

PFSWEB INC
Form 10-Q
August 09, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 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
(State of Incorporation)

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

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ Smaller Reporting Company ☐

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

At August 5, 2016 there were 18,700,125 shares of registrant's common stock outstanding.

PFSWEB, INC. AND SUBSIDIARIES

Form 10-Q

June 30, 2016

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

PFSweb, Inc. and Subsidiaries

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)

	(Unaudited) June 30, 2016	December 31, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 16,692	\$ 21,781
Restricted cash	219	275
Accounts receivable, net of allowance for doubtful accounts of \$485 and \$600		
at June 30, 2016 and December 31, 2015, respectively	60,418	70,700
Inventories, net of reserves of \$607 and \$739 at June 30, 2016 and		
December 31, 2015, respectively	8,049	9,262
Other receivables	4,926	8,704
Prepaid expenses and other current assets	5,841	5,662
Total current assets	96,145	116,384
PROPERTY AND EQUIPMENT, net	26,915	24,093
IDENTIFIABLE INTANGIBLES, net	9,295	8,810
GOODWILL	45,601	39,829
OTHER ASSETS	2,294	2,174
Total assets	\$ 180,250	\$ 191,290
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt and capital lease obligations	\$ 5,166	\$ 3,153
Trade accounts payable	39,649	51,170
Deferred revenue	6,377	7,390
Performance-based contingent payments	867	11,679
Accrued expenses	23,950	30,563
Total current liabilities	76,009	103,955
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less		
current portion	49,864	32,238
DEFERRED REVENUE	4,413	4,499
DEFERRED RENT	4,918	4,362
OTHER LIABILITIES	543	2,478

Total liabilities	135,747	147,532
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COMMITMENTS AND CONTINGENCIES

SHAREHOLDERS' EQUITY:

Preferred stock, \$1.00 par value; 1,000,000 shares authorized; none issued or

outstanding	—	—
Common stock, \$0.001 par value; 35,000,000 shares authorized; 18,724,551		
and 18,136,218 shares issued at June 30, 2016 and December 31, 2015,		
respectively; and 18,691,084 and 18,102,751 outstanding at June 30, 2016		
and December 31, 2015, respectively	18	18
Additional paid-in capital	144,662	141,948
Accumulated deficit	(100,721)	(97,787)
Accumulated other comprehensive income (loss)	669	(296)
Treasury stock at cost, 33,467 shares	(125)	(125)
Total shareholders' equity	44,503	43,758
Total liabilities and shareholders' equity	\$ 180,250	\$ 191,290

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

PFSWEB, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
REVENUES:				
Service fee revenue	\$ 51,166	\$ 39,075	\$ 100,484	\$ 75,783
Product revenue, net	11,380	13,658	24,987	30,312
Pass-through revenue	14,653	10,443	26,809	20,927
Total revenues	77,199	63,176	152,280	127,022
COSTS OF REVENUES:				
Cost of service fee revenue	34,381	26,645	66,655	51,800
Cost of product revenue	10,742	12,911	23,644	28,619
Cost of pass-through revenue	14,653	10,443	26,809	20,927
Total costs of revenues	59,776	49,999	117,108	101,346
Gross profit	17,423	13,177	35,172	25,676

SELLING, GENERAL AND ADMINISTRATIVE

EXPENSES, including stock based compensation expense

of \$629 and \$1,150 in the three months ended

June 30, 2016 and 2015, respectively, and \$1,396 and

\$1,954 in the six months ended June 30, 2016 and

2015, respectively	18,808	14,676	36,358	28,290
Loss from operations	(1,385)	(1,499)	(1,186)	(2,614)
INTEREST EXPENSE, net	609	223	1,094	541
Loss from operations before income taxes	(1,994)	(1,722)	(2,280)	(3,155)
INCOME TAX EXPENSE	188	178	654	438
NET LOSS	\$ (2,182)	\$ (1,900)	\$ (2,934)	\$ (3,593)

