

PFSWEB INC  
Form 10-K  
March 16, 2017

Bm

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, 2016

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	75-2837058
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification Number)

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

Registrant's telephone number, including area code:

972-881-2900

Securities registered pursuant to Section 12(b) of the Act: None

Edgar Filing: PFSWEB INC - Form 10-K

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes      No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes      No

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

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

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

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

Large accelerated filer

Accelerated filer

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2016 (based on the closing price as reported by the National Association of Securities Dealers Automated Quotation System) was \$140,346,569.

At March 7, 2017, there were 18,768,567 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.



## INDEX

	Page
<u>PART I</u>	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	14
Item 1B. <u>Unresolved Staff Comments</u>	24
Item 2. <u>Properties</u>	24
Item 3. <u>Legal Proceedings</u>	25
Item 4. <u>Mine Safety Disclosure</u>	25
<u>PART II</u>	
Item 5. <u>Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	26
Item 6. <u>Selected Consolidated Financial Data</u>	29
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	30
Item 7A. <u>Quantitative and Qualitative Disclosure About Market Risk</u>	44
Item 8. <u>Financial Statements and Supplementary Data</u>	45
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	82
Item 9A. <u>Controls and Procedures</u>	82
Item 9B. <u>Other Information</u>	84
<u>PART III</u>	
Item 10. <u>Directors and Executive Officers and Corporate Governance</u>	84
Item 11. <u>Executive Compensation</u>	84
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	84
Item 13. <u>Certain Relationships and Related Transactions and Director Independence</u>	84
Item 14. <u>Principal Accountant Fees and Services</u>	84
<u>PART IV</u>	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	85
Item 16. <u>Form 10-K Summary</u>	93
<u>Signatures</u>	94

Edgar Filing: PFSWEB INC - Form 10-K

Unless otherwise indicated, all references to “PFSweb,” “the Company,” “we,” “us” and “our” refer to PFSweb, Inc., a Delaware corporation, and its subsidiaries; references to “PFS” refer collectively to our wholly-owned subsidiaries, Priority Fulfillment Services, Inc., Priority Fulfillment Services of Canada, Inc., PFSweb BV (Belgium)(and its subsidiaries), REV Solutions, Inc., REVTECH Solutions India Private Limited, PFSweb Global Services Private Limited, LiveAreaLabs, Inc., Moda Superbe Limited, CrossView, Inc. and Conexus Limited; references to “Supplies Distributors” refer collectively to our wholly-owned subsidiary Supplies Distributors, Inc. and its subsidiaries; and references to “Retail Connect” refers to our wholly-owned subsidiary PFSweb Retail Connect, Inc.

---

## PART I

### Item 1. Business

#### General

PFSweb is a Global Commerce Service Provider using integrated technologies, professional services, and a worldwide network of systems and logistics to deliver global commerce solutions. We provide our clients with best-of-breed service capabilities offered as a complete end-to-end solution or on an à la carte basis. The services we offer are organized into the following categories:

- Strategic Commerce Consulting

- Agency Services

- Technology Services

- Omni-Channel Operations

- Technology Ecosystem Services

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

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

We are headquartered in Allen, Texas where our executive and administrative offices and our primary technology operations and facilities are located, and certain professional services including digital agency and technology services are performed. We operate state-of-the-art call centers from our U.S. facility located in Dallas, Texas and from our international facilities located in Richmond Hill, Ontario, Canada and Liège, Belgium. We lease or manage warehouse facilities of approximately 2.2 million square feet, many containing highly automated and state of the art material handling and communications equipment in Memphis, Tennessee, Southaven, Mississippi, Richmond Hill, Ontario, Canada and Liège, Belgium, allowing us to provide global distribution solutions.

Additionally, we engage in business development activities and provide additional digital agency services and/or technology services from our offices in Minnesota, New York, Washington, England, Bulgaria and India.

#### PFSWEB'S END2END ECOMMERCE® SOLUTIONS

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

Each client has a unique business model and unique strategic objectives that often require highly customized solutions. We support clients in a wide array of industries, including fashion apparel and accessories, fragrance and beauty products, consumer packaged goods (“CPG”), home furnishings and housewares, collectibles and toys and technology products. These clients turn to PFSweb for help in addressing a variety of business needs that include strategic consulting, eCommerce creative design and development, customer satisfaction and retention, time-definite logistics, vendor managed inventory and integration, supply chain compression, cost model realignments, transportation management and international expansion, among others. We also act as a constructive agent of change, providing clients the ability to alter their current distribution model, establish direct relationships with end-customers, and reduce the overall time and costs associated with existing distribution channel strategies. Our clients are seeking solutions that will provide them with dynamic supply chain and multi-channel marketing efficiencies, while ultimately delivering a world-class customer service experience.

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

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

**Improve the Customer Experience.** We enable our clients to provide their customers with a high-touch, positive buying experience thereby maintaining and promoting brand loyalty. Through our use of advanced technology, we can respond directly to customer inquiries by e-mail, voice or data communication and assist them with online ordering and product information. We believe we offer our clients a “world-class” level of service, including Web-enabled customer care service centers, detailed Customer Relationship Management (“CRM”) reporting and exceptional order

accuracy. We have significant experience in the development of eCommerce storefronts that allows us to recommend features and functions easily navigated and understood by our clients' customers. Our technology platform is designed to ensure high levels of reliability and fast response times for our clients' customers. Because of our technology, our clients benefit from being able to offer the latest in customer communication and response conveniences to their customers.

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



investment that our clients might be able to cost justify on their own. These additional capabilities can provide our clients the benefits of enhanced operating performance and efficiency and expanded customer service options.

**Access a Sophisticated Technology Ecosystem.** We provide our clients with access to a Technology Ecosystem featuring best-of-breed eCommerce technologies together in a single, integrated, PCI certified offering. Powered by leading enterprise-class software solutions, our platform is seamlessly integrated into our back-end operations to provide an end-to-end eCommerce solution. Built to accelerate the implementation process, the Technology Ecosystem allows for flexible integrations with other technology providers and client systems.

Our Technology Ecosystem also extends beyond the digital world and into physical commerce channels. Brands and retailers today require flexible technology to control customer shopping experiences regardless of where they shop. Deploying ship from store, in-store pick up, or mobile point of sale capabilities are just a few examples of how we can enable brands to create a dynamic and unique omni-channel shopping experience.

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

#### Strategic Commerce Consulting Services

Our strategic commerce consulting practice leverages our commerce channel management capabilities along with extensive retail, and B2B vertical expertise to assist our clients in identifying new opportunities for revenue/margin growth, new customer/segment acquisition, market expansion, and cost savings. We also monitor emerging technologies and trends, with an eye to measuring business impact and alignment with our clients' end goals. With a focus on industry trends, we seek to optimize clients' commerce investments while anticipating strategic opportunities and threats.

Our clients seek help navigating an increasingly complex digital landscape, with lowering barriers to market for new players and an array of options for companies looking to innovate. We work closely with client stakeholders to develop strategic and prioritization frameworks that drive change while providing the ability to pivot as threats or opportunities are identified. In particular, our consultants focus on three key areas that enable clients to remain competitive while taking a leadership position: commerce ecosystem management (including omni-channel alignment), digital opportunity analysis, and a "continuous beta" operational model to roll out new capabilities and tactics in a measurable yet timely fashion.

**Commerce Strategy.** From identifying new markets and methods to drive higher revenue to competitive and market analysis, we help clients formulate strategies and tactics that work. In our strategy work, we look to leverage existing assets, personnel, and processes wherever possible while identifying where investment is needed. We also offer roadmaps and initiative "backlogs" prioritized for impact, with guidance on taking a phased approach.

**Digital Opportunity Audits.** Our consultants help clients identify where new digital platforms, tools, and technologies can provide competitive advantage or bridge gaps in their current operations and capabilities. Audits can take into account the competitive landscape, industry trends, digital best practices across verticals, and cost models, providing helpful benchmarks and flagging areas of opportunity. Audits may be conducted periodically to track changes and emerging technologies and measure effectiveness.

Organizational/Operational Readiness. Many PFSweb clients require some organizational readiness consulting to ensure they can utilize effectively the platforms and tools we provide. Providing readiness consulting is crucial to driving client satisfaction and confidence when adopting commerce platforms, particularly when business users are given new capabilities and may need to adapt existing business processes. We also provide organizational design consulting, which is often implemented in a phased approach as the client's commerce channel grows; this may include recommendations regarding which functions to outsource and which to maintain in house.

