PFSWEB INC
Form 10-Q
May 15, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended March 31, 2007

OR

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

For the Transition Period from ___to ___

Commission File Number 000-28275

PFSweb, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

At May 8, 2007 there were 46,563,008 shares of registrant s common stock outstanding.

PFSWEB, INC. AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements

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

	March 31, 2007	December 31, 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 14,572	$ 15,066
Restricted cash	852	2,653
Accounts receivable, net of allowance for doubtful accounts of $2,020 and $2,352 at March 31, 2007 and December 31, 2006, respectively	48,292	48,717
Inventories, net of reserves of $2,522 and $2,987 at March 31, 2007 and December 31, 2006, respectively	46,977	47,670
Other receivables	12,825	10,774
Prepaid expenses and other current assets	3,802	3,531
Total current assets	127,320	128,411
PROPERTY AND EQUIPMENT, net	13,057	12,884
IDENTIFIABLE INTANGIBLES	6,429	6,647
GOODWILL	15,362	15,362
OTHER ASSETS	819	848
Total assets	$ 162,987	$ 164,152
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt and capital lease obligations	$ 25,036	$ 23,802
Trade accounts payable	62,072	61,972
Accrued expenses	21,506	21,485
Total current liabilities	108,614	107,259
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	5,918	6,076
OTHER LIABILITIES	1,700	1,977
Total liabilities	116,232	115,312

COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY:		
Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued and outstanding	¾	¾
Common stock, $0.001 par value; 75,000,000 shares authorized; 46,563,008 and 46,553,752 shares issued at March 31, 2007 and December 31, 2006, respectively; and 46,476,708 and 46,467,452 outstanding at March 31, 2007 and December 31, 2006, respectively	47	47
Additional paid-in capital	91,511	91,302
Accumulated deficit	(46,715)	(44,354)
Accumulated other comprehensive income	1,997	1,930
Treasury stock at cost, 86,300 shares	(85)	(85)
Total shareholders equity	46,755	48,840
Total liabilities and shareholders equity	$ 162,987	$ 164,152

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

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
REVENUES:		
Product revenue, net	$ 80,457	$ 90,204
Service fee revenue	16,962	15,919
Pass-through revenue	6,988	4,545
Total net revenues	104,407	110,668
COSTS OF REVENUES:		
Cost of product revenue	74,771	84,354
Cost of service fee revenue	12,664	11,348
Pass-through cost of revenue	6,988	4,545
Total costs of revenues	94,423	100,247
Gross profit	9,984	10,421
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	10,992	10,793
STOCK BASED COMPENSATION	209	239
MERGER INTEGRATION EXPENSE	150	193
AMORTIZATION OF IDENTIFIABLE INTANGIBLES	204	136
Total operating expenses	11,555	11,361
Loss from operations	(1,571)	(940)
INTEREST EXPENSE, NET	584	431
Loss before income taxes	(2,155)	(1,371)
INCOME TAX EXPENSE, NET	206	216
NET LOSS	$ (2,361)	$ (1,587)
NET LOSS PER SHARE:		
Basic and Diluted	$ (0.05)	$ (0.05)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:		
Basic and Diluted	46,475	34,904

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

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (2,361)	$ (1,587)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,994	1,752
Provision for doubtful accounts	67	137
Provision for excess and obsolete inventory	102	63
Deferred income taxes	4	(15)
Stock-based compensation	209	239
Changes in operating assets and liabilities:		
Restricted cash	(92)	476
Accounts receivable	472	(1,686)
Inventories, net	739	(2,578)
Prepaid expenses, other receivables and other assets	(2,208)	2,036
Accounts payable, accrued expenses and other liabilities	(354)	4,454
Net cash provided by (used in) operating activities	(1,428)	3,291
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(789)	(690)
Payment for purchase of eCOST, net of cash acquired		(1,299)
Decrease in restricted cash	150	573
Net cash used in investing activities	(639)	(1,416)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on capital lease obligations	(465)	(384)
Decrease (increase) in restricted cash	1,743	(1,026)
Proceeds from issuance of common stock		15
Proceeds from (payments on) debt, net	296	(209)
Net cash provided by (used in) financing activities	1,574	(1,604)
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(1)	1
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(494)	272
CASH AND CASH EQUIVALENTS, beginning of period	15,066	13,683