NET LOSS PER SHARE:

Basic	\$ (0.12)	\$ (0.11)	\$ (0.16)	\$ (0.21)
Diluted	\$ (0.12)	\$ (0.11)	\$ (0.16)	\$ (0.21)

WEIGHTED AVERAGE NUMBER OF SHARES

OUTSTANDING:

Basic	18,627	17,368	18,477	17,257
Diluted	18,627	17,368	18,477	17,257

COMPREHENSIVE LOSS:

Net loss	\$ (2,182)	\$ (1,900)	\$ (2,934)	\$ (3,593)
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Foreign currency translation adjustment	669	238	965	(668)
TOTAL COMPREHENSIVE LOSS	\$(1,513)	\$(1,662)	\$(1,969)	\$(4,261)

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

PFSweb, Inc. and Subsidiaries

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Six Months Ended June 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$(2,934)	\$(3,593)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	7,403	6,564
Amortization of debt issuance costs	73	—
Gain on sale of fixed assets	—	20
Provision for doubtful accounts	18	16
Provision for excess and obsolete inventory	27	9
Deferred income taxes	(9)	39
Stock-based compensation expense	1,396	1,954
Non-cash compensation expense	—	87
Change in performance-based contingent payments	(1,768)	—
Changes in operating assets and liabilities:		
Restricted cash	—	34
Accounts receivable	11,930	15,607
Inventories	1,205	109
Prepaid expenses, other receivables and other assets	4,867	3,854
Deferred rent	921	(282)
Accounts payable, deferred revenue, accrued expenses and other liabilities	(20,012)	(18,307)
Net cash provided by operating activities	3,117	6,111
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(6,553)	(1,946)
Acquisitions, net of cash acquired	(8,320)	(878)
Net cash used in investing activities	(14,873)	(2,824)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common stock	1,037	1,189
Decrease in restricted cash	56	112
Payments on performance-based contingent payments	(9,454)	(2,043)
Payments on capital lease obligations	(1,415)	(1,081)
Taxes paid on behalf of employees for withheld shares	(1,307)	(588)
Payments on debt, net	(2,492)	(2,212)
Borrowings on term loan	12,000	—
Borrowings on revolver	42,839	—
Payments on revolver	(35,095)	—
Net cash provided by (used in) financing activities	6,169	(4,623)

EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	498	(1,071)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(5,089)	(2,407)
CASH AND CASH EQUIVALENTS, beginning of period	21,781	18,128
CASH AND CASH EQUIVALENTS, end of period	\$ 16,692	\$ 15,721
SUPPLEMENTAL CASH FLOW INFORMATION		
Non-cash investing and financing activities:		
Property and equipment acquired under long-term debt and capital leases	\$ 1,654	\$ 1,637

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

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. OVERVIEW AND BASIS OF PRESENTATION

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

PFSweb Overview

PFSweb is a global provider of omni-channel commerce solutions, including a broad range of technology, infrastructure and professional services, to major brand name companies and others seeking to optimize their supply chain and to enhance their online and traditional business channels and initiatives in the United States, Canada, and Europe. PFSweb’s service offerings include website design, creation and integration, digital agency and marketing, eCommerce technologies, order management, customer care, logistics and fulfillment, financial management and professional consulting.

Supplies Distributors Overview

Supplies Distributors and PFSweb operate under distributor agreements with Ricoh Company Limited and Ricoh USA, Inc., a strategic business unit within the Ricoh Family Group of Companies, (collectively hereafter referred to as “Ricoh”), under which Supplies Distributors acts as a distributor of various Ricoh products. The majority of Supplies Distributors’ revenue is generated by its sale of product purchased from Ricoh.

