

PFSWEB INC
Form 10-Q
August 09, 2018

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, 2018

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 incorporation or organization) | (I.R.S. Employer 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

Not Applicable

Edgar Filing: PFSWEB INC - Form 10-Q

(Former name, former address and former fiscal year, if changed since last report)

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, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of August 6, 2018, there were 19,258,092 shares of registrant’s common stock outstanding.

PFSWEB, INC. AND SUBSIDIARIES

Form 10-Q

INDEX

| | Page |
|---|--------|
| <u>PART I. FINANCIAL INFORMATION</u> | Number |
| Item 1. <u>Financial Statements:</u> | |
| <u>Condensed Consolidated Balance Sheets as of June 30, 2018 (Unaudited) and December 31, 2017</u> | 3 |
| <u>Unaudited Condensed Consolidated Statements of Operations and Comprehensive Loss for the Three and Six Months Ended June 30, 2018 and 2017</u> | 4 |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017</u> | 5 |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> | 6 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 14 |
| Item 3. <u>Quantitative and Qualitative Disclosure about Market Risk</u> | 21 |
| Item 4. <u>Controls and Procedures</u> | 21 |
| <u>PART II. OTHER INFORMATION</u> | |
| Item 1. <u>Legal Proceedings</u> | 22 |
| Item 1A. <u>Risk Factors</u> | 22 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 22 |

| | |
|--|----|
| Item 3. <u>Defaults Upon Senior Securities</u> | 22 |
| Item 4. <u>Mine Safety Disclosure</u> | 22 |
| Item 5. <u>Other Information</u> | 22 |
| Item 6. <u>Exhibits</u> | 23 |
| <u>SIGNATURES</u> | 24 |

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

PFSweb, Inc. and Subsidiaries

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)

| | (Unaudited) | |
|--|-------------------|----------------------|
| | June 30, 2018 | December 31, 2017 |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 13,622 | \$ 19,078 |
| Restricted cash | 214 | 214 |
| Accounts receivable, net of allowance for doubtful accounts of \$393 and \$373 at June 30, 2018 and December 31, 2017, respectively | 53,387 | 72,062 |
| Inventories, net of reserves of \$296 and \$342 at June 30, 2018 and December 31, 2017, respectively | 5,677 | 5,326 |
| Other receivables | 4,460 | 5,366 |
| Prepaid expenses and other current assets | 6,470 | 6,633 |
| Total current assets | 83,830 | 108,679 |
| PROPERTY AND EQUIPMENT: | | |
| Cost | 116,690 | 120,403 |
| Less: accumulated depreciation | (94,932) | (96,225) |
| | 21,758 | 24,178 |
| IDENTIFIABLE INTANGIBLES, net | 2,535 | 3,371 |
| GOODWILL | 45,424 | 45,698 |
| OTHER ASSETS | 3,636 | 3,861 |
| Total assets | \$ 157,183 | \$ 185,787 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade accounts payable | \$ 30,910 | \$ 45,070 |
| Accrued expenses | 22,532 | 29,074 |
| Current portion of long-term debt and capital lease obligations | 5,537 | 9,460 |
| Deferred revenues | 5,397 | 7,405 |
| Performance-based contingent payments | — | 3,967 |
| Total current liabilities | 64,376 | 94,976 |
| LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion | 40,329 | 37,866 |
| DEFERRED REVENUES, less current portion | 2,869 | 4,034 |
| DEFERRED RENT | 5,129 | 5,464 |

| | | |
|---|------------|------------|
| OTHER LIABILITIES | 2,245 | 2,150 |
| Total liabilities | 114,948 | 144,490 |
| 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; 19,291,559 and 19,058,685 shares | | |
| issued at June 30, 2018 and December 31, 2017, respectively; and 19,258,092 and 19,025,218 | | |
| outstanding at June 30, 2018 and December 31, 2017, respectively | 19 | 19 |
| Additional paid-in capital | 153,429 | 150,614 |
| Accumulated deficit | (110,376) | (109,281) |
| Accumulated other comprehensive income | (712) | 70 |
| Treasury stock at cost, 33,467 shares | (125) | (125) |
| Total shareholders' equity | 42,235 | 41,297 |
| Total liabilities and shareholders' equity | \$ 157,183 | \$ 185,787 |

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

PFSWEB, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In Thousands, Except Per Share Data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| REVENUES: | | | | |
| Service fee revenue | \$ 53,141 | \$ 54,700 | \$ 109,628 | \$ 111,965 |
| Product revenue, net | 8,847 | 9,947 | 18,612 | 21,265 |
| Pass-through revenue | 15,063 | 13,419 | 27,232 | 23,604 |
| Total revenues | 77,051 | 78,066 | 155,472 | 156,834 |
| COSTS OF REVENUES: | | | | |
| Cost of service fee revenue | 33,294 | 35,977 | 68,902 | 75,561 |
| Cost of product revenue | 8,403 | 9,505 | 17,719 | 20,230 |
| Cost of pass-through revenue | 15,063 | 13,419 | 27,232 | 23,604 |
| Total costs of revenues | 56,760 | 58,901 | 113,853 | 119,395 |
| Gross profit | 20,291 | 19,165 | 41,619 | 37,439 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 19,756 | 20,735 | 40,415 | 42,453 |
| Income (loss) from operations | 535 | (1,570) | 1,204 | (5,014) |
| INTEREST EXPENSE, net | 585 | 710 | 1,190 | 1,347 |
| Income (loss) before income taxes | (50) | (2,280) | 14 | (6,361) |
| INCOME TAX EXPENSE, net | 576 | 316 | 1,389 | 1,091 |
| NET LOSS | \$(626) | \$(2,596) | \$(1,375) | \$(7,452) |
| NET LOSS PER SHARE: | | | | |
| Basic | \$(0.03) | \$(0.14) | \$(0.07) | \$(0.40) |
| Diluted | \$(0.03) | \$(0.14) | \$(0.07) | \$(0.40) |
| WEIGHTED AVERAGE NUMBER OF SHARES | | | | |
| OUTSTANDING: | | | | |
| Basic | 19,174 | 18,870 | 19,160 | 18,804 |
| Diluted | 19,174 | 18,870 | 19,160 | 18,804 |
| COMPREHENSIVE LOSS: | | | | |
| Net loss | \$(626) | \$(2,596) | \$(1,375) | \$(7,452) |
| Foreign currency translation adjustment | (1,239) | 511 | (782) | 807 |
| TOTAL COMPREHENSIVE LOSS | \$(1,865) | \$(2,085) | \$(2,157) | \$(6,645) |

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, | |
|---|------------------------------|-----------------|
| | 2018 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$(1,375) | \$(7,452) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,957 | 7,565 |
| Amortization of debt issuance costs | 71 | 76 |
| Provision for doubtful accounts | 22 | 89 |
| Provision for excess and obsolete inventory | 108 | 31 |
| Loss on disposal of fixed assets | 42 | — |
| Deferred income taxes | 8 | 240 |
| Stock-based compensation expense | 2,006 | 1,761 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 18,326 | 19,725 |
| Inventories | (459) | (1,125) |
| Prepaid expenses, other receivables and other assets | 1,193 | 3,396 |
| Deferred rent | (300) | 78 |
| Accounts payable, deferred revenues, accrued expenses and other liabilities | (22,887) | (20,962) |
| Net cash provided by operating activities | 2,712 | 3,422 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (1,941) | (1,975) |
| Proceeds from sale of property and equipment | 59 | — |
| Net cash used in investing activities | (1,882) | (1,975) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net proceeds from issuance of common stock | 350 | 402 |
| Taxes paid on behalf of employees for withheld shares | (363) | (256) |
| Payments on performance-based contingent payments | (3,268) | (2,004) |
| Payments on capital lease obligations | (1,359) | (1,678) |
| Payments on term loan | (1,500) | (1,125) |
| Payments on revolving loan | (59,183) | (49,880) |
| Borrowings on revolving loan | 59,949 | 45,619 |
| Payments on other debt | (494) | (490) |
| Borrowings on other debt | 309 | 895 |
| Net cash used in financing activities | (5,559) | (8,517) |
| EFFECT OF EXCHANGE RATES ON CASH, CASH EQUIVALENTS AND RESTRICTED CASH | | |
| | (727) | 1,777 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (5,456) | (5,293) |

| | | |
|---|----------|----------|
| Cash and cash equivalents, beginning of period | 19,078 | 24,425 |
| Restricted cash, beginning of period | 214 | 215 |
| CASH, CASH EQUIVALENTS AND RESTRICTED CASH, beginning of period | 19,292 | 24,640 |
| Cash and cash equivalents, end of period | 13,622 | 19,132 |
| Restricted cash, end of period | 214 | 215 |
| CASH, CASH EQUIVALENTS AND RESTRICTED CASH, end of period | \$13,836 | \$19,347 |

