

PFSWEB INC
Form 10-K
March 31, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
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, 2009

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission file number 000-28275
PFSWEB, INC.
(Exact name of registrant as specified in its charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

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

500 North Central Expressway, Plano, Texas
(Address of principal executive offices)

75074
(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. 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 Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2009 (based on the closing price as reported by the National Association of Securities Dealers Automated Quotation System) was \$13,102,106.

At March 31, 2010, there were 9,954,957 shares of the registrant's Common Stock issued, \$.001 par value.

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.

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General**

PFSweb is an international business process outsourcing provider of end-to-end eCommerce solutions. PFSweb provides these solutions to major brand name companies seeking to optimize their supply chain and to enhance their traditional and online business channels and initiatives. Through our eCOST.com® business unit, we are also a leading multi-category online discount retailer of new, close-out and recertified brand-name merchandise. We derive our revenues from three business segments: 1) eCommerce and business process outsourcing, 2) master distribution and 3) online discount retailing.

First, in our eCommerce and business process outsourcing business segment operated by our Priority Fulfillment Services subsidiaries (PFS), we derive our revenues from a broad range of services as we process individual business transactions on our clients' behalf. These business transactions may include the answering of a phone call or an e-mail, the design and hosting of a client web-site, supporting an email marketing campaign, the deployment of an eCommerce technology platform, the receipt and storage of a client's inventory, the kitting and assembly of products to meet a client's specifications, the shipping of products to our client's customer base, the management of a complex set of electronic data transactions designed to keep our client's suppliers and customers accounting records in balance, and/or the processing of a returned package. In the eCommerce and business process outsourcing segment, we do not own the inventory or the resulting accounts receivable, but provide management services for these client-owned assets.

In our second business segment operated by our Supplies Distributors' subsidiaries we act as a master distributor of product for InfoPrint Solutions Company (IPS), a joint venture company owned by Ricoh and International Business Machines (IBM), and certain other clients. In this capacity, we purchase and resell for our own account, IPS and other manufacturers' inventory. Accordingly, in this business segment, we recognize product revenue and own the accounts receivable and inventory.

Our third business segment is eCOST.com® (eCOST), an online discount retailer of new, close-out and recertified brand-name merchandise. This web-commerce product revenue model is focused on the sale of products to a broad range of consumer and business customers. We currently offer approximately 300,000 products in several primary merchandise categories, including computers, networking, electronics and entertainment, TV's, monitors and projectors, cameras and camcorders, memory and storage, For the Home and sports and leisure.

We are headquartered in Plano, Texas where our executive and administrative offices and our primary technology operations and hosting facilities are located. We have an office in El Segundo, California, which consists of sales, marketing and purchasing operations for our online discount retailer segment. We operate state-of-the-art call centers from our U.S. facilities located in Plano, Texas, and Memphis, Tennessee, and from our international facilities located in Toronto, Canada, Liege, Belgium and Manila, Philippines. We lease or manage warehouse facilities of approximately 1.8 million square feet, many containing highly automated and state of the art material handling and communications equipment, in Memphis, Tennessee, Southaven, Mississippi, Grapevine, Texas, Toronto, Canada and Liege, Belgium, allowing us to provide global distribution solutions.

ECOMMERCE AND BUSINESS PROCESS OUTSOURCING SEGMENT

PFS is a global provider of end-to-end eCommerce and business process outsourcing solutions. Marketed as *PFSweb's End2End eCommerce®* platform, PFS' services breadth includes offerings such as eCommerce technology and integration services, interactive marketing services, global logistics and order fulfillment, freight and transportation management, real-time order management, kitting and assembly, customer care, facility operations and management, turn-key web-commerce infrastructure, payment processing and financial services. Collectively, we define our offering as End-to-End eCommerce and Business Process Outsourcing because we extend our clients infrastructure and technology capabilities, addressing an entire business transaction cycle from demand generation to product delivery. Our solutions support both business-to-business (B2B) and business-to-consumer (B2C) sales channels.

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PFS 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 manufacturers, distributors, online retailers and direct marketing organizations 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 PFS technology, expertise and proven methodologies, we enable client organizations 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 providing 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 this 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 requires highly customized solutions. PFS supports clients in a wide array of industries including fashion apparel and accessories, consumer goods, luxury goods, fragrance and beauty products, technology products, aviation, toys/education, collectibles, food and beverage and home furnishings. These clients turn to PFS 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 technology and business infrastructure offering is flexible, reliable and fully scalable. This flexibility allows us to design custom, variable cost solutions to fit the business requirements of our clients strategies.

Our capabilities are expansive. To offer the most necessary and resourceful solutions to our clients, we are continually developing capabilities to meet the pressing business issues in the marketplace. Our business objective is to focus on Leading the Evolution of Outsourcing™. As our tagline suggests, we will continue to evolve our service offering to meet the needs of the marketplace and the demands of unique client requirements. We are most successful when we provide a new capability to enable a client to pursue a new initiative and we are then able to leverage that revolutionary development across other client or prospect solutions, as it becomes best practice in the marketplace. Our team of experts design and build diverse solutions for online retailers, technology and consumer goods manufacturers, aviation brands as well as other major brand name clients around a flexible core of technology and physical infrastructure that includes:

Technology collaboration provided by our suite of technology services that enable buyers and suppliers to fully automate their business transactions within their supply chain. We support industry standard collaboration techniques and protocols including XML real-time application interfaces, secured text file exchanges and traditional electronic data interchange (EDI);

eCommerce technology solutions with managed hosting and Internet application development services, including web site design, creation, integration and ongoing maintenance, support and enhancement of web sites;

Interactive Marketing Services with professionals and technologies that can be integrated into a total solution to support user experience design, customer acquisition, analytics, customer retention and revenue generation objectives;

Order management, including order processing from any source of entry, back order processing and future order processing, tracking and tracing, credit management, electronic payment processing, calculation and

collection of sales tax and VAT, comprehensive freight calculation and email notification, all with multiple currency and language options;

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Customer Relationship Management (CRM), including interactive voice response (IVR) technology and web-enabled customer contact services through call centers utilizing voice, e-mail, voice over internet protocol (VOIP) and internet chat communications that are fully integrated with real-time systems and historical data archives to provide complete customer lifecycle management;

International fulfillment and distribution services, including warehouse management, inventory management, vendor managed inventory, inventory postponement, product warehousing, order picking and packing, freight and transportation management and reverse logistics;

Facility Operations and Management (FOM) that includes process reengineering, facility design and engineering and employee administration;

Kitting and assembly services, including light assembly, procurement services, supplier relationship management, specialized kitting, and supplier consigned inventory hub in our distribution facilities or co-located in other facilities;

Product management and inspection services, including management of coupon programs, de-kitting and salvage operations and inspection, testing and repackaging services;

Information management, including real-time data interfaces, data exchange services and data mining;

Financial services, including secure online credit card processing related services, fraud protection, invoicing, credit management and collection, and working capital solutions; and

Professional consulting services, including a consultative team of experts that customize solutions to each client and continuously seek out ways to increase efficiencies and produce benefits for the client.

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 B2C 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.

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 e-commerce 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 B2C 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 that 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.