Supplies Distributors has obtained financing to fund certain working capital requirements for the sale of primarily Ricoh products. Pursuant to the transaction management services agreements between PFSweb and Supplies Distributors, PFSweb provides to Supplies Distributors transaction management and fulfillment services, such as managed web hosting and maintenance, procurement support, web-enabled customer contact center services, customer relationship management, financial services including billing and collection services, information management, and international distribution services. Supplies Distributors does not have its own sales force and relies upon Ricoh’s sales force and product demand generation activities for its sale of Ricoh products. Supplies Distributors sells its products in the United States, Canada and Europe.

Supplies Distributors also maintains agreements with certain additional clients where it operates as an agent for the resale of product between the client and the clients’ customer, and records product revenue net of cost of product revenue as a component of service fee revenue. PFSweb also provides various transaction management services to Supplies Distributors under these arrangements.

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

Basis of Presentation

The interim condensed consolidated financial statements as of June 30, 2016, and for the three and six months ended June 30, 2016 and 2015, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and are unaudited. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted pursuant to the rules and regulations promulgated by the SEC. In the opinion of management and subject to the foregoing, the unaudited interim condensed consolidated financial statements of the Company include all adjustments necessary for a fair presentation of the Company's financial position as of June 30, 2016, its results of operations for the three and six months ended June 30, 2016 and 2015 and its cash flows for the six months ended June 30, 2016 and 2015. Certain prior-year amounts have been reclassified to conform to the current year's presentation. Results of the Company's operations for interim periods may not be indicative of results for the full fiscal year.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Estimates and assumptions about future events and their effects cannot be determined with certainty. The Company bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as the operating environment changes. These changes have been included in the condensed consolidated financial statements as soon as they became known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. These uncertainties are discussed in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 in the section entitled "Risk Factors." Based on a critical assessment of accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes the Company's condensed consolidated financial statements are fairly stated in accordance with U.S. GAAP, and provide a fair presentation of the Company's financial position and results of operations.

Revenue and Cost Recognition

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

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

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

Service Fee Revenue Activity

The Company's service fee revenue primarily relates to its distribution services, order management/customer care services, professional digital agency and technology services. The Company typically charges its service fee revenue on either a cost-plus basis, a percent of shipped revenue basis, on a time and materials, project or retainer basis for professional services, or a per transaction basis, such as a per item basis for fulfillment services or a per labor hour basis for web-enabled customer contact center services. Additional fees are billed for other services.

The Company evaluates its contractual arrangements to determine whether or not they include multiple service elements. Revenue recognition is determined for the separate service elements of the contract in accordance with the requirements of Accounting Standards Codification ("ASC") 605, "Revenue Recognition." A deliverable constitutes a separate unit of accounting when it has standalone value and there are no return rights or other contingencies present for the delivered elements. The Company allocates revenue to each element based on estimated selling price. Each of the Company's client contracts, and the related services, is unique, with individual needs and criteria customized for each client. Each client engagement is scoped and priced separately and as such the Company is not able to establish vendor specific objective evidence of fair value for its services, nor is third-party evidence available to establish stand-alone selling prices. Accordingly the Company uses management's best estimate of selling price for the deliverables. The Company establishes its estimates considering internal factors such as margin objectives, pricing practices and controls as well as market conditions such as competitor pricing strategies.

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

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

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

Professional consulting and technology service revenues primarily relate to design, implementation, service and support of eCommerce platforms, website design and solutions and quality control for the Company's clients. Additionally, the Company provides digital agency services that enable client marketing programs to attract new customers, convert buyers and increase website value. These fees are typically charged on either a per labor hour basis, or transaction basis, a dedicated resource model, a fixed price arrangement, or a percent of merchandise shipped basis. Service fee revenue for this activity is generally recognized as the services are rendered.

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

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

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

Product Revenue Activity

Depending on the terms of the customer arrangement, Supplies Distributors recognizes product revenue and product cost either upon the shipment of product to customers or when the customer receives the product. Supplies

Distributors permits its customers to return product for credit against other purchases, which include returns for defective products (that Supplies Distributors then returns to the manufacturer) and incorrect shipments. Supplies Distributors provides a reserve for estimated returns and allowances and offers terms to its customers that it believes are standard for its industry.

