

PFSWEB INC
Form 10-Q
August 10, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2015

OR

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

For the Transition Period from _____ to _____

Commission File Number 000-28275

PFSweb, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

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

505 Millennium Drive, Allen, Texas 75013
(Address of principal executive offices) (Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller Reporting Company

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

At August 5, 2015 there were 18,031,738 shares of registrant's common stock outstanding.

PFSWEB, INC. AND SUBSIDIARIES

Form 10-Q

June 30, 2015

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

PFSweb, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)

	(Unaudited)	
	June 30, 2015	December 31, 2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 15,721	\$ 18,128
Restricted cash	374	521
Accounts receivable, net of allowance for doubtful accounts of \$446 and \$447 at June 30, 2015 and December 31, 2014, respectively	42,961	59,126
Inventories, net of reserves of \$635 and \$768 at June 30, 2015 and December 31, 2014, respectively	10,333	10,534
Other receivables	4,565	5,638
Prepaid expenses and other current assets	4,551	7,103
Total current assets	78,505	101,050
PROPERTY AND EQUIPMENT, net	23,912	26,604
IDENTIFIABLE INTANGIBLES, net	1,813	2,170
GOODWILL	10,322	8,366
OTHER ASSETS	2,101	2,556
Total assets	\$ 116,653	\$ 140,746
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt and capital lease obligations	\$ 5,717	\$ 6,850
Trade accounts payable	27,839	38,842
Deferred revenue	6,806	9,098
Accrued expenses	24,124	28,473
Total current liabilities	64,486	83,263
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	3,739	4,062
DEFERRED REVENUE	4,481	5,355
DEFERRED RENT	4,561	4,870
OTHER LIABILITIES	368	3,091
Total liabilities	77,635	100,641
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		

Preferred stock, \$1.00 par value; 1,000,000 shares authorized; none issued or outstanding	—	—
Common stock, \$0.001 par value; 35,000,000 shares authorized; 17,511,982 and 17,047,093 shares issued at June 30, 2015 and December 31, 2014, respectively; and 17,478,515 and 17,013,622 outstanding at June 30, 2015 and December 31, 2014, respectively	17	17
Additional paid-in capital	132,631	129,457
Accumulated deficit	(93,519)	(89,926)
Accumulated other comprehensive income	14	682
Treasury stock at cost, 33,467 shares	(125)	(125)
Total shareholders' equity	39,018	40,105
Total liabilities and shareholders' equity	\$ 116,653	\$ 140,746

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

PFSWEB, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
REVENUES:				
Product revenue, net	\$ 13,658	\$ 18,120	\$ 30,312	\$ 39,842
Service fee revenue	39,075	27,384	75,783	54,982
Pass-through revenue	10,443	8,539	20,927	16,448
Total revenues	63,176	54,043	127,022	111,272
COSTS OF REVENUES:				
Cost of product revenue	12,911	17,039	28,619	37,555
Cost of service fee revenue	26,645	19,160	51,800	38,380
Cost of pass-through revenue	10,443	8,539	20,927	16,448
Total costs of revenues	49,999	44,738	101,346	92,383
Gross profit	13,177	9,305	25,676	18,889
SELLING, GENERAL AND ADMINISTRATIVE				
EXPENSES, including stock based compensation expense				
of \$1,150 and \$862 in the three months ended				
June 30, 2015 and 2014, respectively, and \$1,954 and				
\$1,656 in the six months ended June 30, 2015 and 2014,				
respectively.				
Loss from operations	14,676	11,485	28,290	22,507
INTEREST EXPENSE, net	(1,499)	(2,180)	(2,614)	(3,618)
Loss from operations before income taxes	(1,722)	(2,353)	(3,155)	(3,934)
INCOME TAX EXPENSE	178	42	438	271
NET LOSS	\$(1,900)	\$(2,395)	\$(3,593)	\$(4,205)
NET LOSS PER SHARE:				
Basic	\$(0.11)	\$(0.14)	\$(0.21)	\$(0.25)
Diluted	\$(0.11)	\$(0.14)	\$(0.21)	\$(0.25)
WEIGHTED AVERAGE NUMBER OF SHARES				
OUTSTANDING:				
Basic	17,368	16,736	17,257	16,630
Diluted	17,368	16,736	17,257	16,630
COMPREHENSIVE LOSS:				
Net loss	\$(1,900)	\$(2,395)	\$(3,593)	\$(4,205)
Foreign currency translation adjustment	238	(40)	(668)	(98)
TOTAL COMPREHENSIVE LOSS	\$(1,662)	\$(2,435)	\$(4,261)	\$(4,303)