SUPPLEMENTAL CASH FLOW INFORMATION

| | | |
|---|---------|---------|
| Cash paid for income taxes | \$973 | \$844 |
| Cash paid for interest | \$1,080 | \$1,152 |
| Non-cash investing and financing activities: | | |
| Property and equipment acquired under long-term debt and capital leases | \$1,033 | \$1,072 |
| Performance-based contingent payments through stock issuance | \$822 | \$354 |

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

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of PFSweb, Inc. and its subsidiaries (the “Company”) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”), and include all normal and recurring adjustments necessary to present fairly the unaudited condensed consolidated balance sheets, statements of operations and comprehensive loss, and statements of cash flows for the periods indicated. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted pursuant to the rules and regulations of the SEC. This report should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. Results of the Company’s operations for interim periods may not be indicative of results for the full fiscal year. The Company reclassifies certain prior year amounts, as applicable, to conform to the current year presentation.

2. Significant Accounting Policies

For a complete set of the Company’s significant accounting policies, refer to the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. During the three and six-month periods ending June 30, 2018, there were no significant changes to our significant accounting policies, other than those policies impacted by the new revenue recognition guidance as described below in the Impact of Recently Issued Accounting Standards.

Revenue and Cost Recognition

We derive revenue primarily from services provided under contractual arrangements with our clients or from the sale of products under our distributor agreements. The majority of our revenue is derived from contracts and projects that can span from a few months to three to five years.

Revenue is recognized when (or as) we satisfy performance obligations by transferring a promised good or service, an asset, to a client or customer. An asset is transferred to a client or customer when, or as, the client or customer obtains control over that asset. The transaction price includes fixed and, in certain contracts, variable consideration.

Variable consideration contained within our contracts includes discounts, rebates, incentives, penalties and other similar items. When a contract includes variable consideration, we estimate the variable consideration to determine whether any of it needs to be constrained. We include the variable consideration in the transaction price only to the extent that it is probable that a significant reversal of the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. We estimate variable consideration and constraints based on our review of the contract terms and conditions. Variable consideration and constraint amounts are the most likely amounts based on our history with the customer. If no history is available, then we will book the most likely amount based on the range of possible consideration amounts. Variable consideration and constraints are updated at each reporting date.

Incremental contract costs (such as sales commissions) are expensed when incurred when the amortization period of the asset that would have been recognized is one year or less; otherwise, incremental contract costs are recognized as an asset and amortized over time as promised goods and services are transferred to a customer.

We evaluate our contractual arrangements to determine whether or not they include multiple performance obligations. Revenue recognition is determined for each distinct performance obligation of the contract in accordance with Accounting Standard Codification (“ASC”) 606 (“ASC 606”). We allocate revenue to each performance obligation based on the relative standalone sales price.

For contracts recognized over time, we recognize the estimated loss to the extent the project has been completed based on actual hours incurred compared to the total estimated hours. We recognized a \$0.2 million contract loss for both the three and six months ended June 30, 2018. The loss is recognized when the current estimate of the consideration we expect to receive, modified to include any variable consideration, is less than the current estimate of total costs for the contract.

Service Fee Revenue

Our service fee revenue includes activities that relate to our PFS Operations and LiveArea Professional Services business units. PFS Operations primarily includes distribution, order management and payment services. LiveArea Professional Services primarily includes e-commerce and digital experience strategy consulting, creative website design and marketing support, and technology platform integration services. We typically charge our service fee revenue on either a time and materials, fixed price, cost-plus a margin, a percent of shipped revenue, or retainer basis for our 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.

Distribution services relate primarily to inventory management, product receiving, warehousing and fulfillment (i.e., picking, packing and shipping product on our clients' behalf). Order management and contact center services relate primarily to taking customer orders for our clients' products via various channels such as telephone call-center, electronic or facsimile. These services

also entail addressing customer questions related to orders, as well as merchandising activities. These performance obligations typically include related set-up and integration services in preparation of performing such activities.

Professional services relate primarily to design, implementation and support of eCommerce platforms, website solutions and quality control for our clients. Additionally, the Company provides digital agency services that enable client marketing programs to attract new customers, convert buyers and increase website value. We recognize this revenue over time as services are rendered.

Most of our fixed price, professional services contracts require the customer to pay us for all costs plus a margin for work performed up until termination date, regardless of which party terminates. For these contracts, revenue is recognized based on input methods, generally hours expended. The input method measures progress toward the satisfaction of the performance obligation by multiplying the transaction price of the performance obligation by the percentage of hours incurred to total estimated hours as of the balance sheet date after giving effect to the most current estimates. When we are not able to reasonably measure the outcome of a performance obligation but expect to recover costs incurred, we recognize revenue to the extent of the costs incurred until such time that we can reasonably measure the outcome of the performance obligation.

Our 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, as incurred. The related reimbursable costs are reflected as cost of pass-through revenue.

Product Revenue

Depending on the terms of the customer arrangement, product revenue and product cost is recognized at the point the customer gains control of the asset. The specific point in time when control transfers depends on the contract with the customer. Typically, our terms are Freight on Board (“FOB”) Shipping point. We permit our customers to return product. Product revenue is reported net of estimated returns and allowances, which are estimated based upon historical return information. Management also considers any other current information and trends in making estimates.

Gross versus Net Revenue

In instances where revenue is derived from product sales from a third-party, we record revenue on a gross basis when we are a principal to the transaction and net of costs when we are acting as an agent between the customer or client and the vendor. We are the principal and therefore record revenue on a gross basis if we control a promised good or service before transferring that good or service to the customer. We are an agent and record revenue on a net basis for what we retain for agency services if our role is to arrange for another entity to control the promised goods or services.

The allocated transaction price when we are the principle will be based on the stand alone selling price of the good or service, which is supported by the invoice. Transaction prices for products are typically based off list prices, plus a margin. The transaction prices for services are primarily based off of labor rate tables, job level categories, material and infrastructure costs, plus a margin.

Indicators that we control the specified good or service before it is transferred to the customer (and are therefore a principal) include: 1) we are primarily responsible for fulfilling the promise to provide the specified good or service, 2) we have inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return), and 3) we have discretion in establishing the price for the specified good or service. We must first identify the specified good or service and determine whether we control that specified good or service before evaluating the indicators. The indicators serve as support for the

entity's control determination and are not a replacement of it.

Practical expedients

The standard allows entities to use several practical expedients, including determining whether a significant financing component exists, treatment of sales and usage-based taxes, and the recognition of certain incremental costs of obtaining a contract with a client or customer. Contracts of less than a year with a financing component will be expensed in that period as a practical expedient. Our current contracts do not have a financing component. Commissions on contracts of less than one year will be expensed as a practical expedient. Commissions will be capitalized on contracts over one year. As of June 30, 2018, we did not have any material commissions on contracts in excess of one year. We also present our revenues net of sales and usage-based tax as a practical expedient.

