						
Income (loss) from operations	46.2	40.6	5.4	13.8%	19.1%	14.4%
Interest expense, net	(4.7)	0.1	(4.8)	(3962.0)%	1.9%	0.1%
Loss from operations before income taxes	0.7	1.0	0.3	(31.3)%	0.3%	0.4%
Income tax expense, net	(5.4)	(0.9)	(4.5)	517.3%	(2.2)%	(0.3)%
Net loss	0.5	0.6	0.1	(16.3)%	0.2%	0.2%
	\$ (5.9)	\$ (1.5)	\$ (4.4)	(289.9)%	(2.4)%	(0.5)%

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

*Product revenue, net.* Product revenue decreased \$ 28.7 million, or 24.0%, in 2013 as compared to 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 continue to decline by approximately 20% to approximately \$70 million to \$75 million in 2014.

*Service fee revenue.* The decrease in service fee revenue for the year ended December 31, 2013 as compared to the prior year was primarily due to decreased service fees related to the conclusion or reduction of operations of several client programs during 2013 (including certain clients that accounted for more than 10% of our service fee revenue in 2012), partially offset by the impact of expanded and new client relationships that began in 2013.

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

Year ended December 31, 2012	\$ 120.4
New service contract relationships	8.2
Change in existing client service fees	(15.1)
Terminated clients not included in 2013 revenue	(0.5)
Year ended December 31, 2013	<u>\$ 113.0</u>

When considering client relationships, we define an existing client to be a client from whom we earned revenue in both the current and prior years, we define a new client to be a client from whom we only earned revenue in the current year, and we define a terminated client as a client from whom we only earned revenue in the prior year. On an annual comparison basis, our service fee revenue will continue to be negatively impacted by the conclusion or anticipated reduction of operations of several client programs. However, based on current client projections, we expect the reduction in revenue derived from these client programs to be more than

offset by new service fee revenue generated by new or expanded client opportunities in 2014. For 2014, we are currently targeting an increase in service fee revenues of approximately 10% as compared to 2013.

*Cost of Product Revenue.* Cost of product revenue decreased by \$24.9 million, or 22.6%, to \$85.3 million in 2013 as compared to the prior year. The resulting gross profit margin was \$5.7 million or 6.3% of product revenue for the year ended December 31, 2013 and \$9.5 million or 8.0% of product revenue for 2012. The gross profit has been negatively impacted by reduced product revenue primarily attributable to the Ricoh restructuring activities, which we expect to continue in 2014 and beyond, and the gross profit margin declined due to a higher percentage of our product revenue generated from lower gross margin product categories and certain inventory adjustments. 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. We currently expect our product revenue gross profit margin to be approximately 6% in 2014.

*Cost of Service Fee Revenue .* Gross profit as a percentage of service fees was 31.7% in 2013 and 25.9% in 2012. The gross profit percentage increase is primarily due to a change in the client mix, an increased level of higher margin professional and technology services, including project activity, and improved operating efficiencies. Additionally, 2013 included an incremental benefit of \$1.2 million applicable to certain client transition related agreements.

We target to earn an overall average gross profit on our service fee activity 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. Gross margins on our service fee business are expected to be within our targeted range of 25-30% for 2014. We are focused on continuing to increase our level of higher margin service fee activity, including our professional and technology services, to help offset other lower margin activities.

*Selling, General and Administrative Expenses .* Selling, general and administrative expenses were \$ 46.2 million, or 19.1% of total net revenues in the 2013 period and \$40.6 million, or 14.4% of total net revenues in the prior year. The increase in expenses is attributable to multiple factors, including an increase in depreciation and amortization expense, certain facility related expenses, a \$1.2 million increase in stock compensation expense compared to 2012 and certain restructuring related charges of approximately \$2.5 million in 2013. In 2012 we incurred approximately \$0.5 million of lease termination costs and approximately \$0.9 million of relocation related costs relating to our facility relocations and expansions due to investments to support growth in our service fee business. Excluding the restructuring related charges, lease termination costs and relocation related costs in 2013 and 2012, selling, general and administrative expenses were 18.1% and 14.0% of total net revenue in 2013 and 2012, respectively. The increased percentage in 2013 is primarily due to a significant reduction in product revenue between years which did not result in a corresponding level of selling, general and administrative expense decreases and due to increased costs to support our service fee business, including depreciation and amortization expense as well as facility related costs. We currently expect our selling, general and administrative expenses for 2014 to be comparable to 2013 results, excluding restructuring related charges.

*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.

### **Supplies Distributors and its Subsidiaries**

We conduct a portion of our Retail business model operations through Supplies Distributors and its subsidiaries, which act as distributors of various Ricoh and other products. We conduct these services through transaction management services agreements under which PFS provides transaction management and fulfillment services to Supplies Distributors and its subsidiaries. In addition to our equity investment in Supplies Distributors, we have also provided Supplies Distributors with a subordinated loan that, as of December 31, 2013, had an outstanding balance of \$3.5 million.

Supplies Distributors paid us dividends of \$1.5 million and \$1.0 million in 2013 and 2012, respectively. Supplies Distributors has received lender approval to pay dividends of approximately \$1.8 million in 2014, but pursuant to the terms of its amended credit agreements, is restricted from paying further cash dividends without the prior approval of its lenders. In addition, no distribution may be made if, after giving effect thereto, Supplies Distributors or its subsidiaries are in noncompliance with its financial covenants under its current facilities.

## Liquidity and Capital Resources

During the year ended December 31, 2013, we generated \$6.8 million of cash from operating activities, which resulted primarily due to a:

- \$10.5 million decrease in inventories primarily applicable to reduced Ricoh related business volumes, and
- \$2.5 million decrease in prepaid expenses, and other receivables and other assets in part due to timing of receipts and reduced product revenue related activity.
- \$7.0 million of cash income from operations before working capital changes.

These sources of cash were partially offset by a:

- \$9.3 million increase in accounts receivable applicable to:
  - o increased activity for certain new and expanded client relationships in which we own the resulting customer trade receivable (through our Agent or Retail models),
  - o the timing of client receipts applicable to service fee activity,
  - o Both of the above partially offset by the impact of reduced Ricoh related business.
- \$3.6 million decrease in accounts payable, deferred revenue, accrued expenses and other liabilities in part due to reduced inventory purchases as a result of a reduction in product revenue.

At December 31, 2013 and 2012, our accounts payable and accrued expenses were higher than normal operating levels due to the timing of various vendor and client reimbursement payments.

During the year ended December 31, 2012, we generated \$28.6 million of cash from operating activities, which resulted primarily due to a:

- \$7.3 million decrease in accounts receivable primarily related to reduced Ricoh related product revenue activity, and
- \$5.7 million reduction in inventories primarily related to reduced Ricoh related product revenue activity;
- \$5.3 million increase in deferred rent related to tenant improvement allowances at certain new facilities;
- \$4.4 million decrease in prepaid expenses, and other receivables and other assets primarily related to timing of receipts and a reduction of value-added tax receivable at our European subsidiary and reduced Ricoh related product revenue activity.
- \$9.3 million of cash income from continuing operations before working capital changes.
- These sources of cash were partially offset by a \$3.3 million decrease in accounts payable, deferred revenue, accrued expenses and other liabilities primarily related to reduced product revenue activity and the timing of payments we make for products and services, payment processing and related transactions costs.

In 2013, we incurred capital expenditures of \$ 8.0 million, exclusive of \$1.8 million of property and equipment acquired under debt and capital lease financing, which consisted primarily of payments for capitalized software costs and equipment purchases. We also received net proceeds of \$15.9 million from the issuance of common stock, consisting of \$1.8 million related to employee stock option exercises and \$14.1 million from a private placement completed in May.

In 2012, we incurred \$14.7 million of capital expenditures, exclusive of \$7.3 million of property and equipment acquired under debt and capital lease financing, primarily related to software costs and costs applicable to our new corporate headquarters and call center facility, which were primarily financed by the facility 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 \$12.3 million and \$12.1 million, during 2013 and 2012, respectively.

Capital expenditures have historically consisted primarily 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 solutions and services for the upcoming twelve months, including costs to implement new clients, will be approximately \$9 million to \$12 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 that we do not obtain the financing results necessary to support such investments.

During 2013, our working capital increased to \$26.4 million from \$15.4 million at December 31, 2012, primarily due to net proceeds of \$15.9 million from issuance of our common stock described above partially offset by the pay-down of debt facilities, capital expenditures and the impact of certain restructuring and personnel 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.

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 the 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 of such obligations. As of December 31, 2013, we were in compliance with all debt covenants. Further, any 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 December 31, 2013, we believe we have adequately accrued for the expected assessment.

In April 2010, a sales employee of eCOST.com, Inc. ("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. In August 2012, the employee pleaded guilty to a misdemeanor. Neither the Company nor eCOST have been charged with any criminal activity, and we are seeking the recovery of the funds, which are currently classified as other receivables in the December 31, 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 \$ 15.0 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 \$ 12.0 million of eligible accounts receivables in the United States and Canada. The Wells Fargo facility expires on the earlier of March 2016 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 \$ 10.3 million at December 31, 2013) of eligible accounts receivables through March 2015.

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 \$2.5 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 (“Comerica”), which provides for up to \$20.0 million (\$17.0 million during certain non-seasonal peak months) of eligible accounts receivable financing through March 2016. The Comerica Agreement also provides for up to \$2.0 million of additional eligible equipment financing (“Equipment Advances”) through March 2015. Outstanding Equipment Advances have a final maturity date of April 15, 2016. 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 of up to \$2.0 million with Wells Fargo, which is collateralized by substantially all of Retail Connect’s assets and expires in May 2014. Based on our current borrowing needs, we do not expect to renew this facility upon its maturity. 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 December 31, 2013, Retail Connect had no borrowings or letters of credit outstanding and no 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, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit.

### ***Private Placement***

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.

### ***Restricted Net Assets***

Certain of our credit facilities contain various financial covenants and include covenants that restrict our ability to incur additional indebtedness, create or permit liens on assets, engage in mergers or consolidations, and place restrictions on the transfer of

assets or the payment of dividends between us and our subsidiaries. At December 31, 2013 and 2012, we had restricted net assets of approximately \$26.9 million and \$20.7 million, respectively.

### **Off-Balance Sheet Arrangements**

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

### **Inventory Management**

In our Retail model, we manage our inventories held for sale by maintaining sufficient quantities of product to achieve high order fill rates while at the same time maximizing inventory turnover rates. Inventory balances will fluctuate as we add new product lines. To reduce the risk of loss due to supplier price reductions, Supplies Distributors' distributor agreement provides for price protection under which it receives credits if the supplier lowers prices on previously purchased inventory.

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

### **Inflation**

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

### **Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. These accounting principles require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. While we do not believe the reported amounts would be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. If there is a significant unfavorable change to current conditions, it would likely result in a material adverse impact to our business, operating results and financial condition. We evaluate our estimates and assumptions on an ongoing basis. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances. All of our significant accounting policies are disclosed in the notes to our consolidated financial statements.

We have defined a critical accounting estimate as one that is both important to the portrayal of our financial condition and results of operations and requires us to make difficult, subjective or complex judgments or estimates about matters that are uncertain. During the past three fiscal years, we have not made any material changes in accounting methodology used to establish the critical accounting estimates discussed below. The following represent certain critical accounting policies that require us to exercise our business judgment or make significant estimates. In addition, there are other items within our consolidated financial statements that require estimation but are not deemed critical as defined above.

#### ***Product Revenue Recognition***

Sales are recognized when the title and risk of loss are passed to the customer, there is persuasive evidence of an arrangement for the sale, delivery has occurred and/or services have been rendered, the sales price is fixed or determinable and collectability is reasonably assured.

Sales are reported net of estimated returns and allowances which are estimated based upon historical return information. Management also considers any other current information and trends in making estimates. If actual sales returns, allowances and discounts are greater than estimated by management, additional expense may be incurred.

### ***Cost of Service Fee Revenue***

Our service fee revenue primarily relates to our distribution services and order management/customer care services and professional and technology services. Distribution services relate primarily to inventory management, product receiving, warehousing and fulfillment (i.e., picking, packing and shipping product on our clients' behalf). Order management/customer care services relate primarily to taking customer orders for our clients' products via various channels such as telephone call-center, electronic or facsimile. These services also entail addressing customer questions related to orders, as well as cross-selling/up-selling activities. Professional and technology services relate primarily to service and support of eCommerce platforms, website solutions and quality control for our clients.

Our cost of service fee revenue represents the cost to provide the services described above, primarily compensation and related expenses and other fixed and variable expenses directly related to providing the services. These also include certain occupancy and information technology costs and depreciation and amortization expenses. Certain of these costs are allocated from general and administrative expenses. For these allocations, we estimate the amount of direct expenses based on client-specific information, such as the number of transactions processed. We believe our allocation methodology is reasonable, however a change in assumptions would result in a different gross profit in our statement of operations, yet no change to the resulting net income or loss.

### ***Allowance for Doubtful Accounts***

The determination of the collectability of amounts due from our customers requires us to use estimates and make judgments regarding future events and trends, including monitoring our customers' payment history and current credit worthiness to determine that collectability is reasonably assured, as well as consideration of the overall business climate in which our clients and customers operate. Inherently, these uncertainties require us to make frequent judgments and estimates regarding our clients and customers' ability to pay amounts due to us to determine the appropriate amount of valuation allowances required for doubtful accounts. Provisions for doubtful accounts are recorded when it becomes evident the client or customer will not make the required payments at either contractual due dates or in the future.

In our Retail model, we also maintain an allowance for uncollectible vendor receivables, which arise from inventory returns to vendors, vendor rebates, price protections and other promotions. We determine the sufficiency of the vendor receivable allowance based upon various factors, including payment history. Amounts received from vendors may vary from amounts recorded because of potential non-compliance with certain elements of vendor programs. If our estimated allowances for uncollectible accounts or vendor receivables subsequently prove insufficient, additional allowance may be required.

Allowance for doubtful accounts totaled \$0.4 million and \$0.5 million at December 31, 2013 and 2012, respectively. We believe our allowances for doubtful accounts are adequate to cover anticipated losses under current conditions; however, uncertainties regarding changes in the financial condition of our clients and customers, either adverse or positive, could impact the amount and timing of any additional provisions for doubtful accounts that may be required.

### ***Inventory Reserves***

Inventories (merchandise, held for resale, all of which are finished goods) are stated at the lower of weighted average cost or market. Supplies Distributors and its subsidiaries assume responsibility for slow-moving inventory under certain distributor agreements, subject to certain termination rights, but have the right to return product rendered obsolete by engineering changes, as defined. We review inventories for impairment on a periodic basis, but at a minimum, annually. Recoverability of the inventory on hand is measured by comparisons of the carrying value to the fair value of the inventory. This requires us to record provisions and maintain reserves for excess or obsolete inventory. If write-downs of inventories are necessary, the cost basis of that inventory is adjusted. The provision for excess and obsolete inventory was \$0.1 million and \$0.4 million in the years ended December 31, 2013 and 2012, respectively. To determine these reserve amounts, we regularly review inventory quantities on hand and compare them to estimates of future product demand and market conditions. These estimates and forecasts inherently include uncertainties and require us to make judgments regarding potential outcomes. At December 31, 2013 and 2012, our reserve for slow moving inventory was \$1.0 million and \$1.8 million, respectively. We believe our reserves are adequate to cover anticipated losses under current conditions. Significant or unanticipated changes to our estimates and forecasts, either adverse or positive, could impact the amount and timing of any additional provisions for excess or obsolete inventory that may be required.