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

PFSweb, Inc. and Subsidiaries

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Six Months Ended June 30,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$(3,593)	\$(4,205)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,564	5,768
Gain on sale of fixed assets	20	—
Provision for doubtful accounts	16	78
Provision for excess and obsolete inventory	9	5
Deferred income taxes	39	39
Stock-based compensation expense	1,954	1,656
Non-cash compensation expense	87	—
Changes in operating assets and liabilities:		
Restricted cash	34	(32)
Accounts receivable	15,607	15,068
Inventories	109	400
Prepaid expenses, other receivables and other assets	3,854	(499)
Deferred rent	(282)	125
Accounts payable, deferred revenue, accrued expenses and other liabilities	(18,895)	(13,433)
Net cash provided by operating activities	5,523	4,970
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,946)	(2,925)
Acquisitions, net of cash acquired	(2,921)	—
Net cash used in investing activities	(4,867)	(2,925)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common stock	1,189	788
Decrease (Increase) in restricted cash	112	(107)
Payments on capital lease obligations	(1,081)	(1,238)
Payments on debt, net	(2,212)	(606)
Net cash used in financing activities	(1,992)	(1,163)
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(1,071)	(105)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,407)	777
CASH AND CASH EQUIVALENTS, beginning of period	18,128	22,418
CASH AND CASH EQUIVALENTS, end of period	\$15,721	\$23,195

SUPPLEMENTAL CASH FLOW INFORMATION

Non-cash investing and financing activities:

Property and equipment acquired under long-term debt and capital leases	\$1,637	\$969
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The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

1. OVERVIEW AND BASIS OF PRESENTATION

PFSweb, Inc. and its subsidiaries are collectively referred to as the “Company”; “Supplies Distributors” refers to Supplies Distributors, Inc. and its subsidiaries; “Retail Connect” refers to PFSweb Retail Connect, Inc.; “REV” collectively refers to REV Solutions, Inc. and REVTECH Solutions India Private Limited; “LAL” refers to LiveAreaLabs, Inc., “Moda” refers to Moda Superbe Limited, and “PFSweb” refers to PFSweb, Inc. and its subsidiaries, excluding Supplies Distributors and Retail Connect.

PFSweb Overview

PFSweb is a global provider of omni-channel commerce solutions, including a broad range of technology, infrastructure and professional services, to major brand name companies and others seeking to optimize their supply chain and to enhance their online and traditional business channels and initiatives in the United States, Canada, and Europe. PFSweb’s service offerings include website design, creation and integration, digital agency and 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 USA, Inc., 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. The majority of Supplies Distributors’ revenue is generated by its sale of product purchased from Ricoh.

Supplies Distributors has obtained financing 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.

Acquisition of REV

On September 3, 2014, Priority Fulfillment Services, Inc. (“PFS”), a wholly-owned subsidiary of PFSweb, acquired the outstanding capital stock of REV, which provides eCommerce website technical design, development and support services, enabling retailers, manufacturers and suppliers to optimize the customer experience across multiple channels. REV maintains operations in the United States and India. The initial consideration paid for the shares was \$3.2 million in cash payments. The purchase agreement provides for future earn-out payments (“REV Earn-out Payments”) payable in 2015 and 2016 based on REV’s achievement of certain 2014 and 2015 financial targets (the “2014 REV Earn-out Payments” and “2015 REV Earn-out Payments”, respectively), in each case, subject to guaranteed minimum and maximum payments and possible offsets for indemnification and other claims arising under the purchase agreement. During the three months ended June 30, 2015, the Company paid \$1.1 million and issued 27,407 shares of common stock of the Company (approximately \$0.3 million in value as of payment date) in payment of the 2014 REV Earn-out Payments. At PFS’ election, up to \$0.2 million of the 2015 REV Earn-out Payments are payable in unregistered shares of common stock of the Company. As of June 30, 2015, the Company has recognized a total current liability of \$1.7 million applicable to the 2015 REV Earn-out Payments which have a guaranteed minimum of \$0.7 million and maximum of \$1.8 million.