Omni-Channel Consulting. Retail clients are concerned with increased consumer expectations for a holistic, seamless experience regardless of where or when they shop, in store or online. We offer an array of services that help retailers meet consumer expectations across the commerce lifecycle, from customer acquisition through the transaction, order fulfillment, customer service, and loyalty. In particular, we implement tools and processes to support "endless aisle" inventory access, ship-to-store and ship-from-store capabilities, buy online and return in-store, and similar delivery scenarios. Likewise, we consult with retailers on leveraging digital tools within the store environment, whether enabling sales associates to prevent walk outs or consumers to enhance their product experience.

Platform Evaluation/Selection. Our strategists take the lead in helping clients evaluate and select the right commerce platforms, leveraging our expertise implementing all market-leading solutions. We walk clients through a process matching their requirements to platform capabilities, measure their operational ability to utilize the platforms under consideration, and provide total cost of ownership (TCO) models comparing initial and ongoing costs for everything from software licensing models to ongoing maintenance and upgrades.

#### Agency Services

LiveArea, a PFS Agency, is a full-service digital experience agency with a boutique approach and world-class capabilities. Combining strategy, creativity, technology, and a customer-centric philosophy, we create digital experiences that deliver tangible results.

Our strategic approach addresses the entire customer journey. From brand strategy and digital experiences to the day-to-day mechanics of digital marketing services, we help brands stand apart from competitors, connect with customers and drive revenue. Our end-to-end, omni-channel expertise allows us to have a holistic marketing strategy, from awareness and attraction to conversion and optimization.

Digital Strategy. We build digital strategies to target the intersection of our client's goals, brand and customers. Informed by in-depth and ongoing collaboration with the client, data-driven insight and practiced expertise, we craft actionable plans that deliver results. We specialize in adapting to the changing market, emerging technologies, and evolving customer behavior. Our strategy capabilities focus on brand development, digital commerce, content, and digital analytics and optimization.

Design. We conceive, design, and write with a deliberate focus on balancing creativity and usability. We believe a beautiful or fun or inspiring vision is only as good as the experience's ability to continually engage customers and drive conversion. Our brand-inspired, user-centered approach creates positive connections that turn customers into brand ambassadors.

User Experience. We architect fully responsive branded commerce sites and tools that eliminate transactional friction, reduce cognitive load, and add delight throughout the shopping experience. We specialize in taking advantage of platform functionality to add one-of-a-kind interactions and designing guided selling apps that use brand expertise to walk customers through complicated purchase decisions.

Interactive Development. We believe front-end development is as much about artfully enhancing a user interaction as it is engineering pixel perfection. We turn digital designs into beautiful, functioning experiences that look and behave the way they were intended to across screens and devices of all types, sizes, and systems. We also take every opportunity to use motion and interactive accents to provide users with guidance and delight throughout an experience.

SEO & Paid Search. We drive traffic by maintaining an in-depth knowledge of the ever-changing best practices for search engine optimization. We provide insight and advice on algorithm changes, content gaps, multi-language global expansion, and competitors' search efforts. From implementation to ongoing management, we can help brands reach customers who are actively looking for what they offer.

Affiliate Marketing. Our approach to affiliate partner marketing focuses on building relationships with reputable, appropriate online influencers. We can help clients reach customers they may not through other channels, improving brand awareness and increasing sales quickly and efficiently. Then, through proactive program management, we can ensure ongoing optimization and continued growth. From publisher research and competitive analysis to payments, we can implement and manage the entire affiliate and partner ecosystem.

Conversion Optimization. Our conversion optimization team applies an in-depth analysis of product and behavioral data on the storefront to continually optimize our client's site. By combining analytics with the capabilities of the platform, we plan and execute A/B tests, optimize onsite search, and create personalized experiences to maximize the impact of the marketing and merchandising efforts. From an audit of an existing site to building a conversion optimization roadmap, we help our clients generate more revenue and provide an ever-improving customer experience that turns shoppers into buyers.

Storefront Management. Through proven strategic merchandising methodologies, we create personalized shopping experiences that drive conversion and increase revenue. With specialized expertise in dynamic merchandising, we can draw on each customer's

history and intent to connect them with the right products and content at the right time. Our day-to-day storefront operations include product and category setup, sorting rules definition, promotion configuration, and price adjustment. Working within predetermined guidelines, we incorporate best practices and make strategic decisions to achieve each client's goals.

**Email Marketing.** Combining technology with proven strategies, we elevate and optimize email programs to develop personalized customer relationships. We create custom customer journeys through dynamic email, automated remarketing, automations, and subscriber segmentation. Our data focused approach reduces the costs of customer acquisition, inspires brand loyalty, and increases ROI through both larger basket sizes and higher customer lifetime value.

**Digital Analytics.** We provide more than snapshots of user activity through the usual charts and dashboards. We mine all available data and use advanced analysis to identify opportunities within the customer journey that will allow brands to improve the overall user experience and generate increased business. With a focus on never-ending improvement, we use the data to continuously pinpoint actions that will strengthen customer relationships and drive results across marketing channels.

#### Technology Services

PFSweb's Technology Services builds world-class eCommerce websites that are designed to maximize revenue opportunities. Built by a seasoned group of professionals, we combine strategy and technology to create innovative user experiences. From high-fashion apparel to CPG, our portfolio consists of brands that accept only the highest quality shopping websites.

We use a proven methodology to deliver quality implementations to meet some of the strictest brand requirements in the industry. Our project teams are comprised of industry-leading professionals that bring eCommerce and web development best practices to our clients' custom solutions. Once live, our team applies the same level of excellence to ongoing development, site maintenance, and solutions support.

**Direct-to-Consumer eCommerce.** Established in 2008, PFSweb's End2End eCommerce® solution for the DTC online channel initially featured Salesforce Commerce Cloud (formerly Demandware Commerce Cloud) as the exclusive eCommerce platform. As a result of our partnership with Salesforce Commerce Cloud, we have deployed one of the largest international Salesforce Commerce Cloud development teams in the world and maintain a talented team of certified developers who create world-class user experiences for some of the world's leading brands. Since 2014, we have expanded the number of platforms supported within PFSweb's End2End eCommerce® solution to include SAP Hybris, Oracle Commerce, IBM Watson Commerce and Magento. We have integrated these platforms with the rest of our world-class technology platform, including other best-of-breed technology partners, to create PFSweb reference applications and platform frameworks that provide our clients with very high-function, platform-specific DTC online store out-of-the-box. We are able to use the PFSweb reference applications and platform frameworks as a starting point to quickly create a completely customized online store for our DTC clients.

Designed specifically for DTC brands, our comprehensive offering redefines end-to-end eCommerce by enabling retailers and branded consumer goods manufacturers with the ability to employ a total outsourcing solution customized to their particular eCommerce strategy, without the loss of site or brand control associated with earlier end-to-end outsourcing solutions.

As a platform-agnostic provider, we manage dedicated eCommerce technology practices specializing in all of the leading enterprise platforms to enable our clients' growth. Our expertise spans across the five major eCommerce platforms, including: Salesforce Commerce Cloud, SAP Hybris, Oracle Commerce, IBM Watson Commerce and

Magento. Our staff is ready to build custom eCommerce solutions on any of these platforms for our clients on a global basis. We employ a proven development methodology, led by a highly-qualified team of solutions architects, web developers, project managers, and Quality Assurance (“QA”) testers. When paired with our Strategic Commerce Consulting Services and our Agency Services, we can provide an entire suite of services that spans strategy, creative, project management, web development, and quality assurance.

eCommerce Development. Our technology services practice partners and actively works with each eCommerce platform provider to ensure we are delivering quality services for our joint clients. We also work to achieve higher-level partner status with each provider to demonstrate our expertise and experience for each practice.

Platform Support. Our work doesn't stop when we launch an eCommerce site. Our Platform Support team provides real-time management and monitoring to ensure our clients' sites are always operating at peak performance. We provide Level 1/2/3 technical, business, and solutions support for optimal issue management.

Quality Assurance. Whether it's a new site build or ongoing development, our team of QA experts employ a full-service test suite that includes quality assurance scripting and testing, regression, load testing, and automation.

Training. We provide on-site, personalized platform training from experienced subject-matter experts. Our training team empowers our clients' business and merchandising staff with the knowledge they need to operate and optimize their eCommerce sites. Core training includes platform essentials, advanced merchandising, front-end design, and developer training.

#### Omni-Channel Operations

Our Omni-Channel Operations services provide the operational activities required and expected of the world's leading brands. We have DTC and B2B experience in customizing solutions to meet the unique nuances of our clients' internal finance, customer care, and supply chain operations. With approximately 2.2 million square feet of leased or managed distribution space and approximately 1,000 call center seats across two continents, we have the global infrastructure to meet the operational needs of our eCommerce and traditional B2B clients.