### ***Stock Compensation***

We utilize our Employee Stock and Incentive Plan and Non-Employee Director Stock Option Plan (collectively, the "Plans") to help attract, retain and incentivize qualified executives, key employees and non-employee directors to increase our shareholder value and help build and sustain growth. As of December 31, 2013, an aggregate of 4,142,341 shares of common stock have been authorized for issuance under the Plans, of which 1,174,674 shares remain available for future grants. The Plans provide for the granting of

incentive awards in a variety of forms such as the award of an option, stock appreciation right, restricted stock award, restricted stock unit, deferred stock unit, among other stock-based awards.

From the service inception date to the grant date, we recognize compensation cost for all share-based payments based on the reporting date fair value of the award. After the grant date, compensation cost is measured based on the grant date fair value. Depending on the conditions associated with the vesting of the award, compensation cost is recognized on a straight-line or graded basis, net of estimated forfeitures, over the requisite service period of each award. .

We estimate the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. For certain of the awards that have a performance condition, we estimate the compensation cost using a Monte-Carlo simulation. The estimated fair value for awards involves assumptions for expected dividend yield, stock price volatility, risk-free interest rates and the expected life of the award.

If, in the future, we determine that another method of estimating an award's fair value is more reasonable, or, if another method for calculating these input assumptions is prescribed by authoritative guidance, and, therefore, should be used to estimate expected volatility or expected term, the fair value calculated for our stock-based compensation could change significantly.

### ***Income Taxes***

The liability method is used for determining our income taxes, under which current and deferred tax liabilities and assets are recorded in accordance with enacted tax laws and rates. Under this method, the amounts of deferred tax liabilities and assets at the end of each period are determined using the tax rate expected to be in effect when taxes are actually paid or recovered. Valuation allowances are established to reduce deferred tax assets to their net realizable value when it is more likely than not that some portion or all of the deferred tax assets will not be realized. In determining the need for valuation allowances, we have considered and made judgments and estimates regarding estimated future taxable income. These estimates and judgments include some degree of uncertainty and changes in these estimates and assumptions could require us to adjust the valuation allowances for our deferred tax assets. The ultimate realization of our deferred tax assets depends on the generation of sufficient taxable income in the applicable taxing jurisdictions. Although we believe our estimates and judgments are reasonable, actual results may differ, which could be material.

Because we operate in multiple countries, we are subject to the jurisdiction of multiple domestic and foreign tax authorities. Determination of taxable income in any jurisdiction requires the interpretation of the related tax laws and regulations and the use of estimates and assumptions regarding significant future events such as the amount, timing and character of deductions, permissible revenue recognition methods under the tax law and the sources and character of income and tax credits. Changes in tax laws, regulations, foreign currency exchange restrictions or our level of operations or profitability in each taxing jurisdiction could have an impact on the amount of income taxes that we provide during any given year.

### **Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

Not Applicable.

**Item 8.**      *Financial Statements and Supplementary Data*

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## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
PFSweb, Inc.:

We have audited the accompanying consolidated balance sheets of PFSweb, Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2013 and 2012, and the related consolidated statements of operations and comprehensive loss, shareholders’ equity, and cash flows for each of the two years in the period ended December 31, 2013. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PFSweb, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

Dallas, Texas  
March 31, 2014

**PFSWEB, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

	<u>December 31, 2013</u>	<u>December 31, 2012</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 22,418	\$ 19,626
Restricted cash	130	283
Accounts receivable, net of allowance for doubtful accounts of \$382 and \$450 at December 31, 2013 and 2012, respectively	55,292	45,684
Inventories, net of reserves of \$962 and \$1,789 at December 31, 2013 and 2012, respectively	14,169	24,654
Other receivables	5,241	7,675
Prepaid expenses and other current assets	4,713	4,346
Total current assets	101,963	102,268
PROPERTY AND EQUIPMENT, net	27,190	27,917
OTHER ASSETS	2,883	3,286
Total assets	\$ 132,036	\$ 133,471
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt and capital lease obligations	\$ 8,231	\$ 16,660
Trade accounts payable	34,096	40,493
Deferred revenue	8,181	6,648
Accrued expenses	25,045	23,097
Total current liabilities	75,553	86,898
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	2,876	5,400
DEFERRED REVENUE	7,491	7,562
DEFERRED RENT	5,191	5,560
Total liabilities	91,111	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; 16,540,904 and 12,812,386 shares issued at December 31, 2013 and 2012, respectively; and 16,507,437 and 12,788,919 outstanding at December 31, 2013 and 2012, respectively	17	13
Additional paid-in capital	124,522	106,018
Accumulated deficit	(85,300)	(79,409)
Accumulated other comprehensive income	1,811	1,554
Treasury stock at cost, 33,467 shares	(125)	(125)
Total shareholders' equity	40,925	28,051
Total liabilities and shareholders' equity	\$ 132,036	\$ 133,471

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

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
**FOR THE YEARS ENDED DECEMBER 31**  
(In thousands, except per share data)

	<u>2013</u>	<u>2012</u>
<b>REVENUES:</b>		
Product revenue, net	\$ 90,982	\$ 119,740
Service fee revenue	112,977	120,433
Pass-through revenue	37,644	41,390
Total revenues	<u>241,603</u>	<u>281,563</u>
<b>COSTS OF REVENUES:</b>		
Cost of product revenue	85,237	110,183
Cost of service fee revenue	77,160	89,249
Cost of pass-through revenue	37,644	41,390
Total costs of revenues	<u>200,041</u>	<u>240,822</u>
Gross profit	41,562	40,741
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES, including stock based compensation expense of \$2,574 and \$1,325 in the years ended December 31, 2013 and 2012, respectively	46,235	40,620
Income (loss) from operations	(4,673)	121
INTEREST EXPENSE, net	679	988
Loss from operations before income taxes	(5,352)	(867)
INCOME TAX EXPENSE	539	644
NET LOSS	<u>\$ (5,891)</u>	<u>\$ (1,511)</u>
NET LOSS PER SHARE:		
Basic	<u>\$ (0.39)</u>	<u>\$ (0.12)</u>
Diluted	<u>\$ (0.39)</u>	<u>\$ (0.12)</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:		
Basic	<u>14,957</u>	<u>12,777</u>
Diluted	<u>14,957</u>	<u>12,777</u>
COMPREHENSIVE LOSS:		
Net Loss	\$ (5,891)	\$ (1,511)
Foreign currency translation adjustment	257	155
TOTAL COMPREHENSIVE LOSS	<u>\$ (5,634)</u>	<u>\$ (1,356)</u>

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



**PFSWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(In thousands, except share data)

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Treasury Stock</u>		<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>				<u>Shares</u>	<u>Amount</u>	
Balance, December 31, 2011	12,782,907	\$ 13	\$ 104,645	\$ (77,898)	\$ 1,399	18,361	\$ (85)	\$ 28,074
Net loss	—	—	0	(1,511)	—	—	—	(1,511)
Stock-based compensation expense	—	—	1,325	—	—	—	—	1,325
Issuance of common stock	29,479	—	48	—	—	—	—	48
Purchase of treasury stock	—	—	—	—	—	15,106	(40)	(40)
Other comprehensive loss— foreign currency translation adjustment	—	—	—	—	155	—	—	155
Balance, December 31, 2012	12,812,386	13	106,018	(79,409)	1,554	33,467	(125)	28,051
Net loss	—	—	—	(5,891)	—	—	—	(5,891)
Stock-based compensation expense	—	—	2,574	—	—	—	—	2,574
Issuance of common stock	3,728,518	4	15,930	—	—	—	—	15,934
Other comprehensive loss— foreign currency translation adjustment	—	—	—	—	257	—	—	257
Balance, December 31, 2013	<u>16,540,904</u>	<u>\$ 17</u>	<u>\$ 124,522</u>	<u>\$ (85,300)</u>	<u>\$ 1,811</u>	<u>33,467</u>	<u>\$ (125)</u>	<u>\$ 40,925</u>

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

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31**  
(In thousands)

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (5,891)	\$ (1,511)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	10,210	9,248
Provision for doubtful accounts	25	(130)
Provision for excess and obsolete inventory	81	353
Deferred income taxes	29	(18)
Stock-based compensation expense	2,574	1,325
Changes in operating assets and liabilities:		
Restricted cash	28	(76)
Accounts receivable	(9,273)	7,315
Inventories, net	10,456	5,650
Prepaid expenses, other receivables and other assets	2,498	4,420
Deferred rent	(273)	5,273
Accounts payable, deferred revenue, accrued expenses and other liabilities	(3,636)	(3,264)
Net cash provided by operating activities	<u>6,828</u>	<u>28,585</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(7,971)	(14,712)
Net cash used in investing activities	<u>(7,971)</u>	<u>(14,712)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from issuance of common stock	15,934	48
Purchase of treasury stock	—	(40)
Decrease in restricted cash	126	620
Payments on capital lease obligations	(2,680)	(2,125)
Payments on debt, net	(9,724)	(10,582)
Net cash provided by (used in) financing activities	<u>3,656</u>	<u>(12,079)</u>
<b>EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>	<u>279</u>	<u>137</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<u>2,792</u>	<u>1,931</u>
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>19,626</u>	<u>17,695</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 22,418</u>	<u>\$ 19,626</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Non-cash investing and financing activities:		
Property and equipment acquired under debt and capital lease obligations	<u>\$ 1,768</u>	<u>\$ 7,310</u>

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

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## **1. Overview**

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 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 (see Notes 3 and 4) 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.

## **2. Significant Accounting Policies**

### ***Principles of Consolidation***

All intercompany accounts and transactions have been eliminated in consolidation.

### ***Investment in Affiliates***

Priority Fulfillment Services, Inc. (“PFS”), a wholly-owned subsidiary of PFSweb, has made advances to Supplies Distributors that are evidenced by a Subordinated Demand Note (the “Subordinated Note”). Under the terms of certain of the Company’s debt facilities, the outstanding balance of the Subordinated Note cannot be increased to more than \$5.0 million or decreased to less than \$2.5 million without prior approval of certain of the Company’s lenders (see Notes 3 and 4). As of both December 31, 2013 and 2012, the outstanding balance of the Subordinated Note was \$3.5 million. The Subordinate Note is eliminated in the Company’s consolidated financial statements.

PFS has also made advances to Retail Connect, which aggregated \$11.1 million as of both December 31, 2013 and 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 December 31, 2013 and 2012, respectively. As of December 31, 2013, PFSweb, Inc. has approximately \$10.7 million available to be advanced to Retail Connect and/or other affiliates. All of these advances are eliminated upon consolidation.

**PFSWEB, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

***Use of Estimates***

The preparation of consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America (“US 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 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. 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 US GAAP, and provide a fair presentation of the Company’s financial position and results of operations.

***Revenue and Cost Recognition***

Depending on the terms of the customer arrangement, Supplies Distributors recognizes product revenue and product cost either upon the shipment of product to customers or when the customer receives the product. Supplies Distributors permits its customers to return product for credit against other purchases, which include returns for defective products (that Supplies Distributors then returns to the manufacturer) and incorrect shipments. Supplies Distributors provides a reserve for estimated returns and allowances and offers terms to its customers that it believes are standard for its industry.

Freight costs billed to customers are reflected as components of product revenue. Freight costs incurred are recorded as a component of cost of goods sold.

Under its distributor agreements (see Note 6), Supplies Distributors bills Ricoh for reimbursements of certain expenses, including: pass-through customer marketing programs, including rebates and coop funds; certain freight costs; direct costs incurred in passing on any price decreases offered by Ricoh to Supplies Distributors or its customers to cover price protection and certain special bids; the cost of products provided to replace defective product returned by customers; and certain other expenses as defined. Supplies Distributors includes these reimbursable amounts as they are incurred with a corresponding reduction in either inventory or cost of product revenue. Supplies Distributors also reflects pass-through customer marketing programs as a reduction of both product revenue and cost of product revenue.

The Company’s service fee revenue relates to its distribution services, order management/customer care services, professional and technology services and the reimbursement of out-of-pocket and third-party expenses. The Company typically charges its service fee revenue on either a cost-plus basis, a percent of shipped revenue basis or a per transaction basis, such as a per item basis for fulfillment services or a per labor hour basis for web-enabled customer contact center services. Additional fees are billed for other services. The Company evaluates its contractual arrangements to determine whether or not they include multiple service elements. Revenue recognition is determined for the separate service elements of the contract in accordance with the requirements of Accounting Standards Codification 605, “Revenue Recognition.”

Distribution services relate primarily to inventory management, product receiving, warehousing and fulfillment (i.e., picking, packing and shipping) and facilities and operations management. Service fee revenue for these activities is recognized as earned, which is either (i) on a per transaction basis or (ii) at the time of product fulfillment, which occurs at the completion of the distribution services.

Order management/customer care services relate primarily to taking customer orders for the Company’s clients’ products. These services also entail addressing customer questions related to orders, as well as cross-selling/up-selling activities. Service fee revenue for this activity is recognized as the services are rendered. Fees charged to the client are on a per transaction basis based on either (i) a pre-determined fee per order or fee per telephone minutes incurred, (ii) a per dedicated agent fee, or (iii) are included in the product fulfillment service fees that are recognized on product shipment.

Professional consulting and technology service revenues primarily relate to service and support of eCommerce platforms, website solutions and quality control for the Company’s clients. Additionally, the Company provides digital agency services that

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

enable client marketing programs to attract new customers, convert buyers and increase website value. These fees are typically charged on either a per labor hour basis, a dedicated resource model, or a percent of merchandise shipped basis. Service fee revenue for this activity is generally recognized as the services are rendered.

The Company's billings for reimbursement of out-of-pocket expenses, including travel and certain third-party vendor expenses such as shipping and handling costs and telecommunication charges, are included in pass-through revenue. The related reimbursable costs are reflected as cost of pass-through revenue.

The Company's cost of service fee revenue, representing the cost to provide the services described above, is recognized as incurred. Cost of service fee revenue also includes certain costs associated with technology collaboration and ongoing technology support that include maintenance, web hosting and other ongoing programming activities. These activities are primarily performed to support the distribution and order management/customer care services and are recognized as incurred.

The Company recognizes revenue and records trade accounts receivable, pursuant to the methods described above, when collectability is reasonably assured. Collectability is evaluated in the aggregate and on an individual customer or client basis taking into consideration payment due date, historical payment trends, current financial position, results of independent credit evaluations and payment terms. Related reserves are determined by either using percentages applied to certain aged receivable categories based on historical results, reevaluated and adjusted as additional information is received, or a specific identification method. After all attempts to collect a receivable have failed, the receivable is written off against the allowance for doubtful accounts.

The Company primarily performs its services under multiple year contracts, certain of which include early termination provisions. In conjunction with these long-term contracts, the Company sometimes receives start-up fees to cover its implementation costs, including certain technology infrastructure and development costs. The Company defers the start-up fees received, and the related costs, and recognizes them over the contract term. The amortization of deferred revenue is included as a component of service fee revenue. The amortization of deferred implementation costs is included as a cost of service fee revenue. To the extent implementation costs for non-technology infrastructure and development exceed the corresponding fees received, the excess costs are expensed as incurred. The following summarizes the deferred implementation revenues and costs, excluding technology and development costs that are included in property and equipment (in thousands):

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
<b>Deferred implementation revenues</b>		
Current	\$ 8,181	\$ 6,573
Non-current	7,491	7,562
	<u>\$ 15,672</u>	<u>\$ 14,135</u>
<b>Deferred implementation costs</b>		
Current	\$ 1,977	\$ 1,833
Non-current	1,780	1,834
	<u>\$ 3,757</u>	<u>\$ 3,667</u>

Current and non-current deferred implementation costs, excluding technology and development costs, are a component of prepaid expenses and other current assets and other assets, respectively. Current and non-current deferred implementation revenues may precede the timing of when the related implementation costs are incurred, and thus deferred.