The transaction was accounted for using the purchase method of accounting for business combinations and, accordingly, the assets acquired and liabilities assumed, including an allocation of purchase price, and the results of operations of REV have been included in the Company's consolidated financial statements since the date of acquisition. The Company determined fair value using a combination of the discounted cash flow, market multiple and market capitalization valuation methods.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

The following table summarizes the estimated fair value of the tangible and intangible assets acquired and liabilities assumed (in thousands):

Cash and cash equivalents	\$ 765
Accounts receivable	1,753
Property and equipment	289
Identifiable intangibles	1,019
Other assets	16
Total assets acquired	3,842
Total liabilities assumed	655
Net assets acquired	3,187
Goodwill	2,756
Total purchase price	\$5,943

Purchase price for REV is as follows (in thousands):

Number of shares of common stock issued	27,407
Multiplied by PFSweb Inc.'s stock price	\$ 10.95
Share consideration for settlement of performance-based contingent payments	\$ 300
Aggregate cash payments	4,254
Performance-based contingent payments (based on fair value at acquisition date)	1,389
Total purchase price	\$5,943

The excess of the purchase price over the fair value of the net identifiable assets acquired and liabilities assumed was allocated to goodwill. Total goodwill of \$2.8 million, none of which is deductible for tax purposes, is not being amortized but is subject to an annual impairment test using a fair-value-based approach.

The Company is amortizing the identifiable intangible assets acquired using a pattern in which the economic benefit of the assets are expected to be realized by the Company over their estimated remaining useful lives. There are no residual values for any of the intangible assets subject to amortization acquired during the REV acquisition.

Definite lived intangible assets acquired in the REV acquisition consist of (in thousands):

	June 30, 2015	Estimated
	Net	Useful Life
Fair Value	Accumulated	
	Carrying	

	at			
	Acquisition	Amortization	Value	from Acquisition
Non-compete agreements	\$ 94	\$(37)	\$ 57	1-3.5 years
Leasehold	45	(15)	30	2.5 years
Customer relationships	880	(233)	647	6 years
Total definite lived intangible assets	\$ 1,019	\$(285)	\$ 734	

Acquisition of LAL

On September 22, 2014, PFS acquired the outstanding capital stock of LAL, which provides digital agency services including strategy, branding, website design, visual design, copywriting, interactive development and support services primarily to manufacturers and retailers. LAL operates in the United States. Consideration paid for the shares included an initial \$4.0 million cash payment and 54,604 unregistered shares of common stock of the Company (approximately \$0.5 million in value as of acquisition date). The purchase agreement provides for future earn out payments (“LAL Earn-out Payments”) payable in 2015 and 2016 based on LAL’s achievement of certain 2014 and 2015 financial targets (the “2014 LAL Earn-out Payments” and “2015 LAL Earn-out Payments,” respectively), in each case, subject to a maximum payment and possible offsets for indemnification and other claims arising under the purchase agreement. During the three months ended June 30, 2015, the Company paid \$1.0 million for the 2014 LAL Earn-out Payments. As of June 30, 2015, the Company has recognized a total current liability of \$1.8 million applicable to the projected 2015 LAL Earn-out Payments with a maximum payment of \$2.0 million. At PFS’ election, up to 25% of the 2015 LAL Earn-out Payments are payable in unregistered shares of common stock of the Company.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

The transaction was accounted for using the purchase method of accounting for business combinations and, accordingly, the assets acquired and liabilities assumed, including an allocation of purchase price, and the results of operations of LAL have been included in the Company's consolidated financial statements since the date of acquisition. The Company determined fair value using a combination of the discounted cash flow, market multiple and market capitalization valuation methods.