As the operational backbone of the online and B2B shopping experience, we focus on three core actions: to deliver, to communicate, and to fulfill the promise behind each brand we support.

#### Order Fulfillment

We design advanced pick-pack-ship operations that streamline our clients' supply chain process and offer a flexible fulfillment distribution model. Our fulfillment team understands the value of the delivery experience by specializing in creating branded solutions with gift wrap and other branded services. Our distribution centers are located in the Memphis, Tennessee area, Toronto, Canada and Liege, Belgium to provide centrally located fulfillment throughout North America and Europe.

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

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

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

We are able to take advantage of a variety of shipping and delivery options, which range from next day service to zone skipping, to optimize transportation costs. Our facilities and systems are equipped with multi-carrier functionality, allowing us to integrate with all leading package carriers and provide a comprehensive freight and transportation management offering.

We offer reverse logistics management services, including issuing return authorizations, return carrier shipping labels, receipt of product, crediting customer accounts and disposition of returned product. We also leverage strategic partnerships to provide our clients with access to distributed returns centers that collect, consolidate, report on and forward to our central facilities returned product allowing us to accelerate credits to our clients' customers, reduce freight costs for our client, improve customer service and reduce complexity and cost in our facilities from handling inbound returns.

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



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

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

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

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

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

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

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

#### Customer Care

Our internal contact center operations are focused on providing essential services such as order entry, returns authorization, product inquiry, and order tracking. These operations also include our iCommerce Agent (“iCA”), a customizable web-based application featuring powerful customer service tools for accessing all required customer

information. Our unique multi-lingual capabilities are possible through our strategically placed locations in Dallas, Belgium and Toronto.

Customer Service Application. Through our web enabled Customer Service Application, iCA, our unique technology leverages the client's website investment by wrapping the Customer Service Application around the existing website. Through iCA, agents provide customer service functions, such as placing orders, checking order status, facilitating returns, initiating upsell and cross sell, managing escalations, and gathering "voice of the customer" information to help our clients evolve with their customers' changing needs. iCA is fully integrated into the client's website, our data analytics platform, and our order processing system, allowing full visibility into customer history and customer trends. Through each of our customer touch-points, information can be analyzed and processed for current or future use in business evaluation product effectiveness and positioning, and supply chain planning. Through this fully integrated system, we are able to provide a complete customer care solution in a PFS customer care center or on a license basis to our clients' owned or outsourced customer care centers.

7

---

**Customer Assistance.** An important feature of evolving commerce is the ability for the customer to communicate with a live customer service representative. Our experience has been that many consumers tell us they visited a web location for information, but not all of those consumers chose to place their order online. Our customer care services utilize features that integrate voice, e-mail, standard mail, fax, data and live chat communications to respond to and handle customer inquiries. Our customer care representatives answer various questions, acting as virtual representatives of our clients' organization, regarding order status, shipping, billing, returns and product information and availability as well as a variety of other questions. We utilize technology that allows us to route each customer contact automatically to the appropriate customer care representative who is individually trained in the clients' business and products.

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

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

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

#### Financial Services

Protecting our clients' brand with secure payment processing and fraud management services is critical to a successful operation. We also provide flexible global payment options as well as gift cards, B2B invoicing, and VAT 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 of credit card services for DTC clients.

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

**Direct-to-Consumer Financial Management.** For DTC clients, we offer secure credit card processing related services for orders made via a client web site or through our customer contact center. We offer manual credit card order review as an additional level of fraud protection. We also calculate sales taxes, goods and services taxes or value added taxes, if applicable, for numerous taxing authorities and on a variety of products. Using third-party leading-edge fraud protection services and risk management systems, we can offer high levels of security and reduce the level of risk for

client transactions.

#### Technology Ecosystem Services

Order Management Interfaces. Our order management system (OMS), based on the Oracle JD Edwards ERP suite, is a scalable solution built for DTC and B2B and order processing. We also offer a distributed order management solution utilizing the Kibo software that is tightly integrated with our internal OMS. This solution provides retailers with a complete technology solution for integrating both online and offline channels. Our order management technology solutions provide interfaces that allow for real-time information retrieval, including information on inventory, sales orders, shipments, delivery, purchase orders, warehouse receipts, customer history, accounts receivable and credit lines. These solutions are seamlessly integrated with our web-enabled customer contact centers, allowing for the processing of orders through shopping cart, phone, fax, mail, email, web chat, and other order receipt methods. As the information backbone for our total supply chain solution, order management services can be used on a stand-alone basis or in conjunction with our other business infrastructure offerings, including customer contact, financial or distribution services. In addition, for the B2B market, our technology platform provides a variety of order receipt methods that facilitate commerce within various stages of the supply chain. Our systems provide the ability for both our clients and their customers to track the status of orders

at any time. Our services are transparent to our clients' customers and are seamlessly integrated with our clients' internal system platforms and web sites. By synchronizing these activities, we can capture and provide critical customer information, including:

• Statistical measurements critical to creating a quality customer experience, containing real-time order status, order exceptions, back order tracking, allocation of product based on timing of online purchase and business rules, the ratio of customer inquiries to purchases, average order sizes and order response time;

• B2B supply chain management information critical to evaluating inventory positioning, for the purpose of improving inventory turns, and assessing product flow-through and end-user demand;

• Reverse logistics information, including customer response and reason for the return or rotation of product and desired customer action;

- Detailed marketing information about what was sold and to whom it was sold, by location and preference; and

• Web traffic reporting showing the number of visits ("hits") received, areas visited, and products and information requested.

**Product Content Management.** Our iCommerce PCM solution provides a comprehensive set of tools for creating, integrating, mastering, and syndicating product content efficiently across an entire organization. Leveraging enterprise-class product information management (PIM) software powered by Riversand Technologies, we provide a solution that enables brands to maximize the selling value of their product content across all commerce channels.

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

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

## SELLER SERVICES FINANCIAL MODELS

### Service Fee Model

We refer to our standard seller services financial model as the "Service Fee" model. In this model, our clients own the inventory and are the merchants of record and engage us to provide various infrastructure, technology and digital agency services in support of their business operations. We provide ecommerce website services, inventory and order management, customer service, payment processing, and operations reports such as product sales, sales tax, and inventory management reports. In this model, we provide infrastructure and services and the clients are responsible for all financial operations and reporting related to the sales transactions.

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

#### Agent (Flash) Financial Model

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

## Retail Financial Model

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

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

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

In general, we seek to structure client relationships in our Retail model under the net revenue approach, although we have one client still operating under the gross revenue approach. We use our Retail model to enable our Supplies Distributors subsidiary to serve as a global distributor of printer supplies for Ricoh Infoprint Solutions Company (“IPS”), a wholly-owned subsidiary of Ricoh Company Ltd. (“Ricoh”). In this model, the product revenues are reported in our Business and Retail Connect segment.

## INDUSTRY INFORMATION AND COMPETITIVE LANDSCAPE

### Industry Overview

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

- ◆Manufacturers strive to restructure their supply chains to maximize efficiency and reduce costs in both B2B and DTC markets, and to create a variable-cost supply chain able to support the multiple, unique needs of each of their initiatives, including traditional and electronic commerce.

- ◆Companies in a variety of industries seek outsourcing as a method to address one or more business functions that are not within their core business competencies, to reduce operating costs or to improve the speed or cost of implementation.

- ◆Retailers, both traditional and e-commerce only, partner with end to end providers to provide a turnkey solution to support their e-commerce channels. Providers with a global presence provide additional value to companies pursuing an international expansion strategy.

### Supply Chain Management Trend

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

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



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, 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 service providers to accelerate their business plans in a cost-effective manner and perform non-core business functions. Outsourcing can provide many key benefits, including the ability to:

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

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

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

### Competition

We face competition from many different sources depending upon the type and range of services requested by a potential client. Many other companies offer one or more of the same services we provide on an individual basis. Our competitors include vertical outsourcers, which are companies that offer a single function solution. We compete with transportation logistics providers, known in the industry as 3PL's and 4PL's (third or fourth party logistics providers),

who offer product management functions as an ancillary service to their primary transportation services. We also compete against other Global Commerce Service Providers, who perform various services similar to our solution offerings. Additionally, we see competition from digital agencies providing creative, commerce strategy and system integration services.

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

Although many of our competitors offer one or more of our services, we believe our primary competitive advantage is our ability to offer a full array of customized services, 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:

- experience supporting a specific product vertically;
- 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.

#### Competitive Landscape

**Global Commerce Service Providers.** We compete with companies that provide a global solution for digital strategy services and commerce implementation such as Accenture Digital, Deloitte Digital, Razorfish, and Sapient/Nitro.