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

***Concentration of Business and Credit Risk***

No product revenue customer or service fee client relationship represented more than 10% of the Company’s consolidated total net revenue during the years ended December 31, 2013 or 2012. One client exceeded 10% of the Company’s accounts receivable at December 31, 2013. A summary of the customer and client concentrations is as follows:

	<b>December 31, 2013</b>	<b>December 31, 2012</b>
<b>Product Revenue (as a percentage of total Product Revenue, net):</b>		
Customer 1	16%	15%
Customer 2	12%	12%
<b>Service Fee Revenue (as a percentage of total Service Fee Revenue):</b>		
Client 1	7%	15%
Client 2	7%	14%

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 ended during 2013 .

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.

***Cash and Cash Equivalents***

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

***Other Receivables***

Other receivables include \$3.9 million and \$6.5 million as of December 31, 2013 and 2012, respectively, primarily for amounts due from Ricoh for costs incurred by the Company under the distributor agreements (see Note 6). In addition, other receivables include \$0.7 million and \$0.6 million as of December 31, 2013 and 2012, respectively, applicable to value added tax receivables.

***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 (see Note 6). In the event PFSweb, 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.

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

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

The Company reviews inventory for impairment on a periodic basis, but at a minimum annually. The provision for excess and obsolete inventory in the years ended December 31, 2013 and 2012 was \$0.1 million and \$0.4 million, respectively. Recoverability of the inventory on hand is measured by comparison of the carrying value of the inventory to the fair value of the inventory. The reserve for slow moving or excess inventory was \$1.0 million and \$1.8 million as of December 31, 2013 and 2012, respectively.

***Property and Equipment***

The components of property and equipment as of December 31, 2013 and 2012 are as follows (in thousands):

	<b>December 31, 2013</b>	<b>December 31, 2012</b>	<b>Depreciable Life</b>
Purchased and capitalized software costs	\$ 39,829	\$ 35,024	1-5 years
Furniture and fixtures	23,158	22,378	2-10 years
Computer equipment	11,050	14,035	3-5 years
Leasehold improvements	13,648	13,229	3-10 years
Other	2,520	2,953	3-5 years
	<u>90,205</u>	<u>87,619</u>	
Less-accumulated depreciation and amortization	<u>(63,015)</u>	<u>(59,702)</u>	
Property and equipment, net	<u>\$ 27,190</u>	<u>\$ 27,917</u>	

The Company makes judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. Additionally, the Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The Company records impairment losses, if any, in the period in which the Company determines the carrying amount is not recoverable. Recoverability of any assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. This may require the Company to make judgments regarding long-term forecasts of future revenues and costs related to the assets subject to review. During 2013 and 2012, no impairment of property and equipment was identified or recorded.

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the respective assets. Capitalized implementation costs are depreciated over the respective client contract term. Leasehold improvements are amortized over the shorter of the useful life of the related asset or the remaining lease term. Depreciation and amortization expense related to property and equipment, excluding capital leases, during 2013 and 2012 was \$7.6 million and \$7.0 million, respectively.

The Company's property held under capital leases amount to approximately \$4.0 million and \$5.1 million, net of accumulated amortization of approximately \$4.4 million and \$2.6 million, at December 31, 2013 and 2012, respectively. Depreciation and amortization expense related to capital leases during 2013 and 2012 was \$2.6 million and \$2.2 million, respectively. In addition, during 2012, PFS incurred approximately \$6.0 million of leasehold improvements at certain of its leased facilities that is 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.

***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 2024. 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.

***Foreign Currency Translation and Transactions***

For the Company's Canadian and European operations, the local currency is the functional currency. All assets and liabilities are translated at exchange rates in effect at the end of the period, and income and expense items are translated at the average exchange rates on a monthly basis.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)

The Company includes currency gains and losses on short-term intercompany advances in the determination of net income and loss. The Company reports gains and losses on intercompany foreign currency transactions that are of a long-term investment nature as a separate component of shareholders' equity.

***Stock-Based Compensation***

The Company uses stock-based compensation, including stock options, deferred stock units and other stock-based awards to provide long-term performance incentives for its executives, key employees and non-employee directors. From the service inception date to the grant date, the Company recognizes compensation cost for all share-based payments based on the reporting date fair value of the award. After the grant date, compensation cost is measured based on the grant date fair value. Depending on the conditions associated with the vesting of the award, compensation cost is recognized on a straight-line or graded basis, net of estimated forfeitures, over the requisite service period of each award. The Company records compensation cost as a component of selling, general and administrative expenses in the consolidated statements of operations.

The Company estimates the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model and estimates the compensation cost for certain of the awards that have a performance condition using a Monte-Carlo simulation. The estimated fair value for awards involves assumptions for expected dividend yield, stock price volatility, risk-free interest rates and the expected life of the award.

***Income Taxes***

For federal income tax purposes, tax years that remain subject to examination include years 2010 through 2013. However, the utilization of net operating loss ("NOL") carryforwards that arose prior to 2010 remain subject to examination through the years such carryforwards are utilized. For Europe, tax years that remain subject to examination include years 2011 to 2013. However, the utilization of NOL carryforwards that arose prior to 2011 remain subject to examination through the years such carryforwards are utilized. For Canada, tax years that remain subject to examination include years 2005 to 2013, depending on the subsidiary. For state income tax purposes, the tax years that remain subject to examination include years 2009 to 2013, depending upon the jurisdiction in which the Company files tax returns. The Company and its subsidiaries have various income tax returns in the process of examination. The Company does not expect these examinations will result in unrecognized tax benefits.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized.

The Company recognizes interest and penalties related to certain tax positions in income tax expense.

***Self Insurance***

The Company is self-insured in the U.S. for medical insurance benefits up to certain stop-loss limits. Such costs are accrued based on known claims and an estimate of incurred, but not reported ("IBNR") claims. IBNR claims are estimated using historical lag information and other data provided by claims administrators.

***Fair Value of Financial Instruments***

The carrying value of the Company's financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable, debt and capital lease obligations, approximate their fair values based on short terms to maturity or current market prices and interest rates.

***Comprehensive Income (Loss)***

Comprehensive income (loss) is defined as the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) consists of net income (loss) and foreign currency translation adjustments.



**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

**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 years ended December 31, 2013 and 2012, were 1.8 million and 2.1 million, respectively, as the effect would be anti-dilutive.

**Cash Paid For Interest and Taxes During Year**

The Company made payments for interest of approximately \$0.7 million and \$1.0 million in the years ended December 31, 2013 and 2012, respectively (see Notes 3 and 4). Income tax payments of approximately \$0.5 million and \$0.6 million were made during each of the years ended December 31, 2013 and 2012, respectively (see Note 8).

**3. Vendor Financing**

Supplies Distributors has a short-term credit facility with IBM Credit LLC (“IBM Credit”) 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, the Company has classified the outstanding amounts under this facility, which were \$9.8 million and \$11.9 million as of December 31, 2013 and 2012, respectively, as accounts payable in the consolidated balance sheets. As of December 31, 2013, Supplies Distributors had \$2.2 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of \$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 both December 31, 2013 and 2012). The facility also includes a monthly service fee.

On March 28, 2014, Supplies Distributors entered into an amended credit facility with IBM Credit, which reduces the maximum financing under the facility from \$20 million to \$15 million, reduces the minimum Subordinated Note balance to \$2.5 million and modifies certain financial covenants.

**4. Debt and Capital Lease Obligations:**

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

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
Loan and security agreements, United States:		
Supplies Distributors	\$ 3,776	\$ 3,264
PFS	1,473	11,077
Master lease agreements	4,973	6,648
Other	885	1,071
Total	<u>11,107</u>	<u>22,060</u>
Less current portion of long-term debt	<u>8,231</u>	<u>16,660</u>
Long-term debt, less current portion	<u>\$ 2,876</u>	<u>\$ 5,400</u>

**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 December 31, 2013, Supplies Distributors had \$2.3 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 (see Note 6) 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 December 31, 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 December 31, 2013 was 3.75% for \$3.8

## PFSWEB, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)

million of outstanding borrowings. As of December 31, 2012, the interest rate was 3.75% for \$1.3 million 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, as well as financial covenants, such as a fixed charge coverage ratio and minimum net worth, as defined, and is secured by all of the assets of Supplies Distributors, as well as a collateralized guarantee of PFSweb. Additionally, PFS is required to maintain a Subordinated Note receivable balance from Supplies Distributors of no less than \$3.5 million and may not maintain restricted cash of more than \$5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and 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 December 31, 2013 and 2012, these bank accounts held \$0.1 million and \$0.2 million, respectively, which was restricted for payment to Wells Fargo.

On March 28, 2014, Supplies Distributors amended the Wells Fargo agreement, which extends the termination date through March 2016, reduces the maximum financing from \$25 million to \$12 million and reduces the minimum Subordinate Note balance to \$2.5 million.

#### ***Loan and Security Agreement – PFSweb***

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 provide d for up to \$3.0 million of eligible equipment purchases (“Equipment Advances”) through January 2013, with principal payments due through April 2015. As of December 31, 2013, PFS had \$12.4 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 this Comerica Agreement accrue interest at prime rate plus 2% (5.25% at both December 31, 2013 and 2012), while the Equipment Advances accrue interest at prime rate plus 2.25% (5.5% at both December 31, 2013 and 2012). The Comerica Agreement contains cross default provisions, various restrictions upon PFS’s 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. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc.

On March 31, 2014, PFS amended the Comerica Agreement, which extends the termination date through March 2016, increases the maximum financing amount to \$20.0 million (\$17.0 million during certain non-peak months), provides additional equipment financing opportunities of \$2.0 million and modifies certain financial covenants.

#### ***Factoring Agreement***

Supplies Distributors’ European subsidiary has a factoring agreement with BNP Paribas Fortis Factor (“BNP Paribas”) that provides factoring for up to 7.5 million Euros (approximately \$10.3 million at December 31, 2013) of eligible accounts receivables through March 2014. This factoring agreement is accounted for as a secured borrowing. There were no outstanding borrowings as of December 31, 2013 or 2012. As of December 31, 2013, Supplies Distributors’ European subsidiary had approximately 0.7 million Euros (approximately \$1.0 million) of available credit under this agreement. Borrowings accrue interest at Euribor plus 0.7% (0.9% at December 31, 2013).

Supplies Distributors’ European subsidiary renewed the factoring agreement with BNP Paribas effective March 31, 2014, which extends the termination date through March 2015.

#### ***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 December 31, 2013 or 2012. As of December 31, 2013, Retail Connect had no 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

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

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, as defined. PFSweb has guaranteed all current and future obligations of Retail Connect under this line of credit. Based on current borrowing needs, the Company does not anticipate renewing this credit facility upon its maturity.

***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. At December 31, 2013 and 2012, the Company had restricted net assets of approximately \$26.9 million and \$20.7 million, respectively. As of December 31, 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.

***Debt and Capital Lease Maturities***

The Company’s aggregate maturities of debt subsequent to December 31, 2013 are as follows (in thousands):

Fiscal year ended December 31,		
2014		\$ 6,074
2015		1,022
2016		150
Thereafter		—
Total		\$ 7,246

The following is a schedule of the Company’s future minimum lease payments under the capital leases, together with the present value of the net minimum lease payments as of December 31, 2013 (in thousands):

Fiscal year ended December 31,		
2014		\$ 2,290
2015		1,099
2016		504
2017		141
2018		41
Thereafter		—
Total minimum lease payments		\$ 4,075
Less amount representing interest at rates ranging from 4.5% to 4.75%		(214)
Present value of net minimum lease payments		3,861
Less: Current portion		(2,157)
Long-term capital lease obligations		\$ <u>1,704</u>

## 5. Stock and Stock Options

In May 2013, the Company completed a private placement 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 expense, of approximately \$14.1 million.

### *Preferred Stock Purchase Rights*

On June 8, 2000, and as amended, the Company's Board of Directors declared a dividend distribution of one preferred stock purchase right (a "Right") for each share of the Company's common stock outstanding on July 6, 2000 and each share of common stock issued thereafter. Each Right entitles the registered shareholders to purchase from the Company one one-thousandth of a share of preferred stock at an exercise price of \$314.90, subject to adjustment. The Rights are not currently exercisable, but would become exercisable if certain events occurred relating to a person or group acquiring or attempting to acquire 23 percent or more of the Company's outstanding shares of common stock. The Rights expire on July 6, 2015, unless redeemed, exchanged or extended by the Company.

### *Stock Compensation Plans*

The Company has an Employee Stock and Incentive Plan (the "Employee Plan") and a Non-Employee Director Stock Option and Retainer Plan (the "Director Plan"), each as amended and restated (collectively, the "Plans") under which an aggregate of 4,142,341 shares of common stock have been authorized for issuance. The Plans provide for the granting of incentive awards to directors, executive management, key employees, and outside consultants of the Company in a variety of forms such as the award of an option, stock appreciation right, restricted stock award, restricted stock unit, deferred stock unit, among other stock-based awards. The Company uses newly issued shares of common stock to satisfy awards under the Plans.

From the service inception date to the grant date, the Company recognizes compensation cost for all share-based payments based on the reporting date fair value of the award. After the grant date compensation cost is measured based on the grant date fair value. Depending on the conditions associated with the vesting of the award, compensation cost is recognized on a straight-line or graded basis, net of estimated forfeitures, over the requisite service period of each award.

Total stock-based compensation expense was \$ 2.6 million and \$1.3 million for the years ended December 31, 2013 and 2012, respectively, and was included as a component of selling, general and administrative expenses in the consolidated statements of operations. As of December 31, 2013, there was \$4.2 million of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Plans, which is expected to be recognized over a weighted average period of approximately 2.6 years. This expected cost does not include the impact of any future stock-based compensation awards.

As of December 31, 2013, there were 1,174,674 shares available for future grants under the Plans. Each stock option or stock appreciation right award granted reduces the total shares available for grant by one share, while each award granted other than in the form of a stock option or stock appreciation right reduces the shares available for grant by 1.22 shares.

### *Stock Options*

The rights to purchase shares under employee stock option agreements issued under the Plans typically vest over a three-year period, one-twelfth each quarter. Stock options must be exercised within 10 years from the date of grant. Stock options are generally issued such that the exercise price is equal to the market value of the Company's common stock at the date of grant.

PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)

The following table summarizes stock option activity under the Plans:

	Shares	Price Per Share	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in millions)
Outstanding, December 31, 2012	2,100,184	\$1.01—\$13.91	\$ 4.55		
Granted	310,500	\$4.01—\$7.89	\$ 5.38		
Exercised	(514,149)	\$1.01—\$8.04	\$ 3.63		
Canceled	(77,943)	\$1.46—\$12.08	\$ 5.29		
Outstanding, December 31, 2013	<u>1,818,592</u>	\$1.01—\$13.91	\$ 4.90		
Exercisable, December 31, 2013	<u>1,498,097</u>	\$1.01—\$13.91	\$ 4.82	5.6	\$ 6.7
Exercisable and expected to vest, December 31, 2013	<u>1,788,882</u>	\$1.01—\$13.91	\$ 4.90	6.2	\$ 7.8

The weighted average fair value per share of options granted during the years ended December 31, 2013 and 2012 was \$ 3.72 and \$1.84, respectively. The total intrinsic value of options exercised under the Stock Option Plans was \$1.5 million during the year ended December 31, 2013.