The following table summarizes the estimated fair value of the tangible and intangible assets acquired and liabilities assumed (in thousands):

Cash	\$30
Accounts receivable, net	1,299
Property and equipment	253
Identifiable intangibles	1,290
Other assets	28
Total assets acquired	2,900
Total liabilities assumed	1,617
Net assets acquired	1,283
Goodwill	5,610
Total purchase price	\$6,893

Purchase price for LAL is as follows (in thousands, except share data):

Number of shares of common stock issued	54,604
Multiplied by PFSweb Inc.'s stock price	\$9.96
Share consideration	\$544
Aggregate cash payments	4,950
Performance-based contingent payments (based on fair value at acquisition date)	1,399
Total purchase price	\$6,893

The excess of the purchase price over the fair value of the net identifiable assets acquired and liabilities assumed was allocated to goodwill. Total goodwill of \$5.6 million, none of which is deductible for tax purposes, is not being amortized but is subject to an annual impairment test using a fair-value-based approach.

The Company is amortizing the identifiable intangible assets acquired using a pattern in which the economic benefit of the assets are expected to be realized by the Company over their estimated remaining useful lives. There are no residual values for any of the intangible assets subject to amortization acquired during the LAL acquisition.

Definite lived intangible assets acquired in the LAL acquisition consist of (in thousands):

	Fair Value at Acquisition	June 30, 2015 Net Carrying Value	Estimated Useful Life from Acquisition
Non-compete agreements	\$ 150	\$(32) \$ 118	3.5 years
Trade name	150	(50) 100	2.25 years
Customer relationships	990	(234) 756	6 years
Total definite lived intangible assets	\$ 1,290	\$(316) \$ 974	

Acquisition of Moda

On June 11, 2015, PFS acquired the outstanding capital stock of Moda, an eCommerce system integrator and consultancy that provides unique digital experiences for fashion brands and retailers. Moda maintains primary operations in London. Consideration paid for the shares included an initial £650,000 (approximately \$1.0 million) cash payment and 16,116 unregistered shares of Company stock (approximately \$0.3 million in value as of the acquisition date). The purchase agreement provides for (i) a further adjustment based on Moda's shareholders' equity balance as of the date of acquisition and (ii) future earn-out payments ("Moda Earn-out Payments") payable in 2016 and 2017 based on Moda's achievement of certain 2015 and 2016 financial targets, with no

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

guaranteed minimum and an aggregate maximum each year of £500,000 (approximately \$0.8 million), in each case, subject to possible offsets for indemnification and other claims arising under the purchase agreement. At PFS' election, up to 25% of each of the 2015 and 2016 Moda Earn-out Payments are payable in restricted shares of common stock of the Company.

The transaction was accounted for using the purchase method of accounting for business combinations and, accordingly, the assets acquired and liabilities assumed, including a preliminary allocation of purchase price, and the results of operations of Moda have been included in the Company's consolidated financial statements since the date of acquisition. The following table summarizes the preliminary unaudited, estimated fair value of the tangible and intangible assets acquired and liabilities assumed. This allocation requires the significant use of estimates and is based on the information available to management at the time these financial statements were prepared. As the acquisition was only recently completed, the Company has not yet completed its assessment of the fair value of the tangible and intangible assets acquired, nor recorded the potentially related amortization expense applicable to such assets, and liabilities assumed. As such, the estimated purchase price in excess of net assets acquired and liabilities assumed has initially been recorded as goodwill and intangible assets. Goodwill is not deductible for tax purposes and will not be amortized but is subject to annual impairment tests using a fair-value-based approach. The Company is in the process of finalizing the purchase price allocation and, accordingly, the following preliminary allocation of the purchase price is subject to adjustment.

The following table summarizes the unaudited estimated fair value of the tangible and intangible assets acquired and liabilities assumed (in thousands):

Cash and cash equivalents	\$ 126
Accounts receivable	335
Property and equipment	27
Other assets	23
Total assets acquired	511
Total liabilities assumed	542
Net liabilities assumed	(31)
Goodwill and intangible assets	1,957
Total purchase price	\$ 1,926

The estimated purchase price for Moda is as follows (in thousands, except share data):

Number of shares of common stock issued	16,116
Multiplied by PFSweb Inc.'s stock price	\$ 14.60
Share consideration	\$ 235
Aggregate cash payments	1,005
Performance-based contingent payments (based on fair value at acquisition date)	686
Total purchase price	\$ 1,926

