PFSWEB INC
Form S-4
December 01, 2005

Table of Contents

As filed with the Securities and Exchange Commission on December 1, 2005
Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form S-4
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

PFSWEB, INC.
(Exact name of registrant as specified in its charter)

Delaware	**7389**	**75-2837058**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification No.)*

500 North Central Expressway
Plano, Texas 75074
(972) 881-2900
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Mark C. Layton
Chief Executive Officer
PFSweb, Inc.
500 North Central Expressway
Plano, Texas 75074
(972) 881-2900
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Morris Bienenfeld **Wolff & Samson PC** **One Boland Drive** **West Orange, New Jersey 07052** **(973) 530-2013**	**Adam Shaffer** **Chief Executive Officer** **eCOST.com, Inc.** **Suite 106** **2555 West 190th Street** **Torrance, California 90504** **(310) 225-4044**	**Steven B. Stokdyk** **Latham & Watkins LLP** **Suite 4000** **633 West Fifth Street** **Los Angeles, CA 90071-2007** **(213) 891-7421**

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effectiveness of this registration statement and upon completion of the merger described in the enclosed joint proxy

statement/ prospectus.

If the securities being registered on this form are to be offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. o

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price per Share(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(3)
Common Stock, par value $0.001 per share, and associated Series A Preferred Stock purchase rights	18,980,039	$26,002,653	$26,002,653	$2,782

(1) Represents the maximum number of shares of PFSweb common stock estimated to be issuable in connection with the merger described in this registration statement, calculated as the product of one share of PFSweb common stock multiplied by 18,980,039, the estimated maximum number of shares of eCOST common stock that may be exchanged for the PFSweb common stock being registered (which amount represents the sum of (i) 17,755,202 shares of eCOST common stock outstanding as of November 29, 2005, and (ii) 1,224,837 shares of eCOST common stock issuable upon the exercise of in-the-money options outstanding as of November 29, 2005). The associated Series A Preferred Stock purchase rights, which are attached to the shares of PFSweb common stock being registered hereunder, will not be exercisable or evidenced separately from the common stock prior to the occurrence of certain events.

(2) Pursuant to Rules 457(c) and 457(f) under the Securities Act of 1933, the Proposed Maximum Aggregate Offering Price is calculated as the product of (i) $1.37, the average of the high and low sale prices of eCOST common stock as reported on the Nasdaq National Market on November 29, 2005, multiplied by (ii) 18,980,039, the estimated maximum number of eCOST shares that may be exchanged for the PFSweb common stock being registered.

(3) Computed in accordance with Rule 457(f) under the Securities Act of 1933.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

The information in this joint proxy statement/ prospectus is not complete and may be changed. PFSweb may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This joint proxy statement/ prospectus shall not constitute an offer to sell these securities nor the solicitation of an offer to buy these securities in any jurisdiction where such offer, solicitation or sale is not permitted.

SUBJECT TO COMPLETION, DATED DECEMBER 1, 2005

[PFSweb logo] [eCOST logo]

MERGER PROPOSED YOUR VOTE IS VERY IMPORTANT

On behalf of the boards of directors and management teams of both PFSweb, Inc. and eCOST.com, Inc., we are pleased to deliver our joint proxy statement/ prospectus for the proposed merger involving PFSweb and eCOST. We are proposing the merger because we believe it will provide substantial strategic and financial benefits to the stockholders of each of our respective companies by creating more stockholder value than either company could create individually and allowing stockholders to participate in a larger, more diversified company.

In the merger, a subsidiary of PFSweb will merge with and into eCOST, with eCOST surviving as a wholly owned subsidiary of PFSweb. As a result of the merger, eCOST stockholders will be entitled to receive one share of PFSweb common stock for each share of eCOST common stock they own. PFSweb stockholders will continue to own their existing shares, which will not be affected by the merger. On November 9, 2005, the last trading day before we announced our letter of intent to pursue a merger, the closing price of PFSweb common stock as reported on the Nasdaq Capital Market was $1.67. PFSweb expects to issue approximately 18,980,000 shares of PFSweb common stock to eCOST stockholders in connection with the merger. Accordingly, we expect that eCOST stockholders will, as a group, own approximately 46% of the outstanding shares of PFSweb common stock immediately after the merger. Upon completion of the merger, PFSweb shares will continue to trade on the Nasdaq Capital Market under the trading symbol PFSW.

We cannot complete the merger unless PFSweb stockholders approve the issuance of PFSweb common stock in the merger and a charter amendment to increase the number of PFSweb authorized shares of common stock and eCOST stockholders approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger. The obligations of PFSweb and eCOST to complete the merger are also subject to the satisfaction or waiver of several other conditions to the merger. Additional information about PFSweb, eCOST and the proposed merger is contained in this joint proxy statement/ prospectus. **We encourage you to read this entire document carefully, including the section entitled Risk Factors beginning on page 28.**

After careful consideration, the PFSweb board of directors has unanimously determined that the merger agreement and the transactions contemplated by the merger agreement are advisable and unanimously recommends that PFSweb stockholders vote FOR the proposal to issue PFSweb common stock pursuant to the merger agreement. In addition, in order to complete the merger, PFSweb must amend its charter to increase the number of authorized shares of PFSweb common stock. Accordingly, the board of directors of PFSweb also recommends a vote FOR the proposed amendment to the PFSweb Amended and Restated Certificate of Incorporation to increase the number of authorized shares of PFSweb common stock from 40 million shares to 75 million shares.

Similarly, the eCOST board of directors has unanimously determined that the merger agreement and the transactions contemplated by the merger agreement are advisable and unanimously recommends that eCOST stockholders vote FOR the proposal to approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger.

Your vote is very important. Whether or not you plan to attend the special meeting of stockholders of PFSweb or eCOST, please take the time to vote by completing and mailing the enclosed proxy card and returning it in the accompanying pre-paid envelope as soon as possible. If your shares are held in street name, you must instruct your broker in order to vote.

Sincerely,

Sincerely,

Mark C. Layton
Chairman of the Board of Directors,
Chief Executive Officer
PFSweb, Inc.

Adam Shaffer
Chairman of the Board of Directors,
Chief Executive Officer
eCOST.com, Inc.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities to be issued under this joint proxy statement/ prospectus or passed upon the adequacy or accuracy of this joint proxy statement/ prospectus. Any representation to the contrary is a criminal offense.

This joint proxy statement/ prospectus is dated , and is first being mailed to PFSweb and eCOST stockholders on or about .

ADDITIONAL INFORMATION

This joint proxy statement/ prospectus incorporates by reference important business and financial information about PFSweb and eCOST from documents that are not included in or delivered with this joint proxy statement/ prospectus. For a more detailed description of the information incorporated by reference into this joint proxy statement/ prospectus and how you may obtain it, see Where You Can Find More Information on page 171.

Each of PFSweb and eCOST is an SEC reporting company and it files annual, quarterly, current reports and other information with the SEC. You can obtain any of these documents from the SEC through the SEC s website at http://www.sec.gov. You may also obtain copies of these documents, without charge, by requesting them in writing or by telephone from the appropriate company at the following addresses.

PFSweb, Inc.	eCOST.com, Inc.
Suite 500	Suite 106
500 North Central Expressway	2555 West 190th Street
Plano, Texas 75074	Torrance, California 90504
(972) 881-2900	(310) 225-4044
Attention: Investor Relations	Attention: Investor Relations

In order to receive timely delivery of the documents in advance of the respective PFSweb and eCOST meetings, any request for any additional documents should be received no later than , .