CASH AND CASH EQUIVALENTS, end of period	$ 14,572	$ 13,955
SUPPLEMENTAL CASH FLOW INFORMATION		
Non-cash investing and financing activities:		
Property and equipment acquired under capital leases	$ 1,237	$ 187
Share consideration to acquire eCOST	$	$ 26,778

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

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PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

1. OVERVIEW AND BASIS OF PRESENTATION

PFSweb, Inc. and its subsidiaries, including Supplies Distributors, Inc., and eCOST.com, Inc., are collectively referred to as the Company; Supplies Distributors refers to Supplies Distributors, Inc. and its subsidiaries; eCOST refers to eCOST.com, Inc.; and PFSweb refers to PFSweb, Inc. and its subsidiaries excluding Supplies Distributors and eCOST.

PFSweb Overview

PFSweb is an international provider of integrated business process outsourcing services to major brand name companies seeking to maximize their supply chain efficiencies and to extend their traditional and e-commerce initiatives in the United States, Canada, and Europe. PFSweb offers such services as professional consulting, technology collaboration, managed web hosting and internet application development, order management, web-enabled customer contact centers, customer relationship management, financial services including billing and collection services and working capital solutions, information management, facilities and operations management, kitting and assembly services, and international fulfillment and distribution services.

Supplies Distributors Overview

Supplies Distributors, PFSweb and International Business Machines Corporation (IBM) have entered into master distributor agreements whereby Supplies Distributors acts as a master distributor of various products, primarily IBM product. Pursuant to transaction management services agreements between PFSweb and Supplies Distributors, PFSweb provides transaction management and fulfillment services to Supplies Distributors.

Supplies Distributors has obtained certain financing that allows it to fund the working capital requirements for the sale of primarily IBM products. Pursuant to the transaction management services agreements, PFSweb provides to Supplies Distributors such services as managed web hosting and maintenance, procurement support, web-enabled customer contact center services, customer relationship management, financial services including billing and collection services, information management, and international distribution services. Additionally, IBM and Supplies Distributors have outsourced the product demand generation to a third party. Supplies Distributors sells its products in the United States, Canada and Europe.

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

eCOST Overview

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

The Company s liquidity has been negatively impacted as a result of the merger with eCOST. During the three months ended March 31, 2007 and the year ended December 31, 2006, eCOST experienced a significant net usage of cash primarily due to losses incurred. As a result, during the process of transitioning and integrating eCOST s operations, the Company has had to support eCOST s cash needs to

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PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

help it achieve a stabilized operational position. The amount of further cash needed to support eCOST operations will depend upon the financing available as well as eCOST s ability to improve its financial results.

In the event eCOST is unable to increase its revenue and/or gross profit from its present levels, it may fail to comply with one or more of the financial covenants required under its working capital line of credit. In such event, absent a waiver, the working capital lender would be entitled to accelerate all amounts outstanding thereunder and exercise all other rights and remedies, including sale of collateral and demand for payment under the Company parent guaranty. Any acceleration of the repayment of the credit facilities would have a material adverse impact on the Company s financial condition and results of operations and no assurance can be given that the Company would have the financial ability to repay all of such obligations.

Management currently believes eCOST will meet the Company s expectations related to annual savings and overall profitability. Nevertheless, due to the absence of any long-term commitments related solely to eCOST, if eCOST does not meet these expectations, the Company anticipates that it would be able to terminate certain of eCOST s short-term facility leases, liquidate remaining inventory through the website and reduce personnel related costs as needed to maintain profitability among the Company s other segments.

The Company expects improvement in eCOST s profitability in 2007 and beyond as a result of planned efforts to increase sales and improve product mix. In addition, the Company currently expects that eCOST, as part of a combined company, should achieve annual cost savings, as compared to 2006 and pre-merger levels, as a result of essentially completing the integration of eCOST into the Company s infrastructure. These savings are expected to result from, among other things, the reduction of certain overhead expenses, changes in corporate infrastructure and reduced freight costs, although there can be no assurance that these cost savings will be achieved.