Pro Forma Information

The following table presents selected pro forma information, for comparative purposes, assuming the acquisitions of REV and LAL had occurred on January 1, 2014 (unaudited) and now include the impact of the acquisition related amortization of intangible assets (approximately \$0.2 million per quarter), which were previously omitted (in thousands, except per share amounts):

	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Total revenues	\$58,239	\$118,780
Net loss	(1,934)	(3,938)
Basic and diluted net loss per share	(0.12)	(0.24)

The unaudited pro forma information combines the historical unaudited consolidated results of the Company's operations and REV's and LAL's operations for the three and six months ended June 30, 2014 giving effect to the acquisitions and related events as if they had been consummated on January 1, 2014. The unaudited pro forma total revenues and pro forma net loss are not necessarily indicative of the consolidated results of operations for future periods or the results of operations that would have been realized had the

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

Company consolidated REV and LAL during the period noted. Moda did not meet the significance test requirements in order to be included in the pro forma presentation above.

Definite Lived Intangible Asset Amortization

The Company recognized \$0.2 million and \$0.5 million of amortization expense, related to the REV and LAL definite lived intangible assets in selling, general and administrative expenses in three and six months ended June 30, 2015, respectively. The estimated amortization expense for each of the next five years is as follows (in thousands):

2015	\$951
2016	533
2017	345
2018	200
2019	138

Basis of Presentation

The interim consolidated financial statements as of June 30, 2015, and for the three and six months ended June 30, 2015 and 2014, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and are unaudited. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. In the opinion of management and subject to the foregoing, the unaudited interim consolidated financial statements of the Company include all adjustments necessary for a fair presentation of the Company’s financial position as of June 30, 2015, its results of operations for the three and six months ended June 30, 2015 and 2014 and its cash flows for the six months ended June 30, 2015 and 2014. Results of the Company’s operations for interim periods may not be indicative of results for the full fiscal year.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as the operating environment changes. These changes have been included in the consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. These uncertainties are discussed in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 in the section entitled "Risk Factors." Based on a critical assessment of accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes the Company's consolidated financial statements are fairly stated in accordance with U.S. GAAP, and provide a fair presentation of the Company's financial position and results of operations.

Revenue and Cost Recognition

The Company derives revenue primarily from services provided under contractual arrangements with its clients or from the sale of products under its distributor agreements. The following revenue recognition policies define the manner in which the Company accounts for sales transactions.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

The Company recognizes revenue when persuasive evidence of a sales arrangement exists, product shipment or delivery has occurred or services are rendered, the sales price or fee is fixed or determinable, and collectability is reasonably assured.

In instances where revenue is derived from sales of third-party vendor services, the Company records revenue on a gross basis when the Company is a principal to the transaction and net of costs when the Company is acting as an agent between the customer or client and the vendor. The Company considers several factors to determine whether it is a principal or an agent, most notably whether the Company is the primary obligor to the vendor or customer, has established its own pricing and has inventory and credit risks, if applicable.

Product Revenue Activity

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, Supplies Distributors bills Ricoh for reimbursements of certain expenses, including: pass-through customer marketing programs, including rebates and co-op 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 records these reimbursable amounts as they are incurred as other receivables in the consolidated balance sheet with a corresponding reduction in either inventory or cost of product revenue. Supplies Distributors also records pass-through customer marketing programs as a reduction of both product revenue and cost of product revenue.

Service Fee Revenue Activity

The Company's service fee revenue primarily relates to its distribution services, order management/customer care services, professional digital agency and technology services. The Company typically charges its service fee revenue on either a cost-plus basis, a percent of shipped revenue basis, on a time and materials, project or retainer basis for professional services, 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." A deliverable constitutes a separate unit of accounting when it has standalone value and there are no return rights or other contingencies present for the delivered elements. The Company allocates revenue to each element based on estimated selling price. Each of the Company's client contracts, and the related services, is unique, with individual needs and criteria customized for each

client. Each client engagement is scoped and priced separately and as such the Company is not able to establish vendor specific objective evidence of fair value for its services, nor is third-party evidence available to establish stand-alone selling prices. Accordingly the Company uses management's best estimate of selling price for the deliverables. The Company establishes its estimates considering internal factors such as margin objectives, pricing practices and controls as well as market conditions such as competitor pricing strategies.