Table of Contents

[PFSweb logo]

PFSWEB, INC.
500 North Central Expressway
Plano, Texas 75074
NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
To Be Held On , 2006

To the Stockholders of PFSweb, Inc.:

NOTICE IS HEREBY GIVEN that a special meeting of stockholders of PFSweb, Inc. will be held on , 2006 at 10:00 a.m., local time, at PFSweb s principal offices at 500 North Central Expressway, Plano, Texas 75074 for the following purposes:

1. to consider and vote upon a proposal to approve the issuance of PFSweb common stock, $0.001 par value, pursuant to the Agreement and Plan of Merger, dated as of November 29, 2005, by and among PFSweb, Inc., Red Dog Acquisition Corp., a wholly owned subsidiary of PFSweb, and eCOST.com, Inc.;

2. to consider and vote upon a proposal to approve the amendment to the PFSweb Amended and Restated Certificate of Incorporation to increase the number of authorized shares of PFSweb common stock, $0.001 par value, from 40 million shares to 75 million shares;

3. to grant discretionary authority to adjourn the meeting, if necessary, to solicit additional proxies with respect to proposals 1 and/or 2; and

4. to transact such other business as may properly come before the special meeting or any adjournment or postponement of the meeting.

Please refer to the attached joint proxy statement/ prospectus for further information with respect to the business to be transacted at the special meeting. Only stockholders of record of PFSweb common stock at the close of business on , 200 , the record date for the PFSweb special meeting, are entitled to notice of and to vote at this special meeting or any adjournment or postponement of the special meeting.

Your vote is important. Whether or not you expect to attend the PFSweb special meeting in person, please complete, sign, date and return the enclosed proxy card as soon as possible to ensure that your shares are represented at the special meeting. If your shares are held in street name, which means your shares are held of record by a broker, bank or other nominee, you must provide your broker, bank or other nominee with instructions on how to vote your shares. For specific instructions on voting procedures, please refer to the section entitled The PFSweb Special Meeting Voting Procedures and Revocation of Proxies beginning on page 50 of this joint proxy statement/ prospectus and the instructions on the proxy card.

The PFSweb board of directors has unanimously approved the merger agreement and unanimously recommends that PFSweb stockholders vote FOR the proposal to issue PFSweb common stock pursuant to the merger agreement. In addition, in order to complete the merger, PFSweb must amend its charter to increase the number of authorized shares of PFSweb common stock. Accordingly, the board of directors of PFSweb also recommends a vote FOR the proposed amendment to the PFSweb Amended and Restated Certificate of Incorporation to increase the number of authorized shares of PFSweb common stock from 40 million shares to 75 million shares.

By order of the Board of Directors,

Harvey Achatz
Secretary

, 200

Table of Contents

[eCost logo]

eCOST.com, Inc.
Suite 106
2555 West 190th Street
Torrance, California 90504

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
To Be Held On , 2006

To the Stockholders of eCOST.com, Inc.:

NOTICE IS HEREBY GIVEN that a special meeting of stockholders of eCOST.com, Inc. will be held on , 2006 at 10:00 a.m., local time, at eCOST s principal offices at 2555 West 190th Street, Suite 106, Torrance, California 90504 for the following purposes:

1. to consider and vote upon a proposal to approve and adopt the Agreement and Plan of Merger, dated as of November 29, 2005, by and among eCOST.com, Inc., PFSweb, Inc. and Red Dog Acquisition Corp., a wholly owned subsidiary of PFSweb, and the transactions contemplated by the merger agreement, including the merger, pursuant to which Red Dog Acquisition Corp. would merge with and into eCOST and each outstanding share of eCOST common stock would be converted into one share of PFSweb common stock;

2. to consider and vote upon a proposal to grant discretionary authority to adjourn the special meeting, if necessary, to solicit additional proxies with respect to proposal 1; and

3. to transact such other business as may properly come before the special meeting or any adjournment or postponement of the meeting.

Please refer to the attached joint proxy statement/ prospectus for further information with respect to the business to be transacted at the special meeting. Only stockholders of record of eCOST common stock at the close of business on , 200 , the record date for the eCOST special meeting, are entitled to notice of and to vote at this special meeting or any adjournment or postponement of the special meeting.

Your vote is important. Whether or not you expect to attend the eCOST special meeting in person, please complete, sign, date and return the enclosed proxy card as soon as possible to ensure that your shares are represented at the special meeting. If your shares are held in street name, which means your shares are held of record by a broker, bank or other nominee, you must provide your broker, bank or other nominee with instructions on how to vote your shares. For specific instructions on voting procedures, please refer to the section entitled The eCOST Special Meeting Voting Procedures and Revocation of Proxies beginning on page 54 of this joint proxy statement/ prospectus and the instructions on the proxy card.

The eCOST board of directors has unanimously approved the merger agreement and unanimously recommends that eCOST stockholders vote FOR the proposal to approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger.

Please do not send any certificates representing your eCOST common stock at this time.

By order of the Board of Directors,

Adam Shaffer
Chief Executive Officer

, 200

TABLE OF CONTENTS

	PAGE
QUESTIONS AND ANSWERS ABOUT THE MERGER	1
SUMMARY	5
The Companies	5
The Merger	6
Reasons for the Merger	6
Recommendations of the Board of Directors	6
Opinion of Wells Fargo Securities, LLC	6
Opinion of Thomas Weisel Partners, LLC	7
Ownership of PFSweb after the Merger	7
Interests of Officers and Directors of eCOST in the Merger	7
Share Ownership of Directors and Executive Officers	7
Management and Operations Following the Merger	8
Appraisal Rights	8
Conditions to Completion of the Merger	8
No Shop and Termination Fees	8
Termination of the Merger Agreement	9
Voting Agreement	9
Regulatory Approvals	9
Material United States Federal Income Tax Consequences of the Merger	9
Accounting Treatment	10
Risks	10
Comparison of Stockholder Rights	10
Summary Selected Historical Financial Data of PFSweb	11
Summary Selected Historical Financial Data of eCOST	13
Selected Unaudited Pro Forma Condensed Combined Financial Data	16
UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS OF PFSWEB AND eCOST	17
NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS	21
Comparative Per Share Information	25
Comparative Market Price	26
RISK FACTORS	28
Risks Related to the Merger	28
Risks Related to PFSweb	31
Risks Related to PFSweb s Business Process Outsourcing Industry	37
Risks Related to eCOST	38
Risks Related to eCOST s Industry	46
CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS	48
THE PFSWEB SPECIAL MEETING	49
Date, Time and Place	49
Matters for Consideration	49
Recommendations of the PFSweb Board of Directors	50
Amendment to Amended and Restated Certificate of Incorporation	50

i

Table of Contents

	PAGE
Voting Procedures and Revocation of Proxies	50
Record Date and Shares Entitled to Vote	51
Quorum and Vote Required	51
Abstentions and Broker Non-Votes	51
Solicitation of Proxies and Expenses	52
Admission to the Special Meeting	52
Other Business	52
Householding	52
Assistance	53
THE eCOST SPECIAL MEETING	54
Date, Time and Place	54
Matters for Consideration	54
Recommendation of the eCOST Board of Directors	54
Voting Procedures and Revocation of Proxies	54
Record Date and Shares Entitled to Vote	55
Quorum and Vote Required	55
Abstentions and Broker Non-Votes	55
Solicitation of Proxies and Expenses	55
Admission to the Special Meeting	56
Other Business	56
Householding	56
Assistance	56
THE MERGER	57
General Structure	57
Background of the Merger	57
PFSweb s Reasons for the Merger	60
Recommendation of the PFSweb Board of Directors	62
eCOST s Reasons for the Merger	62
Recommendation of the eCOST Board of Directors	65
Opinion of Wells Fargo Securities, LLC	65
Opinion of Thomas Weisel Partners LLC	73
Regulatory Approvals Required for the Merger	80
Material United States Federal Income Tax Consequences of the Merger	80
Accounting Treatment	82
Public Trading Markets	82
Resales of PFSweb Common Stock	82
Interests of Directors and Officers of eCOST in the Merger	82
Management and Operations Following the Merger	83
Appraisal Rights	83
THE MERGER AGREEMENT	83
Structure of the Merger	83
Effective Time of the Merger	84
Conversion of Securities	84
Treatment of eCOST Stock Options	84