Acquisition of eCOST

Effective February 1, 2006, a wholly-owned subsidiary of PFSweb merged with and into eCOST, with eCOST surviving the merger as a wholly-owned subsidiary of PFSweb. As a result of the merger, effective February 1, 2006, the Company began consolidating 100% of eCOST s financial position and results of operations into the Company s consolidated financial statements. The following table presents selected pro forma information, for comparative purposes, assuming the acquisition had occurred on January 1 for the period presented (unaudited) (in thousands):

	Three Months Ended March 31, 2006
Net revenues	$123,602
Net loss	(3,177)
Basic and diluted loss per share	(0.08)

The unaudited pro forma information combines the historical unaudited consolidated statements of the Company s operations and eCOST s operations for the three months ended March 31, 2006 giving effect to the merger and related events as if they had been consummated on January 1 for the period presented. Pro forma adjustments have been made to reflect the amortization expense relating to the finite lives of certain acquired intangibles, such as trademark name and customer relationships.

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

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PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

Basis of Presentation

The unaudited interim condensed consolidated financial statements as of March 31, 2007, and for the three months ended March 31, 2007 and 2006, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. In the opinion of management and subject to the foregoing, the unaudited interim condensed consolidated financial statements of the Company include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company s financial position as of March 31, 2007, its results of operations for the three months ended March 31, 2007 and 2006 and its cash flows for the three months ended March 31, 2007 and 2006. Results of the Company s operations for interim periods may not be indicative of results for the full fiscal year.

Certain prior period data has been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net loss or shareholders equity.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The recognition and allocation of certain revenues and operating expenses in these consolidated financial statements also require management estimates and assumptions. The Company s estimates and assumptions are continually evaluated based on available information and experience. Because the use of estimates is inherent in the financial reporting process, actual results could differ from estimates.

Investment in Affiliates

Priority Fulfillment Services, Inc. (PFS), a wholly-owned subsidiary of PFSweb, has loaned Supplies Distributors monies in the form of a Subordinated Demand Note (the Subordinated Note). Under the terms of certain of the Company s debt facilities, the outstanding balance of the Subordinated Note cannot be increased to more than $8.0 million or decreased to lower than $6.0 million without prior approval of the Company s lenders. As of March 31, 2007, the outstanding balance of the Subordinated Note, which is eliminated upon the consolidation of Supplies Distributors financial position, was $6.0 million.

PFS has also advanced eCOST monies under certain terms of the Company s debt facilities, which requires total advances to eCOST not to be less than $2.0 million without prior approval of eCOST s lender or increased above $8.5 million without the approval of PFS lender. The total advances from PFS were $6.4 million as of March 31, 2007. PFSweb has also advanced eCOST $4.7 million as of March 31, 2007.

Concentration of Business and Credit Risk

The Company s service fee revenue is generated under contractual service fee relationships with multiple client relationships. One customer exceeded 10% of consolidated revenue during the three months ended March 31, 2007. A summary of the customer and client concentrations is as follows:

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	Three Months Ended	
	March 31, 2007	March 31, 2006
Product Revenue (as a percentage of Product Revenue):		
Customer 1	14%	8%
Customer 2	10%	9%
Customer 3	9%	12%
Service Fee Revenue (as a percentage of Service Fee Revenue):		
Client 1	24%	22%
Client 2	13%	21%
Client 3	13%	12%
Accounts Receivable:		
1 Client/Customer	11%	14%

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

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

eCOST s arrangements with its vendors are terminable by either party at will. Loss of any vendors could have a material adverse effect on its financial position, results of operations and cash flows. Sales of HP and HP-related products represented 51% of eCOST s net revenues (11% of consolidated net revenues) in the three months ended March 31, 2007. Sales of these products in the two month period ended March 31, 2006 were 31% and 6% of eCOST s net revenues and consolidated net revenues, respectively.

Inventories

The Company establishes inventory reserves based upon estimates of potential declines in values due to inventories that are potentially slow moving or obsolete, potential excess levels of inventory or values assessed at potentially lower than cost. Recoverability of the inventory on hand is measured by comparison of the carrying value of the inventory to the fair value of the inventory.

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

The allowance for slow moving inventory was $2.5 million and $3.0 million at March 31, 2007 and December 31, 2006, respectively.