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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 ensure the same quality performance and superior experience that 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.

The PFS Solution

PFS serves as the brand behind the brand for companies seeking high performance sales channels.

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 wish 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. We act as both a virtual and a physical infrastructure for our clients' businesses, embracing their brand values and strategic objectives. By utilizing our services, our clients are able to:

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Quickly Capitalize on Market Opportunities. Our solutions empower clients to rapidly implement their supply chain and eCommerce strategies and to 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 PFS 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 CRM reporting and exceptional order accuracy. We have significant experience in the development of eCommerce storefronts that allows us to recommend features and functions that are 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 that outsourcing can provide 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 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.

PFS Services

We offer a comprehensive and integrated set of business infrastructure solutions that are tailored to our clients specific needs and enable them to quickly and efficiently implement their supply chain strategies.

Technology Collaboration. We have created the Entente Suite(SM), which illustrates the level of electronic cooperation that is possible when we construct solutions with our clients using this technology service offering. This set of technology services encompasses a wide range of business functions from order processing and inventory reporting to total e-commerce design and implementation. The Entente Suite(SM) comprises five key services EntenteWeb®, EntenteDirect®, EntenteMessage®, EntenteReport® and EntentePartnerConnect .

End-to-End eCommerce. We have integrated our services for contact center management, warehousing, logistics and fulfillment with Demandware eCommerce, a leading on-demand eCommerce platform, to provide a single, flexible solution spanning the eCommerce storefront, delivery of goods and ongoing customer care. Designed specifically for B2C brands, this 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.

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GlobalMerchant Commerceware® B2B Managed Hosting and Internet Application Development. Our GlobalMerchant Commerceware® service provides a complete e-commerce 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 e-commerce 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 IBM's eServer xSeries servers, Microsoft's .NET Technologies and our proprietary GlobalMerchant Commerceware platform, we maintain a robust hosting environment for our hosted client B2B web sites.

Order Management. Our order management solutions provide clients with 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 systems 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 reducing inventory turns, and assessing product flow through and end-consumer 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.

Customer Relationship Management. We offer a completely customized CRM solution for clients. Our CRM solution encompasses a full-scale customer contact management service offering, as well as a fully integrated customer analysis program. All customer contacts are captured and customer purchases are documented. Full-scale reporting on all customer transactions is available for evaluation purposes. 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.

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 a majority of 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, 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 client's organization, regarding order status, shipping, billing, returns and product information and availability as well as a variety of other questions. For certain clients, we handle Level I and Level II technical support. Level I technical support involves assisting clients' customers with basic technical issues, i.e. computer application issues. Level II support may involve a more in-depth question and answer session with the customer. Our web-enabled customer care technology identifies each customer contact automatically and routes it to the available customer care

representative who is individually trained in the client's business and products.

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Our web-enabled customer care centers are designed so that our customer care representatives can handle several different clients and products in a shared environment, thereby creating economy of scale benefits for our clients as well as highly customized dedicated support models that provide the ultimate customer experience and brand reinforcement. Our advanced technology also enables our representatives to up-sell, cross-sell and inform customers of other products and sales opportunities. The web-enabled customer care center is fully integrated into the data management and order processing system, allowing full visibility into customer history and customer trends. Through this fully integrated system, we are able to provide a complete CRM solution.

With the need for efficiency and cost optimization for many of our clients, we have integrated 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.

International Fulfillment and Distribution Services. 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 1.8 million square feet of leased or managed warehouse space domestically and internationally to store and process our and our clients' inventory. We receive client inventory in our distribution centers, verify shipment accuracy, unpack and audit packages (a process that includes spot-checking a small percentage of the client's 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. On behalf of our clients, we pick, pack and ship their customer orders and can provide customized packaging, capabilities of high volume shrink packaging, inserts and promotional literature for distribution with customer orders. For many clients, we provide gift-wrapping services including 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) for our clients, ranging from large high-end laser printers to small cosmetic compacts. Our facilities are flexibly configured to process B2B and single pick B2C 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.

Our primary B2B facility is in Southaven, Mississippi, containing almost 400,000 square feet of space. The Southaven facility has clear height added cubic space utilization, state-of-the-art lighting that increases the quality and volume of light while reducing energy costs, and certain long-term tax incentives offered by the State of Mississippi. Southaven maintains the same proximity to all modes of transportation compared with our Memphis facilities.

During 2009, we warehoused, managed and fulfilled more than \$2.0 billion in merchandise and transactions. Much of this does not represent our revenue, but rather the revenue of our clients for whom we provided eCommerce and business process outsourcing solutions. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

Based upon our clients' needs, 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

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equipped with multi-carrier functionality, allowing us to integrate with all leading package carriers and provide a comprehensive freight and transportation management offering. In addition, an increasingly important function that we provide for our clients is reverse logistics management. We offer a wide array of product return services, including issuing return authorizations, receipt of product, crediting customer accounts, and disposition of returned product.

Our domestic clients enjoy the benefits of having their inventory assets secured by 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. Our security program continues to gain trust and confidence from our clients as we protect their products and assets.

Facility Operations and Management. Our FOM 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 an aircraft parts distribution center in Grapevine, TX on behalf of one of our clients. 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 clients with the advantage of convenience, accountability and speed. Our comprehensive kitting and assembly services provide a quality one-stop resource for any international channel. 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.

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 would 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 product.

Combining our assembly services with our supplier-owned inventory hub services allows our clients to reduce cycle times, to compress their supply chains and to consolidate their operations and supplier management functions. We have supplier inventory management, assembly and fulfillment services all in one place, providing greater flexibility in product line utilization, as well as rapid response to change orders or packaging development. 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.

Our kitting and assembly services also include procurement. We work directly with client suppliers to make JIT inventory orders for each component in client packages, thereby ensuring we receive the appropriate inventory quantities at just the right time and we then turn them around JIT to customers.

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 client business needs worldwide.

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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.

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.

Financial 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 B2C clients.

We offer secure credit and collections services for both B2B and B2C businesses. Specifically, for B2C 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.

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.

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.

Technology Collaboration. Our suite of technology services designed to integrate our technology platform with our clients and their business partners encompasses a wide range of business functions from order processing and inventory reporting to rich content management

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EntentePartnerConnect is a data repository and retrieval service for providing our clients with access to comprehensive product and service information across a wide variety of product and service categories. This information is aggregated from multiple sources including PFS business partners such as Etilize that specialize in creating product content in certain categories. We also rely on other relationships and public-domain information sources to supply raw data for this service. Access to this information is provided through technology interfaces and web sites created using PFSweb's End2End eCommerce® platform. We also provide the EntentePartnerConnect service to our wholly-owned subsidiary eCOST via the eCOST.com® web site enabling the effective merchandising of the wide-range of products offered on eCOST.com®. The information available from EntentePartnerConnect for additional product categories offers eCOST the opportunity to increase revenues through an expanded product offering and potential future product category expansion.

Our collaboration technologies operate in an open systems environment and feature the use of industry-standard XML and SOA web services, enabling customized e-commerce 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 FTP, EDI, MQ Series, ALE, HTTP, and HTTPS.