Table of Contents

	PAGE
Representations and Warranties	84
Conduct of Business by eCOST Prior to Completion of the Merger	84
Conduct of Business by PFSweb Prior to Completion of the Merger	86
Additional Agreements	87
Indemnification of Officers and Directors	88
Tax-Free Reorganization Treatment	88
No Solicitation of Other Transactions	88
Conditions to Completion of the Merger	90
Termination of the Merger Agreement	91
Expenses	92
Termination Fee	92
Amendment and Waiver	93
VOTING AGREEMENT	93
AMENDMENT OF PC MALL AGREEMENTS	93
INFORMATION REGARDING PFSWEB	94
General	94
Industry Overview	96
Supply Chain Management Trend	96
Government Outsourcing Trend	97
Outsourcing Trend	98
The PFSweb Solution	99
The PFSweb Strategy	100
PFSweb Services	100
Clients and Marketing	105
Technology	105
Competition	107
Employees	108
Regulation	108
Properties	108
Legal Proceedings	108
Available Information	109
Red Dog Acquisition Corp.	109
PFSWEB MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	110
Forward-Looking Information	110
Overview	111
Results of Operations	113
Liquidity and Capital Resources	119
Seasonality	123
Inflation	123
Critical Accounting Policies and Estimates	123
Quantitative and Qualitative Disclosure about Market Risk	126
MANAGEMENT OF PFSWEB	127
Directors	127

Table of Contents

	PAGE
Executive Officers and Officers	128
Executive Officers	128
Officers	128
Compensation Committee Interlocks and Insider Participation	129
Compensation of Directors	129
Executive Compensation	130
Change in Control and Severance Agreements	131
SECURITY OWNERSHIP OF CERTAIN PFSWEB BENEFICIAL OWNERS AND MANAGEMENT	132
INFORMATION REGARDING eCOST	133
General	133
Industry Overview	133
Our Strengths	134
Our Growth Strategy	135
Our Customers	135
Our Website	136
Our Merchandise	137
Sales and Marketing	138
Vendors	138
Fulfillment Operations	139
Customer Service	139
Technology	140
Competition	141
Intellectual Property	141
Government Regulation	142
Employees	143
ECOST MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	144
Forward-Looking Statements	144
Overview	144
Basis of Presentation	145
Critical Accounting Policies and Estimates	149
Our Relationship with and Separation from PC Mall	150
Results of Operations	151
Selected Operating Data	151
Liquidity and Capital Resources	156
Contractual Obligations	158
Inflation	158
QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	158
SECURITY OWNERSHIP OF CERTAIN ECOST BENEFICIAL OWNERS AND MANAGEMENT	158
DESCRIPTION OF PFSWEB CAPITAL STOCK	160
COMPARISON OF STOCKHOLDERS RIGHTS AND CORPORATE GOVERNANCE MATTERS	162
BOARD OF DIRECTORS	163

iv

	PAGE
Number of Directors	163
Classification of Directors	164
Removal of Directors	164
Filling Vacancies on the Board of Directors	164
STOCKHOLDER MEETINGS	165
Action by Written Consent of Stockholders	165
Ability to Call Special Meetings of the Stockholders	165
Advance Notice Provision for Stockholder Proposals	166
AMENDMENT OF CERTIFICATE OF INCORPORATION	167
AMENDMENT OF BYLAWS	167
LIMITATIONS ON LIABILITY OF DIRECTORS AND OFFICERS	168
INDEMNIFICATION OF DIRECTORS AND OFFICERS	168
STOCKHOLDER RIGHTS PLAN	169
STATE ANTI-TAKEOVER STATUTES	169
LEGAL MATTERS	169
EXPERTS	169
STOCKHOLDER PROPOSALS	170
PFSweb Stockholder Proposals	170
eCOST Stockholder Proposals	170
WHERE YOU CAN FIND MORE INFORMATION	171
INDEX TO FINANCIAL STATEMENTS	F-1
SUPPLEMENTARY DATA	S-1
Annex A Agreement and Plan of Merger	A-1
Annex B Voting Agreement with eCOST Stockholder	B-1
Annex C Wells Fargo Opinion	C-1
Annex D Opinion of Thomas Weisel Partners LLC	D-1
PART II INFORMATION NOT REQUIRED IN PROSPECTUS	II-1

Legal Opinion of Wolff & Samson PC
Tax Opinion of Latham & Watkins LLP
Consent of KPMG LLP
Consent of PricewaterhouseCoopers LLP
Form of Proxy Card - PFSWeb, Inc.
Form of Proxy Card - eCost.com, Inc.
Consent of Wells Fargo Securities, LLC
Consent of Thomas Weisel Partners LLC

Table of Contents

QUESTIONS AND ANSWERS ABOUT THE MERGER

The following are some questions that you, as a stockholder of PFSweb or eCOST, may have regarding the merger and the other matters being considered at the respective special meetings of stockholders of PFSweb and eCOST and brief answers to those questions. PFSweb and eCOST urge you to read carefully the remainder of this joint proxy statement/ prospectus because the information in this section does not provide all the information that might be important to you with respect to the merger and the other matters being considered at their respective special meetings of stockholders. Additional important information is also contained in the annexes to this joint proxy statement/ prospectus.

Q: Why am I receiving this joint proxy statement/ prospectus?

A: PFSweb and eCOST have agreed to combine pursuant to the terms of a merger agreement that is described in this joint proxy statement/ prospectus. A copy of the merger agreement is attached to this joint proxy statement/ prospectus as ***Annex A.***

In order to complete the merger, PFSweb stockholders must vote to approve the issuance of shares of PFSweb common stock in the merger and to amend the PFSweb charter to increase the number of authorized shares of PFSweb common stock, and eCOST stockholders must vote to approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger.

PFSweb and eCOST will hold separate meetings of their respective stockholders to obtain these approvals. This joint proxy statement/ prospectus contains important information about the merger and the special meetings of the respective stockholders of each of PFSweb and eCOST, and you should read it carefully. The enclosed voting materials allow you to vote your shares without attending your special meeting.

Your vote is important. We encourage you to vote as soon as possible.

Q: Why are we proposing the merger?

A: PFSweb and eCOST believe the merger will provide substantial strategic benefits to the stockholders of PFSweb and eCOST by combining eCOST s key supplier relationships, growing customer base and expansive e-commerce platform with PFSweb s advanced technology and operational infrastructure thereby providing the combined company with the enhanced ability to expand its market share in the fast growing web commerce market. We also believe that the combined company will benefit from a number of synergies that, as implemented, will reduce or eliminate certain eCOST operating costs.

Q: What will happen in the merger?

A: The businesses of PFSweb and eCOST will be combined. At the closing, Red Dog Acquisition Corp., a newly formed and wholly owned subsidiary of PFSweb, will merge with and into eCOST, with eCOST surviving the merger as a wholly owned subsidiary of PFSweb.

Q: What will I receive for my shares of eCOST stock?