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 include 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.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

Professional consulting and technology service revenues primarily relate to design, implementation, service and support of eCommerce platforms, website design and solutions and quality control for the Company's clients. Additionally, the Company provides digital agency services that 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, or transaction basis, a dedicated resource model, a fixed price arrangement, or a percent of merchandise shipped basis. Service fee revenue for this activity is generally recognized as the services are rendered.

The Company performs front-end set-up and integration services to support client eCommerce platforms and websites. When the Company determines that these front-end set-up and integration services do not meet the criteria for recognition as a separate unit of accounting, the Company defers the start-up fees received and the related costs, and recognizes them over the contract term, which the Company believes approximates the performance period. When the Company determines that these front-end set-up and integration services do meet the criteria for recognition as a separate unit of accounting, for time and material arrangements, the Company recognizes revenue as services are rendered and costs as they are incurred. For fixed-price arrangements, if reasonable and reliable cost estimates for a project cannot be made, the Company uses the completed contract method to recognize revenues and costs. If reasonable and reliable costs estimates for a project can be made, the Company recognizes revenue over the contract term on a proportional performance basis, as determined by the relationship of actual costs incurred compared to the estimated total contract costs.

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.

Accounts Receivable

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.

Deferred Revenues and Deferred Costs

The Company primarily performs its services under multiple-year contracts, certain of which include early termination provisions, and clients are obligated to pay for services performed. 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. When the Company determines that these start-up and integration activities do

not meet the criteria for recognition as a separate unit of accounting, the Company defers the start-up fees received, and the related costs, and recognizes them over the contract term, which the Company believes approximates the performance period. 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.

Investment in Subsidiaries

PFS 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. As of June 30, 2015 and December 31, 2014, the outstanding balance of the Subordinated Note was \$2.5 million. The Subordinated Note is eliminated in the Company's consolidated financial statements.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

Concentration of Business and Credit Risk

One service fee client relationship represented approximately 14% of the Company's consolidated total net revenues, including pass-through revenue, during the six months ended June 30, 2015. No customer or service fee client exceeded 10% of consolidated accounts receivable.

A summary of the nonaffiliated customer and client concentrations as a percentage of product revenue and service fee revenue, respectively, is as follows:

	Six Months Ended June 30, 2015 2014	
Product Revenue (as a percentage of total Product Revenue):		
Customer 1	15 %	12 %
Customer 2	14 %	12 %
Service Fee Revenue (as a percentage of total Service Fee Revenue):		
Client 1	15 %	—

The Company currently anticipates that its product revenue from the customers identified above will decline during the next twelve months.

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. These arrangements include Supplies Distributors' distributor agreements and certain of Supplies Distributors' working capital financing agreements. The majority 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.

Inventories

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

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

Operating Leases

The Company leases certain real estate for its warehouse, call center and corporate offices, as well as certain equipment, under non-cancelable operating leases that expire at various dates through 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.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

Property and Equipment

The Company's property held under capital leases totaled approximately \$4.7 million and \$4.8 million, net of accumulated amortization of approximately \$3.6 million and \$4.0 million, at June 30, 2015 and December 31, 2014, respectively. Depreciation and amortization expense related to capital leases during the six months ended June 30, 2015 and 2014 was \$1.0 million and \$1.2 million, respectively.

Income Taxes

The Company records a tax provision primarily associated with state income taxes and its foreign operations. The Company has recorded a valuation allowance for the majority of its domestic net deferred tax assets, which are primarily related to its net operating loss carryforwards and for certain foreign deferred tax assets.

Cash Paid for Interest and Taxes

The Company made payments for interest of approximately \$0.3 million in each of the six month periods ended June 30, 2015 and 2014. Income taxes of approximately \$0.7 million and \$0.4 million were paid by the Company during the six month periods ended June 30, 2015 and 2014, respectively.