Clients and Marketing

Our target clients include online retailers as well as 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 or programs, 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:

IBM (printer supplies in several geographic areas), Xerox (printers and printer supplies), Roots Canada LTD. (apparel), Hewlett-Packard (printers and computer networking equipment), Hawker Beechcraft Corp. (FOM and time-definite logistics supporting parts distribution), Riverbed Technologies (technology products) and LEGO Brand Retail (toys) amongst many others.

We target potential clients through an extensive integrated marketing program that is comprised of a variety of direct marketing techniques, email marketing initiatives, trade event participation, search engine marketing, public relations and a sophisticated outbound tele-sales lead generation model. We have also developed an intricate messaging matrix that defines our various eCommerce and business process outsourcing solutions and products, the vehicles we utilize to deliver marketing communication on these solutions/products and the target audience segments that display a demand for these solutions/products. This messaging matrix allows us to deploy highly targeted solution messages to selected key vertical industry segments where we feel that we are able to provide significant service differentiation and value. 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 or experience to 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.

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

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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.

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 wide array of customized services that cover a broad spectrum of eCommerce and business processes, including web-site design and hosting, kitting and assembly, order processing and shipment, credit card payment processing and customer service, 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.

MASTER DISTRIBUTOR SEGMENT

Our Supplies Distributors subsidiaries act as a master distributor of product for IPS and certain other clients. In this capacity, we purchase from IPS or other manufacturers and resell to their channel partners and end users.

Through Supplies Distributors, we can create and implement client inventory solutions, which may enable manufacturers to remove inventory and receivables from their balance sheets through the use of third party financing. We have years of experience in dealing with the issues related to inventory ownership, secure inventory management, replenishment and product distribution. We can offer prospective clients a management solution for the entire customer relationship, including ownership of inventory and receivables. Through CIP, we utilize technology resources to time the replenishment purchase of inventory with the simultaneous sale of product to the end user. All interfaces are done electronically and almost all processes regarding the financial transactions are automated, creating significant supply chain advantages.

We are experienced in the complex legal, accounting and governmental control issues that can be hurdles in the successful implementation of working capital financing programs. Our knowledge and experience help clients achieve supply chain benefits while reducing inventory-carrying costs. Substantial benefits and improvement to a company's balance sheet can be achieved through these working capital solutions.

While we generally recognize product revenue as a result of our inventory ownership through these relationships, operationally this segment is virtually the same as our eCommerce and Business Process Outsourcing Segment. See the preceding discussion for an overview of that segment.

Table of Contents**ONLINE DISCOUNT RETAILER SEGMENT**

Through eCOST.com®, we operate a leading multi-category online discount retailer of high quality new, close-out and recertified brand-name merchandise. We currently offer approximately 300,000 products in several primary merchandise categories, including computers, networking, electronics and entertainment, TV's, monitors and projectors, cameras and camcorders, memory and storage, For the Home and sports and leisure. Additionally, we offer several other categories of products and services to consumer and small business customers through what we believe is a unique and convenient buying experience, offering multiple shopping formats: every day low price and our proprietary Bargain Countdown®, Outrageous Offer, Secret Sale and Make an Offer. This combination of shopping formats helps attract value-conscious customers to our eCOST.com website who are looking for high quality products at low prices. Additionally, we offer a fee-based membership program to develop customer loyalty by providing subscribers exclusive access to preferential offers and free freight offers. We also provide rapid response customer service utilizing a strategically located distribution center and third-party fulfillment providers, as well as customer support from online and on-call sales representatives. We offer suppliers an efficient sales channel for merchandise in all stages of the product life cycle. We carry products from leading manufacturers such as Sony, JVC, Canon, Hewlett-Packard, Denon, Cuisinart, Sennheiser, Garmin, Panasonic, Toshiba and Microsoft and have access to a broad and deep selection of merchandise, including new and deeply discounted close-out and recertified brand-name merchandise.

Our Strengths

We have developed a differentiated business model, which provides our customers and vendors with numerous benefits. We provide consumers and businesses with quick and convenient access to high quality, new, close-out and recertified brand-name merchandise at discount prices similar to a traditional discount retailer without the stocking limitations and store location constraints. We believe we are unlike many online retailers because we market multiple merchandise categories and product types, serve both small businesses and consumers and offer multiple ways to purchase products: every day low price and our proprietary Bargain Countdown®, Outrageous Offer, Secret Sale and Make an Offer.

We offer the following key benefits to customers shopping on our website:

Broad and deep product selection. We sell high quality products across a broad selection of merchandise categories. Most of the products offered on our website are from well-known, brand-name manufacturers. We currently offer approximately 300,000 different products in several categories. Our product offerings are updated continually to reflect new product trends, keeping our merchandise selection relevant for our customers so they continue to visit our website.

Compelling price-to-value proposition. As part of our strategy to appeal to the high frequency value-oriented shopper, we offer low prices on new products and deeper discounts on our assortment of close-out and recertified merchandise. We employ aggressive promotional strategies to provide incentives for our customers to purchase merchandise on our website and build customer loyalty. We also offer a fee-based membership program to reward customer loyalty by providing exclusive access to preferential offers and free freight to members.

Multiple shopping formats on our website. We appeal to a broad customer base by offering multiple shopping formats designed to attract frequent visits to our website: every day low price and our proprietary Bargain Countdown®, Outrageous Offer, Secret Sale and Make an Offer. For the shopper who wants new and recently released products from leading manufacturers, we offer discounted merchandise in an everyday low price format. For the bargain shopper interested in close-out and recertified merchandise, we market products using our Bargain Countdown® format, which features time- and quantity-limited offers of selected merchandise that are more deeply discounted. Multiple times weekly we create a frenzied shopping environment by offering very limited quantity offers at significantly discounted prices through our Outrageous Offer and Secret Sale shopping formats. These formats are primarily targeted to attract new customers to eCOST.com. For final unit sales of an item we also offer a Make an Offer shopping format where consumers can offer a price of their

choosing and we subsequently decide to accept or decline the offer.

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Rapid response order fulfillment. We ship a majority of customer orders from inventory at our distribution facility located in Memphis, Tennessee. We also utilize virtual warehouse technology to access merchandise that is not in stock at our distribution facility.

Responsive customer service and positive shopping experience. We believe our customer service differentiates the buying experience for our customers. Our experienced team of inbound sales representatives and customer service representatives assist our consumer customers by telephone and e-mail. We also have relationship managers who are assigned to many of our small business customers to service their needs and increase future sales opportunities. Our website contains helpful features such as in-depth product information, inventory levels and order status. In addition, we continually monitor website traffic and order activity and periodically update our website to enhance the shopping experience for our customers.

Appealing features for small business customers. We offer our small business customers dedicated relationship managers to provide personalized service to their unique business needs.

We provide manufacturers and other vendors with a convenient channel to sell both large and small quantities of new, close-out and recertified inventory. We offer manufacturers and vendors the following key benefits:

Single point of distribution. Manufacturers and other vendors often use separate channels to sell new, recertified and close-out products because most retailers offer products in only one stage of the product life cycle. Through our multiple shopping formats, we offer manufacturers and other vendors the flexibility to use eCOST.com to sell products in a brand sensitive manner in any stage of the product life cycle.