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

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

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Accounts Receivable

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

Deferred Revenues and Deferred Costs

The Company primarily performs its services under multiple-year contracts, certain of which include early termination provisions, and clients are obligated to pay for services performed. In conjunction with these long-term contracts, the Company sometimes receives start-up fees to cover its implementation costs, including certain technology infrastructure and development costs. When the Company determines that these start-up and integration activities do not meet the criteria for recognition as a separate unit of accounting, the Company defers the start-up fees received, and the related costs, and recognizes them over the expected performance period. The amortization of deferred revenue is included as a component of service fee revenue. The amortization of deferred implementation costs is included as a cost of service fee revenue. To the extent implementation costs for non-technology infrastructure and development exceed the corresponding fees received, the excess costs are expensed as incurred.

Advances to Affiliates

Priority Fulfillment Services, Inc. ("PFS") a wholly-owned subsidiary of PFSweb, Inc. has made advances to Supplies Distributors that are evidenced by a Subordinated Demand Note (the "Subordinated Note"). Under the terms of certain of Supplies Distributors' debt facilities, the outstanding balance of the Subordinated Note cannot be decreased to less than \$2.5 million without prior approval of certain of Supplies Distributors' lenders. As of June 30, 2016 and December 31, 2015, the outstanding balance of the Subordinated Note was \$2.5 million. The Subordinated Note is eliminated in the Company's condensed consolidated financial statements.

Concentration of Business and Credit Risk

One service fee client relationship represented approximately 10% of the Company's consolidated total revenues during the six months ended June 30, 2016. No customer or service fee client exceeded 10% of consolidated accounts receivable as of June 30, 2016.

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

Six Months
Ended
June 30,

	2016	2015
Product Revenue (as a percentage of total Product Revenue):		
Customer 1	13 %	15 %
Customer 2	15 %	14 %
Service Fee Revenue (as a percentage of total Service Fee Revenue):		
Client 1	10 %	15 %

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

The Company has provided certain collateralized guarantees of its subsidiaries' financings and credit arrangements. These subsidiaries' ability to obtain financing on similar terms would be significantly impacted without these guarantees.

The Company has multiple arrangements with International Business Machines Corporation ("IBM") and Ricoh. These arrangements include Supplies Distributors' distributor agreements and certain of Supplies Distributors' working capital financing agreements. The majority of Supplies Distributors' revenue is generated by its sale of product purchased from Ricoh. Supplies Distributors also relies upon Ricoh's sales force and product demand generation activities and the discontinuance of such services

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

would have a material impact upon Supplies Distributors' business. In addition, Supplies Distributors has product sales to IBM and Ricoh business affiliates.

As a result of certain operational restructuring of its business, Ricoh has implemented, and will continue to implement, certain changes in the sale and distribution of Ricoh products. The changes have resulted, and are expected to continue to result, in reduced revenues and profitability for Supplies Distributors.

Inventories

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

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

Operating Leases

The Company leases certain real estate for its warehouse, call center, sales, professional services and corporate operations, as well as certain equipment, under non-cancelable operating leases that expire at various dates through 2026. Management expects that, in the normal course of business, leases that expire will be renewed or replaced by other similar leases. The Company recognizes escalating lease payments on a straight-line basis over the term of each respective lease with the difference between cash payments and rent expense recognized being recorded as deferred rent in the accompanying condensed consolidated balance sheets.

Property and Equipment

The Company's property held under capital leases totaled approximately \$5.6 million and \$5.5 million, net of accumulated amortization of approximately \$4.8 million and \$4.6 million, at June 30, 2016 and December 31, 2015, respectively. Depreciation and amortization expense related to capital leases during six months ended June 30, 2016 and 2015 was \$1.4 million and \$1.0 million, respectively.