Impact of Recently Issued Accounting Standards

Pronouncements Recently Adopted

In May 2014, the FASB issued ASC 606, "Revenue from Contracts with Customers", which replaces numerous requirements in U.S. GAAP, including industry-specific requirements, provides companies with a single revenue recognition model for recognizing revenue from contracts with clients and customers and significantly expands the disclosure requirements for revenue arrangements. The new standard, as amended, became effective for the Company for interim and annual reporting periods beginning on January 1, 2018.

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method applied to the contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC 605, "Revenue Recognition".

We recorded a net increase to opening retained earnings of \$0.3 million as of January 1, 2018 due to the cumulative impact of adopting ASC 606, with the impact primarily related to our adjustments to deferred revenues and costs. We recorded a reduction of \$0.7 million to deferred revenue, a reduction of \$0.4 million to deferred costs, and a contract liability of \$0.1 million.

The impact of applying ASC 606 for the three and six months ended June 30, 2018 was immaterial to revenues and operating profits.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments - a consensus of the Emerging Issues Task Force" ("ASU 2016-15"). ASU 2016-15 is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. Certain issues addressed in this guidance include debt payments or debt extinguishment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, distributions received from equity method investments and beneficial interests in securitization transactions. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. Adoption of ASU 2016-15 as of January 1, 2018 did not have an impact on the Company's consolidated financial statements.

In November 2016, the FASB issued an ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash" ("ASU 2016-18"). ASU 2016-18 amends the presentation of restricted cash within the consolidated statements of cash flows, requiring that restricted cash be added to cash and cash equivalents on the consolidated statements of cash flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The Company adopted ASU 2016-18 in the three-month period ended March 31, 2018 on a retrospective basis with no impact to the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business" ("ASU 2017-01"). ASU 2017-01 clarifies the definition of a business when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses, ASU 2017-01 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2017. Adoption of ASU 2017-01 did not have an impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU 2017-09"), clarifying when a change to the terms or conditions of a stock-based payment award must be accounted for as a modification. ASU 2017-09 requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change to the terms and conditions of the award. ASU 2017-09 is effective for the Company on a prospective basis beginning on January 1, 2018. Adoption of ASU 2017-09 did not have an impact on the Company's consolidated financial statements as it is not the Company's general practice to change either the terms or conditions of stock-based payment awards once they are granted.

In March 2018, the FASB issued ASU 2018-05, "Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118" ("ASU 2018-05"). The amendments in ASU 2018-05 provide guidance on when to record and disclose provisional amounts for certain income tax effects of the Tax Cuts and Jobs Act ("Tax Reform Act"). The amendments also require any provisional amounts or subsequent adjustments to be included in net income. Additionally, ASU

2018-05 discusses required disclosures that an entity must make with regard to the Tax Reform Act. ASU 2018-05 is effective immediately as new information is available to adjust provisional amounts that were previously recorded. The Company has adopted ASU 2018-05 and will continue to evaluate indicators that may give rise to a change in our tax provision as a result of the Tax Reform Act.

Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, “Leases” (“ASU 2016-02”). ASU 2016-02 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. ASU 2016-02 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. The Company is currently assessing the impact of ASU 2016-02 on its consolidated financial statements, including implementing changes to our systems and processes in conjunction with our review of existing lease agreements. The Company currently expects the most significant impact of this new standard will be the recognition of the right-of-use assets and operating lease liabilities on our consolidated balance sheet upon adoption as well as the related financial statement disclosures.

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill impairment” (“ASU 2017-04”), which removes Step 2 of the goodwill impairment test. A goodwill impairment will now be determined by the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. ASU 2017-04 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2019, with early adoption permitted. The Company does not expect the adoption of ASU 2017-04 to have a material impact on the Company’s consolidated financial statements.

3. Acquisition

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, Inc. (“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. In addition, the purchase agreement provided 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. For the six months ended June 30, 2017 the Company paid an aggregate of \$2.4 million in settlement of the 2016 CrossView Earn-out Payments, of which \$0.4 million was paid by the issuance of 48,173 restricted shares of Company stock. For the six months ended June 30, 2018 the Company paid an aggregate of \$4.1 million in settlement of the 2017 CrossView Earn-out Payments, of which \$0.8 million was paid by the issuance of 76,998 restricted shares of Company stock. As of December 31, 2017, the Company had recorded a liability \$4.0 million applicable to the estimated CrossView Earn-out Payments, which is included in performance-based contingent payments in the consolidated balance sheet. As of June 30, 2018, the Company has no further liability for the Cross View Earn-out.

4. Revenue from Contracts with Clients and Customers

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the client or customer and is the unit of account in ASC 606. A contract’s transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied.

Our performance obligations for PFS Operations, includes distribution, contact center, order management and payment services, and for LiveArea Professional Services, include commerce strategy consulting, creative design and marketing support, and technology platform integration services. For contracts with multiple performance obligations, we allocate transaction price to each performance obligation using the stand alone selling price for the distinct good or service in the contract. The primary method used to calculate the standalone selling price is the list price, which includes margin, approach, under which we forecast our costs of satisfying a performance obligation and then add an appropriate margin for that distinct good or service. If a fixed fee is used, it is based on the underlying projected costs with a margin.

Implementation services related to setup costs for PFS Operations are not distinct within the context of the contract because of the inter-dependence of the integrating services with other services promised in the contract. It represents a bundle of services that reflect the combined output for which the client has contracted. These implementation revenues and costs are amortized from the first full month after go live through the end of the contract period. Transaction based fees are generally charged monthly based on volume and contract price.

Substantially all of our LiveArea professional services are satisfied over time, as the clients or customers simultaneously receive and consume the benefits provided by our service as they are performed. PFS Operations primarily consists of service fee revenue, which is made up of transaction items, such as shipments, which are recognized at a point in time, and services such as storage, which are recognized over time. In addition, PFS Operations has certain product revenue where it acts as a reseller, and when we determine we are the agent, recognizes net revenue at a point in time, typically at FOB shipping point. The transaction price for each performance obligation is based on the consideration specified in the contract with the client or customer and is reflected on the invoice. Additionally, for most of our Service Fee related revenue contracts, we have an enforceable right to payment for performance completed up to the termination date.

Remaining performance obligations represent the transaction price of firm orders for which work has yet not been performed. As of June 30, 2018, the aggregate amount of the transaction price allocated to remaining performance obligations was \$42.8 million. The Company expects to recognize revenue on approximately 23% of the remaining performance obligations in 2018, 59% through 2019, and the remaining recognized thereafter.

Revenue recognition timing and contract modifications

A number of factors relating to our business affect the recognition of contract revenue. We typically price our professional services contracts on either a time and materials, fixed-price or a cost-plus margin basis.

For fixed-price arrangements, we typically recognize revenue based on the input method, as we believe that hours expended over time proportionately, based on actual hours to budgeted hours during the period, provides the most relevant measure of progress for these contracts. For time and materials contracts, we recognize revenue monthly based on the actual hours worked at the labor rates by job category, and cost of materials plus margin. We recognize revenue for a performance obligation satisfied over time only if we can reasonably measure our progress toward complete satisfaction of the performance obligation. In some circumstances (for example, in the early stages of a contract), we may not be able to reasonably measure the outcome of a performance obligation, but we expect to recover the costs incurred in satisfying the performance obligation. In those circumstances, we shall recognize revenue only to the extent of the costs incurred until such time that we can reasonably measure the outcome of the performance obligation.

Contract modifications are routine in the performance of our contracts. Change orders that result from modification of an original contract are taken into consideration for revenue recognition when they result in a change of total contract value and are approved by our clients. In most instances, contract modifications are for services that are not distinct, and therefore, are accounted for as part of the existing contract. If the contract has significant scope changes, then it will be viewed as a separate contract and accounted for separately. Implementation/Integration service fees are considered part of an existing performance obligation, provided that they are dependent and interrelated to that existing performance obligation. On the PFS Operations side, those implementation revenues and costs are deferred and recognized over time, based on the term of the contract. If it was a significant scope change, then it would be accounted for as a separate performance obligation, deferred and amortized over the contract term.