Efficient distribution and sales channel. Our centralized distribution capability reduces vendor costs in shipping product to us. Our ability to rapidly sell inventory is a benefit to those vendors that offer us protection against price erosion. Our centralized product management and feedback to vendors on product sell-through and inventory position allow vendors to efficiently monitor product movement and placement, eliminating the need for frequent visits by vendor representatives to physical retail locations.

Customized manufacturer stores. With our in-house design and merchandising team, we provide manufacturers the opportunity to showcase their full assortment of products and accessories by establishing virtual stores on our website that are specific to individual manufacturers. We believe this allows manufacturers to maximize sales and branding of their products. We promote these manufacturer stores to our customer base through our integrated marketing strategy, including targeted e-mails highlighting a specific manufacturer and its products and directing customers to that manufacturer store on our website.

Speed to market for newly released products. We respond rapidly to new product releases from manufacturers through our ability to quickly post and market new products on our website and satisfy immediate customer demand through our rapid response order fulfillment capabilities.

Our Customers

We focus on consumers and business customers who often display similar consumer buying characteristics. We believe our consumer customers are savvy, online shoppers, who are brand and price conscious, and interested in new technology. Our business customers include small and medium sized businesses that we believe are currently underserved by other multi-category online retailers. While our business customer relationship managers focus on sales to small and medium sized businesses who are seeking to purchase products for use in their business, they also service certain resellers of technology products. We offer these small and medium sized business customers superior and personalized customer service and new and current, close-out and recertified merchandise at competitive prices.

Table of Contents**Our Website**

Our website is comprehensive, easy to use and provides an exciting shopping experience that encourages customer loyalty and repeat visits. We strive to add hundreds of new products to our online product mix weekly. Our website features high-quality product images, detailed product information and manufacturer specifications, as well as highlights of best-selling products and suggested accessories. We continually incorporate new technologies to improve the ease of use of our website.

Currently, the products available on the everyday low price portion of our website are organized into several primary product categories: computers, networking, electronics and entertainment, TV's, monitors and projectors, cameras and camcorders, memory and storage, For the Home and sports and leisure. We also offer the same products, if they meet certain criteria, on the proprietary Bargain Countdown® section of our website where we feature more than 100 limited time and limited quantity product deals across our broad merchandise categories. In addition to being able to use keyword searches to locate specific products on our website, customers can browse or search the products available on the everyday low price portion of our website by navigating the subcategories contained in our primary product categories and our featured manufacturer product showcases. Products that fall within more than one subcategory on our website are often posted on more than one web page, which we believe increases the visibility of the products and assists the customer in finding desired merchandise.

Everyday low price. Our multi-category merchandise assortment is available in an everyday low price retail format. Products are organized by subcategory under each major category tab. Each major category includes informative and shopper-friendly showcases organized by manufacturer, new technology, best sellers, seasonal gift guides, and new products. This shopping format features discounted new products and recently released products from leading manufacturers.

Bargain Countdown®. Our proprietary Bargain Countdown® shopping format offers more than 100 close-out, recertified and highly allocated deal products in limited quantities for a limited time. The Bargain Countdown® feature is designed as a purchasing marketplace for consumers that creates purchase urgency by uniquely indicating the quantity of items remaining for a current offer and the time remaining to purchase the product. Based on the popularity of an offer, an animated graphic icon will appear to alert the customer of the item's current sales velocity. After the offer has expired, the product is removed from Bargain Countdown® and may no longer be available at the previously deeply discounted price. Our Bargain Countdown® shopping format encourages repeat visits to our website due to the rapidly changing mix of merchandise deals, the animated graphics, the unique collection of close-out deals and the search for bargains. We also have theme-based Bargain Countdown® tabs throughout the year, including Holiday Countdown, Watches and Jewelry Countdown, and Game of the Year Countdown. Our Clearance Countdown tab is primarily used to liquidate overstocked and excess inventory across all product categories. Our Bargain Countdown Platinum Club® format is a version of Bargain Countdown® and offers exclusive pricing on select merchandise to our fee-based members.

Other key features of our website include: advanced search, online order status retrieval, online payment, shipping alternatives, online registration for promotions and catalogs and online extended service agreement recommendations.

As a commitment to our small and medium sized business customers, we offer them access to our business customer relationship management team, credit terms of up to net 30-days for qualified customers, software licensing, computer system configurations and extended payment term alternatives.

Our Merchandise

We strive to offer our customers an expansive selection of varied types of merchandise and currently offer approximately 300,000 products in several primary merchandise categories. While our product offerings change on a regular basis due to product availability and customer demand, we continually offer a wide variety of merchandise.

Computers and Networking. Our computers and networking product categories contains several subcategories including systems, software and networking equipment. In these subcategories customers can find products such as desktop, notebook and handheld computers; servers; personal digital assistants; various hardware, including CD and

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DVD drives and burners, flat screen monitors, color laser printers, scanners; and business, education and entertainment software.

Electronics and Entertainment. Our electronics and entertainment product category contains subcategories for DVD movies and gaming, audio systems, video systems and accessories. Within these subcategories, customers can find products such as DVD players; DVD movies and gaming; personal audio systems; speakers; digital video recorders that pause, rewind and replay live television; digital music players and a variety of accessories such as cables, remote controls and headphones.

TV s, Monitors and Projectors. Our TV s, monitors and projectors product category contains subcategories for monitors, projectors and accessories.

Cameras and Camcorders. Our cameras and camcorders product category contains products including digital still cameras; video cameras and camcorders in MiniDV format; drawing tablets for digital photo editing; digital photo and image editing software and photo printers.

Memory and Storage. Our memory and storage product category contains products including media formats such as Blu Ray, CD and DVD R/W as well as flash and system memory.

For the Home. Our For the Home product category offers customers the ability to shop in subcategories dedicated to home and housewares, personal care, home improvement, outdoor, automotive and apparel including watches and sunglasses. Within this portion of our website consumers can find products such as traditional household appliances including blenders, toasters and vacuum cleaners, professional quality cookware and gourmet kitchen appliances such as coffee grinders.

Sports and Leisure. Our sports and leisure product category offers products that range from various sports accessories for baseball, football and numerous other activities to toys, musical instruments and wedding accessories.

We continually evaluate expanding into additional categories to attract new customers and offer a broader variety of merchandise to our existing customers. We also plan to increase our depth in our current categories by adding new subcategories, brands and products and continuing to develop and increase the number of affiliate categories.

Sales and Marketing

We currently focus our advertising efforts on efficient and effective marketing campaigns aimed at acquiring new customers, encouraging repeat purchases and establishing the eCOST.com brand. Our online prospecting activities may include cost-per-click arrangements that include displaying our products within various price comparison sites and search engines such as Shopzilla, Microsoft Live Search Cashback and Google, strategic online banner advertising, affinity e-mail programs and participation in various online affiliate marketing programs. From time to time we test other prospecting vehicles including radio and magazine advertising. We send our current customers targeted e-mails focused on new product and category launches, special promotions, and product-related add-on and accessory offers, as well as cooperative manufacturer branding campaigns.