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

	Year Ended December 31, 2013	Year Ended December 31, 2012
Expected dividend yield	—	—
Expected stock price volatility	80% - 82%	82% - 83%
Weighted average stock price volatility	82%	83%
Risk-free interest rate	1.0% - 2.1%	0.9% - 1.1%
Expected life of options (years)	6	6

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock-price volatility. The assumptions listed above represent management’s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Company’s recorded and pro forma stock-based compensation expense could have been different. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the Company’s actual forfeiture rate is materially different from its estimate, the share-based compensation expense could be materially different. The expected life of options has been computed using the simplified method.

*Performance Shares*

On May 22, 2013, pursuant to the Employee Plan, the Company issued Performance-Based Share Awards (“Performance Shares”, as defined in the Employee 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 Company’s 2013 financial results, the aggregate maximum number of Performance Shares that may be issued for 2013 is approximately 598,000. The issuance of the Performance Shares is subject to four year vesting (beginning with fiscal year 2013) based upon continued employment and the comparative market performance (on an annual and cumulative basis) of the Company’s common stock on NASDAQ compared to the Russell Micro Cap Index. The actual number of shares issued on each annual vesting date could range from zero to 100%, depending on satisfaction of the vesting conditions.

The compensation cost for the market condition portion of the Performance Shares was estimated based on a grant date valuation using a Monte-Carlo simulation, which resulted in a range of estimated fair values of \$5.29 - \$ 9.07 for the annual performance market condition and \$7.34 - \$9.07 for the cumulative performance market condition. The estimated fair values used for the Performance Shares were computed assuming a risk-free interest rate of 0.8% and an expected volatility of 52.6%.

As of December 31, 2013, the aggregate intrinsic value of the vested and unvested Performance Shares was \$1.6 million and \$3.8 million, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)

**6. Distributor Agreements**

Supplies Distributors, PFSweb and Ricoh have entered into distributor agreements under which Supplies Distributors acts as a distributor of various products, primarily Ricoh products, and PFSweb provides transaction management and fulfillment services to Supplies Distributors. The distributor agreements are subject to periodic renewals, the next of which is in December 2014. Under the distributor agreements, Ricoh sells product to Supplies Distributors and reimburses Supplies Distributors for certain freight costs, direct costs incurred in passing on any price decreases offered by Ricoh to Supplies Distributors or its customers to cover price protection and certain special bids, the cost of products provided to replace defective product returned by customers and other certain expenses as defined. Supplies Distributors can return to Ricoh product rendered obsolete by Ricoh engineering changes after customer demand ends. Ricoh determines when a product is obsolete. Ricoh and Supplies Distributors also have agreements under which Ricoh reimburses or collects from Supplies Distributors amounts calculated in certain inventory cost adjustments. Supplies Distributors passes through to customers marketing programs specified by Ricoh and administers such programs according to Ricoh guidelines.

**7. Supplies Distributors**

Pursuant to a credit agreement, Supplies Distributors is restricted from making any distributions to PFSweb if, after giving effect thereto, Supplies Distributors' would be in noncompliance with its financial covenants. Under the terms of its amended credit agreements, Supplies Distributors is restricted from paying annual cash dividends without the prior approval of its lenders (see Notes 3 and 4). Supplies Distributors has received lender approval to pay approximately \$ 1.8 million of dividends in 2014. Supplies Distributors paid dividends to PFSweb of \$1.5 million and \$1.0 million in 2013 and 2012, respectively.

**8. Income Taxes**

The consolidated income (loss) from continuing operations before income taxes, by domestic and foreign entities, is as follows (in thousands):

	Year Ended December 31, 2013	Year Ended December 31, 2012
Domestic	\$ (6,043)	\$ (492)
Foreign	691	(375)
Total	<u>\$ (5,352)</u>	<u>\$ (867)</u>

A reconciliation of the difference between the expected income tax expense from continuing operations at the U.S. federal statutory corporate tax rate of 34%, and the Company's effective tax rate is as follows (in thousands):

	Year Ended December 31, 2013	Year Ended December 31, 2012
Income tax benefit computed at statutory rate	\$ (1,820)	\$ (295)
Foreign dividends received	45	171
Items not deductible for tax purposes	41	780
Change in valuation reserve	1,654	1,976
State taxes	367	492
Impact of foreign taxation	94	96
Foreign exchange rate difference	104	(76)
Net operating loss adjustments	(220)	(1,616)
Prior year return-to-provision true-up	567	(665)
Other	(293)	(219)
Provision for income taxes	<u>\$ 539</u>	<u>\$ 644</u>

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

Current and deferred income tax expense (benefit) is summarized as follows (in thousands):

	<b>Year Ended December 31, 2013</b>	<b>Year Ended December 31, 2012</b>
<b>Current</b>		
State	\$ 406	\$ 537
Foreign	104	125
Total current	510	662
<b>Deferred</b>		
State	(107)	—
Foreign	136	(18)
Total deferred	29	(18)
<b>Total</b>	<b>\$ 539</b>	<b>\$ 644</b>

The components of the deferred tax asset (liability) are as follows (in thousands):

	<b>December 31, 2013</b>	<b>December 31, 2012</b>
<b>Deferred tax assets:</b>		
Allowance for doubtful accounts	\$ 616	\$ 639
Inventory reserve	347	630
Accrued expenses	2,104	1,485
Net operating loss carryforwards	20,893	20,617
Other	4,192	3,191
	28,152	26,562
Less — Valuation allowance	26,568	24,914
<b>Total deferred tax asset</b>	<b>1,584</b>	<b>1,648</b>
<b>Deferred tax liabilities:</b>		
Property and equipment	(931)	(1,238)
Other	—	(46)
<b>Total deferred tax liabilities</b>	<b>(931)</b>	<b>(1,284)</b>
<b>Deferred tax assets, net</b>	<b>\$ 653</b>	<b>\$ 364</b>

Management believes that PFSweb has not established a sufficient history of earnings, on a stand-alone basis, to support the more likely than not realization of certain deferred tax assets in excess of existing taxable temporary differences. A valuation allowance has been provided for the majority of these net deferred income tax assets as of December 31, 2013 and 2012. The remaining net deferred tax assets at both December 31, 2013 and 2012 primarily relate to the Company's European operations and certain state tax benefits. At December 31, 2013, net operating loss ("NOL") carryforwards relate to taxable losses of PFSweb's European subsidiary totaling approximately \$0.4 million, PFSweb's Canadian subsidiary totaling approximately \$6.0 million and PFSweb's U.S. subsidiaries totaling approximately \$56.7 million that expire at various dates from 2014 through 2033. The U.S. NOL carryforward includes approximately \$4.9 million relating to tax benefits of stock option exercises and, if utilized, will be recorded against additional paid-in capital upon utilization rather than as an adjustment to income tax expense from continuing operations. The U.S. NOL also includes approximately \$20.3 million of NOL acquired before February 2006, which is subject to annual limits of \$1.2 million and \$16.0 million of NOL created before February 2006 subject to annual limits of \$1.4 million under IRS Section 382.

The Company evaluates its tax positions for potential liabilities associated with unrecognized tax benefits. As of December 31, 2013 and 2012, no unrecognized tax benefits, penalties or interest were identified or recorded. The Company does not expect to record unrecognized tax benefits in the next twelve months .

## **9. Commitments and Contingencies**

The Company leases facilities, warehouse and office space and transportation and other equipment under operating leases expiring in various years through February 28 , 2024. In most cases, management expects that, in the normal course of business, leases will be renewed or replaced by other similar leases. The Company's facility leases generally contain one or more renewal options.

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

Minimum future annual rental payments under non-cancelable operating leases having original terms in excess of one year are as follows (in thousands):

Fiscal year ended December 31,	<b>Operating Lease Payments</b>
2014	\$ 6,281
2015	6,203
2016	5,452
2017	4,510
2018	4,393
Thereafter	18,577
Total	<u>\$ 45,416</u>

Minimum rental payments under operating leases are recognized on a straight-line basis over the term of the lease including any periods of free rent. Any differences between cash rental payments made and straight-line rent expense is recorded as deferred rent on the accompanying consolidated balance sheets. Total rental expense under operating leases approximated \$ 6.6 million and \$6.5 million for the years ended December 31, 2013 and 2012, respectively. Certain landlord required deposits are secured by letters of credit.

In 2012, the Company incurred approximately \$6.0 million of leasehold improvements at certain of its leased facilities that will be amortized over the shorter of the assets lives or the lease terms and were primarily financed via tenant allowances that will also be 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 December 31, 2013, the Company believes it has adequately accrued for the expected assessment.

In April 2010, a sales employee of eCOST.com, Inc. ("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. 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 is seeking the recovery or reimbursement of the funds which are currently classified as other receivables on the December 31, 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.



PFSWEB, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)

10. Segment and Geographic 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.

	Year Ended December 31, 2013	Year Ended December 31, 2012
<b>Revenues (in thousands):</b>		
PFSweb	\$ 152,338	\$ 167,220
Business and Retail Connect	100,960	120,419
Eliminations	(11,695)	(6,076)
	<u>\$ 241,603</u>	<u>\$ 281,563</u>
<b>Income (loss) from operations (in thousands):</b>		
PFSweb	\$ (5,859)	\$ (2,030)
Business and Retail Connect	1,186	2,151
	<u>\$ (4,673)</u>	<u>\$ 121</u>
<b>Depreciation and amortization (in thousands):</b>		
PFSweb	\$ 10,051	\$ 9,147
Business and Retail Connect	159	101
	<u>\$ 10,210</u>	<u>\$ 9,248</u>
<b>Capital expenditures (in thousands):</b>		
PFSweb	\$ 7,876	\$ 14,449
Business and Retail Connect	95	263
	<u>\$ 7,971</u>	<u>\$ 14,712</u>
<b>Assets (in thousands):</b>		
PFSweb	\$ 98,745	\$ 94,940
Business and Retail Connect	47,116	52,648
Eliminations	(13,825)	(14,117)
	<u>\$ 132,036</u>	<u>\$ 133,471</u>

**PFSWEB, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (continued)**

Geographic areas in which the Company operates include the United States, Europe (primarily Belgium), and Canada. The following is geographic information by area. Revenues are attributed based on the Company's domicile.

	<b>Year Ended December 31, 2013</b>	<b>Year Ended December 31, 2012</b>
<b>Revenues (in thousands):</b>		
United States	\$ 192,522	\$ 225,591
Europe	44,770	51,582
Canada	5,988	5,817
Inter-segment eliminations	(1,677)	(1,427)
	<u>\$ 241,603</u>	<u>\$ 281,563</u>
<b>Other long-lived assets (in thousands):</b>		
United States	\$ 25,549	\$ 25,826
Europe	4,168	4,929
Canada	356	448
	<u>\$ 30,073</u>	<u>\$ 31,203</u>

**11. Employee Savings Plan**

The Company has a defined contribution employee savings plan under Section 401(k) of the Internal Revenue Code. Substantially all full-time and part-time U.S. employees are eligible to participate in the plan. The Company, at its discretion, may match employee contributions to the plan and also make an additional matching contribution in the form of profit sharing in recognition of the Company's performance. The Company contributed approximately \$0.2 million during each of the years ended December 31, 2013 and 2012, to match an approved percentage of employee contributions.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. CONTROLS AND PROCEDURES.**

**Evaluation of 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 (the “Exchange Act”). As of December 31, 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 year ended December 31, 2013, there was no change in internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Management’s Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) under the Exchange Act. Our internal control over financial reporting is designed, under the supervision of our principle executive and principle financial officers, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America (GAAP). Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and Board of Directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

We conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2013. This evaluation was based on the framework in “Internal Control—Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 1992. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our Chief Executive Officer and Chief Financial Officer concluded that internal control over financial reporting was effective as of December 31, 2013.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by our independent registered public accounting firm pursuant to the exemption provided to issuers that are not “large accelerated filers” or “accelerated filers” under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

**Item 9B. Other Information**

None.

## PART III

### Item 10. *Directors and Executive Officers and Corporate Governance*

Reference is made to the information to be set forth in the section entitled “Board of Directors” and “Committees of the Board” in the definitive proxy statement in connection with our Annual Meeting of Shareholders (the “Proxy Statement”), which section is incorporated herein by reference. Our Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the last day of our fiscal year ended December 31, 2013.

### Item 11. *Executive Compensation*

Information required by Part III, Item 11, will be included in the section entitled “Executive Compensation” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

### Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

Information required by Part III, Item 12, will be included in the Sections entitled “Election of Directors” and “Security Ownership of Certain Beneficial Owners and Management” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

The following table summarizes information with respect to equity compensation plans under which equity securities of the Company are authorized for issuance as of December 31, 2013:

<u>Plan category (1)</u>	<u>Number of securities to be issued upon exercise of outstanding options</u>	<u>Weighted-average exercise price of outstanding options</u>	<u>Number of securities remaining available for future issuance</u>
Equity compensation plans approved by shareholders	1,818,592	\$ 4.90	1,174,674

(1) See Note 5 to the Consolidated Financial Statements for more detailed information regarding the Company’s equity compensation plans.

### Item 13. *Certain Relationships and Related Transactions and Director Independence*

Information regarding certain of our relationships and related transactions will be included in the section entitled “Certain Relationship and Related Transactions” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

### Item 14. *Principal Accounting Fees and Services*

Information required by Part III, Item 14, will be included in the section entitled “Ratification of Appointment of Independent Auditors” of our Proxy Statement relating to our annual meeting of shareholders and is incorporated herein by reference.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules

(a) *The following documents are filed as part of this report:*

1. *Financial Statements*

PFSweb, Inc. and Subsidiaries

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets  
Consolidated Statements of Operations  
Consolidated Statements of Shareholders' Equity and Comprehensive Loss  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

*Financial Statement Schedules*

Schedule I – Condensed Financial Information of Registrant

Schedule II – Valuation and Qualifying Accounts

All other schedules are omitted because the required information is not present in amounts sufficient to require submission of the schedule or because the information required is included in the financial statements or notes thereto.

2. *Exhibits*

<u>Exhibit Number</u>	<u>Description of Exhibits</u>
3.1 (1)	Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.1.1 (20)	Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.1.2 (32)	Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.
3.1.3 (36)	Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.1.4 (53)	Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.
3.2 (1)	Amended and Restated Bylaws
3.2.1 (26)	Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
3.2.2 (39)	Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
3.2.3 (53)	Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
4.1 (30)	Rights Agreement, dated as of June 8, 2000, between the Company and ChaseMellon Shareholder Services, LLC
4.1 (31)	Amendment No. 1 to Rights Agreement, dated as of May 30, 2008 between the Company and Mellon Investor Services LLC, as successor to ChaseMellon Shareholder Services, L.L.C., as rights agent.
4.1 (38)	Amendment No. 2 to Rights Agreement, dated as of May 24, 2010 between the Company and Mellon Investor Services LLC, as successor to ChaseMellon Shareholder Services, L.L.C., as rights agent.
4.1 (39)	Amendment No. 3 to Rights Agreement, dated as of July 2, 2010 between the Company and Mellon Investor Services LLC, as successor to ChaseMellon Shareholder Services, L.L.C., as rights agent.
4.1 (49)	Amendment No. 4 to Rights Agreement, dated as of May 15, 2013 between the Company and Computershare Shareowner Services LLC (formerly known as Mellon Investor Services LLC,) as successor to ChaseMellon Shareholder Services, L.L.C., as rights agent.
10.1 (18)	Amendment 3 to Loan and Security Agreement.
10.2 (18)	Amendment 6 to Agreement for Inventory Financing.