Contract Assets and Contract Liabilities

Contract assets primarily relate to the Company's rights to consideration for work completed but not billed at the reporting date. The contract assets are reclassified as receivables when the rights become unconditional. The contract liabilities primarily relate to the advance consideration received from clients for client contracts, including amounts received for implementation services which are not distinct performance obligations.

The Company's payment terms vary by the type and location of our clients and the type of services offered. The term between invoicing and when payment is due is generally not significant.

Contract balances consisted of the following (in thousands):

| | June 30, 2018 | January 1, 2018 |
|--------------------------------------|------------------|-----------------------|
| Trade Accounts Receivable | | |
| Trade Accounts Receivable, net | \$52,823 | \$70,923 |
| Unbilled Accounts Receivable | 371 | 172 |
| Total Trade Accounts Receivable, net | \$53,194 | \$71,095 |
| Contract Liabilities | | |
| Accrued Contract Liabilities | \$625 | \$583 |
| Deferred Revenue | 8,266 | 10,697 |
| Total Contract Liabilities | \$8,891 | \$11,280 |

Changes in contract liabilities during the period was a decrease of \$2.4 million in our contract liabilities from January 1, 2018 to June 30, 2018, primarily due to an increase of approximately \$2.2 million from new projects, offset by approximately \$4.6 million of amortization and recognition of revenue in the six months ended June 30, 2018.

The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables, and customer advances and deposits (contract liabilities) on the consolidated balance sheet.

Changes in the contract asset and liability balances during the six months ended June 30, 2018 were not materially impacted by any other factors.

The following table presents our revenues, excluding sales and usage-based taxes, disaggregated by revenue source (in thousands):

| | Three Months Ended June 30, 2018 | | | Six Months Ended June 30, 2018 | | |
|-----------------------|-------------------------------------|--------------------------|-----------------|-----------------------------------|--------------------------|------------------|
| | LiveArea | | Total | LiveArea | | Total |
| | PFS Operations | Professional Services | | PFS Operations | Professional Services | |
| Revenues: | | | | | | |
| Service fee revenue | \$33,194 | \$ 19,948 | \$53,141 | \$68,116 | \$ 41,513 | \$109,628 |
| Product revenue, net | 8,847 | — | 8,847 | 18,612 | — | 18,612 |
| Pass-through | | | | | | |
| revenue | 14,574 | 488 | 15,063 | 26,374 | 857 | 27,232 |
| Total revenues | \$56,615 | \$ 20,436 | \$77,051 | \$113,102 | \$ 42,370 | \$155,472 |

The following table presents our revenues, excluding sales and usage-based taxes, disaggregated by region (in thousands):

| | Three Months Ended June 30, 2018 | | | Six Months Ended June 30, 2018 | | |
|----------------------------|-------------------------------------|--------------------------|-----------------|-----------------------------------|--------------------------|------------------|
| | LiveArea | | Total | LiveArea | | Total |
| | PFS Operations | Professional Services | | PFS Operations | Professional Services | |
| Revenues by region: | | | | | | |
| North America | \$46,073 | \$ 18,036 | \$64,109 | \$90,690 | \$ 37,202 | \$127,892 |
| Europe | 10,542 | 2,400 | 12,942 | 22,412 | 5,168 | 27,580 |
| Total revenues | \$56,615 | \$ 20,436 | \$77,051 | \$113,102 | \$ 42,370 | \$155,472 |

5. Inventory Financing

Supplies Distributors has a short-term credit facility with IBM Credit LLC (“IBM Credit Facility”) to finance its purchase and distribution of products of Ricoh Company Limited and Ricoh USA, Inc., a strategic business unit within the Ricoh Family Group of Companies (collectively hereafter referred to as “Ricoh”), in the United States, providing financing for eligible Ricoh inventory and certain receivables.

In January 2018, Supplies Distributors entered into Amendment No. 19 to the IBM Credit Facility. The Amended IBM Credit Facility adjusted the maximum borrowing under the facility from \$13.0 million to \$11.0 million and reduced the minimum PFS Subordinated Note receivable PFSweb is required to maintain from \$2.5 million to \$1.0 million.

Given the structure of this facility and as outstanding balances, which represent inventory purchases, are repaid within twelve months, the Company has classified the outstanding amounts under this facility, which were \$7.4 million and

\$7.1 million as of June 30, 2018 and December 31, 2017, respectively, as trade accounts payable in the condensed consolidated balance sheets. As of June 30, 2018, Supplies Distributors had no available credit under this facility. Borrowings under the credit facility accrue interest, after a defined free financing period, at prime rate plus 0.5%, which resulted in a weighted average interest rate of 5.25% and 4.75% as of as of June 30, 2018 and December 31, 2017, respectively.

6. Debt and Capital Lease Obligations

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

| | June 30, 2018 | December 31, 2017 |
|--|------------------|----------------------|
| U.S. Credit Agreement | | |
| Revolver | \$ 14,000 | \$ 13,234 |
| Term loan | 25,500 | 27,000 |
| Equipment loan | 3,740 | 4,205 |
| Debt issuance costs | (305) | (376) |
| Master lease agreements | 2,830 | 3,135 |
| Other | 101 | 128 |
| Total | 45,866 | 47,326 |
| Less current portion of long-term debt | 5,537 | 9,460 |
| Long-term debt, less current portion | \$ 40,329 | \$ 37,866 |

U.S. Credit Agreement

As of June 30, 2018, the Company had \$18.5 million of available credit under the revolving loan facility of the credit agreement of PFSweb, Inc. and its U.S. subsidiaries with Regions Bank, as agent for itself and one or more future lenders (“Credit Agreement”). As of June 30, 2018 and December 31, 2017, the weighted average interest rate on the revolving loan facility was 5.59% and 4.65%, respectively. As of June 30, 2018 and December 31, 2017, the weighted average interest rate on the term loan facility of the Credit Agreement was 4.38% and 4.05%, respectively.

7. Earnings Per Share

Basic net loss per common share was computed by dividing net loss by the weighted-average number of common shares outstanding for the reporting period. In periods when we recognize a net loss, we exclude the impact of outstanding common stock equivalents from the diluted loss per share calculation as their inclusion would have an antidilutive effect. As of June 30, 2018 and June 30, 2017, we had outstanding common stock equivalents of approximately 2.1 million and 1.6 million, respectively, that have been excluded from the calculations of diluted earnings per share attributable to common stockholders because their effect would have been antidilutive.

8. Segment Information

Prior to January 1, 2018, the Company’s operations were organized into two reportable segments: PFSweb and Business and Retail Connect. In accordance with ASC 280, Segment Reporting (“ASC 280”), an operating segment is defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the Chief Operating Decision Maker (“CODM”), or decision-making group, to evaluate performance and make operating decisions.

Effective January 1, 2018, we changed our organizational structure in an effort to create more effective and efficient operations and to improve client and service focus. In that regard, we revised the information that our chief executive officer and chief financial officer, who are also our Chief Operating Decision Makers, regularly review for purposes of allocating resources and assessing performance. As a result, beginning January 1, 2018, we now report our financial performance based on our new reportable segments. These segments are comprised of strategic businesses that are defined by the service offerings they provide and consist of PFS Operations (which provides client services in relation

to the customer physical experience, such as order management (OMS), order fulfillment, customer care and financial services) and Professional Services LiveArea (which provides client services in relation to the digital shopping experience of shopping online, such as strategic commerce consulting, strategy, design and digital marketing services and technology services). Each segment is led by a separate Business Unit Executive who reports directly to the Company's Chief Executive Officer.

The CODM evaluates segment performance using business unit direct contribution, which is defined as business unit revenues less costs of fees and direct selling, general and administrative expenses, including depreciation and amortization. Direct contribution does not include any allocated corporate expenses nor does it include stock-based compensation. The CODM does not routinely review assets by segment. The balance sheet by segment is not prepared and, therefore, we do not present segment assets below.