Vendors

We purchase products for resale both directly from manufacturers and indirectly through distributors and other sources, all of whom we consider our vendors. We provide vendors with a convenient channel to sell both large and small quantities of new, closeout and recertified inventory. We offer significant advantages for vendors, including a single point of distribution, efficient channel relationships, customized manufacturer stores and speedy release of their newest merchandise. Our vendors provide us with brand name new and current products, close-out models and manufacturer recertified products. We also have arrangements with third-party providers through which we receive commissions for products in certain categories, such as cellular phones and service, as well as other marketing and promotional services generated through our eCOST.com website.

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We offer products on our website from numerous third-party vendors. In general, we agree to offer products on our website and the manufacturers agree to provide us with information about their products and honor our customer service policies. We have established direct vendor relationships with many key suppliers and intend to continue to seek direct relationships with vendors and suppliers.

Competition

The market for our products is intensely competitive, rapidly evolving and has relatively low barriers to entry. New competitors can launch new websites at relatively low cost. We believe that competition in our market is based predominantly on:

price;

product selection, quality and availability;

shopping convenience;

customer service; and

brand recognition.

We currently or potentially compete with a variety of companies that can be divided into several broad categories: other multi-category online retailers and liquidation e-tailers;

online discount retailers of computer and consumer electronics merchandise such as Buy.com, NewEgg and TigerDirect;

consumer electronics and office supply superstores such as Best Buy, Office Depot, OfficeMax and Staples; and

manufacturers such as Apple, Dell, Gateway, Hewlett-Packard and IBM, who sell directly to customers.

Our largest manufacturers have sold, and continue to intensify their efforts to sell, their products directly to consumers. To the extent additional manufacturers adopt this selling format or this trend becomes more prevalent, it could adversely affect our sales growth and profitability.

Intellectual Property

We have five trademarks and/or service marks that we consider to be material to the successful operation of our business: eCOST®, eCOST.com®, eCOST.com Your Online Discount Superstore!®, Bargain Countdown® and Bargain Countdown Platinum Club®. We currently use these marks in connection with telephone, mail order, catalog, and online retail services, as well as with various business services. We have registrations in the United States for eCOST® and eCOST.com® for telephone, mail order, catalog, and online retail order services, and a registration for Bargain Countdown® for online retail order services. We also have a registration in the United States for Bargain Countdown Platinum Club® for business services, namely, promoting the goods and services of others by means of a customer loyalty program featuring information, incentives, discounts and rewards. We have registrations in Canada and in the United Kingdom for eCOST®, eCOST.com®, Bargain Countdown® and eCOST.com Your Online Discount Superstore!®. We own an additional registration in Canada for Bargain Countdown Platinum Club®.

We have received a patent from the U.S. Patent and Trademark Office for our proprietary Bargain Countdown® technology, although we cannot provide any assurance that effective patent and trademark protection will be available in all instances, including in other countries in which our products and services may be available.

ALL BUSINESS SEGMENTS

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 that are essential for us and our clients to efficiently manage

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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. 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 that 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 AT&T for our private enterprise network and long distance carrier. We use Oracle's J.D. Edwards as the software provider for the primary ERP applications that we use in our operational areas and financial areas. We use Dematic/Rapistan Materials Handling Automation for our automated order selection, automated conveyor and pick-to-light (inventory retrieval) systems, and Symbol Technologies/Telxon 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 e-commerce infrastructure to speed their time to market and minimize resource investment and risk, and allows 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 e-commerce 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 J.D. Edwards order management and fulfillment application. We utilize Gentran Integration Suite (GIS) as our technology platform for Enterprise Application Integration with our clients and clients' trading partners. With GIS, we have greatly increased our ability to quickly design and deploy customized B2B and B2C e-commerce 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.

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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.

Strategy

We continue to maintain our simple but effective strategy statement to drive our actions, QGP. This acronym stands for Quality, Growth and Profit. We believe that if we can achieve outstanding performance on these three basic elements, they will provide for a stable foundation for our future. As the evolution of our business model continues, we will remain focused on these three fundamentals:

Quality: To exceed our client's service level requirements and enhance the value of their brand while providing their customers a positive, memorable and efficient experience.

Growth: To increase our revenue and gross profit from its current levels. To aggressively market simplified product messages to drive new clients and revenue and profit growth. To become a larger company and create career and additional employment opportunities. Embrace strategic partnering to accentuate strengths and minimize weaknesses.

Profit: To generate positive cash flow and continue to strive for consistent profitable results. To increase the value of our company for all of its stakeholders while rewarding our team members with challenging, fun and memorable life experiences.

The successful balance of the execution of these fundamental strategies is targeted to result in the formation of a solid strategic and financial foundation and provide us a sustainable and profitable business model for the future.

See Risk Factors for a complete discussion of risk factors related to our ability to achieve our objectives and fulfill our business strategies.

Employees

As of December 31, 2009, we had approximately 1,000 employees, of which approximately 800 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 mentioned in collective bargaining agreements 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 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.

Table of Contents**Internet Access to Reports**

We maintain an Internet website, 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, or furnish it to the Securities and Exchange Commission. We also maintain an Internet website for our online discount retailer, www.ecost.com. The information on these websites 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 where 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, became effective in the United States on January 1, 2004 and imposes 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.

We collect sales or other similar taxes for shipments of goods in certain states. 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.

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.

Risks Related to All Our Business Segments

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.

During the past two years, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial

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institutions and an unprecedented level of intervention from the United States and foreign governments. 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.

Our business and future growth currently depend on our ability to access bank and commercial lines of credit. We currently depend on an aggregate of approximately \$111 million in line of credit facilities provided by various banks and commercial lenders. These lines of credit currently mature in at various dates through May 2011 and are secured by substantially all our assets. Our ability to renew our line of credit facilities depends upon various factors, including the availability of bank loans and commercial credit in general, as well as our financial condition and prospects. Therefore, we cannot guarantee that these credit facilities will continue to be available beyond their current 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.

Our clients and customers may be unable to pay us for our products and services

Our clients and customers include some companies that may from time to time encounter financial difficulties, especially in light of the current economic environment and the turmoil in the credit markets. If a client's or customer's financial difficulties become severe, they may be unwilling or unable to pay our invoices in the ordinary course of business, which could adversely affect collections of both our accounts receivable and unbilled services. The bankruptcy of a client or customer with a substantial account receivable could have a material adverse effect on our financial condition and results of operations. In addition, if a client or customer declares bankruptcy after paying us certain invoices, a court may determine that we are not properly entitled to that payment and may require repayment of some or all of the amount we received, which could adversely affect our financial condition 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 if our operating and marketing expenses exceed our expectations, we may not generate sufficient revenue to be profitable or be able to sustain or increase profitability on a quarterly or an annual basis in the future. Additionally, if our revenue grows slower than either we anticipate or our clients' projections indicate, we may incur unnecessary or redundant costs and our operating results could be adversely affected.