Impact of Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (the "FASB") issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single, comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 is applicable for fiscal years beginning after December 15, 2016, including interim periods therein, and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. Early adoption is not permitted. The proposed guidance (ASU 2014-09), if approved, would allow a one-year deferral of adoption. The Company is currently evaluating the impact of the new guidance on the consolidated financial statements and related disclosures.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15") which will require management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosures in certain circumstances. ASU 2014-15 is effective for annual and interim periods beginning after December 15, 2016. The Company currently intends to adopt ASU 2014-15 as of and for the annual period ending December 31, 2016 and does not expect the adoption of this standard to have any impact on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Topic 835-30): Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03") which will require debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by ASU 2015-03. This guidance is effective for annual and interim periods beginning after December 15, 2015, and early adoption is permitted. The Company currently expects to adopt ASU 2015-03 during the quarter ending September 30, 2015 by recognizing debt issuance costs as a direct deduction of the related debt liability.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, which modifies existing requirements regarding measuring inventory at the lower of cost or market. Under existing standards, the market amount requires consideration of replacement cost, net realizable value (NRV), and NRV less an approximately normal profit margin. The new ASU replaces market with NRV, defined as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This eliminates the need to determine and consider replacement cost or NRV less an approximately normal profit margin when measuring inventory. This standard is effective for the Company prospectively beginning January 1, 2017, with early adoption permitted. The Company is currently assessing this ASU's impact on the Company's consolidated financial statements.

3. NET LOSS PER COMMON SHARE

Basic and diluted net loss per common 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 common share for the six months ended June 30, 2015, and 2014 were 1.3 million and 1.8 million, respectively, as the effect would be anti-dilutive.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

4. STOCK AND STOCK OPTIONS

On March 23, 2015, pursuant to the Company's Employee Stock and Incentive Plan, as amended and restated ("the Plan"), the Company issued approximately 12,000 Other Stock-Based Awards and approximately 38,000 Restricted Stock Unit Awards (as such terms are defined in the Plan) to certain of the Company's executive officers and senior management. The Restricted Stock Unit Awards are subject to three year vesting based on continued employment.

In March 2015, the Company issued Restricted Stock Units and Performance-Based Share Awards (as such terms are defined in the Plan) to the Company's executives and senior management. Under the terms of the 2015 awards, the number of restricted stock units and performance shares that each such individual may receive is subject to, and calculated by reference to, the achievement by the Company of a performance goal measured by a range of targeted financial performance, as defined, for 2015, as well as, for certain of the restricted stock units, individual performance goals, as defined. Assuming achievement of the highest financial and individual performance goal, the aggregate maximum number of restricted stock units is 86,500 and the aggregate maximum number of performance shares is approximately 280,000, which performance shares are subject to annual vesting based upon continued employment, and for certain of the performance shares, the comparative performance (on an annual and cumulative basis) of the Company's common stock on NASDAQ compared to the Russell Micro Cap Index.

During the six months ended June 30, 2015 the Company issued an aggregate of 156,000 options to purchase shares of common stock, which generally vest over a three-year period.

Total stock-based compensation expense was \$2.0 million and \$1.7 million for the six month periods ended June 30, 2015 and 2014, respectively, and was included as a component of selling, general and administrative expenses in the consolidated statements of operations.

5. VENDOR FINANCING

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of Ricoh products in the United States, providing financing for eligible Ricoh inventory and certain receivables up to \$15.0 million. The agreement has no stated maturity date and provides either party the ability to exit the facility following a 90-day notice. Given the structure of this facility and as outstanding balances, which represent inventory purchases, are repaid within twelve months, the Company has classified the outstanding amounts under this facility, which were \$7.9 million and \$8.4 million as of June 30, 2015 and December 31, 2014, respectively, as accounts payable in the consolidated balance sheets. As of June 30, 2015, Supplies Distributors had \$2.5 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends. The credit facility also contains financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and is secured by certain of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note

receivable balance from Supplies Distributors of \$2.5 million and the Company is required to maintain a minimum shareholders' equity of \$18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5% (3.75% as of June 30, 2015). The facility also includes a monthly service fee.