Corporate operations is a non-operating segment that develops and implements strategic initiatives and supports the Company's operations by centralizing certain administrative functions such as finance, treasury, information technology and human resources.

All prior period segment information has been restated to conform to the 2018 presentation. The changes in the reportable segments have no effect on the consolidated balance sheets, statements of operations or cash flows for the periods presented.

Subsequent to change in the Company's operating segments, the Company's reporting units changed. We now have two reporting units: PFS Operations and LiveArea Professional Services. We allocated goodwill to our new reporting units using a relative fair value approach. In addition, we completed an assessment of any potential goodwill impairment for all reporting units immediately prior to and after the reallocation and determined that no impairment existed.

The following table discloses segment information for the periods presented (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-------------|------------------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenues: | | | | |
| PFS Operations | \$ 56,615 | \$ 55,660 | \$ 113,102 | \$ 113,896 |
| LiveArea Professional Services | 20,436 | 22,406 | 42,370 | 42,938 |
| Total revenues | \$ 77,051 | \$ 78,066 | \$ 155,472 | \$ 156,834 |
| Business unit direct contribution: | | | | |
| PFS Operations | \$ 6,488 | \$ 5,026 | \$ 12,820 | \$ 9,934 |
| LiveArea Professional Services | 2,910 | 2,523 | 5,879 | 4,577 |
| Total business unit direct contribution | \$ 9,398 | \$ 7,549 | \$ 18,699 | \$ 14,511 |
| Unallocated corporate expenses | (8,863) | (9,119) | (17,493) | (19,525) |
| Income (loss) from operations | \$ 535 | \$ (1,570) | \$ 1,204 | \$ (5,014) |

9. Commitments and Contingencies

The Company received municipal tax abatements in certain locations. In prior years, the Company received notice from a municipality that it did not satisfy certain criteria necessary to maintain the abatements and that the municipal authority planned to make an adjustment to the Company's tax abatement. The Company disputed the adjustment and such dispute has been settled with the municipality. However, the amount of additional property taxes to be assessed against the Company and the timing of the related payments has not been finalized. As of June 30, 2018, the Company believes it has adequately accrued for the expected assessment.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our results of operations and financial condition should be read in conjunction with the unaudited condensed consolidated financial statements and related notes appearing elsewhere in this Form 10-Q.

Forward-Looking Information

We have made forward-looking statements in this Report on Form 10-Q. 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. 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 about 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.

Risk factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the Securities and Exchange Commission could cause our results to differ materially from those expressed in our forward-looking statements.

Key Transactions and Events

During the three and six months ended June 30, 2018, we were impacted by the following key transactions and events:

Effective January 1, 2018, we changed our organizational structure in an effort to create more effective and efficient operations and to improve client and service focus. As a result, beginning January 1, 2018, we report our financial performance based on our new reportable segments PFS Operations and LiveArea Professional Services. All prior period segment information has been restated to conform with the 2018 presentation. The changes in the reportable segments have no effect on the consolidated balance sheets, statements of operations and comprehensive loss or cash flows for the periods presented.

We adopted Accounting Standards Codification (“ASC”) 606, Revenue from Contracts with Customers (“ASC 606”) on January 1, 2018. We used the modified retrospective method for the transition. Under the modified retrospective method, the cumulative effect of applying the new standard was recorded at January 1, 2018 for open contracts. Therefore, results for the three and six months ended June 30, 2018 and June 30, 2017 may not be comparable.

Overview

We are a global commerce solutions company. We manage the entire customer shopping experience for major branded manufacturers and retailers through two business segments, LiveArea Professional Services and PFS Operations. The LiveArea Professional Services segment provides services in relation to the digital shopping experience of shopping online, such as strategic commerce consulting, strategy, design and digital marketing services and technology services. The PFS Operations segment provides services in relation to the physical experience, such as order management, order fulfillment, customer care and payment services. We offer our services on an a la carte basis or as a complete end-to-end solution.

Service Fee Model. We refer to our standard seller services financial model for both of our business segments 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 time and material basis, a cost-plus basis, a percent of shipped revenue basis, 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.

Agent (Flash) Model. In our PFS Operations business unit, 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.

Retail Model. Our PFS Operations business unit also provides a Retail model allows us to purchase inventory from the client. 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.

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 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 Agent 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.

Operating Results

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 revenues (in thousands, except percentages):

| | Three Months Ended | | | % of Total | | Six Months Ended | | | % of Total | |
|--------------------------------|--------------------|-----------|-----------|------------------|--------|------------------|------------|-----------|------------------|--------|
| | June 30, 2018 | 2017 | Change | Revenues 2018 | 2017 | June 30, 2018 | 2017 | Change | Revenues 2018 | 2017 |
| Revenues | | | | | | | | | | |
| Service fee revenue | \$ 53,141 | \$ 54,700 | \$(1,559) | 69.0% | 70.1% | \$ 109,628 | \$ 111,965 | \$(2,337) | 70.5% | 71.4% |
| Product revenue, net | 8,847 | 9,947 | (1,100) | 11.5% | 12.7% | 18,612 | 21,265 | (2,653) | 12.0% | 13.6% |
| Pass-through revenue | 15,063 | 13,419 | 1,644 | 19.5% | 17.2% | 27,232 | 23,604 | 3,628 | 17.5% | 15.1% |
| Total revenues | 77,051 | 78,066 | (1,015) | 100.0% | 100.0% | 155,472 | 156,834 | (1,362) | 100.0% | 100.1% |
| Costs of Revenues | | | | | | | | | | |
| Cost of service fee | | | | | | | | | | |
| revenue (1) | 33,294 | 35,977 | (2,683) | 62.7% | 65.8% | 68,902 | 75,561 | (6,659) | 62.9% | 67.5% |
| Cost of product revenue | | | | | | | | | | |
| (2) | 8,403 | 9,505 | (1,102) | 95.0% | 95.6% | 17,719 | 20,230 | (2,511) | 95.2% | 95.1% |
| Pass-through cost of | | | | | | | | | | |
| revenue (3) | 15,063 | 13,419 | 1,644 | 100.0% | 100.0% | 27,232 | 23,604 | 3,628 | 100.0% | 100.0% |
| Total costs of revenues | 56,760 | 58,901 | (2,141) | 73.7% | 75.5% | 113,853 | 119,395 | (5,542) | 73.2% | 76.1% |
| Service fee gross | | | | | | | | | | |
| profit (1) | 19,847 | 18,723 | 1,124 | 37.3% | 34.2% | 40,726 | 36,404 | 4,322 | 37.1% | 32.5% |
| Product revenue gross | | | | | | | | | | |
| profit (2) | 444 | 442 | 2 | 5.0% | 4.4% | 893 | 1,035 | (142) | 4.8% | 4.9% |
| Pass-through gross | | | | | | | | | | |
| profit (3) | — | — | — | 0.0% | 0.0% | — | — | — | 0.0% | 0.0% |
| Total gross profit | 20,291 | 19,165 | 1,126 | 26.3% | 24.5% | 41,619 | 37,439 | 4,180 | 26.8% | 23.9% |
| Selling General and | | | | | | | | | | |
| Administrative | | | | | | | | | | |
| expenses | 19,756 | 20,735 | (979) | 25.6% | 26.6% | 40,415 | 42,453 | (2,038) | 26.0% | 27.1% |
| Income (loss) from | | | | | | | | | | |
| operations | 535 | (1,570) | 2,105 | 0.7% | -2.0% | 1,204 | (5,014) | 6,218 | 0.8% | -3.2% |
| Interest expense, net | 585 | 710 | (125) | 0.8% | 0.9% | 1,190 | 1,347 | (157) | 0.8% | 0.9% |

Edgar Filing: PFSWEB INC - Form 10-Q

Income (loss) before

| | | | | | | | | | |
|-------------------------|----------|------------|---------|------------|------------|------------|---------|-------|-------|
| income taxes | (50) | (2,280) | 2,230 | -0.1%-2.9% | 14 | (6,361) | 6,375 | 0.0% | -4.1% |
| Income tax expense, net | 576 | 316 | 260 | 0.7% 0.4% | 1,389 | 1,091 | 298 | 0.9% | 0.7% |
| Net loss | \$(626) | \$(2,596) | \$1,970 | -0.8%-3.3% | \$(1,375) | \$(7,452) | \$6,077 | -0.9% | -4.8% |

(1) Represents the percent of Service fee revenue.