A: Upon completion of the merger of Red Dog with and into eCOST, eCOST stockholders will be entitled to receive one share of PFSweb common stock for each share of eCOST common stock owned immediately prior to the closing of the merger. Instead of any fractional shares of PFSweb common stock, eCOST stockholders will receive cash equal to the value of any fractional shares remaining. Please see The Merger Agreement Conversion of Securities on page 84.

Q: How will PFSweb s stockholders be affected by the merger and issuance of PFSweb common stock in the merger?

A: After the merger, PFSweb s stockholders will continue to own their existing shares of PFSweb common stock. Accordingly, PFSweb s stockholders will hold the same number of shares of PFSweb common stock that they held immediately prior to the merger. However, because PFSweb will be issuing new shares of PFSweb common stock to the eCOST stockholders in the merger, each outstanding share of

PFSweb common stock immediately prior to the merger will represent a smaller percentage of the total number of shares of PFSweb common stock outstanding after the merger.

Q: When and where are the special meetings?

A: The PFSweb special meeting will take place on , 2006 at 10:00 a.m., local time, at 500 North Central Expressway, Plano, Texas 75074.

The eCOST special meeting will take place on , 2006 at 10:00 a.m., local time, at 2555 West 190th Street, Torrance, California 90504.

Q: What vote of PFSweb stockholders is required to approve the issuance of shares of PFSweb common stock pursuant to the merger agreement and to amend the PFSweb charter to increase the number of authorized shares?

A: Approval of the proposal to issue shares of PFSweb common stock pursuant to the merger agreement requires the affirmative vote of a majority of the total votes cast at the PFSweb special meeting. In addition, in order to complete the merger, it is necessary to amend the PFSweb certificate of incorporation to increase the number of authorized shares of PFSweb common stock from 40 million shares to 75 million shares. The authorization of the amendment to the PFSweb certificate of incorporation to increase the number of authorized shares of common stock will require the affirmative vote of the holders of a majority of the outstanding shares of PFSweb common stock entitled to vote thereon.

Q: Why does PFSweb need to amend its certificate of incorporation?

A: The amendment to PFSweb s certificate of incorporation authorizing additional shares of common stock is required by the merger agreement and is necessary for PFSweb to have enough authorized common stock to close the merger and have the flexibility to meet business needs and take advantage of opportunities as they arise. The additional shares would also be available for other corporate purposes, such as the issuance of shares of PFSweb common stock upon the exercise of employee stock options.

Q: What will happen if PFSweb stockholders approve the issuance of shares of PFSweb common stock pursuant to the merger agreement but do not approve the proposal to amend the PFSweb charter to increase the number of authorized shares?

A: The merger will not occur since approval of the proposal to amend the PFSweb charter to increase the number of authorized shares of PFSweb common stock is a condition of the merger agreement.

Q: What vote of eCOST stockholders is required to adopt the merger agreement?

A: The affirmative vote of a majority of the outstanding shares of eCOST common stock is required to adopt the merger agreement. A stockholder of eCOST beneficially owning as of November 29, 2005 1,988,813 shares of eCOST common stock (representing approximately 11.2% of the voting power of the eCOST common stock outstanding as of such date), has agreed to vote such shares in favor of the adoption of the merger agreement.

Q: How does my company s board of directors recommend I vote?

A: The PFSweb board of directors unanimously recommends that PFSweb stockholders vote **FOR** the proposal to issue PFSweb common stock pursuant to the merger agreement and **FOR** the proposal to amend the certificate of

incorporation to increase the number of authorized shares. For a more complete description of the recommendation of the PFSweb board of directors, see The Merger PFSweb s Reasons for the Merger on page 60.

The eCOST board of directors unanimously recommends that eCOST stockholders vote **FOR** the proposal to approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger. For a more complete description of the recommendation of the eCOST board of directors, see The Merger eCOST s Reasons for the Merger on page 62.

Table of Contents

Q: Are stockholders entitled to appraisal rights?

A: Neither PFSweb stockholders nor eCOST stockholders are entitled to appraisal rights in connection with the merger.

Q: What do I do now?

A: Carefully read and consider the information contained in this joint proxy statement/ prospectus, including its annexes. There are several ways your shares can be represented at your stockholder meeting. You can attend your stockholder meeting in person or you can indicate on the enclosed proxy card how you want to vote and return it in the accompanying pre-addressed postage paid envelope.

Q: How do I cast my vote?

A: If you are a holder of record, you may vote in person at your special meeting or by submitting a proxy for your special meeting. You can submit your proxy by signing and dating the enclosed proxy card and promptly returning it in the enclosed envelope.

Q: If my broker holds my shares in street name, will my broker vote my shares?

A: If you hold your shares in street name in a stock brokerage account or if your shares are held by a broker, bank or other nominee, you must provide your broker, bank or other nominee with instructions on how to vote your shares. Please see the voting form of your broker, bank or other nominee that accompanies this joint proxy statement/ prospectus.

Q: Can I change my vote after I have delivered my proxy?

A: Yes. You can change your vote at any time before your proxy is voted at your company s stockholder meeting. You can do this in one of three ways: (1) you can send a written notice of revocation; (2) you can submit a new, later dated proxy card; or (3) if you are a holder of record, you can attend your stockholder meeting and vote in person; however, your attendance alone will not revoke your proxy. If you choose either of the first two methods, you must submit your notice of revocation or your new proxy to the Corporate Secretary of PFSweb or eCOST, as appropriate, before the applicable stockholder meeting. However, if your shares are held in a street name account at a brokerage firm or bank, you must contact your brokerage firm or bank to change your vote. If you would like more information and you are a PFSweb stockholder, please see The PFSweb Special Meeting Voting Procedures and Revocation of Proxies on page 50. If you would like additional information and you are a eCOST stockholder, please see The eCOST Special Meeting Voting Procedures and Revocation of Proxies on page 54.

Q: What will happen if I abstain from voting or fail to vote?

A: In the case of PFSweb stockholders, the failure to cast your vote will not have any impact on the proposal to issue shares of PFSweb common stock in connection with the merger. Abstentions will count toward the presence of a quorum, but will not be considered votes cast and will therefore have no impact on the proposal to issue shares of PFSweb common stock in connection with the merger. However, abstentions and broker non- votes will have the same effect as a vote against the proposal to increase the number of authorized shares. As noted above, the proposal to increase the number of authorized shares must be approved in order for the merger to occur.

In the case of eCOST stockholders, an abstention by you or your failure to cast your vote or instruct your broker how to vote if your shares are held in street name will have the same effect as voting against the proposal to

approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger, because the required vote is a majority of the outstanding shares of eCOST common stock.

Q: Should I send in my eCOST stock certificates now?

A: No. After the merger is completed, you will receive written instructions from the exchange agent on how to exchange your eCOST stock certificates for PFSweb stock certificates. Please do not send in your eCOST stock certificates with your proxy card.

Table of Contents

Q: When do you expect the merger to be completed?

A: PFSweb and eCOST are working to complete the merger as quickly as practicable. PFSweb and eCOST currently expect to complete the merger in the first quarter of 2006. However, the exact timing of the completion of the merger cannot be predicted because the merger is subject to stockholder approvals and other conditions.

Q: What should PFSweb stockholders or eCOST stockholders do if they receive more than one set of voting materials for their company s special meeting?

A: You may receive more than one set of voting materials for your special meeting, including multiple copies of this joint proxy statement/ prospectus and multiple proxy cards or voting instruction cards. For example, if you hold your shares in more than one brokerage account, you will receive a separate voting instruction card for each brokerage account in which you hold shares. If you are a holder of record and your shares are registered in more than one name, you will receive more than one proxy card. Please complete, sign, date and return each proxy card and voting instruction card that you receive.