Income Taxes

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

Cash Paid for Interest and Taxes

The Company made payments for interest of approximately \$0.8 million and \$0.3 million in the six months ended June 30, 2016 and 2015, respectively. Income taxes of approximately \$0.6 million and \$0.7 million were paid by the Company during the six months ended June 30, 2016 and 2015, respectively.

Impact of Recently Issued Accounting Standards

Accounting Standards Recently Adopted

In March 2016, the Financial Accounting Standards Board (the “FASB”) issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” The amendment in this ASU affects all organizations that issue share-based payment awards to employees and is intended to simplify several aspects of the accounting for these awards, including income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows, and allowing an accounting policy election to account for forfeitures as they occur. As permitted by ASU 2016-09, the Company elected to early adopt ASU 2016-09 in the quarter ended June 30, 2016 with an effective date of January 1, 2016. As a result of the adoption, the Company recognized previously unrecognized excess tax benefits of \$1.9 million, which was offset by a valuation

PFSweb, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

allowance in the same amount as the Company does not believe, on a more-likely-than-not basis, the net operating losses will be realized. The adoption of ASU 2016-09 resulted in a cumulative adjustment to equity, subject to a full valuation allowance, as of January 1, 2016.

The Company has not yet adopted and is currently assessing the potential effect of the following pronouncements on its condensed consolidated financial statements and related disclosures:

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), which outlines a single, comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for the fiscal year beginning January 1, 2018, with early adoption permitted for fiscal years beginning January 1, 2017. The FASB has also issued the following standards which clarify ASU 2014-09 and have the same effective date as the original standard:

- ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net);
- ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing; and
- ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.

In February 2016, the FASB issued ASU 2016-02, “Leases”. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

3. ACQUISITIONS

Acquisitions have been recorded using the purchase method of accounting for business combinations.

Acquisition Related Expenses

The acquisitions discussed below are expected to enhance the Company's overall service offering to its existing clients and customers as well as support anticipated growth opportunities. For the three months ended June 30, 2016 and 2015, acquisition related costs were \$1.4 million and \$0.9 million, respectively, and for the six months ended June 30, 2016 and 2015, acquisition related costs were \$1.6 million and \$1.3 million, respectively, and recognized in selling, general and administrative expenses in the condensed consolidated statements of operations.

2016 Acquisition

Acquisition of Conexus

On June 8, 2016, PFSweb, Inc. acquired the outstanding capital stock of Conexus, an eCommerce system integrator that provides strategic consulting, system integration, and managed services for leading businesses and technology companies. Conexus maintains primary operations in Basingstoke, Hampshire (U.K.). The purchase price for the shares consists of (i) an initial cash payment of £5,855,000 (approximately \$8.5 million), subject to a post-closing adjustment based upon a May 31, 2016 balance sheet analysis to be completed following the closing, and (ii) up to an aggregate maximum of £1,445,000 (approximately \$1.9 million at June 30, 2016), subject to Conexus achieving certain operational and financial targets during the post-closing period ending December

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31, 2016 (the “Earn-out Payments”), subject to possible offsets for indemnification and other claims arising under the purchase agreement. Up to 40% (but not to exceed £450,000) (approximately \$0.6 million at June 30, 2016) of the Earn-out Payments may be paid by the issuance of restricted shares of PFSweb common stock, based on its then current market value at the time of issuance. As of June 30, 2016, the Company has recorded a liability of \$0.6 million applicable to the estimated Earn-out Payments, which is included in performance-based contingent payments in the condensed consolidated balance sheets.