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Property and Equipment

The Company s property held under capital leases amounted to approximately $4.3 million and $3.7 million, net of accumulated amortization of approximately $10.5 million and $10.0 million, at March 31, 2007 and December 31, 2006, respectively.

Long-Lived Assets

The Company reviews long-lived assets for impairment periodically, but at a minimum annually, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets include property, intangible assets, goodwill and certain other assets. Recoverability of assets is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value would be determined using appraisals, discounted cash flow analysis or similar valuation techniques. We make judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. We record impairment losses in the period in which we determine that the carrying amount is not recoverable. This may require us to make judgments regarding long-term forecasts of our future revenues and costs related to the assets subject to review.

Cash Paid During Year

The Company made payments for interest of approximately $0.7 million and $0.4 million and income taxes of approximately $0.4 million and $0.02 million during the three months ended March 31, 2007 and 2006, respectively.

Impact of Recently Issued Accounting Standards

In 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48), which prescribes accounting for and disclosure of uncertainty in tax positions. This interpretation defines the criteria that must be met for the benefits of a tax position to be recognized in the financial statements and the measurement of tax benefits recognized. Effective January 1, 2007, the Company adopted the provisions of FIN 48; however, there was no impact as a result of adopting such provisions and the amount of unrecognized tax benefits at adoption was insignificant. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

For federal income tax purposes, tax years that remain subject to examination include years 2003 to 2006. However, the utilization of net operating loss (NOL) carryforwards that arose prior to 2003 remain subject to examination through the years such carryforwards are utilized. For Europe tax years that remain subject to examination include years 2004 to 2006. However, the utilization of NOL carryforwards that arose prior to 2004 remain subject to examination through the years such carryforwards are utilized. For Canada, tax years that remain subject to examination include years 1999 to 2006, depending on the subsidiary. For state income tax purposes, the tax years that remain subject to examination include years 2002 to 2006, depending upon the jurisdiction in which the Company files tax returns.

3. COMPREHENSIVE LOSS (in thousands)

	Three Months Ended March 31	
	2007	**2006**
Net loss	$ (2,361)	$ (1,587)
Other comprehensive loss:		
Foreign currency translation adjustment	67	203
Comprehensive loss	$ (2,294)	$ (1,384)

PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

4. NET LOSS PER COMMON SHARE

Basic and diluted net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding for the reporting period. For the three months ended March 31, 2007 and 2006, outstanding options of 5.9 million and 6.1 million, respectively, to purchase common shares were anti-dilutive and have been excluded from the weighted diluted average share computation. Warrants not included in the calculation of diluted net loss per share for the three months ended March 31, 2007 and 2006 were 0.6 million for each period.

5. VENDOR FINANCING:

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

	March 31, 2007	December 31, 2006
Inventory and working capital financing agreements:		
United States	$ 26,166	$ 28,037
Europe	13,378	12,713
Total	$ 39,544	$ 40,750

Inventory and Working Capital Financing Agreement, United States

Supplies Distributors has a short-term credit facility with IBM Credit LLC to finance its distribution of IBM products in the United States, providing financing for eligible IBM inventory and for certain receivables up to $30.5 million through its expiration in March 2008. As of March 31, 2007, Supplies Distributors had $3.5 million of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFS is required to maintain a minimum Subordinated Note receivable balance from Supplies Distributors of $6.0 million and a minimum shareholders equity of $18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5% (8.75% as of March 31, 2007). The facility also includes a monthly service fee. The Company has classified the outstanding amounts under this facility as accounts payable in the consolidated balance sheets.

Inventory and Working Capital Financing Agreement, Europe

Supplies Distributors European subsidiaries have a short-term credit facility with IBM Belgium Financial Services S.A. (IBM Belgium) to finance their distribution of IBM products in Europe. The asset based credit facility with IBM Belgium provides up to 12.5 million Euros (approximately $16.6 million) in financing for purchasing IBM inventory and for certain receivables through its expiration in March 2008. As of March 31, 2007, Supplies Distributors European subsidiaries had 1.7 million euros ($2.3 million) of available credit under this facility. The credit facility contains cross default provisions, various restrictions upon the ability of Supplies Distributors and its European subsidiaries to, among others, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue, and total liabilities to tangible net worth, as defined, and are secured by certain of the assets of Supplies Distributors European subsidiaries, as well as collateralized guaranties of Supplies Distributors and PFSweb. Additionally, PFSweb is required to maintain a minimum Subordinated Note receivable balance

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

from Supplies Distributors of $6.0 million and a minimum shareholders equity of $18.0 million. Borrowings under the credit facility accrue interest, after a defined free financing period, at Euribor plus 1.5% (5.3% as of March 31, 2007). Supplies Distributors European subsidiaries pay a monthly service fee on the commitment. The Company has classified the outstanding amounts under this facility as accounts payable in the consolidated balance sheets.