**End-to-end Commerce.** In North America, we compete with full service commerce providers such as Trade Global and OneStop, as well as other providers such as BrandShop and Newgistics. In the European market, we compete with companies such as Arvato, Yoox and other geographically focused providers in Western Europe.

**Digital Agency Services.** We compete with a wide range of digital agency firms, including SapientNitro, Fluid, Huge, AKQA, and Digitas LBI.

**Technology Services.** Globally, we compete with a wide range of technology services providers or systems integrators, including providers such as Astound Commerce, OSF, Optaros, Gorilla Group, Object Edge, and Lyons CG.

**Omni-Channel Operations.** We compete with eCommerce focused order fulfillment providers such as Radial and OHL, as well as, depending on the client's retail and/or supply chain strategy, Excel Logistics, UPS Logistics, and other "pure-play" fulfillment or call center providers.

#### COMPANY INFORMATION

##### Clients and Marketing

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

Procter & Gamble (consumer packaged goods), L'Oréal (health & beauty), LEGO Brand Retail (toys), T.J. Maxx (apparel and home fashion), Canada Goose (outdoor apparel), Diageo (premium beverages), Roots Canada Ltd. (apparel), Ricoh (printer supplies), Xerox (printers and printer supplies), Pandora (jewelry), Charlotte Russe (fashion), among many others.

We target potential clients through an extensive integrated marketing program comprised of a variety of direct marketing techniques, email marketing initiatives, trade event participation, search engine marketing, public relations, social media and a sophisticated outbound tele-sales lead generation model. We have also developed a global business development methodology which allows us to effectively showcase our various eCommerce service solutions and products. We also pursue strategic marketing alliances

with consulting firms, software manufacturers and other logistics providers to increase market awareness and generate referrals and customer leads.

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

### Technology

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

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

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

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

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

Our information technology operations and infrastructure are built on the premise of reliability and scalability. We maintain diesel generators and un-interruptible power supply equipment to provide constant availability to computer

rooms, call centers and warehouses. Multiple internet service providers and redundant web servers provide for a high degree of availability to web sites that interface with our systems. Capacity planning and upgrading is performed regularly to allow for quick implementation of new clients and avoid time-consuming infrastructure upgrades that could slow growth rates. In the event of a disastrous situation, we also have a disaster recovery plan that provides geographically separated and comparably equipped data centers that are able to recover stored data in a reasonable and effective manner.

#### Employees

As of December 31, 2016, we had approximately 2,500 employees, of which approximately 1,600 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 India, we are not a party to any collective bargaining agreements and while our European subsidiaries are not a party to a collective-bargaining agreement, certain of them are required to comply with certain rules agreed upon by their employee Works Councils.

Our success in recruiting, hiring and training large numbers of skilled employees and obtaining large numbers of hourly employees and temporary staff during peak periods for distribution and call center operations is critical to our ability to provide high

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

#### Internet Access to Reports

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

#### Government Regulation

We are subject to federal, state, local and foreign consumer protection laws, including laws protecting the privacy of our customers' personally identifiable information and other non-public information and regulations prohibiting unfair and deceptive trade practices. Furthermore, the growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens and greater penalties on online companies. Moreover, there is a trend toward regulations requiring companies to provide consumers with greater information regarding, and greater control over, how their personal data is used, and requiring notification when unauthorized access to such data occurs. For example, many states currently require us to notify each of our customers who are affected by any data security breach in which an unauthorized person, such as a computer hacker, obtains such customer's name and one or more of the customer's social security number, driver's license number, credit or debit card number or other similar personal information. In addition, several jurisdictions, including foreign countries, have adopted privacy-related laws that restrict or prohibit unsolicited email promotions, commonly known as "spam," and that impose significant monetary and other penalties for violations.

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. Also, an increasing number of countries have introduced and/or increased enforcement of comprehensive privacy laws, or are expected to do so. In Europe, a new data protection regulation will likely come into effect in 2018 and will supersede Directive 95/46/EC, which has governed the processing of personal data since 1995. The new regulation will enhance the security and privacy obligations of entities that process data of residents of members of the European Economic Area and substantially increase penalties for violations. In addition, the European Court of Justice has invalidated a decision of the European Commission that permitted our European affiliates and our European customers to transfer personal data to us and other entities in the United States that are certified under the EU-US safe harbor framework. This decision, a failure of the European Union and the United States to implement a new safe-harbor framework, and new regulations and laws in other countries that restrict the export of personal data may require us to increase our IT infrastructure, maintenance and support costs.

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 Our Business

We operate with significant levels of indebtedness and are required to comply with certain financial and non-financial covenants; and we have guaranteed certain indebtedness and obligations of our subsidiaries.

As of December 31, 2016, our total credit facilities outstanding, including debt, capital lease obligations and our vendor accounts payable related to financing of Ricoh product inventory, was approximately \$67 million. 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. Certain of these covenants also restrict our ability to transfer funds among our various subsidiaries, which may adversely affect the ability of our subsidiaries to operate their businesses or comply with their respective loan covenants. We cannot provide assurance that we will be able to maintain compliance with these covenants. A non-renewal, default under or acceleration of any of our credit facilities may have a material adverse impact



upon our business and financial condition. 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.

Our business and future growth depend on our continued access to bank and commercial financing.

Our business and future growth currently depend on our ability to access bank, vendor and commercial lines of credit. We currently depend on line of credit facilities provided by various banks and commercial lenders that provided for an aggregate of up to approximately \$76 million in available financing as of December 31, 2016. These lines of credit currently mature at dates through August 2020 and are secured by substantially all our assets. Our ability to renew our lines of credit depends upon various factors, including the availability of bank loans and commercial credit in general, as well as our financial condition and prospects. Therefore, we cannot guarantee that these credit facilities will continue to be available beyond their current maturities on reasonable terms or at all. Our inability to renew or replace our credit facilities or find alternative financing would materially adversely affect our business, financial condition, operating results and cash flow.

We are uncertain about the availability of additional capital.

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

We 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 currently expect to increase our operating, sales, and marketing expenses, as well as capital expenditures. To offset these expenses, we will need to generate additional profitable business. If our revenue declines or grows slower than either we anticipate or our clients' projections indicate, or if our operating, sales and marketing expenses exceed our expectations or cannot be reduced to an appropriate level, we may not generate sufficient revenue to be profitable or be able to sustain or increase profitability on a quarterly or annual basis in the future. Additionally, if our revenue grows slower than either we anticipate or our clients' projections indicate, we may incur unnecessary or redundant costs and our operating results could be adversely affected.

Our service fee revenue and gross margin are dependent upon our clients' business and transaction volumes and our costs. A reduction in our clients' ecommerce business or our inability to grow our business or increase service fee revenue from new or existing clients could negatively impact our operating results.

Our service fee revenue is primarily transaction and project based and fluctuates with the volume of transactions or level of sales of the products by our clients for whom we provide omni-channel services and the size and scope of projects for clients for whom we perform technology and agency 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 revenues at projected levels or sufficient revenues, or whose products do not generate substantial customer sales, our business may be materially adversely affected in a number of ways.

For example, we seek to maintain sufficient capacity in our fulfillment, call center and professional services operations and computer technology systems to support our projected existing and new client business activity, including seasonal volumes and we currently plan on increasing capacity to support future projected growth. The fixed cost structure of many of these investments limits our flexibility to reduce our costs when excess capacity occurs. A reduction in our clients' business or our inability to grow our business or increase service fee revenue from new or existing clients could result in an underutilization in our invested assets. While certain of our building leases permit early termination in advance of their regular scheduled maturity date, these early terminations would require incremental termination related payments which reduce the potential benefit of this flexibility.

Similarly, salaries and payroll-related expenses are a significant component of our costs. Balancing our workforce levels against the demands for our services is difficult. We generally cannot reduce our labor costs as quickly as negative changes in revenue may occur. We may retain underutilized employees to maintain scalability to meet client demand. We must maintain our utilization at an appropriate rate to achieve our desired level of profitability. If we are unable to achieve and maintain our target utilization rates, our

profitability could be adversely impacted. Further, if labor costs increase, this could put upward pressure on our costs and adversely affect our profitability if we are unable to recover these increased costs by increasing the prices for our services.

Moreover, our ability to estimate service fee revenue for future periods is substantially dependent upon our clients' and our own projections, the accuracy of which has been, and will continue to be, unpredictable. Therefore, our planning for client activity and targeted goals for service fee revenue and gross margin may be materially adversely affected by incomplete, delayed or inaccurate projections. In addition, most of our service agreements with our clients are non-exclusive and we cannot assure you any of our clients will continue to use our services for any period of time. The loss of a significant amount of service fee revenue due to client terminations or material reductions in the services provided to one or more clients could have a material adverse effect on our ability to cover our costs and thus on our profitability.