- 10.3 (18) Amendment 1 to First Amended and Restated Loan and Security Agreement.
- 10.4 (16) Amendment 5 to Amended and Restated Platinum Plan Agreement.
- 10.5 (16) Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.
- 10.6 (16) Amendment No. 5 to Agreement for Inventory Financing.
- 10.7 (1) Industrial Lease Agreement between Shelby Drive Corporation and Priority Fulfillment Services, Inc.
- 10.8 (1) Lease Contract between Transports Weerts and Priority Fulfillment Services Europe B.V.
- 10.9 (2) Form of Change of Control Agreement between the Company and each of its executive officers
- 10.11 (5) Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., Inventory Financing Partners, LLC and IBM Credit Corporation
- 10.12 (5) Amended and Restated Collateralized Guaranty by and between Priority Fulfillment Services, Inc. and IBM Credit Corporation
- 10.13 (5) Amended and Restated Guaranty to IBM Credit Corporation by PFSweb, Inc.
- 10.14 (5) Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors Europe B.V., PFSweb B.V., and IBM Belgium Financial Services S.A.
- 10.15 (5) Amended and Restated Guaranty to IBM Belgium Financial Services S.A. by PFSweb, Inc.
- 10.16 (5) Subordinated Demand Note by and between Supplies Distributors, Inc. and Priority Fulfillment Services, Inc.
- 10.17 (5) Notes Payable Subordination Agreement between Congress Financial Corporation (Southwest) and Priority Fulfillment Services, Inc.
- 10.18 (5) Guarantee in favor of Congress Financial Corporation (Southwest) by Business Supplies Distributors Holdings, LLC, Priority Fulfillment Services, Inc. and PFSweb, Inc.
- 10.19 (5) General Security Agreement by Priority Fulfillment Services, Inc. in favor of Congress Financial Corporation (Southwest).
- 10.20 (5) Inducement Letter by Priority Fulfillment Services, Inc. and PFSweb, Inc. in favor of Congress Financial Corporation (Southwest).
- 10.21 (6) Form of Executive Severance Agreement between the Company and each of its executive officers.
- 10.21.1 (33) Form of Amendment to Executive Severance Agreement.
- 10.21.2 (33) Form of Amendment to Change in Control Severance Agreement.
- 10.21.3 (39) Severance, Nondisclosure, Nonsolicitation and Noncompete Agreement dated July 2, 2010 between the Company and Cynthia Almond.
- 10.22 (7) Amendment to Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., Inventory Financing Partners, LLC and IBM Credit Corporation
- 10.23 (7) Amendment to Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors Europe B.V., PFSweb B.V., and IBM Belgium Financial Services S.A.
- 10.24 (7) Amendment to Factoring agreement dated March 29, 2002 between Supplies Distributors S.A. and Fortis Commercial Finance N.V.
- 10.25 (8) Unconditional Guaranty of PFSweb, Inc. to Comerica Bank – California
- 10.26 (8) Security Agreement of PFSweb, Inc. to Comerica Bank – California

- 10.27 (8) Intellectual Property Security Agreement between Priority Fulfillment Services, Inc. and Comerica Bank – California
- 10.28 (8) Amendment 2 to Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors B.V., PFSweb B.V., and IBM Belgium Financial Services S.A.
- 10.29 (8) Amendment to Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., and IBM Credit LLC
- 10.30 (9) Amendment to factoring agreement dated April 30, 2003 between Supplies Distributors S.A. and Fortis Commercial Finance N.V.
- 10.31 (9) Loan and Security Agreement by and between Congress Financial Corporation (Southwest), as Lender and Supplies Distributors, Inc., as Borrower dated March 29, 2002.
- 10.32 (9) General Security Agreement – Business Supplies Distributors Holdings, LLC in favor of Congress Financial Corporation (Southwest)
- 10.33 (9) Stock Pledge Agreement between Supplies Distributors, Inc. and Congress Financial Corporation (Southwest)
- 10.34 (9) First Amendment to General Security Agreement by Priority Fulfillment Services, Inc. in favor of Congress Financial Corporation (Southwest)
- 10.35 (12) Industrial Lease Agreement between New York Life Insurance Company and Daisytek, Inc.
- 10.36 (12) First Amendment to Industrial Lease Agreement between New York Life Insurance Company, Daisytek, Inc. and Priority Fulfillment Services, Inc.
- 10.37 (12) Second Amendment to Industrial Lease Agreement between ProLogis North Carolina Limited Partnership and Priority Fulfillment Services, Inc.
- 10.38 (12) Modification, Ratification and Extension of Lease between Shelby Drive Corporation and Priority Fulfillment Services, Inc.
- 10.39 (13) Amendment to Agreement for Inventory Financing by and among Business Supplies Distributors Holdings, LLC, Supplies Distributors, Inc., Priority Fulfillment Services, Inc., PFSweb, Inc., and IBM Credit LLC
- 10.40 (13) Amendment 4 to Amended and Restated Platinum Plan Agreement (with Invoice Discounting) by and among Supplies Distributors, S.A., Business Supplies Distributors B.V., PFSweb B.V., and IBM Belgium Financial Services S.A.
- 10.41 (13) First Amendment to Loan and Security Agreement by and between Congress Financial Corporation (Southwest), as Lender and Supplies Distributors, Inc., as Borrower.
- 10.42 (13) Form of Modification to Executive Severance Agreement.
- 10.43 (14) Industrial Lease Agreement by and between Industrial Developments International, Inc. and Priority Fulfillment Services, Inc.
- 10.44 (14) Guaranty by PFSweb, Inc. in favor of Industrial Developments International, Inc.
- 10.45 (15) First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.
- 10.46 (20) Amendment to factoring agreement dated December 12, 2005 between Supplies Distributors S.A. and Fortis Commercial Finance N.V.
- 10.47 (21) Amendment 7 to Agreement for Inventory Financing.
- 10.48 (21) Amendment 6 to Amended and Restated Platinum Plan Agreement.
- 10.49 (21) Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.
- 10.50 (21) Second Amendment to Loan and Security Agreement by and between eCOST.com, Inc. and Wachovia Capital Finance Corporation (Western).
- 10.51 (21) Amendment 4 to Loan and Security Agreement.

- 10.52 (21) Guaranty by PFSweb, Inc., in favor of Wachovia Capital Finance Corporation (Western).
- 10.53 (21) Second Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.
- 10.54 (24) Amendment 8 to Agreement for Inventory Financing.
- 10.55 (24) Fourth Amendment to the Loan and Security Agreement by and between eCOST.com, Inc. and Wachovia Capital Finance Corporation (Western).
- 10.56 (24) Amendment 5 to Loan and Security Agreement.
- 10.57 (24) Amendment 7 to Amended and Restated Platinum Plan Agreement.
- 10.58 (24) Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.
- 10.59 (25) Fifth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.
- 10.60 (27) Second Amendment to Industrial Lease Agreement by and between Industrial Property Fund VI, LLC and Priority Fulfillment Services, Inc.
- 10.61 (29) Amendment 9 to Agreement for Inventory Financing.
- 10.62 (29) Amendment 8 to Amended and Restated Platinum Plan Agreement.
- 10.63 (29) Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.
- 10.64 (29) Sixth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.
- 10.65 (34) Sixth Amendment to Loan and Security Agreement dated January 6, 2009 between Wachovia Bank and Supplies Distributors, Inc.
- 10.66 (34) Fifth Amendment to Loan and Security Agreement dated January 6, 2009 between Wachovia Bank and eCOST.com Inc.
- 10.67 (35) Amendment 10 to Agreement for Inventory Financing.
- 10.68 (35) Amendment 9 to Amended and Restated Platinum Plan Agreement.
- 10.69 (35) Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.
- 10.70 (35) Seventh Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.
- 10.71 (36) Amended and Restated 2005 Employee Stock and Incentive Plan of PFSweb, Inc.
- 10.72 (36) Amended and Restated Non-Employee Director Stock Option and Retainer Plan of PFSweb, Inc.
- 10.73 (37) Eighth Amended and Restated Notes Payable Subordination Agreement by and between Priority Fulfillment Services, Inc., Supplies Distributors, Inc. and IBM Credit Corporation.
- 10.74 (37) Amendment 11 to Agreement for Inventory Financing.
- 10.75 (37) Amendment 10 to Amended and Restated Platinum Plan Agreement.
- 10.76 (37) Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule.
- 10.77 (37) Eighth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment Services, Inc.
- 10.78 (42) Factoring Agreement by and between BNP Paribas Fortis Factor and Supplies Distributors, S.A.
- 10.79 (42) Amendment 12 to Agreement for Inventory Financing



- 10.80 (42) Amendment 11 to Amended and Restated Platinum Plan Agreement
- 10.81 (42) Agreement for IBM Global Financing Platinum Plan Invoice Discounting Schedule
- 10.82 (42) Ninth Amendment to First Amended and Restated Loan and Security Agreement by and between Comerica Bank and Priority Fulfillment services, Inc.
- 10.83 (42) Seventh Amendment to Loan and Security Agreement dated January 6, 2009 between Wells Fargo Bank and Supplies Distributors, Inc.
- 10.84 (43) Seventh Amendment to Loan and Security Agreement dated January 6, 2009 by and between Wells Fargo Bank, National Association and PFSweb Retail Connect, Inc.
- 10.85 (44) Tenth Amendment to First Amended and Restated Loan and Security Agreement dated November 10, 2011 by and between Priority Fulfillment Services, Inc., and Comerica Bank
- 10.86 (45) Lease agreement by and between Binyan Realty LP and Priority Fulfillment Services, Inc.
- 10.87 (45) Lease Guaranty by PFSweb, Inc. in favor of Binyan Realty LP
- 10.88 (45) Lease Agreement dated December 8, 2011, between CCI-Millennium, L.P. and Priority Fulfillment Services, Inc.
- 10.89 (45) Guaranty of PFSweb, Inc. to CCI-Millennium, L.P.
- 10.90 (45) Eleventh Amendment to First Amended and Restated Loan and Security Agreement by and between Priority Fulfillment Services, Inc., and Comerica Bank
- 10.91 (45) Amendment 13 to Agreement for Inventory Financing
- 10.92 (46) Twelfth Amendment to First Amended and Restated Loan and Security Agreement dated May 14, 2012 by and between Priority Fulfillment Services, Inc., and Comerica Bank.
- 10.93 (46) Eighth Amendment to Loan and Security Agreement dated January 6, 2009 by and between Wells Fargo Bank, National Association and PFSweb Retail Connect, Inc.
- 10.94 (46) Fourteenth Amendment to First Amended and Restated Loan and Security Agreement between Priority Fulfillment Services, Inc. and Comerica Bank.
- 10.95 (48) Amendment to Executive Severance Agreement dated March 26, 2013 between PFSweb, Inc., and Mark Layton.
- 10.96 (49) Securities Purchase Agreement dated May 15, 2013 between the Company and transcocosmos, inc.
- 10.97 (49) Registration Rights Agreement dated May 15, 2013 between the Company and transcocosmos, inc.
- 10.98 (50) First Amendment to Industrial Lease Agreement dated May 7, 2013 by and between US Industrial REIT II and Priority Fulfillment Services, Inc.
- 10.99 (51) Agreement, dated as of May 15, 2013, by and among PFSweb, Inc. and Privet Fund LP, Privet Fund Management LLC, Ryan Levenson and Benjamin Rosenzweig.
- 10.100 (52) Form of Performance-Based Cash Award Agreement.
- 10.101 (52) Form of Performance Shares Award Agreement.
- 10.102 (54) Ninth Amendment to Loan and Security Agreement dated May 31, 2013, by and between Wells Fargo Bank, National Association and PFSweb Retail Connect, Inc.
- 10.103 (55) Modification, Ratification and Extension of Lease dated February 28, 2014 between Southpark Distribution Center Inc., (successor-in-interest to Shelby Drive Corporation) and Priority Fulfillment Services, Inc.
- 21 (55) Subsidiary Listing
- 23.1 (55) Consent of GRANT THORNTON, LLP, Independent Registered Public Accounting Firm
- 31.1 (55) Certifications of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350
- 31.2 (55) Certifications of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350

32.1 (55)	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS (55)	XBRL Instance Document.
101.SCH (55)	XBRL Taxonomy Extension Schema.
101.CAL (55)	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF (55)	XBRL Taxonomy Extension Definition Linkbase.
101.LAB (55)	XBRL Taxonomy Extension Label Linkbase.
101.PRE (55)	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 March 31, 2001
- (3) Incorporated by reference from PFSweb, Inc. Form 10-Q/A for the quarterly period ended September 30, 2001
- (4) Incorporated by reference from PFSweb, Inc. Form 10-K for the transition period ended December 31, 2001
- (5) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2002
- (6) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended June 30, 2002
- (7) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2002
- (8) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2003
- (9) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended June 30, 2003
- (10) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended September 30, 2003
- (11) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on November 10, 2003
- (12) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2003
- (13) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2004
- (14) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended September 30, 2004
- (15) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2004.
- (16) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2005.
- (17) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 14, 2005.
- (18) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended June 30, 2005.
- (19) Incorporated by reference from PFSweb, Inc. Current Report on Form 8-K filed on November 30, 2005.
- (20) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2005.
- (21) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2006.
- (22) Incorporated by reference from PFSweb, Inc. Current Report on Form 8-K filed on June 2, 2006.
- (23) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended September 30, 2006.
- (24) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2006.
- (25) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2007.
- (26) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on November 13, 2007.
- (27) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2007.
- (28) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 2, 2008.
- (29) Incorporated by reference from PFSweb, Inc. Form 10-Q for the quarterly period ended March 31, 2008.
- (30) Incorporated by reference from PFSweb, Inc. Registration Statement on Form 8-A filed on June 14, 2000.
- (31) Incorporated by reference from PFSweb, Inc. Report on Form 8K filed on May 30, 2008.
- (32) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 2, 2008.
- (33) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on January 6, 2009.
- (34) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on January 9, 2009.
- (35) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 15, 2009.
- (36) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 14, 2009.
- (37) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 17, 2010.
- (38) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 25, 2010.
- (39) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 2, 2010.
- (40) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on February 23, 2011.
- (41) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2010.
- (42) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 16, 2011
- (43) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 15, 2011.
- (44) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on November 14, 2011.
- (45) Incorporated by reference from PFSweb, Inc. Form 10-K for the year ended December 31, 2011.
- (46) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 15, 2012.
- (47) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on November 14, 2012.