The results of operations of Conexus have been included in the Company's condensed consolidated financial statements since the date of acquisition which, for the three and six months ended June 30, 2016, includes \$0.5 million of service fee revenue and \$0.3 million of net loss. The net loss for Conexus for the three months ended June 30, 2016 included \$0.5 million of acquisition related costs. Additional acquisition related costs applicable to the Conexus acquisition of approximately \$1.0 million and \$1.1 million were also incurred by the Company during the three and six month ended June 30, 2016, respectively. The Company determined fair value using a combination of the discounted cash flow, market multiple and market capitalization valuation methods. The Company is in the process of finalizing the purchase price allocation and, accordingly, the following preliminary allocation of the purchase price is subject to adjustment.

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

Cash	\$156
Accounts receivable, net	1,458
Other receivables	1,434
Property and equipment	200
Other assets	82
Intangible assets	2,181
Total assets acquired	5,511
Total liabilities assumed	2,211
Net assets acquired	3,300
Goodwill	5,772
Total purchase price	\$9,072

Aggregate cash payments	8,476
Performance-based contingent payments (based on estimated fair value at acquisition date)	596
Total purchase price	\$9,072

The excess of the purchase price over the fair value of the net identifiable assets acquired and liabilities assumed was allocated to goodwill. Total goodwill of \$5.8 million, none of which is deductible for tax purposes, is not being amortized but is subject to an annual impairment test using a fair-value-based approach.

The Company is amortizing the identifiable intangible assets acquired using a pattern in which the economic benefit of the assets are expected to be realized by the Company over their estimated remaining useful lives. There are no residual values for any of the intangible assets subject to amortization acquired during the Conexus acquisition. Estimated definite lived intangible assets acquired in the Conexus acquisition consist of customer relationships of \$1.5 million, with an estimated useful life of approximately five years and developed technology of \$0.7 million, with an estimated useful life of approximately three years.

2015 Acquisitions

Acquisition of Moda

On June 11, 2015, PFSweb, Inc. acquired the outstanding capital stock of Moda, an eCommerce system integrator and consultancy that provides unique digital experiences for fashion brands and retailers. Moda maintains primary operations in London. Consideration paid for the shares included an initial £650,000 (approximately \$1.0 million) cash payment and 16,116 unregistered shares of Company stock (approximately \$0.2 million in value as of the acquisition date). The purchase agreement provides for future earn-out payments (“Moda Earn-out Payments”) payable in 2016 and 2017 based on Moda’s achievement of certain 2015 and 2016 financial targets, with no guaranteed minimum and an aggregate maximum each year of £500,000 (approximately \$0.8 million), in each case, subject to possible offsets for indemnification and other claims arising under the purchase agreement. As of June 30, 2016,

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the Company has recorded a liability of \$0.1 million applicable to the estimated 2016 Moda Earn-out Payments, which is included in performance-based contingent payments in the condensed consolidated balance sheets. The estimated performance-based contingent liability for the Moda 2016 Earn-out Payments was reduced from \$0.3 million as of December 31, 2015 to \$0.1 million as of June 30, 2016 as a result of updated 2016 Moda financial projections. At the Company's election, up to 25% of the 2016 Moda Earn-out Payments are payable in restricted shares of common stock of the Company.

The results of operations of Moda have been included in the Company's condensed consolidated financial statements since the date of acquisition.

The Company determines fair value using a combination of the discounted cash flow, market multiple and market capitalization valuation methods. The following table summarizes the fair value of the tangible and intangible assets acquired and liabilities assumed (in thousands):

Cash and cash equivalents	\$ 126
Accounts receivable	335
Property and equipment	27
Identifiable intangibles	340
Other assets	23
Total assets acquired	851
Total liabilities assumed	658
Net assets acquired	193
Goodwill	1,287
Total purchase price	\$ 1,480

Purchase price for Moda is as follows (in thousands, except share data and stock price):

Number of shares of common stock issued	16,116
Multiplied by PFSweb Inc.'s stock price	\$ 14.60
Share consideration	\$ 235
Aggregate cash payments	1,005
Performance-based contingent payments (based on estimated fair value at acquisition date)	240
Total purchase price	\$ 1,480

The excess of the purchase price over the fair value of the net identifiable assets acquired and liabilities assumed was allocated to goodwill. Total goodwill of \$1.3 million, none of which is deductible for tax purposes, is not being amortized but is subject to an annual impairment test using a fair-value-based approach.