We may incur financial penalties if we fail to meet contractual service levels under client service agreements.

Many of our client service agreements contain minimum service level requirements and impose financial penalties if we fail to meet such requirements. The imposition of a substantial amount of such penalties could have a material adverse effect on our business and operations. 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 are dependent on our key personnel, and if we are unable to keep our supply of skills and resources in balance with client demand and attract and retain skilled professionals, our business, the utilization rate of our professionals and our results of operations may be materially adversely affected.

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. For example, if we are unable to hire or continually train our employees to keep pace with the rapid and continuing changes in technology and the markets we serve or changes in the types of services our clients are demanding, we may not be able to develop and deliver new services and solutions to fulfill client demand. As we expand our services and solutions, we must also hire and retain an increasing number of professionals with different skills and expectations than those of the professionals we have historically hired and retained. 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.

Our business may suffer if we are unable to hire and retain sufficient temporary workers or if labor costs increase. In addition, current and future healthcare legislation and related regulations could affect our cost of providing healthcare benefits adversely affecting our results and cash flows.

We regularly hire a large number of part-time and seasonal workers, particularly during the fourth quarter holiday season and to meet temporary increases in client activity volume related to "flash sales" and other short-term marketing programs. Any difficulty we may encounter in hiring such workers could result in significant increases in labor costs, or inability to support our clients' business, which could have a material adverse effect on our business, financial condition and results of operations. We may also hire more full-time and part-time employees to mitigate the risk of the unavailability of temporary workers, and our failure to maintain an appropriate mix of labor personnel may result in higher costs. Competition for labor could also substantially increase our labor costs. In addition, current and future healthcare legislation could materially impact our future healthcare costs and our employee benefits costs, which

would adversely affect our results and cash flows. Although we seek to preserve the contractual ability to pass through increases in labor costs to our clients, not all of our current contracts provide us with this protection, and we may enter into contracts in the future, which limit or prohibit our ability to pass through increases in labor costs to our clients.

Our business is susceptible to risks associated with international operations.

Outside of the United States, we currently maintain distribution facilities, call centers, technology centers, administrative offices and/or have sales personnel in Belgium, Canada, India, Bulgaria and England, and we currently intend to expand our international operations. We cannot assure you we will be successful in expanding in these or any additional international markets. In addition, we may face competition from companies that may have more experience with operations in these countries or with international operations generally. We may also face difficulties integrating new facilities in different countries into our existing operations, as well as integrating employees that we hire in different countries into our existing corporate culture. In addition to the uncertainty regarding our ability to generate revenue or profits from foreign operations and expand our international presence, there are risks inherent in doing business internationally that we have not generally faced in our U.S. operations, including:

- lack of familiarity with, and resulting risk of breach of, and/or unanticipated additional cost of compliance with, foreign laws and regulations governing privacy, data security, data transfer, employment, taxes, tariffs, trade restrictions, transfer pricing and other matters;
- changes in regulatory environments;
- difficulties and expenses associated with localizing our services and operations to local markets, including language and cultural differences;
- difficulties in staffing and managing international operations, including complex and costly hiring, disciplinary, and termination requirements;
- the complexities of foreign value-added taxes and restrictions on the repatriation of earnings;
- reduced or varied protection for intellectual property rights in some countries;
- political, social and economic instability abroad, terrorist attacks and security concerns;
- fluctuations in currency exchange rates; and
- increased accounting and reporting burdens and complexities.

Additionally, operating in international market requires significant management attention and financial resources. We cannot be certain that the investments and additional resources required to establish and maintain operations in other countries will hold their value or produce desired levels of revenues or profitability. Any negative impact from our international business efforts could negatively impact our business, results of operations and financial condition as a whole.

Our financial results may be adversely affected by fluctuations in the foreign currency exchange markets.

The revenues and expenses of our international operations generally are denominated in local currencies. Accordingly, we are subject to exchange rate fluctuations between such local currencies and the U.S. dollar. These exchange rate fluctuations subject us to currency translation risk with respect to the reported results of our international operations. Significant strengthening or weakening of the U.S. dollar against currencies like the Canadian Dollar, British Pound and the Euro may materially impact our revenue and profits. As we continue to expand our presence in India, we will have increased exposure to fluctuations between the Indian Rupee and the U.S. dollar. In addition, we have transactions with clients, as well as inter-company transactions between our subsidiaries, that cross currencies and expose us to foreign currency gains and losses. These types of events are difficult to predict and may recur. There can be no assurance that we will be able to reduce the currency risks associated with our international operations. We seek to manage our exposure to changes in foreign currency exchange rates through our normal operating and financing activities and, if deemed appropriate, we may use derivative financial instruments. There is no assurance that we will be successful in managing or controlling foreign currency risks.

We may engage in future strategic alliances or acquisitions that could dilute our existing shareholders' ownership, cause us to incur significant expenses or harm our business. Acquisitions can result in an increase in our operating costs, divert management's attention away from other operational matters and expose us to other risks associated with

acquisitions.

We have pursued an acquisition strategy designed to enhance or add to our offerings of services and solutions, or to enable us to expand in certain geographic and other markets, and we may continue to seek appropriate acquisition candidates. We may not succeed in completing targeted transactions, or achieve desired results of operations. Furthermore, we face risks in successfully integrating any businesses we acquire. Ongoing business may be disrupted and our management's attention may be diverted by acquisitions, transition or integration activities. In addition, we might need to dedicate additional management and other resources, and our organizational structure could make it difficult for us to efficiently integrate acquired businesses into our ongoing operations and assimilate and retain employees of those businesses into our culture and operations.

17

---

We might fail to realize the expected benefits or strategic objectives of any acquisition we make. We might not achieve our expected return on investment, or we may lose money. We may be adversely impacted by liabilities that we assume from a company we acquire, including from that company's known and unknown obligations, intellectual property or other assets, terminated employees, current or former clients, or other third parties, and we may fail to identify or adequately assess the magnitude of certain liabilities, shortcomings or other circumstances prior to acquisition, which could result in unexpected legal or regulatory exposure, unfavorable accounting treatment, unexpected increases in taxes, or other adverse effects on our business. If we are inefficient or unsuccessful at integrating any acquired businesses into our operations, we may not be able to achieve our planned rates of growth or improve our market share, profitability, or competitive position in specific markets or services.

In addition, acquisitions involve further risks, such as:

- lack of synergy, or inability to realize expected synergies, resulting from the acquisition;
- the risk that the issuance of our common stock, if any, in an acquisition or merger, or the consolidation of an acquired company's financial results could be dilutive to our shareholders;
- acquired assets becoming impaired as a result of technological advancements or worse-than-expected performance of the acquired company;
- the potential impact of the announcement or consummation of a proposed transaction on the market value of our common stock or relationships with third parties;
- reductions in cash balances and/or increases in debt obligations to finance activities associated with a transaction, including future payments under earn-outs and other contingent payments, which reduce the availability of cash flow for general corporate or other purposes or impact our financial results; and
- inadequacy or ineffectiveness of an acquired company's internal financial controls, disclosure controls and procedures, and/or other policies or practices; and unknown, underestimated and/or undisclosed commitments or liabilities.

Our financial results may be negatively impacted by impairment in the carrying value of our goodwill and intangible assets.

Goodwill and identifiable intangible assets represented approximately 25% of our total assets as of December 31, 2016. The carrying value of goodwill represents the fair value of an acquired business in excess of identifiable assets and liabilities as of the acquisition date. We are required to test goodwill and intangible assets for impairment annually, as well as on an interim basis to the extent that factors or indicators become apparent that could reduce the fair value of any of our reporting units below its book value. Such factors requiring an interim test for impairment include financial performance indicators such as negative or declining cash flows or a decline in actual or planned revenue or earnings and a sustained decrease in share price. Our cash flow estimates involve projections that are inherently subject to change based on future events. A significant downward revision in the fair value of one or more of our business units that causes the carrying value to exceed the fair value could cause goodwill or intangible assets to be considered impaired, and could result in a non-cash impairment charge in our consolidated statement of operations.

Our business and profitability could be adversely affected if the operations of one or more of our facilities were interrupted or shut down as the result of a natural disaster.

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

more of our facilities could adversely affect our business and profitability.

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

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

We may be required to expend significant capital and other resources to protect against security breaches or to address any problem they may cause. Because our activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage our reputation, cause us to lose clients, impact our ability to attract new clients and we could be exposed to litigation and possible liability. Our security measures may not prevent security breaches, and failure to prevent security



breaches may disrupt our operations. The failure to adequately control fraudulent transactions on either our behalf or our client's behalf could increase our expenses and expose us to reputational damage which would adversely affect our business.