- (48) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on March 29, 2013.
- (49) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 15, 2013.
- (50) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on May 15, 2013.
- (51) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 20, 2013.
- (52) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on May 29, 2013.
- (53) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 18, 2013.
- (54) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 14, 2013.
- ( 55 ) Filed herewith.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**BALANCE SHEETS – PARENT COMPANY ONLY**  
(In thousands)

	December 31, 2013	December 31, 2012
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 10,722	\$ 5,408
Receivable from subsidiaries.	25,252	14,418
Investment in subsidiaries	4,951	8,225
Total assets	<u>\$ 40,925</u>	<u>\$ 28,051</u>
<b>LIABILITIES:</b>		
Total liabilities	<u>\$ —</u>	<u>\$ —</u>
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock	—	—
Common stock	17	13
Additional paid-in capital	124,522	106,018
Accumulated deficit	(85,300)	(79,409)
Accumulated other comprehensive income	1,811	1,554
Treasury stock	(125)	(125)
Total shareholders' equity	<u>40,925</u>	<u>28,051</u>
Total liabilities and shareholders' equity	<u>\$ 40,925</u>	<u>\$ 28,051</u>

The condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**STATEMENTS OF OPERATIONS – PARENT COMPANY ONLY**  
**FOR THE YEARS ENDED DECEMBER 31**  
**(In thousands)**

	<u>2013</u>	<u>2012</u>
EQUITY IN NET LOSS OF CONSOLIDATED SUBSIDIARIES	\$ (5,891)	\$ (1,511)
NET LOSS	<u>\$ (5,891)</u>	<u>\$ (1,511)</u>

The condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto.

**PFSWEB, INC. AND SUBSIDIARIES**  
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**STATEMENTS OF CASH FLOWS – PARENT COMPANY ONLY**  
**FOR THE YEARS ENDED DECEMBER 31**  
(In thousands)

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (5,891)	\$ (1,511)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in net loss of consolidated subsidiaries	5,891	1,511
Net cash provided by operating activities	<u>—</u>	<u>—</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	15,934	48
Purchase of treasury stock	—	(40)
Increase in receivable from subsidiaries, net	(10,620)	(476)
Net cash provided by (used in) financing activities	<u>5,314</u>	<u>(468)</u>
<b>NET INCREASE (DECREASE) IN CASH</b>	<u>5,314</u>	<u>(468)</u>
CASH AND CASH EQUIVALENTS, beginning of period	5,408	5,876
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 10,722</u>	<u>\$ 5,408</u>

The condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto.

**PFSWEB, INC. AND SUBSIDIARIES**  
**VALUATION AND QUALIFYING ACCOUNTS**  
**FOR THE YEARS ENDED DECEMBER 31**  
(Amounts in thousands)

	Balance at Beginning of Period	Additions		Deductions	Balance at End of Period
		Charges to Cost and Expenses	Charges to Other Accounts		
Year Ended December 31, 2012:					
Allowance for doubtful accounts	\$ 663	(131)	—	(82)	\$ 450
Year Ended December 31, 2013:					
Allowance for doubtful accounts	\$ 450	(25)	—	(43)	\$ 382

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/Michael Willoughby</u> Michael Willoughby	Chief Executive Officer (Principal Executive Officer)	March 31, 2014
<u>/s/Thomas J. Madden</u> Thomas J. Madden	Executive Vice President and Chief Financial and Accounting Officer (Principal Financial and Accounting Officer)	March 31, 2014
<u>/s/James F. Reilly</u> James F. Reilly	Chairman of the Board	March 31, 2014
<u>/s/Neil Jacobs</u> Dr. Neil Jacobs	Director	March 31, 2014
<u>/s/David I. Beatson</u> David I. Beatson	Director	March 31, 2014
<u>/s/Benjamin Rosenzweig</u> Benjamin Rosenzweig	Director	March 31, 2014
<u>/s/Shinichi Nagakura</u> Shinichi Nagakura	Director	March 31, 2014



### THIRD MODIFICATION, RATIFICATION AND EXTENSION OF LEASE

THIS THIRD MODIFICATION, RATIFICATION AND EXTENSION OF LEASE (the “Third Amendment”) is made as of the 28th day of February, 2014, by and between SOUTHPARK DISTRIBUTION CENTER, INC., a Maryland corporation, as successor-in-interest to TIAA Realty, Inc., a Delaware corporation, as successor-in-interest to Shelby Drive Corporation, a Florida corporation (“Landlord”), and PRIORITY FULFILLMENT SERVICES, INC. , a Delaware corporation (“Tenant”).

WHEREAS, Landlord and Tenant entered into that certain Industrial Lease Agreement dated August 31, 1999, (the “Base Lease”) as modified, ratified and extended by that certain Modification, Ratification and Extension of Lease dated December 19, 2003 (the “First Amendment”) and by that certain Second Modification, Ratification and Extension of Lease dated June 3, 2008 (the “Second Amendment, and collectively with the Base Lease and the First Amendment, the “Lease”), regarding the leasing by Landlord to Tenant of approximately 442,184 square feet comprising all of the building space located at 4650 Shelby Drive, Memphis, Tennessee, also known as Southpark Building N (the “Demised Premises”); and

WHEREAS, Landlord and Tenant now desire to further modify, ratify and extend the Lease on the terms and conditions set forth below.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the undersigned hereby agree to modify, ratify and extend the Lease as follows:

1. Modification of Base Rent. Effective as of March 1, 2014, paragraphs 1(d) and 1(e) of the Base Lease are hereby deleted in their entirety and replaced with the following:

(d) Annual Base Rent:

<u>Period</u>	<u>Rate Per Square Foot</u>	<u>Annual Base Rent</u>
March 1, 2014 - June 30, 2014	<b>Free Rent</b>	<b>Free Rent</b>
July 1, 2014 - February 28, 2015	\$ 2.75	\$ 810,670.67 <sup>1</sup>
March 1, 2015 - February 29, 2016	\$ 2.801	\$ 1,238,502.11
March 1, 2016 - February 28, 2017	\$ 2.853	\$ 1,261,414.40
March 1, 2017 - February 28, 2018	\$ 2.905	\$ 1,284,750.57
March 1, 2018 - February 28, 2019	\$ 2.959	\$ 1,308,518.45
March 1, 2019 - February 29, 2020	\$ 3.014	\$ 1,332,726.04
March 1, 2020 - February 28, 2021	\$ 3.070	\$ 1,357,381.48
March 1, 2021 - February 28, 2022	\$ 3.127	\$ 1,382,493.03
March 1, 2022 - February 28, 2023	\$ 3.184	\$ 1,408,069.15
March 1, 2023 - February 29, 2024	\$ 3.243	\$ 1,434,118.43

<sup>1</sup> As prorated for the partial year from July 1, 2014 through February 28, 2015.

(e) Monthly Base Rent Installments:

<u>Period</u>	<u>Monthly Base Rent</u>
March 1, 2014 - June 30, 2014	<b>Free Rent</b>
July 1, 2014 - February 28, 2015	\$ 101,333.83
March 1, 2015 - February 29, 2016	\$ 103,208.51
March 1, 2016 - February 28, 2017	\$ 105,117.87
March 1, 2017 - February 28, 2018	\$ 107,062.55
March 1, 2018 - February 28, 2019	\$ 109,043.20
March 1, 2019 - February 29, 2020	\$ 111,060.50
March 1, 2020 - February 28, 2021	\$ 113,115.12
March 1, 2021 - February 28, 2022	\$ 115,207.75
March 1, 2022 - February 28, 2023	\$ 117,339.10
March 1, 2023 - February 29, 2024	\$ 119,509.87

2. Extension of Term. Paragraph 1(h) and 1(i) of the Base Lease are hereby deleted in their entirety and replaced with the following:

- (h) Expiration Date: February 29, 2024
- (i) Term: 24 years and 6 months (294 months)

3. Address for Notice. Paragraph 1(m) of the Base Lease is hereby deleted in its entirety and replaced with the following:

- (m) Address for notice:
  - Landlord Southpark Distribution Center, Inc.  
3090 Olive Street  
Suite 300  
Dallas, Texas 75219  
Attn: Toby Rogers
  - Tenant Priority Fulfillment Services, Inc.  
505 Millennium Drive  
Allen, TX 5013  
Attn: Chief Financial Officer

4. Address for Rental Payments. Paragraph 1(n) of the Base Lease is hereby deleted in its entirety and replaced with the following:

- (n) Address for rental payments:
  - Southpark Distribution Center, Inc.  
3090 Olive Street  
Suite 300  
Dallas, Texas 75219

5. Assignment and Subleasing.

- (i) The following is hereby added to the first sentence of Section 29 of the Base Lease:

provided, however, that Landlord's prior express written consent shall not be required, and there shall be no splitting of profits, in connection with an assignment of the Lease or a sublease of all or any portion of the Leased Premises to a parent, subsidiary or affiliate of Tenant.

- (ii) The following is hereby added to the end of Section 29 of the Base Lease:

Any excess rents resulting from a sublease, after first deducting brokerage, advertising, subtenant improvement allowances, costs of improvements made on behalf of the subtenant, sublease rent abatements and credits, and other costs and expenses of the sublease transaction, shall be shared equally between Landlord and Tenant.

6. Termination Options. Tenant has not exercised any previous options to terminate under the Lease and any previous termination options under the Lease are expired. The following is hereby added as Section 41 to the Base Lease:

(a) Effective as of June 30, 2020, Tenant shall have a right to terminate the Lease, provided that Tenant delivers to Landlord no later than June 30, 2019: (i) written notice of termination; and (ii) payment of one half of the termination fee equal to \$385,942. The remaining half of the termination fee equal to \$385,942 shall be due January 1, 2020.

(b) Effective as of June 30, 2021, Tenant shall have a right to terminate the Lease, provided that Tenant delivers to Landlord no later than June 30, 2020: (i) written notice of termination; and (ii) payment of one half of the termination fee equal to \$298,553. The remaining half of the termination fee equal to \$298,553 shall be due January 1, 2021.

(c) Effective as of June 30, 2022, Tenant shall have a right to terminate the Lease, provided that Tenant delivers to Landlord no later than June 30, 2021: (i) written notice of termination; and (ii) payment of one half of the termination fee equal to \$203,910. The remaining half of the termination fee equal to \$203,910 shall be due January 1, 2022.

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(d) Effective as of June 30, 2023, Tenant shall have a right to terminate the Lease, provided that Tenant delivers to Landlord no later than June 30, 2022: (i) written notice of termination; and (ii) payment of one half of the termination fee equal to \$101,412. The remaining half of the termination fee equal to \$101,412 shall be due January 1, 2023.

7. Tenant's Work. The following shall be added as Section 42 of the Base Lease:

42. Tenant's Work. The parties acknowledge and agree that certain improvements will be made to the Demised Premises in accordance with the terms and provisions of Exhibit G, attached hereto and incorporated herein.

8. Renewal Option Special Stipulation.

(i) The first sentence of paragraph 10(a) of Exhibit C to the Base Lease is hereby deleted in its entirety and replaced with the following:

(a) Landlord hereby grants to Tenant one (1) option to extend the Term for a period of five (5) years, such option to be exercised by Tenant giving written notice of its exercise to Landlord in the manner provided in this Lease on or before the later of March 1, 2023 or the date that is twelve (12) months prior to the expiration date of the Term, as it may have been previously extended.

(ii) The first sentence of paragraph 10(b) of Exhibit C to the Base Lease is hereby deleted in its entirety and replaced with the following:

(b) If Tenant exercises its option to extend the Term, Landlord shall, within thirty (30) days after the receipt of Tenant's notice of exercise, notify Tenant in writing of Landlord's reasonable determination of the Base Rent for the Demised Premises, which amount shall be the then-prevailing market rental rate for comparable properties, determined by Landlord taking into account all relevant factors for space of this type in the southeast Memphis, Tennessee area.

(iii) The following provision is hereby added to the end of paragraph 10(b) of Exhibit C to the Base Lease:

Notwithstanding anything herein to the contrary, if within such thirty (30) day period Tenant shall deliver notice ("Tenant's Arbitration Notice") to Landlord that Tenant desires to arbitrate the Base Rent for the Demised Premises during the option term, then Tenant shall have no right to retract its exercise of the renewal option and the Base Rent for the Renewal Term shall be determined in accordance with the following provisions:

- (i) Within thirty (30) days of Tenant's delivery of Tenant's Arbitration Notice to Landlord (such 30 day period, the "Arbitrator Designation Period"), each party shall deliver notice to the other designating an appraiser or real estate broker with at least ten (10) years of experience valuing or leasing properties comparable to the Building in the Memphis metropolitan area as the designating party's arbitrator.
  - (ii) If only one party shall deliver notice designating its arbitrator within the Arbitrator Designation Period, the determination by such arbitrator of the fair market rent for the Demised Premises during the option term shall be conclusive and binding upon the parties.
  - (iii) If both parties shall timely designate an arbitrator within the Arbitrator Designation Period, the two arbitrators shall meet and confer and agree upon the third arbitrator for determining the Base Rent. If the two arbitrators shall be unable to reach agreement upon the third arbitrator within twenty (20) days of the expiration of the Arbitrator Designation Period, either party may contact the nearest office of the American Arbitration Association (the "Association") and request that the Association pick an independent arbitrator with qualifications satisfying the requirements set forth in clause (i) above. Upon the Association's designation of such arbitrator, such arbitrator shall be deemed to be the third arbitrator for purposes of this paragraph 10(b). Landlord and Tenant shall split evenly the fees and expenses of the Association in selecting the third arbitrator and shall each pay their own costs and expenses of working with the Association in connection with such selection.
  - (iv) Upon such date as shall be designated by the third arbitrator by written notice to Landlord and Tenant (which date shall be no sooner than ten (10) business days of the delivery of such notice), Tenant's arbitrator and Landlord's arbitrator each shall submit to the third arbitrator its written determination
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of the fair market rent for the Demised Premises for the option term. If only one party's arbitrator shall submit such a written determination by the date designated by the third arbitrator, such party's arbitrator's determination of the fair market rent shall be conclusive and binding upon the parties and shall be the Base Rent during the option term. If both parties' arbitrators shall timely deliver their written determinations of the fair market rent for the Demised Premises to the third arbitrator, the third arbitrator shall select the determination which is closest to the third arbitrator's own determination of the fair market rent for the Demised Premises during the option term, and such determination shall be the Base Rent for the Demised Premises during the option term. The third arbitrator must select one of the two submitted determinations; it may not select its own determination. The third arbitrator shall provide notice of its selection to Landlord and Tenant within ten (10) business days of its receipt of the last of the arbitrators' determinations. Landlord and Tenant shall split evenly the fees and expenses of the third arbitrator and shall each pay its own costs and expenses of participating in the determination of the Base Rent for the option term.

9. Sublease Special Stipulation. Section 11 of Exhibit C to the Base Lease is hereby deleted in its entirety and replaced with the following:

11. Intentionally Omitted

10. PILOT Program. Section 12 of Exhibit C to the Base Lease is hereby deleted in its entirety and replaced with the following:

12. Intentionally Omitted

11. SNDA. Promptly following the final execution and delivery of this Third Amendment, Landlord shall deliver to Tenant at least two (2) original counterparts of the Subordination, Non-Disturbance and Attornment Agreement annexed hereto as Lease Exhibit H (the "SNDA") executed (and notarized as required) by Landlord. Pursuant to paragraph 24 of the Base Lease, Landlord shall use reasonable efforts to cause its lender to enter into the SNDA, and, upon complete execution by all parties of the SNDA, Landlord shall promptly record the SNDA with the Shelby County Register of Deeds.

12. ADA / Code Compliance Special Stipulation. Section 15 of Exhibit C to the Base Lease is hereby added as follows:

15. ADA / Code Compliance. Except for the Tenant-provided items set forth in the following paragraph, Landlord at its sole cost and expense shall perform such alterations and improvements to the Demised Premises and the Building Appurtenance Area so that upon the substantial completion of the Work (as defined in Exhibit G to this Lease) the Demised Premises shall comply with the requirements of the Americans with Disabilities Act of 1990 ("ADA"), 42 U.S.C. § 12101 et seq., and any applicable local codes. After the substantial completion of the Work, Tenant shall be responsible for compliance with ADA and any applicable local codes.