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

We prepare our financial statements to conform to United States generally accepted accounting principles, or GAAP. GAAP is subject to interpretation by the Financial Accounting Standards Board, the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results and may even affect our reporting of transactions that were completed before a change is announced. Accounting rules affecting many aspects of our business, including rules relating to accounting for revenue recognition, arrangements involving multiple deliverables, and operating leases, have recently been revised or are currently under review. Changes to those rules or current interpretation of those rules may have a material adverse effect on our reported financial results or on the way we conduct our business.

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

As of December 31, 2009, our total credit facilities outstanding, including debt, capital lease obligations and our vendor accounts payable related to financing of IPS product inventory, was approximately \$54.2 million. Certain of the credit facilities have maturity dates in calendar year 2011, but are classified as current liabilities in our

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consolidated financial statements. We cannot provide assurance that our credit facilities will be renewed by the lending parties. Additionally, these credit facilities include both financial and non-financial covenants, many of which also include cross default provisions applicable to other agreements. These covenants also restrict our ability to transfer funds among our various subsidiaries, which may adversely affect the ability of our subsidiaries to operate their businesses or comply with their respective loan covenants. We cannot provide assurance that we will be able to maintain compliance with these covenants. Any non-renewal or any default under any of our credit facilities would have a material adverse impact upon our business and financial condition. In addition we have provided \$5.0 million of subordinated indebtedness to Supplies Distributors as of December 31, 2009. The maximum level of this subordinated indebtedness to Supplies Distributors that may be provided without approval from our lenders is \$5.5 million. The restrictions on increasing this amount without lender approval may limit our ability to comply with certain loan covenants or further grow and develop Supplies Distributors' business. We have guaranteed most of the indebtedness of Supplies Distributors. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors by its lenders to the extent Supplies Distributors is unable to do so. We have also guaranteed eCOST's \$7.5 million credit line, as well as certain of its vendor trade payables. We currently expect that it may be necessary to provide additional guarantees of certain eCOST vendor trade payables in the future.

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

Our performance is highly dependent on the continued services of our executive officers and other key personnel, the loss of any of whom could materially adversely affect our business. In addition, we need to attract and retain other highly-skilled, technical and managerial personnel for whom there is intense competition. We cannot assure you 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 center in Liege, Belgium with approximately 150,000 square feet and a distribution center in Toronto, Canada with approximately 23,000 square feet, both of which currently have excess capacity. We also operate a facility in the Philippines with approximately 7,000 square feet to provide call center and customer service functions, technical support, product management and sales activities. We cannot assure you that we will be successful in expanding in these or any additional international markets. In addition to the uncertainty regarding our ability to generate revenue from foreign operations and expand our international presence, there are risks inherent in doing business internationally, including:

changing regulatory requirements;

legal uncertainty regarding foreign laws, tariffs and other trade barriers;

political instability;

potentially adverse tax consequences;

foreign currency fluctuations; and

cultural differences.

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

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

Our future capital needs are difficult to predict. We may require additional capital to take advantage of unanticipated opportunities, including strategic alliances and acquisitions 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. 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 or reduce the market value of our common stock.

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We may engage in future strategic alliances or acquisitions that could dilute our existing shareholders, 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. We may not be able to operate any acquired businesses profitably or otherwise implement our growth strategy successfully. If we are unable to integrate any newly acquired entities or technologies effectively, our operating results could suffer. Future acquisitions could also result in incremental expenses and the incurrence of debt and contingent liabilities, any of which could harm our operating results.

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

As of December 31, 2009 and based on the current requirements, and our public float, we were not required to comply with the requirements of Section 404 of the Sarbanes-Oxley Act to obtain a report by our independent auditors opining on the effectiveness of our internal controls over financial reporting. We will be subject to this independent auditor requirement for the year ending December 31, 2010. If we fail to correct any issues in the design or operating effectiveness of internal controls over financial reporting or fail to prevent fraud, current and potential shareholders could lose confidence in our financial reporting, which could harm our business and the trading price of our common stock.

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 distribution or call center facilities were interrupted or shut down as the result of a natural disaster.

We operate a majority of our distribution facilities in or around the Memphis, Tennessee area and our call center operations are centered in Plano, Texas. Any natural disaster or other serious disruption to these 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 these facilities, which may or may not be reimbursed by insurance. As a result, disruption at one or more of these facilities could adversely affect our profitability.

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We may be a party to litigation involving our e-commerce intellectual property rights. If third parties claim we 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.

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

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 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 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 against those who license technology to us, 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 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.

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

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

We may be required to expend significant capital and other resources to protect against security breaches or to address any problem they may cause. Because our activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage 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 clients' 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 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

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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.

We are subject to a dispute with a municipal authority, which, if not resolved in our favor, may materially adversely affect our results of operations.

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

Risks Related to Our PFS and Supplies Distributors Operating Segments

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

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

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

For the year ended December 31, 2009 and 2008, a U.S. government agency, a technology company, and a consumer products company represented approximately 7%, 15% and 10%, respectively, and approximately 37%, 10% and 6%, respectively, of our total service fee revenue, excluding pass-through revenue. Our activity under our contract with the U.S. government agency concluded in the second quarter of 2009. PFS currently operates three distinct geographical contract arrangements with the technology company, which are aggregated in the service fee revenue percentages above. During 2010, the technology company notified PFS that it is not renewing two of its three contracts with PFS expiring during 2010. The non-renewal of these contracts has had, and may continue to have, a material adverse effect upon our business.

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

Sales by Supplies Distributors to two customers accounted for approximately 30% of Supplies Distributors ' total product revenue for each of the years ended December 31, 2009 and 2008 (16% and 15% of our consolidated net revenues for the years ended December 31, 2009 and 2008, respectively). The loss of any one or more of such customers, or non-payment of any material amount by these or any other customer, would have a material adverse effect upon Supplies Distributors ' business.

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

Our business is materially impacted by our client mix and the seasonality of their business. Based upon our current client mix and their current projected business volumes, we anticipate our service fee revenue business activity will be at its lowest in the first quarter of our fiscal year and that our master distributor product 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 that 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 that the volume of transactions will increase significantly as we expand our operations. If this occurs, additional stress will be placed upon the network hardware and software that manages our operations. We cannot assure you of our ability to efficiently manage a large number of transactions. If we are not able to maintain an appropriate level of operating performance, we may develop a negative reputation, and impair existing and prospective client relationships and our business would be materially adversely affected.

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

We generally incur start-up costs in connection with the planning and implementation of business process solutions for our clients. Although we generally attempt to recover these costs from the client in the early stages of the client relationship, or upon contract termination if the client terminates without cause prior to full amortization of these costs, there is a risk that the client contract may not fully cover the start-up costs. To the extent start-up costs exceed the start-up fees received, 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.

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

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

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

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

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

The sales cycle for our services is variable, typically ranging between several months to up to a year 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 that of us or our clients.

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

Our clients' businesses may also be harmed from any system or equipment failures we 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.

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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 clients' products could be slowed or stopped.

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 e-commerce environments are characterized by rapid technological change, changes in user requirements and preferences, frequent new product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our technology and systems obsolete. Our success will depend, in part, on our ability to both internally develop and license leading technologies to enhance 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 eCOST, our Online Discount Retailer Segment

We may not be able to achieve or maintain profitability.