In August 2015, the Company amended this facility with IBM Credit LLC. See Note 9 below.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

6. DEBT AND CAPITAL LEASE OBLIGATIONS;

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

	June 30, 2015	December 31, 2014
Loan and security agreements		
Supplies Distributors	\$2,167	\$ 3,267
PFS	1,704	1,890
Master lease agreements	5,370	5,589
Other	215	166
Total	9,456	10,912
Less current portion of long-term debt	5,717	6,850
Long-term debt, less current portion	\$3,739	\$ 4,062

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 \$12 million of eligible accounts receivable in the United States and Canada. As of June 30, 2015, Supplies Distributors had \$2.9 million of available credit under this agreement. 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. Borrowings under the Wells Fargo facility accrue interest at prime rate plus 0.25% to 0.75% (3.75% as of June 30, 2015) or Eurodollar rate plus 2.5% to 3.0%, dependent on excess availability and subject to a minimum of 3.0%, as defined. The interest rate as of June 30, 2015 was 3.75% for \$1.2 million of outstanding borrowings and 3.0% for \$1.0 million of outstanding borrowings. As of December 31, 2014, the interest rate was 3.75% for \$2.3 million of outstanding borrowings and 3.0% for \$1.0 million of outstanding borrowings. This agreement includes a monthly service fee and contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends. This agreement also contains financial covenants, such as minimum net worth, as defined, and is secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFS. Additionally, PFS is required to maintain a Subordinated Note receivable balance from Supplies Distributors of no less than \$2.5 million, may not maintain restricted cash of more than \$5.0 million and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks pursuant to which a security interest was granted to Wells Fargo for all U.S. and Canadian customer remittances received in specified bank accounts.

In August 2015, the Company replaced this Wells Fargo facility with a new credit facility with Regions Bank. See Note 9 below.

Loan and Security Agreement – PFS

PFS has a Loan and Security Agreement (“Comerica Agreement”) with Comerica Bank (“Comerica”). The Comerica Agreement provides for up to \$17.0 million (\$20.0 million during certain seasonal peak months) of eligible accounts receivable financing (“Working Capital Advances”) through March 2016. The Comerica Agreement also provided for up to \$2.0 million of eligible equipment advances (“Equipment Advances”) through March 2015, with a final maturity date of September 15, 2017. As of June 30, 2015, PFS had \$16.9 million of available credit under the Working Capital Advance portion of this facility and no available credit for Equipment Advances. Effective March 31, 2014, borrowings under the Working Capital Advance portion of the Comerica Agreement accrue interest at prime rate plus 1% (4.25% at June 30, 2015) while the Equipment Advances accrue interest at prime rate plus 1.5% (4.75% at June 30, 2015). The Comerica Agreement includes a monthly service fee and contains cross default provisions and various restrictions upon PFS’ ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of \$20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the Subordinated Note receivable from Supplies Distributors to a maximum of \$5.0 million. Comerica has provided approval for PFS to advance incremental amounts subject to certain financial covenants, as defined, to certain of its subsidiaries and/or affiliates, if needed. The Comerica Agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb, Inc.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

In August 2015, the Company replaced this Comerica facility with a new credit facility with Regions Bank. See Note 9 below.

Debt Covenants

To the extent the Company or any of its subsidiaries fail to comply with its covenants applicable to its debt or vendor financing obligations, including the monthly financial covenant requirements, such as profitability and cash flow, and required level of shareholders' equity or net worth (as defined), the Company would be required to obtain a waiver from the lender or the lender would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral and enforcement of payment under the Company parent guarantee. Any acceleration of the repayment of the credit facilities may have a material adverse impact on the Company's financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations. As of and for the six months ended June 30, 2015, the Company was in compliance with all debt covenants.

Master Lease Agreements

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

7. SEGMENT INFORMATION

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Revenues (in thousands):				
PFSweb	\$ 49,434	\$ 36,138	\$ 96,143	\$ 71,890
Business and Retail Connect	17,062	21,676	37,896	47,458
Eliminations	(3,320)	(3,771)	(7,017)	(8,076)
	\$ 63,176	\$ 54,043	\$ 127,022	\$ 111,272
Income (loss) from operations (in thousands):				
PFSweb	\$ (1,869)	\$ (2,677)	\$ (3,531)	\$ (4,530)
Business and Retail Connect	370	497	917	912

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	\$ (1,499)	\$ (2,180)	\$ (2,614)	\$ (3,618)
Depreciation and amortization (in thousands):				
PFSweb	\$ 3,290	\$ 2,834	\$ 6,521	\$ 5,681
Business and Retail Connect	19	44	43	