Tenant shall be responsible for providing certain consumable items (e.g. fire extinguishers) and for providing certain tenant-specific items, including, but not limited to, voice/data wiring, security systems, any required exit-path lighting or fire alarm modifications associated with Tenant's materials storage or racking equipment, and re-keying all locks on the Demised Premises after completion of the Work.

13. Broker. Landlord and Tenant each represents and warrants to the other that it has dealt with no broker, finder or other person entitled to receive a commission, finder's fee or other like compensation in connection with this Third Amendment other than for Commercial Advisors, LLC (the "Broker"). Landlord shall pay the Broker any commission and other compensation due the Broker in connection with this Third Amendment pursuant to a separate written agreement. Landlord and Tenant each agree to indemnify, defend and hold harmless the other against any liability, demand, claim, action, cause of action, loss, damage, cost and/or expenses resulting from or relating to its breach of any its representations, warranties and/or covenants set forth in this Paragraph 13.

14. Surrender. Notwithstanding anything in Paragraph 18 of the Base Lease, or any other provision of the Lease, to the contrary, Tenant shall have no obligation to remove any of the Work upon Tenant's surrender of possession of the Leased Premises or upon the sooner expiration or termination of the Term of the Lease. In addition and supplementing Paragraph 13 of the First Amendment, Landlord and Tenant acknowledge and agree that the Starter fixtures or improvements include the tri-level "blue rack" bolted to the Building and the conveyor equipment servicing and/or located therein.

15. Counterparts. This Third Amendment may be executed in one or more counterparts, each of which shall be deemed an original, and all such counterparts together shall constitute one and the same agreement.

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16. Governing Law. This Third Amendment shall be governed by and construed in accordance with the laws of the State of Tennessee.

17. Full Force and Effect; Defined Terms. Except as expressly modified hereby, the Lease is and shall remain in full force and effect in accordance with its original terms and conditions; provided, however, that to the extent that any terms and conditions of the Lease conflict or are inconsistent with the terms and provisions hereof, this Third Amendment shall control and govern. All capitalized terms used but not otherwise defined in this Third Amendment shall have the definitions set forth in the Lease.

18. Binding Effect. This Third Amendment shall be binding upon and inure to the benefit of the parties hereto, their successors and assigns.

[Remainder of Page Intentionally Left Blank –  
Signatures on Following Page(s)]

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IN WITNESS WHEREOF, the parties hereto have executed this Third Amendment (or caused it to be executed by their respective duly authorized officers) to be effective on the date and year first above written.

**SOUTHPARK DISTRIBUTION CENTER,  
INC.,** a Maryland corporation

By: \_\_\_\_\_

Title: \_\_\_\_\_

**PRIORITY FULFILLMENT SERVICES,  
INC .,** a Delaware corporation

By: \_\_\_\_\_

Title: \_\_\_\_\_

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**EXHIBIT G to the Base Lease**

**Tenant Improvements; Allowance**

**Acceptance of Premises.** Except as set forth in this Exhibit G, Tenant accepts the Demised Premises in their “**AS-IS**” condition on the Commencement Date.

1. Space Plans.

Preparation and Delivery. By March 30, 2014, Tenant shall meet with a design consultant selected by Landlord (the “Architect”) to discuss the nature and extent of all improvements that Tenant proposes to install in the Demised Premises and, at such meeting, provide the Architect with all necessary data and information concerning Tenant’s proposed improvements that are requested by the Architect sufficiently in advance of the meeting for Tenant to have them available without incurring overtime fees and costs. Tenant further shall provide the Architect after such meeting with any such data and information requested by the Architect at or after the meeting. On or before April 30, 2014, Landlord shall deliver to Tenant a space plan prepared by the Architect depicting improvements to be installed in the Demised Premises (the “Space Plans”). Concurrent with the delivery of the Space Plans to Tenant, Landlord shall deliver an estimate of the Construction Costs. Furthermore, every time Landlord delivers a revision of the Space Plans, as outlined below, Landlord shall deliver a Construction Cost Estimate with those plans. Such Architect’s fees shall be included in the Total Construction Costs (defined below).

Approval Process. Tenant shall notify Landlord whether it approves of the submitted Space Plans within ten (10) business days after Landlord’s submission thereof. If Tenant disapproves of such Space Plans, then Tenant shall notify Landlord thereof specifying in reasonable detail the reasons for such disapproval, in which case Landlord shall, within fifteen (15) business days after such notice, revise such Space Plans in accordance with Tenant’s objections and submit the revised Space Plans to Tenant for its review and approval. Tenant shall notify Landlord in writing whether it approves of the resubmitted Space Plans within five (5) business days after Tenant’s receipt thereof. This process shall be repeated until the Space Plans have been finally approved by Tenant and Landlord. If Tenant fails to notify Landlord that it disapproves of the initial Space Plans within ten (10) business days (or, in the case of resubmitted Space Plans, within five (5) business days) after the submission thereof, then Tenant shall be deemed to have approved the Space Plans in question.

**Working Drawings.**

Preparation and Delivery. On or before the date which is fifteen (15) business days following the date on which the Space Plans are approved (or deemed approved) by Tenant and Landlord, Landlord shall cause to be prepared final working drawings of all improvements to be installed in the Demised Premises and deliver the same to Tenant for its review and approval (which approval shall not be unreasonably withheld, delayed or conditioned). Such working drawings shall be prepared by a design consultant selected by Landlord and reasonably acceptable to Tenant, and such design consultant’s reasonable fees shall be included in the Total Construction Costs (defined below).

Approval Process. Tenant shall notify Landlord whether it approves of the submitted working drawings within five (5) business days after Landlord’s submission thereof. If Tenant disapproves of such working drawings, then Tenant shall notify Landlord thereof specifying in reasonable detail the reasons for such disapproval, in which case Landlord shall, within five (5) business days after such notice, revise such working drawings in accordance with Tenant’s objections and submit the revised working drawings to Tenant for its review and approval. Tenant shall notify Landlord in writing whether it approves of the resubmitted working drawings within five (5) business days after its receipt thereof. This process shall be repeated until the working drawings have been finally approved by Landlord and Tenant. If Tenant fails to notify Landlord that it disapproves of the initial working drawings within five (5) business days (or, in the case of resubmitted working drawings, within five (5) business days) after the submission thereof, then Tenant shall be deemed to have approved the working drawings in question.

**Landlord's Approval; Performance of Work.** If any of Tenant's proposed construction work will affect the Building's structure or the Building's systems, then the working drawings pertaining thereto must be approved by the Landlord. Landlord's approval of such working drawings shall not be unreasonably withheld, provided that (a) they comply with all Laws (defined below), (b) the improvements depicted thereon do not adversely affect (in the reasonable discretion of Landlord) the Building's structure or the Building's systems (including the Building's restrooms or mechanical rooms), the exterior appearance of the Building, or the appearance of the Building's common areas or elevator lobby areas, and (c) such working drawings are sufficiently detailed to allow construction of the improvements in a good and workmanlike manner. As used herein, "Working Drawings" shall mean the final working drawings approved by Landlord, as amended from time to time by any approved changes thereto, and "Work" shall mean all improvements to be constructed in accordance with and as indicated on the Working Drawings, together with any work required by governmental authorities to be made to other areas of the Building as a result of the improvements indicated by the Working Drawings. Landlord's approval of the Working Drawings shall not be a representation or warranty of Landlord that such drawings are adequate for any use or comply with any Law, but shall merely be the consent of Landlord thereto. Tenant shall, at Landlord's request, sign the Working Drawings to evidence its review and approval thereof. After the Working Drawings have been approved, Landlord shall cause the Work to be performed in accordance with the Working Drawings and in such a manner as shall not unreasonably interfere with Tenant's normal business operations in the Demised Premises. Landlord acknowledges that Tenant will continue to conduct its normal business operations in the Demised Premises while the Work is being performed and that, subject to Tenant's payment of any overtime costs and expenses which are in excess of the Construction Allowance, Landlord will consult with Tenant concerning the performance of the Work and shall perform the Work at such times as Tenant may reasonably require. Tenant acknowledges that performing the Work upon the schedule and according to the criteria listed above may require Landlord to incur additional, non-customary costs and expenses (such as overtime costs, etc.) and all such costs and expenses shall either be paid by Landlord under the Construction Allowance or by Tenant to the extent such costs and expenses exceed the Construction Allowance.

**Costs of Work.** Prior to commencing the Work, Landlord shall obtain an estimate from the Contractor (as defined herein) for the Work (the "Estimate") and deliver same to Tenant. If the estimated Total Construction Costs (as defined herein) are expected to exceed the Construction Allowance (as defined herein), Tenant shall notify Landlord of (i) any items in the Working Drawings that Tenant desires to change and/or (ii) any of the Work for which Tenant requires that Landlord solicit additional bids, within five (5) business days after Landlord's submission thereof to Tenant. If Tenant fails to notify Landlord of its election within such five (5) business day period, Tenant shall be deemed to have approved the Estimate. Within ten (10) business days following Landlord's submission to Tenant of the Estimate, Tenant shall have completed all of the following items: (a) finalized with the Landlord the pricing of any requested revisions to the Estimate for the Work, and (b) approved in writing any overage in the Total Construction Costs in excess of the Construction Allowance. Tenant shall have the right upon request to review all bids submitted for the Work and any general contractor(s) retained in connection with the Work shall be retained on a cost-plus basis.

**Change Orders.** Tenant may initiate changes in the Work. Each such change must receive the prior written approval of Landlord, such approval not to be unreasonably withheld, conditioned or delayed; however, if such requested change would adversely affect (in the reasonable discretion of Landlord) (1) the Building's structure or the Building's systems (including the Building's restrooms or mechanical rooms), (2) the exterior appearance of the Building, or (3) the appearance of the Building's common areas, Landlord may withhold consent in its sole and absolute discretion. If Tenant requests any changes to the Work described in the Space Plans or the Working Drawings, then such increased costs and any additional design costs incurred in connection therewith as the result of any such change shall be added to the Total Construction Costs.

**Definitions.** As used herein "Substantial Completion," "Substantially Completed," and any derivations thereof mean the Work in the Demised Premises is substantially completed (as reasonably determined by Landlord) in substantial accordance with the Working Drawings. Substantial Completion shall have occurred even though minor details of construction, decoration, landscaping and mechanical adjustments remain to be completed by Landlord so long as such incompleteness shall not interfere with Tenant's use and enjoyment of the Leased Premises other than to a de minimis extent. As used herein, "Law" or "Laws" shall mean and refer to all federal, state and local laws, ordinances, rules and regulations, all court orders, governmental directives and governmental orders.

**Walk-Through; Punchlist.** When Landlord considers the Work in the Demised Premises to be Substantially Completed, Landlord will notify Tenant and within three (3) business days thereafter, Landlord's representative and Tenant's representative shall conduct a walk-through of the Demised Premises and identify any necessary touch-up work, repairs and minor completion items that are necessary for final completion of the Work. Neither Landlord's representative nor Tenant's representative shall unreasonably withhold his or her agreement on punchlist items. Landlord shall use reasonable efforts to cause the Contractor performing the Work to complete all punchlist items within thirty (30) calendar days after agreement thereon.



**Excess Costs** . The entire cost of performing the Work (including design of the Work and preparation of the Space Plans and Working Drawings, costs of construction labor and materials, electrical usage during construction, additional janitorial services, general tenant signage, and related taxes and insurance costs, all of which costs are herein collectively called the "Total Construction Costs") in excess of the Construction Allowance (hereinafter defined) shall be paid by Tenant (the "Tenant Improvement Overage"). Upon approval of the Working Drawings, Tenant shall promptly execute a work order agreement prepared by Landlord and reasonably acceptable to Tenant which identifies such drawings and itemizes the Total Construction Costs, sets forth the Construction Allowance and calculates the Tenant Improvement Overage due from Tenant to Landlord. In addition, if the Tenant Improvement Overage is calculated to be more than fifty thousand dollars (\$50,000), Tenant shall pay to the Landlord, upon approval of the Working Drawings, 45% of the total Tenant Improvement Overage. Within thirty (30) calendar days of Substantial Completion of the Work, Tenant shall pay to Landlord the remaining balance of the Tenant Improvement Overage (as adjusted for any approved changes to the Work) less retainage of ten (10%) of the aggregate amount of the Tenant Improvement Overage. Upon the final completion of all punchlist items, Tenant shall promptly (but in no event more than thirty (30) days after Tenant receives notice of such final completion) pay such retainage to Landlord. In the event of default of payment of the Tenant Improvement Overage, Landlord (in addition to all other remedies) shall have the same rights as for an Event of Default under the Lease.

**Construction Allowance** . Landlord shall provide to Tenant a construction allowance not to exceed Two Million Dollars (\$2,000,000) (the "Construction Allowance") to be applied toward the Total Construction Costs, as adjusted for any changes to the Work. The Construction Allowance shall not be disbursed to Tenant in cash, but shall be applied by Landlord to the payment of the Total Construction Costs, if, as, and when the cost of the Work is actually incurred and paid by Landlord. As to any remaining Construction Allowance balance, on or before October 31, 2014, Tenant must (i) approve in writing the total costs for and scope of any remaining Work and (ii) pay to Landlord any applicable Tenant Improvement Overage, and, if such items (i) and (ii) are not completed by Tenant by October 31, 2014, Tenant shall forfeit any remaining Construction Allowance. The approval in item (i) above shall include, without limitation, Tenant's written approval of (or Tenant being deemed to have approved pursuant to the terms hereof) the Space Plans, Working Drawings (including execution of a work order agreement), Estimate and, as applicable, any overage in the Total Construction Costs in excess of the Construction Allowance.

**Construction Management** . Landlord or its agent shall supervise the Work, make disbursements required to be made to the contractor, and act as a liaison between the Contractor and Tenant and coordinate the relationship between the Work, the Building and the Building's systems. In consideration for Landlord's construction supervision services, Tenant shall pay to Landlord a construction supervision fee equal to two percent (2%) of the Total Construction Costs, which supervision fee shall be deducted from the Construction Allowance.

**Warranty** . Tenant shall receive a minimum one-year warranty for all work performed pursuant to this Exhibit G, with such warranty beginning on the date of Substantial Completion. Certain items and materials that are installed as part of the work contemplated pursuant to this Exhibit G may be warranted by third parties beyond the minimum one-year warranty period. Tenant shall receive the benefit of all warranties provided by labor and materials suppliers associated with the work performed pursuant to this Exhibit G, either by Landlord performing the warranted work at its sole cost and expense or by Landlord assigning such warranties to Tenant. If any such warranties shall prohibit such an assignment, Landlord shall enforce such warranties on Tenant's behalf at Landlord's sole cost and expense to the extent allowable.