Q: What are the U.S. federal income tax consequences of the merger?

A: PFSweb and eCOST intend for the merger to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code. If the merger qualifies as a reorganization, eCOST stockholders generally will not recognize any gain or loss upon their receipt of PFSweb common stock in the merger, except for gain or loss resulting from the receipt of cash in lieu of a fractional share of PFSweb common stock. No gain or loss will be recognized by eCOST, PFSweb or its stockholders as a result of the merger.

The tax consequences of the merger to each eCOST stockholder will depend on each stockholder s particular circumstances. eCOST stockholders should read the discussion in the section entitled The Merger Material United States Federal Income Tax Consequences and consult their tax advisors regarding the tax consequences of their participation in the merger in light of their individual circumstances.

Q: Who can help answer my questions?

A: PFSweb stockholders who have any questions about the merger or how to submit a proxy, or who need additional copies of this joint proxy statement/ prospectus or the enclosed proxy card or voting instruction card, should contact:

PFSweb, Inc.
500 North Central Expressway
Plano, Texas 75074
Attention: Investor Relations
Telephone: (972) 881-2900

eCOST stockholders who have any questions about the merger or how to submit a proxy, or who need additional copies of this joint proxy statement/ prospectus or the enclosed proxy card or voting instruction card, should contact:

eCOST.com, Inc.
2555 West 190th Street
Torrance, California 90504
Attention: Investor Relations
Telephone: (310) 225-4044

SUMMARY

This summary highlights selected information from this document. It does not contain all of the information that is important to you. We urge you to carefully read the entire document and the other documents to which we refer in order to fully understand the merger and the related transactions. See Where You Can Find More Information on page 171. Each item in this summary refers to the page of this document on which that subject is discussed in more detail.

The Companies

PFSweb, Inc.
500 North Central Expressway
Plano, Texas 75074
(972) 881-2900

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

PFSweb also operates a products division through its wholly-owned subsidiary, Supplies Distributors. Supplies Distributors is a master distributor of various products, primarily technology products manufactured by or for International Business Machines Corporation. Through its merger with eCOST, PFSweb expects to diversify its product line and seek new opportunities in the fast growing web commerce market.

eCOST.com, Inc.
2555 West 190th Street
Torrance, California 90504
(310) 225-4044

eCOST is a leading multi-category online discount retailer of high quality new, close-out and refurbished brand-name merchandise. eCOST currently offers over 100,000 products in twelve primary merchandise categories, including computer hardware and software, home electronics, digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. Additionally, we offer other categories of products and services, including pet supplies and flowers through various affiliate relationships. eCOST appeals to a broad range of consumer and small business customers through what it believes is a unique and convenient buying experience offering two shopping formats: every day low price and its proprietary Bargain Countdown[tm.] This combination of shopping formats helps attract value-conscious customers looking for high quality products at low prices to the eCOST.com website. Additionally, eCOST offers a fee-based membership program to develop customer loyalty by providing subscribers exclusive access to preferential offers. eCOST offers suppliers an efficient sales channel for merchandise in all stages of the product life cycle. eCOST carries products from leading manufacturers such as Apple, Canon, Citizen, Denon, Hewlett-Packard, Nikon, Onkyo, Seiko and Toshiba and has access to a broad selection of merchandise, including deeply discounted close-out and refurbished merchandise.

eCOST was previously a wholly-owned subsidiary of PC Mall, Inc., a direct marketer of computer hardware, software, peripheral, electronics, and other consumer products and services. In September 2004, eCOST completed an initial public offering of 3,465,000 shares of common stock, leaving PC Mall with ownership of approximately 80.2% of the outstanding shares of common stock. On April 11, 2005,

PC Mall distributed its ownership interest in eCOST to PC Mall common stockholders by means of a special dividend.

The Merger (page 57)

PFSweb and eCOST have agreed to a merger under the terms of the merger agreement described in this joint proxy statement/ prospectus. We have attached the merger agreement as ***Annex A*** to this joint proxy statement/ prospectus. We encourage you to read the merger agreement in its entirety.

Under the terms of the merger agreement, Red Dog Acquisition Corp., a newly formed and wholly owned subsidiary of PFSweb, will merge with and into eCOST and the separate corporate existence of Red Dog will cease. eCOST will be the surviving corporation in the merger and will continue as a wholly owned subsidiary of PFSweb.

Upon completion of the merger, eCOST stockholders will be entitled to receive one share of PFSweb common stock for each share of eCOST common stock owned immediately prior to the closing of the merger. Instead of any fractional shares of PFSweb common stock, eCOST stockholders will receive cash equal to the value of any fractional shares remaining. Stockholders of PFSweb will continue to own their existing shares.

Reasons for the Merger (page 60 and page 62)

PFSweb and eCOST believe the merger will provide substantial strategic benefits to the stockholders of PFSweb and eCOST by combining eCOST s key supplier relationships, growing customer base and expansive e-commerce platform with PFSweb s advanced technology and operational infrastructure thereby providing the combined company with the enhanced ability to expand its market share in the fast growing web commerce market. The combined company should also benefit from a number of synergies that, as implemented, should reduce or eliminate certain eCOST operating costs.

Recommendations of the Boards of Directors (page 62 and page 65)

The PFSweb board of directors unanimously approved the merger agreement and unanimously recommends that PFSweb stockholders vote **FOR** the proposal to issue PFSweb common stock pursuant to the merger agreement and **FOR** the proposal to amend the PFSweb certificate of incorporation to increase the number of authorized shares.

The eCOST board of directors unanimously approved the merger agreement and unanimously recommends that eCOST stockholders vote **FOR** the proposal to approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger.

Opinion of Wells Fargo Securities, LLC (page 65)

On November 23, 2005, Wells Fargo Securities, LLC (referred to in this joint proxy statement/ prospectus as Wells Fargo Securities) rendered its oral opinion to the PFSweb board of directors, subsequently confirmed in writing as of November 23, 2005, that, as of the date of its opinion and based upon and subject to the various considerations set forth in its written opinion, the exchange ratio pursuant to the merger agreement was fair, from a financial point of view, to PFSweb.

The full text of the Wells Fargo Securities opinion, which sets forth, among other things, the assumptions made, procedures followed, matters considered and limitations on the scope of the review undertaken by Wells Fargo Securities in rendering its opinion, is attached as ***Annex C*** to this joint proxy statement/ prospectus. PFSweb stockholders are urged to, and should, read the Wells Fargo Securities opinion carefully and in its entirety. The Wells Fargo Securities opinion addresses only the fairness, from a financial point of view, of the exchange ratio to PFSweb as of November 23, 2005, and does not constitute a recommendation to any stockholder of PFSweb or eCOST as to how such stockholder should vote or take any other action with respect to the merger.

Opinion of Thomas Weisel Partners LLC (page 73)

On November 29, 2005, Thomas Weisel Partners LLC delivered its written opinion to the eCOST board of directors that, as of the date of its opinion and based upon the assumptions made, matters considered and limits of review set forth in its written opinion, the exchange ratio pursuant to the merger was fair to the holders of eCOST common stock from a financial point of view.

The full text of the Thomas Weisel Partners written opinion, which sets forth, among other things, assumptions made, procedures followed, matters considered and limitations on the scope of the review undertaken by Thomas Weisel Partners in rendering its opinion, is attached as ***Annex D*** to this joint proxy statement/ prospectus. eCOST stockholders are urged to, and should, read the Thomas Weisel Partners opinion carefully and in its entirety. The Thomas Weisel Partners opinion addresses only the fairness to the stockholders of eCOST, from a financial point of view, of the exchange ratio, and does not constitute a recommendation to any stockholder as to how such stockholder should vote or act on any matter relating to the merger.