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

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

We rely on encryption and authentication technology 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 measures 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.

Our insurance policies may not fully cover all losses we may incur.

Although we attempt to limit our liability for damages arising from negligent acts, errors or omissions through contractual provisions, the limitations of liability included in our contracts may not fully protect us from liability or damages and may not be enforceable in all instances. In addition, not all of our contracts may limit our exposure for certain liabilities, such as data security claims or claims of third parties for which we may be required to indemnify our clients. Although we have general liability and errors and omissions insurance coverage, this coverage may not continue to be available on terms reasonable to us or in sufficient amounts to cover one or more large claims, and our insurers may disclaim coverage as to any future claim. The successful assertion of one or more large claims against us that are excluded from our insurance coverage or that exceed our available insurance coverage, or changes in our insurance policies (including premium increases or the imposition of large deductible or co-insurance requirements), could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Changes in regulations, regulatory scrutiny, or user concerns regarding privacy and protection of user data could adversely affect our business.

We are subject to U.S. and foreign laws relating to the collection, use, retention, security and transfer of personally identifiable information. The interpretation and application of user data protection laws are in a state of flux, and may vary from country to country. In many cases, these laws apply not only to third-party transactions, but also to transfers of information between or among ourselves, our subsidiaries and other parties with which we have commercial relations. Further, these laws continue to develop in ways we cannot predict and which may adversely impact our business. For example, new laws or regulations, in particular, financial or privacy laws or regulations, may be enacted in jurisdictions in which we do business that require data (including customer information, transaction data or other information) to be stored locally on servers in that jurisdiction and/or prohibit such data from being transmitted outside of that jurisdiction, which would increase our operational costs or capital expenditures and potentially impact the performance or availability of our services and/or our ability to use or process customer data.

In particular, with regard to transfers of personal data, we historically have relied upon adherence to the U.S. Department of Commerce's Safe Harbor Privacy Principles and compliance with the U.S.-EU Safe Harbor Framework agreed to by the U.S. Department of Commerce and the European Union. The U.S.-EU Safe Harbor Framework, which established means for legitimizing the transfer of personal data by U.S. companies from the European Economic Area (the EEA) to the U.S., was recently invalidated by a decision of the European Court of Justice (the ECJ). In light of the ECJ's decision, we are reviewing our business practices and may

find it necessary or desirable to make changes to our handling of personal data to comply with new requirements under applicable European law. We may be unsuccessful in establishing legitimate means for our transfer and receipt of personal data from the EEA or otherwise responding to the ECJ's decision or new European requirements, and we may experience reluctance or refusal by current or prospective European customers to use our services. We may be required to assume additional liabilities or incur additional costs, and our business, operating results and financial condition may be materially adversely affected. Because of the uncertainty arising from the ECJ decision, we may face a risk of enforcement actions by data protection authorities in the EEA. Any such enforcement actions could result in substantial costs and diversion of resources, distract management and technical personnel and negatively affect our business, operating results and financial condition.

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

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

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

We currently, and may in the future, rely on third party providers to provide various material portions of our solution service offering. If our business relationship with a third-party provider of a material portion of our solution service offering is negatively affected, or is terminated, we might not be able to deliver the corresponding service offering to our clients, which could cause us to lose clients and future business, reducing our revenues. Under the terms of several of our contracts with our service clients, we remain liable to provide such third party services and may be liable for the actions and omissions of such third party providers. In certain instances, certain clients prepay in advance a portion of the service fees payable in respect of the third party services, and, under certain circumstances, including our breach or the breach by our third party provider of our or their respective obligations, we are liable to refund all or a portion of such prepaid fees. Consequently, in the event our third party provider fails to provide the third party services in compliance with required services levels, or otherwise breaches its obligations, or discontinues its business, whether as the result of bankruptcy, insolvency or otherwise, we may be required to provide such services at a higher cost to us and may otherwise be liable for various costs and expenses related to such event. In addition, any such failure may damage our reputation and otherwise result in a material adverse effect upon our business and financial condition.

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

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

Our business is subject to the risk of customer terminations.

Most of our client agreements state a contract expiration date, but many also include an early termination clause permitting the client to terminate the contract for convenience prior to its stated expiration date or to reduce the scope of services or delay the commencement of services to be provided under the contract. Termination, reduction, or delay of our services under a contract could result from factors unrelated to our work product or the progress of the project, such as factors related to business or financial conditions of the client, changes in client strategies or the domestic or global economy generally. The early termination, reduction or substantial delay of services any significant client, or nonrenewal of any significant client contract, or the nonpayment of a material amount of our service fees by a significant client, could have a material adverse effect upon our business, results of operation and financial condition.

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

Sales by Supplies Distributors to two customers in the aggregate accounted for approximately 29% of Supplies Distributors' total product revenue for the year ended December 31, 2016 and 4% of consolidated net revenue. The loss of one or both of such customers, or non-payment of any material amount by these or any other customer, would have a material adverse effect upon Supplies Distributors' business, results of operations and financial condition.

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

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

Our systems may not accommodate significant growth in our number of clients; we may incorrectly design client solutions.

Our success depends on our ability to handle a large number of transactions for many different clients in various product categories and to design client solutions that are effective and profitable. We expect the volume of transactions will increase significantly as we expand our operations. In addition, client marketing programs, such as "secret sales", "flash sales" or holiday related promotions often result in significant short-term spikes in transaction volumes. When this occurs, additional stress is placed upon our network hardware and software and our ability to efficiently manage our operations, and we cannot assure you of our ability to efficiently manage a large number of transactions. In addition, if we incorrectly design a client solution, we may incur additional costs to operate the solution, which may result in the client solution being unprofitable or otherwise not meeting our margin targets. If we are not able to maintain an appropriate level of operating performance, we may be in breach of our client contractual obligations, develop a negative reputation, and impair existing and prospective client relationships and our business would be materially adversely affected.

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

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

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

Many companies offer, on an individual basis, one or more of the same services we do, and we face competition from many different sources depending upon the type and range of services requested by a potential client. Our competitors include vertical outsourcers, which are companies that offer a single function, such as call centers, public warehouses or professional services firms such as system integrators and digital agencies. 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 infrastructure service 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 addition, we compete against other professional service firms that have substantial offshore operations with lower labor costs, which enable them to offer lower pricing to potential clients. In many instances, our competition is the in-house operations of potential clients themselves. The in-house operations of potential clients often believe they can perform the same services we do, while others are reluctant to outsource business functions that involve direct customer contact. We cannot be certain we will be able to compete successfully against these or other competitors in the future.

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

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

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

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

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

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

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

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

We and our clients may be subject to sales tax in one or more jurisdictions, which could adversely affect our business.

We collect sales or other similar taxes for shipments of our and our clients' goods in certain states and jurisdictions. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us and other out-of-state companies, including our clients, that engage in online commerce, depending upon the nexus we or our clients may have with that jurisdiction and the product or services being performed. If unexpected sales tax obligations are successfully imposed upon us or our clients by a state



or other jurisdiction, we or our clients could be exposed to substantial tax liabilities for past sales and fines and penalties for failure to collect sales taxes and we or our clients could suffer decreased sales in that state or jurisdiction as the effective cost of purchasing goods from or through 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 or our clients may be subject to significant fines or other payments for any past failures to comply with these requirements.

Determinations under government audits could negatively affect our business.

We provide services to a U.S. government agency under a contract that provides the agency with the right to audit and review our performance under the contract, our pricing practices, our cost structure, and our compliance with applicable laws, regulations, and standards. If a government audit determines that we are in breach of our contractual terms, or have engaged in improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of the contract, suspension of payments, or disqualification from continuing to do business, or bidding on new business, with this agency and other federal agencies.

We may recognize losses or reduced profitability if we do not accurately estimate the cost of engagements conducted on a fixed-price basis.

When making a proposal for or managing a fixed-price engagement, we rely on our estimates of costs and timing for delivering our services, which may be based on limited data and could be inaccurate. If we do not accurately estimate our costs and the timing for completion of a fixed-price project, the contract for such a project could prove unprofitable or yield a profit margin that is lower than expected. Losses, if any, on fixed-price contracts are recognized when the loss is determined. Any increased or unexpected costs or unanticipated delays in connection with the performance of fixed-price contracts, including delays caused by factors outside of our control, could make these contracts less profitable or unprofitable and may affect the amount of revenue, profit, and profit margin reported in any period.