(2) Represents the percent of Product revenue, net.

(3) Represents the percent of Pass-through revenue.

16

Segment Operating Data

PFS Operations (in thousands, except percentages)

| | Three Months Ended | | | | Six Months Ended | | | |
|--------------------------------|--------------------|-----------------|------------------|-------------|------------------|------------------|------------------|-------------|
| | June 30, 2018 | 2017 | Change | Change % | June 30, 2018 | 2017 | Change | Change % |
| Revenues: | | | | | | | | |
| Service fee revenue | \$33,194 | \$32,634 | \$560 | 2 % | \$68,116 | \$69,641 | \$(1,525) | (2)% |
| Product revenue, net | 8,847 | 9,947 | \$(1,100) | (11)% | 18,612 | 21,265 | \$(2,653) | (12)% |
| Pass-through revenue | 14,574 | 13,079 | 1,495 | 11 % | 26,374 | 22,990 | 3,384 | 15 % |
| Total revenues | \$56,615 | \$55,660 | \$955 | 2 % | \$113,102 | \$113,896 | \$(794) | (1)% |
| Costs of revenues: | | | | | | | | |
| Cost of service fee revenue | \$22,964 | \$25,254 | \$(2,290) | (9)% | \$48,303 | \$54,623 | \$(6,320) | (12)% |
| Cost of product revenue | 8,403 | 9,505 | (1,102) | (12)% | 17,719 | 20,230 | (2,511) | (12)% |
| Cost of pass-through revenue | 14,574 | 13,079 | 1,495 | 11 % | 26,374 | 22,990 | 3,384 | 15 % |
| Total costs of revenues | \$45,941 | \$47,838 | \$(1,897) | (4)% | \$92,396 | \$97,843 | \$(5,447) | (6)% |
| Gross profit | \$10,674 | \$7,822 | \$2,852 | 36 % | \$20,706 | \$16,053 | \$4,653 | 29 % |
| Direct operating expenses | 4,186 | 2,796 | 1,390 | 50 % | 7,886 | 6,119 | 1,767 | 29 % |
| Direct contribution | \$6,488 | \$5,026 | \$1,462 | 29 % | \$12,820 | \$9,934 | \$2,886 | 29 % |

PFS Operations total revenues for the three months ended June 30, 2018 increased by \$1.0 million compared with the corresponding period in 2017. Service fee revenue increased \$0.6 million due to the new and expanded client relationships, partially offset by the impact of client transitions, including certain lower-margin engagements. Product revenue, net, decreased by \$1.1 million due to the revenue stream being primarily dependent on one client, which restructured its operations and discontinued certain product lines which has resulted, and is expected to continue to result, in reduced product revenue activity

PFS Operations total revenues for the six months ended June 30, 2018 decreased by \$0.8 million compared with the corresponding period in 2017. Service fee revenue decreased \$1.5 million, primarily due to the impact of client transitions, including certain lower-margin engagements, partially offset by new and expanded client relationships. Product revenue, net, decreased \$2.7 million as a result of the client's operational restructuring changes discussed above.

PFS Operations gross margin improved to 18.9% for the three months ended June 30, 2018 as compared to 14.1% in the same period of the prior year due to an increase in service fee related gross margin, which increased to 30.8% for the three months ended June 30, 2018 as compared to 22.6% in the prior year.

PFS Operations gross margin improved to 18.3% for the six months ended June 30, 2018 as compared to 14.1% in the same period of the prior year due to an increase in service fee related gross margin, which increased to 29.1% for the six months ended June 30, 2018 as compared to 21.6% in the prior year. The service fee gross margin increase in both the three and six-month periods ended June 30, 2018 were primarily due to the transition of certain lower margin engagements, improved operational efficiency and focus on higher margin service offerings.

Direct operating expenses increased by \$1.4 million for the three months ended June 30, 2018 compared to the corresponding period in 2017 and by \$1.8 million for the six months ended June 30, 2018 compared to the corresponding period in 2017. The increase in both periods was primarily due to higher personnel and facility costs.

LiveArea Professional Services (in thousands, except percentages)

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|------------------------------|--------------------------------|----------|-----------|----------|------------------------------|----------|---------|----------|
| | 2018 | 2017 | Change | Change % | 2018 | 2017 | Change | Change % |
| Revenues: | | | | | | | | |
| Service fee revenue | \$19,948 | \$22,066 | \$(2,118) | (10)% | \$41,513 | \$42,324 | \$(811) | (2)% |
| Pass-through revenue | 488 | 340 | 148 | 44% | 857 | 614 | 243 | 40% |
| Total revenues | \$20,436 | \$22,406 | \$(1,970) | (9)% | \$42,370 | \$42,938 | \$(568) | (1)% |
| Costs of revenues: | | | | | | | | |
| Cost of service fee revenue | \$10,331 | \$10,723 | \$(392) | (4)% | \$20,600 | \$20,938 | \$(338) | (2)% |
| Cost of pass-through revenue | 488 | 340 | 148 | 44% | 857 | 614 | 243 | 40% |
| Total costs of revenues | \$10,819 | \$11,063 | \$(244) | (2)% | \$21,457 | \$21,552 | \$(95) | (0)% |
| Gross profit | \$9,617 | \$11,343 | \$(1,726) | (15)% | \$20,913 | \$21,386 | \$(473) | (2)% |
| Direct operating expenses | 6,707 | 8,820 | (2,113) | (24)% | 15,034 | 16,809 | (1,775) | (11)% |
| Direct contribution | \$2,910 | \$2,523 | \$387 | 15% | \$5,879 | \$4,577 | \$1,302 | 28% |

LiveArea Professional Services revenues for the three and six months ended June 30, 2018 decreased by \$2.0 million and \$0.6 million, respectively, as compared with the corresponding periods in 2017. The decreases in revenues are primarily due to reduced technology services project activity for certain clients as well as client transitions, partially offset by increased service fee revenue from new and expanded client relationships.

LiveArea Professional Services gross margin decreased to 47.1% from 50.6% in the three months ended June 30, 2018, and to 49.4% from 49.8% in the six months ended June 30, 2018, as compared to the corresponding periods of the prior year. The decreases in gross margin are primarily applicable to higher than expected costs incurred on certain client projects.

Direct operating expenses decreased by \$2.1 million and \$1.8 million for the three and six months ended June 30, 2018, respectively, compared to the corresponding period in 2017. The decreases were primarily due to lower personnel and contractor costs.

Corporate (in thousands, except percentages)

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|--------------------------------|---------|---------|----------|------------------------------|----------|-----------|----------|
| | 2018 | 2017 | Change | Change % | 2018 | 2017 | Change | Change % |
| Unallocated corporate expenses | \$8,863 | \$9,119 | \$(256) | (3)% | \$17,493 | \$19,525 | \$(2,032) | (10)% |
| Unallocated corporate expenses decreased by \$0.3 million for the three months ended June 30, 2018 compared to the corresponding period in 2017. The decrease was primarily due to a decrease in personnel related costs, partially offset by an increase in professional services, stock-based compensation expenses and certain technology systems costs. | | | | | | | | |

Unallocated corporate expenses decreased by \$2.0 million for the six months ended June 30, 2018 compared to the corresponding period in 2017. The decrease was primarily due to a \$2.1 million decrease in earnout expense related to our performance-based contingent payments applicable to our 2015 acquisition of CrossView, Inc., and a \$0.8 million decrease in severance costs which was partially offset by an increase in professional services, stock-based compensation expenses and certain technology systems costs.