Ownership of PFSweb after the Merger

PFSweb expects to issue approximately 18,980,000 shares of PFSweb common stock to eCOST stockholders in connection with the merger. Accordingly, eCOST stockholders will, as a group, own approximately 46% of the outstanding shares of PFSweb common stock immediately after the merger.

Interests of Officers and Directors of eCOST in the Merger (page 82)

In considering the recommendation of the eCOST board of directors regarding the merger agreement and the transactions contemplated by the merger agreement, including the merger, you should be aware that members of the eCOST board of directors and certain eCOST executive officers have interests in the transactions contemplated by the agreement that may be different than, or in addition to, the interests of eCOST stockholders, generally. These interests include:

- the agreement of PFSweb to issue an aggregate of approximately 700,000 options to purchase PFSweb common stock to officers and key employees of eCOST, of which two executive officers will receive 550,000 options; and

- the entitlement of eCOST officers and directors to certain indemnification rights and director and officer insurance for a period of six years following the merger.

The eCOST board of directors was aware of these interests and considered them, among other matters, in making its recommendation with respect to the merger agreement and the transactions contemplated by the merger agreement, including the merger.

Share Ownership of Directors and Executive Officers

As of November 21, 2005, directors and executive officers of PFSweb and their affiliates beneficially owned and were entitled to vote approximately 948,000 shares of PFSweb common stock, collectively representing approximately 4.2% of the shares of PFSweb common stock outstanding on that date. Approval of the proposal to issue shares of PFSweb common stock pursuant to the merger agreement requires the affirmative vote of a majority of the total votes cast at the PFSweb special meeting. The authorization of the amendment to the PFSweb certificate of incorporation to increase the number of authorized shares of common stock will require the affirmative vote of the holders of a majority of the outstanding shares of PFSweb common stock entitled to vote thereon.

As of November 10, 2005, directors and executive officers of eCOST and their affiliates beneficially owned and were entitled to vote 15,036 shares of eCOST common stock, collectively representing approximately less than 1% of the shares of eCOST common stock outstanding on that date. The affirmative vote of a majority of the outstanding shares of eCOST common stock is required to adopt the merger agreement.

Management and Operations Following the Merger (page 83)

After the merger, all of the executive officers of PFSweb will remain with PFSweb in their current capacities, and Adam Shaffer will continue as Chief Executive Officer of eCOST, subject to the terms of his employment agreement with eCOST.

Appraisal Rights (page 83)

Neither PFSweb stockholders nor eCOST stockholders are entitled to appraisal rights in connection with the merger.

Conditions to Completion of the Merger (page 90)

In order to complete the merger, PFSweb and eCOST must satisfy a number of conditions, including, but not limited to, the following:

- the registration statement covering the shares of PFSweb common stock to be issued to eCOST stockholders in the merger, of which this joint proxy statement/ prospectus forms a part, must have been declared effective by the Securities and Exchange Commission;
- PFSweb stockholders must approve the proposal to amend the PFSweb charter to increase the number of authorized shares and issue PFSweb common stock pursuant to the merger agreement;
- eCOST stockholders must approve the proposal to approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger;
- no governmental agency or court shall have issued any order that prevents or prohibits the completion of the merger;
- all material consents, approvals and authorizations of any governmental agency must have been obtained;
- the shares of PFSweb common stock issuable to the eCOST stockholders in the merger must have been approved for listing on the Nasdaq Capital Market;
- since the date of the merger agreement, no event shall have occurred that has a material adverse effect on eCOST or PFSweb;
- eCOST shall not be in breach of, and no condition, event or act which with the giving of notice or lapse of time, or both, would become an event of default, shall have occurred and be continuing under, any indebtedness for borrowed money;
- The chief executive officer and the chief financial officer of each of eCOST and PFSweb must not have failed to provide the certifications required by the Sarbanes-Oxley Act;
- eCOST must have received a written opinion from its legal counsel to the effect that the merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code; and
- eCOST must have received a written opinion from its legal counsel to the effect that the merger should not cause Section 355(e) of the Internal Revenue Code to apply to the April 2005 spin-off distribution of shares of eCOST Common Stock by its former parent, PC Mall.

No Shop and Termination Fees (page 88 and 92)

The merger agreement contains a no shop provision that, subject to limited fiduciary exceptions, restricts the ability of eCOST to initiate, solicit or knowingly encourage competing third-party proposals to acquire all or a significant part of eCOST. There are only limited exceptions to eCOST s agreement that the eCOST board of directors

will not withdraw, modify or amend in a manner adverse to PFSweb the recommendation of the eCOST board of directors to holders of eCOST common stock that they vote in

favor of adopting the merger agreement. The eCOST board of directors is generally permitted to participate in discussions or negotiations with, request clarifications from, or furnish information to a third party that has made an unsolicited acquisition proposal and may withdraw, modify or amend its recommendation in a manner adverse to PFSweb if the eCOST board of directors determines in good faith that failure to take such actions would be inconsistent with its fiduciary duties. If the eCOST board of directors fails to recommend that stockholders of eCOST vote to adopt the merger agreement or withdraws or adversely modifies or changes its recommendation or approves or recommends a competing acquisition proposal or, upon PFSweb s request, within five days of eCOST s receipt of a competing acquisition proposal fails to affirm its recommendation to stockholders, PFSweb generally will be able to terminate the merger agreement and be entitled to reimbursement of all of its out-of-pocket costs and expenses incurred by it in connection with the merger, including the fees and expenses of its legal counsel, accountants and financial advisors, and to be paid a $1.2 million termination fee by eCOST. In addition, in some situations where a competing acquisition proposal has been made and the merger agreement is subsequently terminated, eCOST would be required to pay PFSweb the $1.2 million termination fee if eCOST completes, or enters into a binding agreement with respect to, that competing acquisition proposal during the twelve-month period following the termination.

Termination of the Merger Agreement (page 91)

PFSweb and eCOST can jointly agree to terminate the merger agreement at any given time. Either company may also terminate the merger agreement if the merger is not completed by February 14, 2006, subject to certain limitations, and under other circumstances described in this joint proxy statement/ prospectus.

Voting Agreement (page 93)

PFSweb and Red Dog have entered into a voting agreement with Frank F. Khulusi, Chairman, President and Chief Executive Officer of PC Mall, pursuant to which he has agreed to vote the shares beneficially owned by him in favor of the adoption of the merger agreement. As of November 29, 2005, Mr. Khulusi beneficially owned 1,988,813 shares of eCOST common stock (representing approximately 11.2% of the voting power of the eCOST common stock outstanding as of such date). This voting agreement is attached to this joint proxy statement/ prospectus as ***Annex B***.

Regulatory Approvals (page 80)

Since the size of the transaction does not meet the statutory minimum, no filing or waiting period is required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. Neither PFSweb nor eCOST is aware of any governmental or regulatory approvals required to complete the merger.

Material United States Federal Income Tax Consequences of the Merger (page 80)

PFSweb and eCOST intend for the merger to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code. If the merger qualifies as a reorganization, eCOST stockholders generally will not recognize any gain or loss upon their receipt of PFSweb common stock in the merger, except for gain or loss resulting from the receipt of cash in lieu of a fractional share of PFSweb common stock. No gain or loss will be recognized by eCOST, PFSweb or its stockholders as a result of the merger.

The tax consequences of the merger to each eCOST stockholder will depend on each stockholder s particular circumstances. eCOST stockholders should read the discussion in the section entitled The Merger Material United States Federal Income Tax Consequences and consult their tax advisors regarding the tax consequences of their participation in the merger in light of their individual circumstances.