7. *DEBT AND CAPITAL LEASE OBLIGATIONS;*

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

	March 31, 2007	December 31, 2006
Loan and security agreements, United States Supplies Distributors	$ 12,679	$ 12,102
PFS	7,838	6,985
Credit facility eCOST		
Factoring agreement, Europe	618	1,039
Taxable revenue bonds	4,000	4,500
Master lease agreements	5,465	4,742
Other	354	510
Total	30,954	29,878
Less current portion of long-term debt	25,036	23,802
Long-term debt, less current portion	$ 5,918	$ 6,076

Loan and Security Agreement Supplies Distributors

Supplies Distributors has a loan and security agreement with Wachovia Bank, N.A. (Wachovia) to provide financing for up to $25 million of eligible accounts receivable in the United States and Canada. As of March 31, 2007, Supplies Distributors had $1.5 million of available credit under this agreement. The Wachovia facility expires on the earlier of March 29, 2009 or the date on which the parties to the IBM master distributor agreement no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such agreement. Borrowings under the Wachovia facility accrue interest at prime rate or Eurodollar rate plus 1.75% to 2.25%, dependent on excess availability, as defined. The interest rate as of March 31, 2007 was 8.25% for $6.7 million of outstanding borrowings and 7.8% for $6.0 million of outstanding borrowings. This agreement contains cross default provisions, various restrictions upon the ability of Supplies Distributors to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital stock ownership structure and pay dividends, as well as financial covenants, such as minimum net worth, as defined, and is secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, PFSweb is required to maintain a Subordinated Note receivable balance from Supplies Distributors of no less than $5.5 million and restricted cash of less than $5.0 million, and is restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure. Supplies Distributors has entered into blocked account agreements with its banks and Wachovia pursuant to which a security interest was granted to Wachovia for all U.S. and Canadian customer remittances received in specified bank accounts. At March 31, 2007 and December 31, 2006, these bank accounts held $0.5 million and $2.2 million, respectively, which was restricted for payment to Wachovia.

Loan and Security Agreement PFSweb

PFS has a Loan and Security Agreement (Comerica Agreement) with Comerica Bank (Comerica). The Comerica Agreement provides for up to $7.5 million of eligible accounts receivable financing (Working Capital Advances) through April 2008, a Term Loan of $1.5 million due in monthly installments through December 2007 and

$2.5 million of equipment financing (Equipment Advances) through June 15, 2008. Outstanding Working Capital Advances, $6.5 million as of March 31, 2007, accrue interest at prime rate plus 1% (9.25% as of March 31, 2007). Outstanding Equipment Advances, ($0.3 million as of March 31, 2007) and the Term Loan ($1.0 million outstanding as of March 31, 2007), accrue

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PFSweb, Inc. and Subsidiaries
Notes to Unaudited Interim Condensed Consolidated Financial Statements

interest at prime rate plus 1.5% (9.75% as of March 31, 2007). As of March 31, 2007, PFS had $0.6 million of available credit under the Working Capital Advance portion of this facility and no available credit under the Equipment Advance or Term Loan portions of this facility. In April 2007, the Company repaid the $6.5 million of Working Capital Advances outstanding as of March 31, 2007. The Comerica Agreement contains cross default provisions, various restrictions upon PFS ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of $20 million, as defined, a minimum earnings before interest and taxes, plus depreciation, amortization and non-cash compensation accruals, if any, as defined, and a minimum liquidity ratio, as defined. The Comerica Agreement restricts the amount of the subordinated note receivable from Supplies Distributors to a maximum of $8 million. Comerica has provided approval for PFS to adva