Income Taxes

During the three months ended June 30, 2018, we recorded a tax provision of \$0.6 million comprised primarily of \$0.3 million related to the majority of our international operations, \$0.2 million related to state income taxes, and \$0.1 million associated with the tax amortization of goodwill relation to our CrossView acquisition. A valuation allowance has been provided for the majority of our domestic net deferred tax assets, which are primarily related to our net operating loss carryforwards, and for certain foreign deferred tax assets.

During the six months ended June 30, 2018, we recorded a tax provision of \$1.4 million comprised primarily of \$0.9 million related to the majority of our international operations, \$0.3 million related to state income taxes, and \$0.2 million associated with the tax amortization of goodwill relation to our CrossView acquisition. A valuation allowance has been provided for the majority of our domestic net deferred tax assets, which are primarily related to our net operating loss carryforwards, and for certain foreign deferred tax assets.

For the six months ended June 30, 2018 and 2017, the Company has utilized the discrete effective tax rate method, as allowed by Accounting Standards Codification (“ASC”) 740-270-30-18, “Income Taxes—Interim Reporting,” to calculate its interim income tax provision. The discrete method is applied when the application of the estimated annual effective tax rate is impractical because it is not possible to reliably estimate the annual effective tax rate. The discrete method treats the year to date period as if it was the annual period and determines the income tax expense or benefit on that basis. The Company believes that, at this time, the use of this discrete method is more appropriate than the annual effective tax rate method as (i) the estimated annual effective tax rate method is not reliable due to the high degree of uncertainty in estimating annual pretax earnings and (ii) the Company’s ongoing assessment that the recoverability of its deferred tax assets is not likely in several jurisdictions.

On December 22, 2017, the United States government enacted the Tax Cuts and Jobs Act, commonly referred to as the Tax Reform Act. The Tax Reform Act includes significant changes to the U.S. income tax system, including, but not limited to: a federal corporate rate reduction from 35% to 21%; limitations on the deductibility of interest expense and executive compensation; repeal of the Alternative Minimum Tax (“AMT”); full expensing provisions related to business assets; creation of new minimum taxes, such as the base erosion anti-abuse tax (“BEAT”) and Global Intangible Low Taxed Income (“GILTI”) tax; and the transition of U.S. international taxation from a worldwide tax system to a modified territorial tax system, which will result in a one-time U.S. tax liability on those earnings which have not previously been repatriated to the U.S. (the “Transition Tax”). The provisional impacts of this legislation are outlined below:

Beginning January 1, 2018, the U.S. corporate income tax rate is 21%. The Company is required to recognize the impacts of this rate change on its deferred tax assets and liabilities in the period enacted. At December 31, 2017, we remeasured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%. However, we are still analyzing certain aspects of the Tax Reform Act and refining our calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. The provisional amount related to the remeasurement of our deferred tax balance was \$12.1 million that was mostly offset by a change in the valuation allowance, except for a \$0.6 million benefit that was recorded to our income statement related to tax amortization of goodwill for the period ended December 31, 2017.

The Transition Tax on unrepatriated foreign earnings is a tax on previously untaxed accumulated and current earnings and profits (“E&P”) of the Company’s foreign subsidiaries. To determine the amount of the Transition Tax, the Company must determine, among other factors, the amount of post-1986 E&P of its foreign subsidiaries, as well as the amount of non-U.S. income taxes paid on such earnings. Based on the Company’s reasonable estimate of the Transition Tax, there is no provisional Transition Tax expense. The Company has not completed accounting for the income tax effects of the transition tax and is continuing to evaluate this provision of the Tax Reform Act.

The Tax Reform Act creates a new requirement that Global Intangible Low Tax Income (“GILTI”) earned by foreign subsidiaries must be included currently in the gross income of the U.S. shareholder. Due to the complexity of the new GILTI tax rules, the Company is continuing to evaluate this provision of the Tax Reform Act. Under U.S. GAAP, the Company is permitted to make an accounting policy election to either treat taxes due on future inclusions in U.S. taxable income related to GILTI as a current period expense when incurred or to factor such amounts into the Company’s measurement of its deferred taxes. The Company has not yet completed its analysis of the GILTI tax rules and is not yet able to reasonably estimate the effect of this provision of the Tax Reform Act or make an accounting policy election for the accounting treatment whether to record deferred taxes attributable to the GILTI tax. The Company has not recorded any amounts related to potential GILTI tax in the Company’s consolidated financial statements.

The income tax effects recorded in the Company’s consolidated financial statements as a result of the Tax Reform Act are provisional in accordance with ASU 2018-05, ASU 2018-05, “Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118” (“SAB 118”) (“ASU 2018-05”), as the Company has not yet completed its evaluation of the impact of the new law. SAB 118 allows for a measurement period of up to one year after the enactment date of the Tax Reform Act to finalize the recording of the related tax impacts.

The preliminary net tax effects recorded may differ in the future due to changes in the interpretations of the Tax Reform Act, legislative action, and changes to estimates we have utilized to calculate the tax impact. We expect to finalize the tax analysis related to the Tax Reform Act with the filing of our tax return and record any differences between the final and provisional amounts in the 2018 fourth quarter at that time, if any.

Liquidity and Capital Resources

We currently believe our cash position, financing available under our credit facilities and funds generated from operations will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our current debt and lease obligations, and additional loans to our subsidiaries, if necessary, for at least the next twelve months.

Our cash position decreased in the six months ended June 30, 2018 primarily from using cash generated from operations to make payment for the cash portion of the CrossView Earnout of approximately \$3.3 million, capital expenditures and payments on our outstanding debt obligations.

Cash Flows from Operating Activities

During the six months ended June 30, 2018, net cash provided from operations was \$2.7 million, compared to \$3.4 million in the same period of the prior year. Cash flow benefits due to decreases in accounts receivable, prepaid expenses, other receivables and other assets were partially offset by decreases in accounts payable, deferred revenues, accrued expenses and other liabilities.

Cash Flows from Investing Activities

Cash used in investing activities included capital expenditures of \$1.9 million during the six months ended June 30, 2018 compared to \$2.0 million in the same period of 2017, exclusive of property and equipment acquired under debt and capital lease financing, which consisted primarily of capitalized software costs and equipment purchases.

Capital expenditures have historically consisted of additions to upgrade our management information systems, development of customized technology solutions to support and integrate with our service fee clients and general expansion and upgrades to our facilities, both domestic and foreign. We expect to incur capital expenditures to support new contracts and anticipated future growth opportunities. Based on our current client business activity and our targeted growth plans, we anticipate our total investment in upgrades and additions to facilities and information technology solutions and services for the upcoming twelve months, including costs to implement new clients, will be approximately \$7.0 million to \$10.0 million, although additional capital expenditures may be necessary to support the infrastructure requirements of new clients. To maintain our current operating cash position, a portion of these expenditures may be financed through client reimbursements, debt, operating or capital leases or additional equity. We may elect to modify or defer a portion of such anticipated investments in the event that we do not obtain the financing results necessary to support such investments.

Cash Flows from Financing Activities

During the six months ended June 30, 2018 and 2017, cash used in financing activities was \$5.6 million and \$8.5 million, respectively, primarily related to performance-based contingent payments and repayments on our debt and capital lease obligations, partially offset by borrowings under our revolving loan.

Working Capital

During the six months ended June 30, 2018, our working capital increased to \$19.5 million as of June 30, 2018 compared to \$13.7 million at December 31, 2017. This increase was primarily related to income generated from operations before working capital changes and increases in long-term debt, partially offset by capital expenditures.