Accounting Treatment (page 82)

The merger will be accounted for using the purchase method of accounting under U.S. generally accepted accounting principles.

Risks (page 28)

In evaluating the merger, the merger agreement or the issuance of shares of PFSweb common stock in the merger, you should carefully read this joint proxy statement/ prospectus and especially consider the factors discussed in the section entitled Risk Factors on page 28.

Comparison of Stockholder Rights (page 162)

The rights of eCOST stockholders will change as a result of the merger due to differences in PFSweb s and eCOST s governing documents. Although both PFSweb and eCOST are incorporated under the laws of the State of Delaware, the rights of eCOST stockholders currently are governed by the eCOST certificate of incorporation and the eCOST bylaws. Upon completion of the merger, eCOST stockholders will be entitled to receive shares of capital stock of PFSweb, and their rights will be governed by the Delaware General Corporation Law, the PFSweb certificate of incorporation and the PFSweb bylaws.

Table of Contents

Summary Selected Historical Financial Data

PFSweb and eCOST are providing the following information to aid you in your analysis of the financial aspects of the merger.

PFSweb, Inc.

The following selected historical consolidated financial information as of December 31, 2004, 2003 and for the years ended December 31, 2004, 2003 and 2002 has been derived from PFSweb s audited financial statements, which have been included in this proxy statement/ prospectus. The information as of September 30, 2005, and for the nine-month periods ended September 30, 2005 and 2004, has been derived from PFSweb s unaudited financial statements, which have been included in this proxy statement/ prospectus and which have been prepared on the same basis as the audited financial statements and, in the opinion of management of PFSweb, include all adjustments, consisting only of normal recurring adjustments and accruals, necessary for a fair presentation of the financial condition at such date and the results of operations for such periods. Historical results are not necessarily indicative of the results to be obtained in the future.

The selected consolidated statements of operations data for the nine months ended December 31, 2001 and the year ended March 31, 2001 and the selected consolidated balance sheet data as of December 31, 2002 and 2001 and March 31, 2001 have been derived from PFSweb s audited consolidated financial statements, and should be read in conjunction with those statements, which are not included in this proxy statement/ prospectus. The selected consolidated statements of operations data for the twelve months ended December 31, 2001 and nine months ended December 31, 2000, and the selected consolidated balance sheet data as of December 31, 2000 have been derived from PFSweb s unaudited condensed consolidated financial statements, and should be read in conjunction with those statements, which are not included in this proxy statement/ prospectus.

The selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risks Related to PFSweb, and the consolidated financial statements and notes thereto that are included in this prospectus/proxy. See Where You Can Find More Information on page 171.

Table of Contents

Historical Selected Condensed Consolidated Financial Data

	Nine Months Ended September 30,		Year Ended December 31,				Nine Months Ended December 31,		Year Ended March 31,
	2005	2004	2004	2003	2002	2001	2001(a)	2000	2001
	(Unaudited)	(Unaudited)				(Unaudited)		(Unaudited)	
	(In thousands, except per share data)								
Condensed Consolidated Statements of Operations Data:									
Revenues:									
Product revenue, net	$ 189,352	$ 195,435	$ 267,470	$ 249,230	$ 57,492	$	$	$	$
Service fee revenue	45,274	29,764	42,076	33,771	35,825	39,194	27,953	37,017	48,258
Pass-through revenue	13,601	9,323	12,119	3,435	3,692	5,118	3,721	5,554	6,952
Other revenue						497	100	1,700	2,097
Total revenues	248,227	234,522	321,665	286,436	97,009	44,809	31,774	44,271	57,307
Costs of revenues:									
Cost of product revenue	176,651	184,302	251,968	235,317	54,343				
Cost of service fee revenue	33,860	19,614	28,067	23,159	22,660	25,840	18,209	26,790	34,421
Cost of pass-through revenue	13,601	9,323	12,119	3,435	3,692	5,118	3,721	5,554	6,952
Cost of other revenue						(568)	(627)	2,411	2,470
	224,112	213,239	292,154	261,911	80,695	30,390	21,303	34,755	43,843

Total costs of revenues									
Gross profit	24,115	21,283	29,511	24,525	16,314	14,419	10,471	9,516	13,464
Percent of revenues	9.7%	9.1%	9.2%	8.6%	16.8%	32.2%	33.0%	21.5%	23.5%
Selling, general and administrative expenses	23,359	20,493	27,091	25,442	27,012	23,254	16,892	18,924	25,286
Severance and other termination costs					1,213				
Asset and lease impairments				257	922				
Other						(5,141)	(5,141)		
Income (loss) from operations	756	790	2,420	(1,174)	(12,833)	(3,694)	(1,280)	(9,408)	(11,822)
Percent of revenues	0.3%	0.3%	0.8%	(0.4)%	(13.2)%	(8.2)%	(4.0)%	(21.3)%	(20.6)%
Equity in earnings of affiliate					1,163				
Interest expense (income), net	1,325	1,125	1,460	2,000	(161)	(707)	(496)	(880)	(1,091)
Income (loss) before income taxes and extraordinary item	(569)	(335)	960	(3,174)	(11,509)	(2,987)	(784)	(8,528)	(10,731)
Income tax expense (benefit)	644	533	734	572	94	(230)	(219)	36	25
Income (loss) before extraordinary item	(1,213)	(868)	226	(3,746)	(11,603)	(2,757)	(565)	(8,564)	(10,756)

Extraordinary item gain on purchase of 51% share of Supplies Distributors					203				
Net income (loss)	$ (1,213)	$ (868)	$ 226	$ (3,746)	$ (11,400)	$ (2,757)	$ (565)	$ (8,564)	$ (10,756)
Per share data:									
Net income (loss) per share:									
Basic	$ (0.05)	$ (0.04)	$ 0.01	$ (0.20)	$ (0.63)	$ (0.15)	$ (0.03)	$ (0.48)	$ (0.60)
Diluted	$ (0.05)	$ (0.04)	$ 0.01	$ (0.20)	$ (0.63)	$ (0.15)	$ (0.03)	$ (0.48)	$ (0.60)
Weighted average number of shares outstanding:									
Basic	22,349	21,270	21,332	19,011	18,229	18,004	18,036	17,870	17,879
Diluted	22,349	21,270	23,468	19,011	18,229	18,004	18,036	17,870	17,879

	As of September 30, 2005	As of December 31, 2004	2003	2002	2001(a)	2000	As of March 31, 2001
	(Unaudited)					(Unaudited)	
Consolidated Balance Sheet Data:							
Cash and cash equivalents	$ 14,681	$ 13,592	$ 14,743	$ 8,595	$ 10,669	$ 18,143	$ 22,266
Working capital	23,780	22,608	21,407	16,045	11,189	21,055	19,941
Total assets	127,502	130,327	108,359	107,222	51,611	58,789	59,089
Long-term obligations	8,527	8,749	3,760	4,514	5,873	4,100	4,353
Shareholders equity	29,596	29,926	28,417	26,470	36,605	39,010	37,001

(a) In June 2001, PFSweb changed its fiscal year end from March 31 to December 31.

eCOST

The following selected historical financial information as of December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003 and 2002 has been derived from eCOST s audited financial statements, which have been included in this proxy statement/ prospectus. The selected balance sheet data as of December 31, 2002 has been derived from eCOST s audited financial statements, and should be read in conjunction with those statements, which are not included in this proxy statement/ prospectus. The historical financial information for the years ended December 31, 2001 and 2000 has been derived from financial statements contained in eCOST s Registration Statement on Form S-1 filed with the SEC on August 27, 2004, in which the financial information with respect to the year ended December 31, 2000 was unaudited. The information as of September 30, 2005, and for the nine-month periods ended September 30, 2005 and 2004, has been derived from eCOST s unaudited financial statements, which have been included in this proxy statement/ prospectus and which have been prepared on the same basis as the audited financial statements and, in the opinion of management of eCOST, include all adjustments, consisting only of normal recurring adjustments and accruals, necessary for a fair presentation of the financial condition at such date and the results of operations for such periods. Historical results are not necessarily indicative of the results to be obtained in the future.

eCOST had been historically consolidated as a wholly-owned subsidiary of PC Mall and consequently, the financial information through April 11, 2005 (the date of the spin-off of eCOST from PC Mall) has been derived from the consolidated financial statements and accounting records of PC Mall and reflect significant assumptions and allocations. Accordingly, the financial statements through the year ended December 31, 2004 do not necessarily reflect the financial position and results of operations of eCOST had it been a stand-alone company. Additionally, the results of operations for the period from January 1, 2005 to April 11, 2005, included in the results for the nine months ended September 30, 2005, do not necessarily reflect the results of operation of eCOST had it been a stand-alone company.