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

Estimated definite lived intangible assets acquired in the Moda acquisition consist of (in thousands):

	Fair Value at Acquisition	June 30, 2016 Net Accumulated Amortization	December 31, 2015 Net Accumulated Amortization	Estimated Useful Life from Acquisition
Customer relationships	\$ 309	\$(203) \$ 106	\$(141) \$ 168	1.6 years
Non-compete agreements	31	(21) 10	(12) 19	2.5 years
Total definite lived intangible assets	\$ 340	\$(224) \$ 116	\$(153) \$ 187	

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Acquisition of CrossView

On August 5, 2015, PFSweb, Inc. acquired substantially all of the assets, and assumed substantially all of the liabilities, in each case, other than certain specified assets and liabilities, of CrossView, an ecommerce systems integrator and provider of a wide range of ecommerce services in the U.S. and Canada.

Consideration paid by the Company included an initial cash payment of \$30.7 million and 553,223 unregistered shares of Company common stock (approximately \$6.3 million in value as of the acquisition date). The initial cash payment was subject to adjustment based upon a post-closing balance sheet reconciliation. In addition, the purchase agreement provides for future earn-out payments (“CrossView Earn-out Payments”) payable in 2016, 2017 and 2018 based on the achievement of certain 2015, 2016 and 2017 financial targets. The CrossView Earn-out Payments have no guaranteed minimum and an aggregate maximum of \$18.0 million and are subject to possible offsets for indemnification and other claims. In the quarter ended June 30, 2016, the Company paid an aggregate of \$7.9 million in settlement of the 2015 CrossView Earn-out Payments, of which, \$1.6 million was paid by the issuance of restricted shares of Company stock. The Company will pay 15% of any 2016 and 2017 earn-outs payments in restricted shares of Company common stock, based on its current market value at the time of issuance. As of June 30, 2016, the Company has recorded a total liability of \$0.8 million applicable to the projected CrossView Earn-out Payments, which is included in performance-based contingent payments and other liabilities in the condensed consolidated balance sheets. This estimated performance-based liability was reduced from \$10.2 million as of December 31, 2015 to \$0.8 million as of June 30, 2016 following \$7.9 million of payments during the quarter ended June 30, 2016 and as a result of updated CrossView financial projections for the 2016 and 2017 earn-out periods.

The results of operations of CrossView have been included in the Company's condensed consolidated financial statements since the date of acquisition

The Company determined fair value using a combination of the discounted cash flow, market multiple and market capitalization valuation methods. The following table summarizes the preliminary estimated fair value of the tangible and intangible assets acquired and liabilities assumed (in thousands):

Accounts receivable	\$7,595
Property and equipment	441
Other assets	149
Identifiable intangibles	9,050
Total assets acquired	17,235
Total liabilities assumed	2,556
Net assets acquired	14,679
Goodwill	30,176
Total purchase price	\$44,855

Purchase price for CrossView is as follows (in thousands, except share data and stock price):

Number of shares of common stock issued		553,223	
Multiplied by PFSweb Inc.'s stock price	\$	11.40	
Share consideration	\$	6,307	
Aggregate cash payments		30,740	
Performance-based contingent payments (based on estimated fair value at acquisition date)		9,195	
Post-closing balance sheet reconciliation adjustment		(1,387)
Total purchase price	\$	44,855	

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The excess of the purchase price over the fair value of the net identifiable assets acquired and liabilities assumed was allocated to goodwill. Total goodwill of \$30.2 million, which, given the structure of the acquisition, is expected to be deductible for tax purposes over 15 years.

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

	June 30, 2016	December 31, 2015
Fair Value		