#### Risks Related to Our Industry

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

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

#### Risks Related to Our Stock

Institutional shareholders hold a significant amount of our common stock and these shareholders may have conflicts of interests with the interests of our other shareholders.

As of December 31, 2016, institutional investors (including transcosmos, our largest shareholder) own or control approximately 85% of the voting power of our common stock. The interests of these shareholders may differ from our other shareholders in material respects. This concentration of voting power of our common stock may make it difficult for our other shareholders to approve or defeat matters that may be submitted for action by our shareholders, including the election of directors and amendments to our Certificate of Incorporation or Bylaws. This also may have the effect of deterring, delaying, or preventing a change in control, even when such a change in control could benefit our other shareholders. These shareholders may have the power to exert significant influence over our affairs in ways that may be adverse to the interests of our other shareholders.

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

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

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

As of December 31, 2016, we have issued an aggregate of (i) 1.2 million stock options outstanding to employees, directors and others with a weighted average exercise price of \$7.56 per share (ii) 213,000 performance shares of common stock, of which 88,000 are vested and the remainder of which may vest, subject to satisfaction of vesting conditions, over the next two years, (iii) 27,000 restricted stock units, of which 13,000 are vested and the remainder of which may vest subject to satisfaction of vesting conditions, over the next three years, and (iv) 118,000 deferred stock units to the non-employee members of our Board of Directors under which the underlying shares will be issued upon the termination of service of the holder. The current and future issuance and/or vesting of shares of our common stock under the foregoing stock awards, performance shares and deferred stock units, sales of substantial amounts of common stock in the public market following the issuance and/or vesting of such shares, and/or the perception that future sales of these shares could occur, could reduce the market price of our common stock and make it more difficult to sell equity securities in the future.

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

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

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our headquarters are located in Allen, Texas, a Dallas suburb. In the U.S., we operate a distribution facility in Memphis, Tennessee, with aggregate space of more than 440,000 square feet. We also operate four additional distribution facilities totaling an aggregate of approximately 1,050,000 square feet in Southaven, Mississippi. These facilities are located approximately ten miles from the Memphis International Airport. We also manage for a client a DTC facility in Memphis, Tennessee with approximately 410,000 square feet.

24

---

Internationally, we operate a distribution complex in Liège, Belgium with approximately 200,000 square feet, and distribution operations in Ontario, Canada with approximately 80,000 square feet. We also operate facilities in Bangalore, India, London, England, Basingstoke, England and Sofia, Bulgaria, each of which provide primarily technology development and administrative support.

We lease all of our distribution and other facilities under third party leases that generally contain one or more renewal options.

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

### Item 3. Legal Proceedings

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

### Item 4. Mine Safety Disclosures

Not Applicable

## PART II

Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities  
 Common Stock

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

	Price	
	High	Low
Year Ended December 31, 2015		
First Quarter	\$12.72	\$10.01
Second Quarter	\$15.42	\$10.79
Third Quarter	\$14.45	\$11.29
Fourth Quarter	\$16.54	\$11.32
Year Ended December 31, 2016		
First Quarter	\$13.99	\$9.95
Second Quarter	\$15.87	\$9.05
Third Quarter	\$11.21	\$8.90
Fourth Quarter	\$9.60	\$6.71

As of March 1, 2017, there were approximately 2,800 shareholders, of which 112 were record holders of the common stock.

#### Dividend Policy

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

Comparative Stock Performance

The graph below matches our cumulative 5-Year total shareholder return on common stock with the cumulative total returns of the NASDAQ Composite index and the Russell 2000 index. The graph tracks the performance of a \$100 investment in our common stock and in each index (with the reinvestment of all dividends) from 12/31/2011 to 12/31/2016.

	12/11	12/12	12/13	12/14	12/15	12/16
PFSweb Inc.	100.00	86.63	275.68	384.80	391.19	258.36
NASDAQ Composite	100.00	116.41	165.47	188.69	200.32	216.54
Russell 2000	100.00	116.35	161.52	169.43	161.95	196.45

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Equity Compensation Plan Information

The following table summarizes information with respect to equity compensation plans under which equity securities of the Company are authorized for issuance as of December 31, 2016:

	(a)	(b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average price of outstanding options, warrants and rights (2)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Plan category (1)			
Equity compensation plans approved by			
shareholders	1,573,088	\$ 7.56	1,338,560
Equity compensation plans not approved by			
shareholders	—	—	—

(1) See Note 7 to the Consolidated Financial Statements for more detailed information regarding the Company's equity compensation plans.

(2) Excludes 27,000 restricted stock units, 213,000 Performance Shares and 118,000 deferred stock units.



## Item 6. Selected Consolidated Financial Data

The following selected financial data should be read in conjunction with Item 8, Financial Statements and Supplementary Data and related notes and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and other financial information appearing elsewhere in this Annual Report on Form 10-K. We derived the following historical financial information from our consolidated audited financial statements for the fiscal years noted (in thousands, except per share data):

	Years Ended December 31,				
	2016	2015	2014	2013	2012
<b>REVENUES:</b>					
Service fee revenue	\$226,165	\$182,175	\$134,385	\$112,977	\$120,433
Product revenue, net	48,695	58,659	75,284	90,982	119,740
Pass-through revenue	59,783	47,435	37,379	37,644	41,390
Total revenues	334,643	288,269	247,048	241,603	281,563
<b>COSTS OF REVENUES:</b>					
Cost of service fee revenue	155,513	123,574	94,858	77,160	89,249
Cost of product revenue	45,883	55,587	71,019	85,237	110,183
Cost of pass-through revenue	59,783	47,435	37,379	37,644	41,390
Total costs of revenues	261,179	226,596	203,256	200,041	240,822
Gross profit	73,464	61,673	43,792	41,562	40,741
<b>SELLING, GENERAL AND ADMINISTRATIVE</b>					
EXPENSES	76,304	66,280	47,658	46,235	40,620
(Loss) Income from operations	(2,840 )	(4,607 )	(3,866 )	(4,673 )	121
INTEREST EXPENSE, net	2,323	1,757	813	679	988
Loss from operations before income taxes	(5,163 )	(6,364 )	(4,679 )	(5,352 )	(867 )
INCOME TAX EXPENSE (BENEFIT)	2,367	1,497	(53 )	539	644
NET LOSS	\$(7,530 )	\$(7,861 )	\$(4,626 )	\$(5,891 )	\$(1,511 )
<b>NET LOSS PER SHARE:</b>					
Basic	\$(0.41 )	\$(0.45 )	\$(0.28 )	\$(0.39 )	\$(0.12 )
Diluted	\$(0.41 )	\$(0.45 )	\$(0.28 )	\$(0.39 )	\$(0.12 )
<b>Weighted average shares outstanding:</b>					
Basic	18,542	17,608	16,737	14,957	12,777
Diluted	18,542	17,608	16,737	14,957	12,777
<b>Balance Sheet Data:</b>					
Total assets	\$211,336	\$191,290	\$140,746	\$132,036	\$133,471
Short-term debt	7,300	3,153	6,850	8,231	16,660
Long-term debt	52,399	32,238	4,062	2,876	5,400
Shareholders' equity	40,283	43,758	40,105	40,925	28,051

The selected financial statements presented above are not comparable due to the acquisitions that occurred in the years ended December 31, 2016, 2015 and 2014.



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;
- Key transactions and events during 2016, 2015 and 2014;
- Our financial structure, including our historical financial presentation;
- Our results of operations for the previous three years as well as certain projections for the future;
- Certain aspects of our relationships with our subsidiaries;
- Our liquidity and capital resources;
- The impact of seasonality, inflation and recently issued accounting standards on our financial statements; and
- Our critical accounting policies and estimates.

Forward-Looking Information

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

- our ability to retain and expand relationships with existing clients and attract and implement new clients;
- our reliance on the fees generated by the transaction volume, product sales and technology and agency projects and support of our clients;
- our reliance on our clients' projections or transaction volume or product sales;
- our dependency upon our agreements with International Business Machines Corporation ("IBM") and Ricoh Company Limited and Ricoh USA, Inc., a strategic business unit within the Ricoh Family Group of Companies, (collectively hereafter referred to as "RicoH");
- our dependency upon our agreements with our major clients;
- our client mix, their business volumes and the seasonality of their business;
- our ability to finalize pending client and customer contracts;
- the impact of strategic alliances and acquisitions;
- trends in 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;
- our reliance on third-party providers and other subcontracted services;
- the unknown effects of possible system failures and rapid changes in technology;
- foreign currency risks and other risks of operating in foreign countries;
- potential litigation;

- our dependency upon key personnel;
- our ability to retain seasonal and temporary workers;
- the impact of new accounting standards and changes in existing accounting rules or the interpretations of those rules;
- our ability to raise additional capital or obtain additional financing;
- our ability, and the ability of our subsidiaries, to borrow under current financing arrangements and maintain compliance with debt covenants;
- our relationship with, and our guarantees of, certain of the liabilities and indebtedness of our subsidiaries; and
- taxation on the sale of our products and provision of our services.