We have incurred continuing operating losses and may not be able to achieve or maintain profitability on a quarterly or annual basis. Our ability to achieve or maintain profitability depends on a number of factors, including our ability to:

increase sales;

maintain and expand vendor relationships;

obtain additional and increase existing trade credit with key suppliers;

generate sufficient gross profit; and

control costs and generate the expected synergies applicable to the merger.

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

We may need to obtain additional financing and there can be no assurance that we will be able to obtain additional financing on commercially reasonable terms or at all. Our failure to obtain additional financing or our inability to obtain financing on acceptable terms will materially adversely affect our ability to achieve profitability and grow our business.

Our operating results are difficult to predict.

Our operating results have fluctuated in the past and are likely to vary significantly in the future based upon a number of factors, many of which we cannot control. We operate in a highly dynamic industry and future results

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could be subject to significant fluctuations. Revenue and expenses in future periods may be greater or less than revenue and expenses in the immediately preceding period or in the comparable period of the prior year. Therefore, period-to-period comparisons of our operating results are not necessarily a good indication of our future performance. Some of the factors that could cause our operating results to fluctuate include:

price competition that results in lower sales volumes, lower profit margins, or net losses;

our ability to prevent credit card fraud and reduce chargeback activity;

the amount, timing and impact of advertising and marketing costs;

our ability to successfully implement new technologies or software systems;

our ability to obtain sufficient financing;

changes in the number of visitors to our website or our inability to convert those visitors into customers;

technical difficulties, including system or Internet failures;

fluctuations in the demand for our products or overstocking or under-stocking of products;

fluctuations in revenues and shipping costs, particularly during the holiday season;

economic conditions generally or economic conditions specific to the Internet, online commerce, the retail industry or the mail order industry;

changes in the mix of products that we sell; and

fluctuations in levels of inventory theft, damage or obsolescence.

The failure to improve our financial and operating performance may result in a failure to comply with our financial covenants.

In the event we are unable to increase our revenue and/or gross profit from our present levels and do not achieve a sufficient level of operating efficiencies, we may fail to comply with one or more of the financial covenants required under our working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding thereunder and exercise all other rights and remedies, including sale of collateral and payment under the parent guaranty.

If we fail to accurately predict our inventory risk, our margins may decline as a result of write-downs of our inventory due to lower prices obtained for older or obsolete products.

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

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

We make allowances for product returns based on historical return rates. We are responsible for returns of certain products ordered through our website from our distribution center as well as products that are shipped to our customers directly from our vendors. If our actual product returns significantly exceed our allowances for returns, especially as we expand into new product categories, our revenues and profitability could decrease. In addition, because our allowances are based on historical return rates, the introduction of new merchandise categories, new products, changes in our product mix, or other factors may cause actual returns to exceed return allowances, perhaps

significantly. Any policies intended to reduce the number of product returns may result in customer dissatisfaction, increased credit card chargeback activity and fewer repeat customers.

Our ability to offer a broad selection of products at competitive prices is dependent on our ability to maintain existing and build new relationships with manufacturers and vendors. We do not have long-term agreements with our manufacturers or vendors and some of our manufacturers and vendors compete directly with us.

We purchase products for resale both directly from manufacturers and indirectly through distributors and other sources, all of whom we consider our vendors. We do not have any long-term agreements with any of these vendors. Any agreements with vendors governing our purchase of products are generally terminable by either party upon 30 days notice or less. In general, we agree to offer products on our website and the vendors agree to provide us with

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information about their products and honor our customer service policies. If we do not maintain relationships with vendors on acceptable terms, including favorable product pricing and vendor consideration, we may not be able to offer a broad selection of products or continue to offer products at competitive prices, and customers may choose not to shop at our website. In addition, some vendors may decide not to offer particular products for sale on the Internet, and others may avoid offering their new products to retailers like us who offer a mix of close-out and recertified products in addition to new products. From time to time, vendors may terminate our right to sell some or all of our products, change the applicable terms and conditions of sale or reduce or discontinue the incentives or vendor consideration that they offer. Any such termination or the implementation of such changes could have a negative impact on our operating results. Additionally, some products are subject to manufacturer or distributor allocation, which limits the number of units of those products that are available to us and other resellers.

Our business is subject to the risk of supplier concentration.

Our business is dependent on sales of Hewlett Packard (HP) and HP-related products, which represented approximately 44% of eCOST's net revenues (11% of our consolidated revenues) in 2009 and 43% of eCOST's net revenues (9% of our consolidated revenues) in 2008. If our ability to purchase direct from HP is terminated or restricted, or if the demand for HP and HP-related products declines, our business could be materially adversely affected.

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

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

Because we experience seasonal fluctuations in our revenues, our quarterly results may fluctuate.

Our business is moderately seasonal, reflecting the general pattern of peak sales for the retail industry during the holiday shopping season. Typically, a larger portion of our revenues occur during the first and fourth fiscal quarters. We believe that our historical revenue growth makes it difficult to predict the effect of seasonality on our future revenues and results of operations. In anticipation of increased sales activity during the first and fourth quarters, we incur additional expenses, including higher inventory and staffing costs. If sales for the first and fourth quarters do not meet anticipated levels, then increased expenses may not be offset which could decrease our profitability. If we were to experience lower than expected sales during our first or fourth quarters, for any reason, it would decrease our profitability.

Our business may be harmed by fraudulent activities on our website.

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

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

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

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

Historically, we have generated the substantial majority of our revenues from the sale of computer hardware, software and accessories and consumer electronics products. In recent years, we have added several new product categories, including For the Home and sports and leisure. While our merchandising platform has been incorporated into and tested in the online computer and consumer electronics retail markets, we cannot predict with certainty whether it can be successfully applied to other product categories. In addition, expansion of our business strategy into new product categories may require us to incur significant marketing expenses, develop relationships with new vendors and comply with new regulations. We may lack the necessary expertise in a new product category to realize the expected benefits of that new category. These requirements could strain managerial, financial and operational resources. Additional challenges that may affect our ability to expand into new product categories include our ability to:

establish or increase awareness of new brands and product categories;

acquire, attract and retain customers at a reasonable cost;

achieve and maintain a critical mass of customers and orders across all product categories;

attract a sufficient number of new customers to whom new product categories are targeted;

successfully market new product offerings to existing customers;

maintain or improve gross margins and fulfillment costs;

attract and retain vendors to provide an expanded line of products to customers on terms that are acceptable;
and

manage inventory in new product categories.

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

Credit card fraud could materially adversely affect our business.

We do not currently carry insurance against the risk of credit card fraud, so the failure to adequately control fraudulent credit card transactions could reduce our revenues and gross margin. We may suffer losses as a result of orders placed with fraudulent credit card data even though the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions because we did not obtain a cardholder's signature. If we are unable to detect or control credit card fraud, or if credit card companies require more burdensome terms, refuse to accept credit card charges or assess financial penalties, our business could be materially adversely affected.

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If we are unable to provide satisfactory customer service, we could lose customers.

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

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

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

other multi-category online retailers and liquidation e-tailers;

online discount retailers of computer and consumer electronics merchandise such as Buy.com, NewEgg and TigerDirect;

consumer electronics and office supply superstores such as Best Buy, Office Depot, OfficeMax and Staples; and

manufacturers such as Apple, Dell, Gateway, Hewlett-Packard and IBM, that sell directly to customers.