**Construction Representatives** . Landlord's and Tenant's representatives for coordination of construction and approval of change orders will be as follows, provided that either party may change its representative upon written notice to the other:

Landlord's Representative	Southpark Distribution Center, Inc. 3090 Olive Street; Suite 300 Dallas, Texas 75219 Attn: <u>Mike Jones</u>
Tenant's Representative	Priority Fulfillment Services, Inc. 4650 Shelby Drive Memphis, Tennessee 38118 Attn: Scott Talley

[Separate Signature Page Attached]

**IN WITNESS WHEREOF** , the parties hereto agree to the terms and conditions as set forth in this Exhibit G.

**LANDLORD:**

**SOUTHPARK DISTRIBUTION CENTER,  
INC .,** a Maryland corporation

By: \_\_\_\_\_  
Title: \_\_\_\_\_

**TENANT:**

**PRIORITY FULFILLMENT SERVICES,  
INC .,** a Delaware corporation

By: \_\_\_\_\_  
Title: \_\_\_\_\_

## LEASE EXHIBIT H

This instrument prepared by:

Gail Livingston Mills  
Burr & Forman LLP  
420 North 20th Street  
Suite 3400  
Birmingham, Alabama 35203

### SUBORDINATION, NON-DISTURBANCE AND ATTORNMENT AGREEMENT

This Subordination, Non-Disturbance and Attornment Agreement (the “Agreement”) is dated as of the \_\_\_\_ day of \_\_\_\_\_, 2014, among SYNOVUS BANK, a Georgia state banking corporation, whose address is 800 Shades Creek Parkway, Suite 325, Birmingham, Alabama 35209 (“Lender”), PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation, whose address is 505 Millennium Drive, Allen, TX 75013 (“Tenant”), and SOUTHPARK DISTRIBUTION CENTER, INC., a Maryland corporation., whose address is c/o Mr. Robert T. Vicente, Executive Vice President, Hillwood Investment Properties, 3090 Olive Street, Suite 200, Dallas, Texas 75219 (“Landlord”),

### **RECITALS**

A. Lender has made a mortgage loan (the “Loan”) to the Landlord with respect to certain real property located in the Southpark Distribution Center in Memphis, Shelby County, Tennessee more particularly described in Exhibit A attached hereto and made a part hereof (such property, including the Premises, is hereinafter referred to as the “Property”). The Loan is secured by that certain Deed of Trust and Security Agreement recorded at Instrument No. 12111972 on October 2, 2012 with the Register of Deeds of Shelby County, Tennessee (as amended from time to time, the “Mortgage”) and that certain Assignment of Rents and Leases recorded at Instrument No. 12111973 on October 2, 2012 with the Register of Deeds of Shelby County, Tennessee (as amended from time to time, the “Assignment of Leases and Rents”). The Mortgage and the Assignment of Leases and Rents are hereinafter collectively referred to as the “Security Documents.”

B. Pursuant to that certain Industrial Lease Agreement dated August 31, 1999, as amended by that certain Modification, Ratification and Extension of Lease dated December 19, 2003, that certain Second Modification, Ratification and Extension of Lease dated June 3, 2008 and that certain Third Modification, Ratification and Extension of Lease dated February \_\_, 2014 (as so modified and amended, and as same may be hereinafter modified and amended, the “Lease”), the Landlord is leasing to the Tenant a portion of the Property or the improvements located thereon (the “Premises”) for a term of 24 years and 6 months expiring February 29, 2024, with one (1) option to extend said lease term for an additional period of five (5) years so that the total or aggregate number of possible years under said Lease is a total of twenty nine (29) years six (6) months, at the rental and upon the terms and conditions set forth in said Lease.

C. Lender requires the execution of this Agreement as a condition to Landlord and Tenant entering into the Lease.

### **AGREEMENT**

For mutual consideration, including the mutual covenants and agreements set forth below, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Tenant agrees that the Lease is and shall be subject and subordinate to the lien of the Security Documents and to all present or future advances under the obligations secured thereby and all renewals, amendments, modifications, consolidations, replacements and extensions of the secured obligations and the Security Documents, to the full extent of all amounts secured by the Security Documents from time to time. Said subordination is to have the same force and effect as if the Security Documents and such renewals, modifications, consolidations, replacements and extensions thereof had been executed, acknowledged, delivered and recorded prior to the Lease, any amendments or modifications thereof and any notice thereof.

2. Lender agrees that, if the Lender exercises any of its rights under the Security Documents, including an entry by Lender pursuant to the Mortgage or a foreclosure of the Mortgage, Lender shall not disturb Tenant's right of quiet possession of the Premises under the terms of the Lease so long as Tenant is not in default beyond any applicable grace, notice and cure periods of any term, covenant or condition of the Lease.

3. Tenant agrees that, in the event of a foreclosure of the Mortgage by Lender or the acceptance of a deed in lieu of foreclosure by Lender or any other succession of Lender to fee ownership, Tenant will attorn to and recognize Lender as its landlord under the Lease for the remainder of the term of the Lease (including all extension periods which have been or are hereafter exercised) upon the same terms and conditions as are set forth in the Lease, and Tenant hereby agrees to pay and perform all of the obligations of Tenant pursuant to the Lease.

4. Tenant agrees that, in the event Lender succeeds to the interest of Landlord under the Lease, Lender shall not be:

(a) liable for any act or omission of any prior Landlord (including, without limitation, the then defaulting Landlord) which does not continue after Lender so succeeds to the interest of Landlord under the Lease provided Lender has received notice of such act or omission from Tenant as provided in Section 6 below; or

(b) subject to any defense or offsets which Tenant may have against any prior Landlord (including, without limitation, the then defaulting Landlord) for any such non-continuing defaults of the Landlord under the Lease, or

(c) bound by any payment of rent or additional rent which Tenant might have paid for more than one month in advance of the due date under the Lease to any prior Landlord (including, without limitation, the then defaulting Landlord), or

(d) bound by any obligation to make any payment to Tenant which was required to be made prior to the time Lender succeeded to any prior Landlord's interest, or

(e) accountable for any monies deposited with any prior Landlord (including security deposits), except to the extent such monies are actually received by Lender, or

(f) bound by any surrender, termination, amendment or modification of the Lease made without the consent of Lender, other than for (a) a termination made by Tenant pursuant to any right or option of termination expressly set forth in the Lease or (b) a termination for any Landlord default that is not cured by Landlord within the applicable cure periods set forth in the Lease, or under applicable law or in equity, or by Lender in accordance with the provisions of Paragraph 6 below.

5. Tenant agrees that, notwithstanding any provision hereof to the contrary, the terms of the Mortgage shall continue to govern with respect to the disposition of any insurance proceeds or eminent domain awards, and any obligations of Landlord to restore the real estate of which the Premises are a part shall, insofar as they apply to Lender, be limited to insurance proceeds or eminent domain awards received by Lender after the deduction of all costs and expenses incurred in obtaining such proceeds or awards.

6. Tenant hereby agrees to give to Lender copies of all notices of Landlord default(s) under the Lease in the same manner as, and whenever, Tenant shall give any such notice of default to Landlord, and, as between Lender and Tenant only, no such notice of default shall be deemed given to Landlord unless and until a copy of such notice shall have been so delivered to Lender. Lender shall have the right to remedy any Landlord default under the Lease, or to cause any default of Landlord under the Lease to be remedied, and for such purpose Tenant hereby grants Lender such additional period of time as may be reasonable to enable Lender to remedy, or cause to be remedied, any such default in addition to the period given to Landlord for remedying, or causing to be remedied, any such default so long (A) as Lender (i) delivers notice to Tenant within thirty (30) days of Tenant's delivery of notice of such default to Lender of Lender's intention to commence such proceedings, if any, as shall be required to obtain such necessary possession or control of the Property as shall be required for Lender to cure Landlord's default, (ii) Lender commences such



c/o Mr. Robert T. Vicente  
Executive Vice President  
Hillwood Investment Properties  
3090 Olive Street  
Suite 200  
Dallas, Texas 75219

With a copy to: Haynes and Boone, LLP  
2323 Victory Avenue  
Suite 700  
Dallas, TX 75219-7673  
Attn: Sue P. Murphy

12. The term “Lender” as used herein includes any successor or assign of the named Lender herein, including without limitation, any co-lender at the time of making the Loan, any purchaser at a foreclosure sale and any transferee pursuant to a deed in lieu of foreclosure, and their successors and assigns, and the terms “Tenant” and “Landlord” as used herein include any successor and assign of the named Tenant and Landlord herein, respectively; provided, however, that such reference to Tenant’s or Landlord’s successors and assigns shall not be construed as Lender’s consent to any assignment or other transfer by Tenant or Landlord.

13. If any provision of this Agreement is held to be invalid or unenforceable by a court of competent jurisdiction, such provision shall be deemed modified to the extent necessary to be enforceable, or if such modification is not practicable, such provision shall be deemed deleted from this Agreement, and the other provisions of this Agreement shall remain in full force and effect, and shall be liberally construed in favor of Lender.

14. Neither this Agreement nor any of the terms hereof may be terminated, amended, supplemented, waived or modified orally, but only by an instrument in writing executed by the party against which enforcement of the termination, amendment, supplement, waiver or modification is sought.

13. This Agreement shall be construed in accordance with the laws of the state in which the Property is located.

14. This Agreement and all of the covenants, terms, conditions and obligations herein contained are covenants running with the land (the Property and the Premises) and binding thereon and shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns and successors in title to the Premises and successors in title to the Property.

*[Remainder of Page Left Intentionally Blank]*

WITNESS the execution hereof as of the date first above written.

**LENDER:**

SYNOVUS BANK,  
a Georgia state banking corporation

By: \_\_\_\_\_  
Print name: \_\_\_\_\_  
Title: \_\_\_\_\_

**STATE OF ALABAMA            )**  
**COUNTY OF JEFFERSON        )**

Before me, the undersigned, a Notary Public of the State and County aforesaid, personally appeared, \_\_\_\_\_, with whom I am personally acquainted (or proved to me on the basis of satisfactory evidence), and who, upon oath, acknowledged himself to be the \_\_\_\_\_ of Synovus Bank, a Georgia state banking corporation, the within named bargainor, and that he as such officer executed the foregoing instrument for the purposes therein contained, by signing the name of Synovus Bank, by himself as \_\_\_\_\_ of said corporation.

WITNESS my hand and seal, at office in \_\_\_\_\_, \_\_\_\_\_, this \_\_\_\_ day of \_\_\_\_\_, 2014.

[NOTARIAL SEAL]

\_\_\_\_\_  
**Notary Public**  
**My Commission Expires:** \_\_\_\_\_

**TENANT:**

PRIORITY FULFILLMENT SERVICES, INC., a Delaware corporation

By: \_\_\_\_\_  
Print name: \_\_\_\_\_  
Title: \_\_\_\_\_

**STATE OF \_\_\_\_\_ )**  
**COUNTY OF \_\_\_\_\_ )**

Before me, the undersigned, a Notary Public of the State and County aforesaid, personally appeared, \_\_\_\_\_, with whom I am personally acquainted (or proved to me on the basis of satisfactory evidence), and who, upon oath, acknowledged himself to be the \_\_\_\_\_ of Priority Fulfillment Services, Inc., a Delaware corporation, the within named bargainor, and that he as such \_\_\_\_\_ executed the foregoing instrument for the purposes therein contained, by signing the name of \_\_\_\_\_, by himself as \_\_\_\_\_ of said corporation.

WITNESS my hand and seal, at office in \_\_\_\_\_, \_\_\_\_\_, this \_\_\_\_ day of \_\_\_\_\_, 2014.

[NOTARIAL SEAL]

\_\_\_\_\_  
**Notary Public**  
**My Commission Expires:** \_\_\_\_\_

**LANDLORD:**

**SOUTHPARK DISTRIBUTION  
CENTER, INC .**, a Maryland corporation

By: \_\_\_\_\_  
Print name: \_\_\_\_\_  
Title: \_\_\_\_\_

**STATE OF TEXAS        )**  
**COUNTY OF DALLAS    )**

Before me, the undersigned, a Notary Public of the State and County aforesaid, personally appeared, \_\_\_\_\_, with whom I am personally acquainted (or proved to me on the basis of satisfactory evidence), and who, upon oath, acknowledged himself to be the \_\_\_\_\_ of Southpark Distribution Center, Inc., a Maryland corporation, the within named bargainor, and that he as such officer executed the foregoing instrument for the purposes therein contained, by signing the name of Southpark Distribution Center, Inc., by himself as \_\_\_\_\_ of said corporation.

WITNESS my hand and seal, at office in Dallas, Texas, this \_\_\_\_ day of \_\_\_\_\_, 2014.

[NOTARIAL SEAL]

\_\_\_\_\_  
**Notary Public**  
My Commission Expires: \_\_\_\_\_



**EXHIBIT A**

**LEGAL DESCRIPTION**

Lots 4, 5, 6, 7, 8, 9 and 10, Phase Two, Southpark Industrial Subdivision, First Addition, as shown on plat of record in Plat Book 151, Page 73, in the Register's Office, Shelby County, Tennessee, to which plat reference is hereby made for a more particular description of said property.

Together with easement for ingress and egress as contained in Reciprocal Easement Agreement of record in Instrument FD 8806, in the Register's Office, Shelby County, Tennessee, as to Lot 4.

Together with Driveway Easements as contained in Reciprocal Easement Agreement of record in Instrument EV 7311, in the Register's Office, Shelby County, Tennessee, as to Lots 4, 5 and 6.

Together with easements for ingress and egress as contained in Access and Road Easement Agreement of record in Instrument EE7037, in the Register's Office, Shelby County, Tennessee, as to Lot 9.

Together with easements for ingress and egress as contained in Special Warranty Deed of record in Instrument EA 9544, in the Register's Office, Shelby County, Tennessee, as to Lot 10.

Being the same property conveyed to Southpark Distribution Center, Inc., a Maryland corporation, by Special Warranty Deed of record in Instrument 12077759, in the Register's Office, Shelby County, Tennessee.

<b>Name</b>	<b>Jurisdiction</b>
Priority Fulfillment Services, Inc.	Delaware
Priority Fulfillment Services of Canada, Inc.	Ontario
PFSweb BV SPRL (f/k/a Priority Fulfillment Services Europe, B.V.)	Belgium
Business Supplies Distributors Holdings, LLC	Delaware
Supplies Distributors, Inc.	Delaware
Supplies Distributors of Canada, Inc.	Ontario
Supplies Distributors S.A.	Belgium
PFSweb Retail Connect, Inc.,	Delaware
PFSweb Philippines Services, LLC	Philippines

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our report dated March 31, 2014, with respect to the consolidated financial statements in the Annual Report of PFSweb, Inc. on Form 10-K for the year ended December 31, 2013. We hereby consent to the incorporation by reference of said report in the Registration Statements of PFSweb, Inc. on Forms S-8 (File Nos. 333-164973, effective February 18, 2010; 333-128486, effective September 21, 2005; 333-75764, effective December 21, 2001; 333-75772, effective December 21, 2001; 333-46096, effective September 19, 2000; 333-42186, effective July 25, 2000; and 333-40020, effective June 23, 2000 ) and on Forms S-3 (File Nos. 333-164971, effective February 18, 2010; 333-135794, effective July 17, 2006; and 333-110853, effective December 1, 2003).

/s/ GRANT THRONTON LLP

Dallas, Texas  
March 31, 2014

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

I, Michael Willoughby, certify that:

1. I have reviewed this annual report on Form 10-K of PFSweb, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of 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: March 31, 2014

By: /s/ MICHAEL WILLOUGHBY  
Chief Executive Officer

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

I, Thomas Madden, certify that:

1. I have reviewed this annual report on Form 10-K of PFSweb, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of 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: March 31, 2014

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 Annual Report on Form 10-K for the year ended December 31, 2013 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in the Form 10-K.

March 31, 2014

/s/ Michael Willoughby

Michael Willoughby  
Chief Executive Officer

March 31, 2014

/s/ Thomas J. Madden

Thomas J. Madden  
Chief Financial Officer

The foregoing certification is being furnished as an exhibit to the Form 10-K 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-K 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.