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

#### Key Transactions and Events

We were impacted by the following key transactions and events that also affect comparability of our results to other periods:

##### Year ended December 31, 2016:

- Acquired the outstanding capital stock of Conexus Limited (“Conexus”) on June 8, 2016. The results of operations of Conexus have been included in our consolidated financial statements since the acquisition date.
- Implemented fulfillment solutions for three new large clients, resulting in incremental operating expenses in excess of associated revenues.

##### Year ended December 31, 2015:

- Acquired the outstanding capital stock of Moda Superbe Limited (“Moda”) on June 11, 2015. The results of operations of Moda have been included in our consolidated financial statements since the acquisition date.
- Completed an asset purchase agreement with CrossView, Inc. (“CrossView”) and its shareholders on August 5, 2015. The results of operations of CrossView have been included in our consolidated financial statements since the acquisition date.

##### Year ended December 31, 2014:

- Implemented a significant new contract with a United States government agency.
- Acquired the outstanding capital stock of REV Solutions, Inc. and REVTECH Solutions India Private Limited (collectively “REV”) on September 3, 2014. The results of operations of REV have been included in our consolidated financial statements since the acquisition date.
- Acquired the outstanding capital stock of LiveAreaLabs, Inc. (“LAL”) on September 22, 2014. The results of operations of LAL have been included in our consolidated financial statements since the acquisition date.

## Overview

We are a global provider of omni-channel commerce solutions. Comprised of a broad range of technology, critical infrastructure and professional services, we provide our clients with best-of-breed capabilities offered as a complete end-to-end solution or on an à la carte basis. We provide these solutions and services to major brand name companies and others seeking to optimize their supply chain and to enhance their online and traditional business channels and initiatives. We derive our revenues from providing a broad range of services using three different seller services financial models: 1) the Service Fee model, 2) the Agent (or Flash) model and 3) the Retail model.

We refer to our standard seller services financial model as the Service Fee model. In this model, our clients own the inventory and are the merchants of record and engage us to provide various infrastructure, technology and digital agency services in support of their business operations. We derive our service fee revenues from a broad range of service offerings that include digital agency and marketing, eCommerce technologies, system integration, order management, customer care, logistics and fulfillment, financial management and professional consulting. We offer our services as an integrated solution, which enables our clients to outsource their complete ecommerce needs to a single source and to focus on their core competencies, though clients are also able to select individual or groupings of our various service offerings on an à la carte basis. We currently provide services to clients that operate in a range of vertical markets, including technology manufacturing, computer products, cosmetics, fragile goods, coins and collectibles, apparel, telecommunications, consumer electronics and consumer packaged goods, among others.

In the Service Fee model, we typically charge for our services on a cost-plus basis, a percent of shipped revenue basis, a time and materials, project or retainer basis for our professional services or a per-transaction basis, such as a per-labor hour basis for web-enabled customer contact center services and a per-item basis for fulfillment services. Additional fees are billed for other services. We price our services based on a variety of factors, including the depth and complexity of the services provided, the amount of capital expenditures or systems customization required, the length of contract and other factors.

Many of our service fee contracts involve third-party vendors who provide additional services, such as package delivery. The costs we are charged by these third-party vendors for these services are often passed on to our clients. Our billings for reimbursements of these costs and other 'out-of-pocket' expenses include travel, shipping and handling costs and telecommunication charges and are included in pass-through revenue.

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

Finally, our Retail model allows us to purchase inventory from the client. In this model, we place the initial and replenishment purchase orders with the client and take ownership of the product upon delivery to our facility. In this model, depending on the terms of our client arrangements, we may own the inventory and the accounts receivable arising from our product sales. Under the Retail model, depending upon the product category and sales characteristics, we may require the client to provide product price protection as well as product purchase payment terms, right of return, and obsolescence protection appropriate to the product sales profile. Depending on the terms of our client arrangements in the Retail model, we record in our consolidated statement of operations either: 1) product revenue as a component of product revenue, or 2) product revenue net of cost of product revenue as a component of service fee revenue. In general, we seek to structure client relationships in our Retail model under the net revenue approach to more closely align with our service fee revenue financial presentation and mitigate inventory ownership, although we have one client still utilizing the gross revenue approach. Freight costs billed to customers are reflected as components of product revenue. This business model generally requires significant working capital, for which we have credit available either through credit terms provided by our clients or under senior credit facilities.

In general, we provide the Service Fee model through all of our subsidiaries, the Agent (or Flash) model through our PFS and Supplies Distributors subsidiaries and the Retail model through our Supplies Distributors subsidiary.

Growth is a key element to achieving our future goals, including achieving and maintaining sustainable profitability. Growth in our Service Fee and Agent models is driven by two main elements: new client relationships and organic growth from existing clients. We focus our sales efforts on larger contracts with brand-name companies within four primary target markets, health and beauty, home goods and collectibles, fashion and consumer packaged goods, which, by nature, require a longer duration to close but also have the potential to be higher quality and longer duration engagements. Through recent acquisitions, we have expanded our service offering capabilities and added new client relationships, which we currently expect to enhance our growth opportunities.

Currently, we are targeting growth within our Retail model to be through relationships with clients under which we can record service fee revenue (product revenue net of cost of product revenue) in our consolidated statement of operations as opposed to product revenue as generated in the Agent or Flash model above. These relationships are often driven by the sales and marketing efforts of the manufacturers and third party sales partners. In addition, as a result of certain operational restructuring of its business, our primary client relationship operating in the Retail model, Ricoh, has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced product revenues and profitability under our Retail model.

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

Our expenses comprise primarily four categories: 1) cost of service fee revenue, 2) cost of product revenue, 3) cost of pass-through revenue and 4) selling, general and administrative expenses.

Cost of service fee revenue – consists primarily of compensation and related expenses for our web-enabled customer contact center services, international fulfillment and distribution services and professional, digital agency and technology services, and other fixed and variable expenses directly related to providing services under the terms of fee based contracts, including certain occupancy and information technology costs and depreciation and amortization expenses.

Cost of product revenue – consists of the purchase price of product sold and freight costs, which are reduced by certain reimbursable expenses. These reimbursable expenses include pass-through customer marketing programs, direct costs incurred in passing on any price decreases offered by vendors to cover price protection and certain special bids, the cost of products provided to replace defective product returned by customers and certain other expenses as defined under the distributor agreements.

Cost of pass-through revenue – the related reimbursable costs for pass-through expenditures are reflected as cost of pass-through revenue.

Selling, General and Administrative expenses – consist of expenses such as compensation and related expenses for sales and marketing staff, distribution costs (excluding freight) applicable to the Supplies Distributors business and the Retail model, executive, management and administrative personnel and other overhead costs, including certain occupancy and information technology costs and depreciation and amortization expenses and acquisition related costs.

Monitoring and controlling our available cash balances and our expenses continues to be a primary focus. Our cash and liquidity positions are important components of our financing of both current operations and our targeted growth.



## Results of Operations

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

	2016	2015	Change		% of Net Revenues			Change		% of Net Revenues		
			\$	%	2016	2015	2014	\$	%	2014		
<b>Revenues</b>												
Service fee revenue	\$226.2	\$182.2	\$44.0	24.1 %	67.6 %	63.2 %	\$134.4	\$47.8	35.6 %	54.4 %		
Product revenue, net	48.7	58.7	(10.0)	(17.0)%	14.6 %	20.4 %	75.3	(16.6)	(22.1)%	30.5 %		
Pass-through revenue	59.8	47.4	12.4	26.0 %	17.8 %	16.4 %	37.4	10.0	26.9 %	15.1 %		
Total net revenues	334.7	288.3	46.4	16.1 %	100.0%	100.0%	247.1	41.2	16.7 %	100.0 %		
<b>Cost of Revenues</b>												
Cost of service fee revenue (1)	155.5	123.6	31.9	25.8 %	68.8 %	67.8 %	94.9	28.7	30.3 %	70.6 %		
Cost of product revenue (2)	45.9	55.6	(9.7 )	(17.5)%	94.2 %	94.8 %	71.0	(15.4)	(21.7)%	94.3 %		
Pass-through cost of revenue (3)	59.8	47.4	12.4	26.0 %	100.0%	100.0%	37.4	10.0	26.9 %	100.0 %		
Total cost of revenues	261.2											