To obtain additional financing in the future, in addition to our current cash position, we plan to evaluate various financing alternatives including the sale of equity, utilizing capital or operating leases, borrowing under our credit facilities, expanding our current credit facilities or entering into new debt agreements. No assurances can be given we will be successful in obtaining any additional financing or the terms thereof. We currently believe our cash position, financing available under our credit facilities and funds generated from operations will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our current debt and lease obligations, and additional loans to our subsidiaries, if necessary, for at least the next twelve months.

Our term and revolving loan facilities described below contain both financial and non-financial covenants. To the extent we fail to comply with our debt covenants, including the financial covenant requirements, and we are not able to obtain a waiver, the lenders would be entitled to accelerate the repayment of any outstanding credit facility obligations, and exercise all other rights and remedies, including sale of collateral. An acceleration of the repayment of our credit facility obligations may have a material adverse impact on our financial condition and results of operations. We can provide no assurance we will have the financial ability to repay all such obligations. As of June 30, 2018, we were in compliance with all debt covenants. Further, non-renewal of any of our credit facilities may have a material adverse impact on our business and financial condition.

Inventory Financing

To finance its distribution of Ricoh products in the U.S., Supplies Distributors has a short-term credit facility with IBM Credit LLC (“IBM Credit”) that provides financing for eligible inventory and certain receivables. We have provided a collateralized guarantee to secure the repayment of this credit facility. The IBM Credit facility does not have a stated maturity and both parties have the ability to exit the facility following a 90-day notice. The Company has direct vendor credit terms with Ricoh to finance Supplies Distributors European subsidiary’s inventory purchases.

This credit facility contains various restrictions upon the ability of Supplies Distributors and its subsidiaries to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans, investments and payments to related parties (including entities directly or indirectly owned by PFSweb, Inc.), provide guarantees, make investments and loans, pledge assets, make changes to capital

stock ownership structure and pay dividends, as well as financial covenants, such as annualized revenue to working capital, net profit after tax to revenue and total liabilities to tangible net worth, as defined, and are secured by all of the assets of Supplies Distributors, as well as a collateralized guaranty of PFSweb. Additionally, we are required to maintain a subordinated loan to Supplies Distributors, not maintain restricted cash of more than \$5.0 million, and are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership. Furthermore, we are obligated to repay any over-advance made to Supplies Distributors or its subsidiaries under these facilities if they are unable to do so. We have also provided a guarantee of substantially all of the obligations of Supplies Distributors and its subsidiaries to IBM Credit and Ricoh.

In January 2018, Supplies Distributors entered into Amendment No. 19 to the IBM Credit Facility. The Amended IBM Credit Facility adjusted the maximum borrowing under the facility from \$13.0 million to \$11.0 million and reduced the minimum PFS Subordinated Note receivable PFSweb is required to maintain from \$2.5 million to \$1.0 million.

Debt and Capital Lease Obligations

U.S. Credit Agreement. In August 2015, we entered into a credit agreement (“Credit Agreement”) with Regions Bank, as agent for itself, Bank of America N.A., HSBC Bank USA, National Association and one or more future lenders (the “Lenders”). Under this Credit Agreement, and subject to the terms set forth therein, the Lenders have agreed to provide a revolving loan facility for up to \$32.5 million and a term loan facility for up to \$30 million. Subject to the terms of the Credit Agreement, we have the ability to increase the total loan facilities to \$75 million. Availability under the revolving loan facility, which was approximately \$18.5 million as of June 30, 2018, may not exceed a borrowing base of eligible accounts receivable (as defined). Advances under the Credit Agreement accrue interest at a variable rate, plus an applicable margin, and have a five-year maturity, with scheduled amortization payments for term loan advances. The Credit Agreement is secured by a lien on substantially all of the assets of the Company and its U.S. subsidiaries and a pledge of 65% of the shares of certain of the Company’s foreign subsidiaries. The Credit Agreement contains cross default provisions, various restrictions upon our ability to, among other things, merge, consolidate, sell assets, incur indebtedness, make loans and payments to subsidiaries, affiliates and related parties, make capital expenditures, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants, as defined, of a minimum fixed charge ratio and a maximum leverage ratio. In June 2016, PFSweb also entered into a Master Agreement with Regions Bank to provide equipment loans financing for certain capital expenditures.

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

Other than our capital and operating lease commitments, we do not have any other material financial commitments, although future client contracts may require capital expenditures and lease commitments to support the services provided to such clients.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

Not applicable.

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain a comprehensive set of disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (“Exchange Act”). As of June 30, 2018, an evaluation of the effectiveness of our disclosure controls and procedures was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, these disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

During the three months ended June 30, 2018, there was no change in internal control over financial reporting (as defined in Rule 13a-15(f) or Rule 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

None.

ITEM 1A. Risk Factors

There have been no material changes from the risk factors disclosed in Part I, Item 1A. of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the Securities and Exchange Commission.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

22

ITEM 6. Exhibits

a) Exhibits:

Exhibit No. Description of Exhibits

- 3.1 (1) Amended and Restated Certificate of Incorporation of PFSweb, Inc.
- 3.1.1 (2) Certificate of Amendment of Certificate of Incorporation of PFSweb, Inc.
- 3.1.2 (4) Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.
- 3.1.3 (5) Certificate of Amendment to Certificate of Incorporation of PFSweb, Inc.
- 3.1.4 (7) Certificate of Amendment to Amended and Restated Certificate of Incorporation of PFSweb, Inc.
- 3.2 (1) Amended and Restated By-Laws.
- 3.2.1 (3) Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
- 3.2.2 (6) Amendment to the Amended and Restated By-Laws of PFSweb, Inc.
- 3.2.3 (7) Amendments to the Amended and Restated By-Laws of PFSweb, Inc.
- 4.1 (10) Amendment No. 7 to Rights Agreement, dated as of June 27, 2018 between the Company and Computershare Inc., successor in interest to Computershare Shareowner Services LLC (formerly known as Mellon Investor Services LLC.) as successor to ChaseMellon Shareholder Services, LLC., as rights agent.
- 10.77 (11) Form of 2018 LTI TSR Executive Performance Share Award.
- 10.78 (11) Form of 2018 LTI Time Based Restricted Stock Unit Award.
- 10.79 (11) Form of 2018 STI Company Performance Based Share Award.

- 10.80 (11) Form of 2018 STI Company Performance Based Cash Award.
- 10.81 (11) Form of 2018 LTI Non-Executive Time and Performance-Based Restricted Stock Unit Award.
- 10.82 (11) Form of Deferred Stock Unit.
- 31.1 (10) Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 (10) Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 (10) Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS (10) XBRL Instance Document.
- 101.SCH (10) XBRL Taxonomy Extension Schema.
- 101.CAL (10) XBRL Taxonomy Extension Calculation Linkbase.
- 101.DEF (10) XBRL Taxonomy Extension Definition Linkbase.
- 101.LAB (10) XBRL Taxonomy Extension Label Linkbase.
- 101.PRE (10) XBRL Taxonomy Extension Presentation Linkbase.

(1) Incorporated by reference from PFSweb, Inc. Registration Statement on Form S-1 (Commission File No. 333-87657).

(2) Incorporated by reference from PFSweb, Inc. Form 10-K for the fiscal year ended December, 31, 2005 filed on March 31, 2006.

(3) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on November 13, 2007.

Edgar Filing: PFSWEB INC - Form 10-Q

- (4) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 2, 2008.
- (5) Incorporated by reference from PFSweb, Inc. Form 10-Q filed on August 14, 2009.
- (6) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 2, 2010.
- (7) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 18, 2013.
- (8) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 19, 2015.
- (9) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on July 30, 2015.
- (10) Incorporated by reference from PFSweb, Inc. Report on Form 8-K filed on June 28, 2018.
- (11) Filed Herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 9, 2018

PFSweb, Inc.

By: /s/ Thomas J. Madden
Thomas J. Madden
Chief Financial Officer
Chief Accounting Officer
Executive Vice President