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

If the protection of our trademarks and proprietary rights is inadequate, our eCOST brand and reputation could be impaired and we could lose customers.

We have five trademarks and/or service marks that we consider to be material to the successful operation of our business: eCOST ® , eCOST.com ® , eCOST.com Your Online Discount Superstore! ® , Bargain Countdown ® and Bargain Countdown Platinum Club ® . We currently use these marks in connection with telephone, mail order, catalog and online retail services. We rely on trademark and copyright law, trade secret protection and confidentiality agreements with our employees, consultants, suppliers and others to protect our proprietary rights. Our competitors or others could adopt trademarks and/or service marks similar to our marks, or try to prevent us from using our marks, and/or contest our registrations in and to our marks thereby impeding our ability to build brand identity and possibly leading to customer confusion. Any claim by another party against us for customer confusion caused by use of our trademarks and/or service marks, or our failure to obtain registrations for our marks, could negatively affect our competitive position and could cause us to lose customers.

Although we have received a patent from the U.S. Patent and Trademark Office for our proprietary Bargain Countdown ® technology, we cannot provide any assurance that effective patent and trademark protection will be available in all instances, including in other countries in which our products and services may be available.

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

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

We sell products manufactured and distributed by third parties, some of which may be defective or may not comply with applicable laws or regulations, such as laws or regulations requiring warning labels. If any product that we sell were to cause physical injury or damage to property or otherwise not comply with applicable laws or regulations, we may be subject to claims being asserted against us as the retailer of the product. Our insurance coverage may not be available or adequate to cover every claim that could be asserted. If a successful claim were brought against us in excess of its insurance coverage, it could expose us to significant liability. Even unsuccessful claims could result in the expenditure of funds and management time and could decrease profitability.

eCOST may be subject to future impairment charges related to eCOST's intangible assets.

The valuation of intangible assets related to eCOST is dependent upon, among other things, the estimated value of eCOST's projected cash flows for its business. In the event eCOST is unable to meet such projections, or such estimated values are otherwise less than the carrying value of such intangibles, we may be required under current accounting rules to record an impairment charge in connection with the write-down of such intangibles.

Risks Related to Our eCOST Online Retailer Operating Segment's Industry

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

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

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

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet and e-commerce. Such existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, user privacy, marketing and promotional practices, database protection, pricing, content, copyrights, distribution, electronic contracts, email and other communications, consumer protection, product safety, the provision of online payment services, intellectual property rights, unauthorized access (including the Computer Fraud and Abuse Act), and the characteristics and quality of products and services. It is unclear how existing laws governing issues such as property ownership, sales and other taxes, libel, trespass, data mining and collection, and personal privacy apply to the Internet and e-commerce. Unfavorable resolution of these issues may expose us to liabilities and costly changes in our business operations, and could reduce customer demand. The growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens on online

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companies. For example, the laws of many states require notice to customers if certain personal information about them is obtained by an unauthorized person, such as a computer hacker. These consumer protection laws could result in substantial compliance costs and could decrease profitability.

Risks Related to Our Stock

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

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

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

As of December 31, 2009, we have an aggregate of 1.8 million stock options outstanding to employees, directors and others with a weighted average exercise price of \$4.75 per share. The shares of common stock that may be issued upon exercise of these options may be resold into the public market. Sales of substantial amounts of common stock in the public market as a result of the exercise of these options, or the perception that future sales of these shares could occur, could reduce the market price of our common stock and make it more difficult to sell equity securities in the future.

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

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

Pursuant to our bylaws and under Delaware law, our directors are not liable to us or our 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.

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Item 2. *Properties*

Our general corporate headquarters and the corporate headquarters of our PFS service fee and Supplies Distributors businesses are located in Plano, Texas, a Dallas suburb. Our eCOST corporate headquarters is located in El Segundo, California.

In the U.S., we operate two distribution facilities in Memphis, Tennessee, with aggregate space of approximately 600,000 square feet. We also operate approximately 825,000 square feet of distribution facilities in Southaven, Mississippi. Both of these complexes are located approximately five miles from the Memphis International Airport. We also manage a distribution facility in Grapevine, Texas with approximately 200,000 square feet.

We operate a distribution center in Liege, Belgium with approximately 150,000 square feet, which contains advanced distribution systems and equipment. We operate a distribution center in Toronto, Canada with approximately 23,000 square feet. We also operate a facility in the Philippines with approximately 7,000 square feet to provide call center and customer service functions. We operate customer service centers in our facilities in Tennessee, Texas, Belgium and the Philippines. Our call center technology permits the automatic routing of calls to available customer service representatives in several of our call centers.

Except for the Grapevine, Texas facility, which we manage on our client's behalf, all of our facilities are leased and the material lease agreements contain one or more renewal options.

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. *Reserved*

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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, 2008		
First Quarter	\$6.02	\$3.62
Second Quarter	\$5.56	\$3.50
Third Quarter	\$4.85	\$2.22
Fourth Quarter	\$2.59	\$0.69
Year Ended December 31, 2009		
First Quarter	\$1.90	\$0.70
Second Quarter	\$1.74	\$0.90
Third Quarter	\$1.90	\$1.11
Fourth Quarter	\$1.83	\$1.22

As of March 3, 2010, there were approximately 5,400 shareholders of which approximately 107 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. We currently intend to retain all earnings to finance the further development of our business. 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.

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 last three years;

Our relationship with our subsidiaries Supplies Distributors and eCOST;

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

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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 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 or transaction volume or product sales;

our dependence upon our agreements with International Business Machines Corporation (IBM) and InfoPrint Solutions Company (IPS), a joint venture company owned by Ricoh and IBM;

our dependence upon our agreements with our major clients;

our client mix, their business volumes and the seasonality of their business;

our ability to finalize pending contracts;

the impact of strategic alliances and acquisitions;

trends in e-commerce, outsourcing, government regulation both foreign and domestic and the market for our services;

whether we can continue and manage growth;

increased competition;

our ability to generate more revenue and achieve sustainable profitability;

effects of changes in profit margins;

the customer and supplier concentration of our business;

the reliance on third-party subcontracted services;

the unknown effects of possible system failures and rapid changes in technology;

foreign currency risks and other risks of operating in foreign countries;

potential litigation;

our dependency on key personnel;

the impact of new accounting standards, and changes in existing accounting rules or the interpretations of those rules;

our ability to raise additional capital or obtain additional financing;

our ability and the ability of our subsidiaries to borrow under current financing arrangements and maintain compliance with debt covenants;

relationship with and our guarantees of certain of the liabilities and indebtedness of our subsidiaries;

taxation on the sale of our products;

eCOST's ability to maintain existing and build new relationships with manufacturers and vendors and the success of its advertising and marketing efforts;

eCOST's ability to increase its sales revenue and sales margin and improve operating efficiencies; and

eCOST's ability to generate projected cash flows sufficient to cover the values of its intangible assets.

We have based these statements on our current expectations about future events. Although we believe 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