The selected financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risks Related to Our Business, and the financial statements and notes thereto that are included in this prospectus/proxy. See Where You Can Find More Information on page 171.

	Nine Months Ended September 30,		Year Ended December 31,				
	2005	2004	2004	2003	2002	2001	2000
	(Unaudited)	(Unaudited)					(Unaudited)
Statements of Operations Data:							
Net sales	$ 134,290	$ 120,389	$ 178,464	$ 109,709	$ 89,009	$ 83,996	$ 109,513
Cost of goods sold	125,084	109,055	162,139	99,409	79,429	75,057	104,170
Gross profit	9,206	11,334	16,325	10,300	9,580	8,939	5,343
Percent of net sales	6.9%	9.4%	9.1%	9.4%	10.8%	10.6%	4.9%
Selling, general and administrative expenses	17,393	12,783	18,384	9,885	8,945	8,578	14,956
Income (loss) from operations	(8,187)	(1,449)	(2,059)	415	635	361	(9,613)
Percent of net sales	(6.1)%	(1.2)%	(1.2)%	0.4%	0.7%	0.4%	(8.8)%
Interest (income) expense(1)	(139)	(7)	(67)	76	461	675	430
Interest expense PC Mall commercial line of credit(2)		1,329	1,329	1,476	1,097	709	1,070
Interest income PCMall commercial line of credit(2)		(1,329)	(1,329)	(1,476)	(1,097)	(709)	(1,070)
Income (loss) before income taxes	(8,048)	(1,442)	(1,992)	339	174	(314)	(10,043)
Income tax provision (benefit)	5,350(3)	(535)	(784)	(5,872)(3)	27		
Income (loss) before cumulative effect of change in accounting principle	$ (13,398)	$ (907)	$ (1,208)	$ 6,211	$ 147	$ (314)	$ (10,043)
Cumulative effect of change in accounting							(10)

principle(4)							
Net income (loss)	$ (13,398)	$ (907)	$ (1,208)	$ 6,211	$ 147	$ (314)	$ (10,053)
Per Share Data:							
Earnings (loss) per share before cumulative effect of change in accounting principle and net income (loss) per share:							
Basic	$ (0.76)	$ (0.06)	$ (0.08)	$ 0.44	$ 0.01	$ (0.02)	$ (0.72)
Diluted	$ (0.76)	$ (0.06)	$ (0.08)	$ 0.43	$ 0.01	$ (0.02)	$ (0.72)
Weighted Average Number of Shares Outstanding(5):							
Basic	17,576	14,385	15,155	14,000	14,000	14,000	14,000
Diluted	17,576	14,385	15,155	14,279	14,422	14,000	14,000

(1) Interest expense related to net advances from PC Mall. See note 7 of the notes to financial statements in eCOST s annual report on Form 10-K/ A for the year ended December 31, 2004 included in this proxy statement/ prospectus.

(2) Interest expense and interest income related to borrowings by PC Mall under its commercial line of credit and the related receivable from PC Mall. See note 3 of the notes to financial statements in eCOST s annual report on Form 10-K/ A for the year ended December 31, 2004 included in this proxy statement/ prospectus.

Table of Contents

(3) Results primarily from the reversal and subsequent reestablishment of a valuation allowance for the net deferred tax asset in 2003 and the nine months ended September 30, 2005, respectively. See note 4 of the notes to financial statements in eCOST s annual report on Form 10-K/ A for the year ended December 31, 2004 included in this proxy statement/ prospectus and note 4 to financial statements in eCOST s Form 10-Q for the period ended September 30, 2005 included in this proxy statement/ prospectus for an explanation of the deferred tax asset and related reserve.

(4) Represents the cumulative effect of the adoption of Staff Accounting Bulletin No. 101 resulting from the change in timing of revenue recognition for goods delivered. The change in accounting did not have a material effect on basic or diluted net loss per share.

(5) See note 1 of the notes to financial statements in eCOST s annual report on Form 10-K/ A for the year ended December 31, 2004 included in this proxy statement/ prospectus for an explanation of the determination of the number of shares used to compute the basic and diluted per share amounts.

	As of September 30, 2005	As of December 31, 2004	2003	2002	2001	2000
	(Unaudited)				(Unaudited)	(Unaudited)
Balance Sheet Data:						
Cash and cash equivalents	6,290	8,790				
Working capital (deficiency)	6,529	16,348	(1,312)	(16,276)	(16,649)	(16,622)
Total assets	21,048	26,514	39,476	24,765	13,589	26,827
Long-term obligations						
Shareholders equity (deficit)	8,576	21,280	4,039	(16,101)	(16,263)	(15,949)

Table of Contents

Selected Unaudited Pro Forma Condensed Combined Financial Data

The merger transaction will be accounted for using the purchase method of accounting in accordance with accounting principles generally accepted in the United States of America. The tangible and intangible assets and liabilities assumed of eCOST will be recorded as of the merger transaction date, at their respective fair values, and added to those of PFSweb. For a more detailed description of purchase accounting, see The Merger Accounting Treatment on page 82.

PFSweb has presented below summary unaudited pro forma combined financial information that reflects the purchase method of accounting and is intended to provide you with a better picture of what the businesses might have looked like had they actually been combined. The combined financial information may have been different had the companies actually been combined. The selected unaudited pro forma combined financial information does not reflect the effect of asset dispositions, if any, or cost savings that may result from the merger. You should not rely on the summary unaudited pro forma combined financial information as being indicative of the historical results that would have occurred had the companies been combined or the future results that may be achieved after the merger.

The following summary unaudited pro forma combined financial information (i) has been derived from, and should be read in conjunction with, the unaudited pro forma condensed combined financial statements and related notes included in this joint proxy statement/ prospectus beginning on page 17 and (ii) should be read in conjunction with the consolidated financial statements of PFSweb and eCOST and other information included in this joint proxy statement/prospectus or previously filed by PFSweb and eCOST with the SEC. See Where You Can Find More Information on page 171.

	Nine Months Ended September 30, 2005 (In millions except per share data)	Fiscal Year December 31, 2004 (In millions except per share data)
Statements of Operations Data:		
Net revenues	$ 382.5	$ 500.1
Loss from operations	(8.1)	(0.6)
Net loss	(9.9)	(2.7)
Net loss per share of common stock		
Basic	(0.24)	(0.07)
Diluted	(0.24)	(0.07)

	At September 30, 2005 (In millions)
Balance Sheet Data:	
Cash and cash equivalents	$ 21.9
Working capital	29.6
Total assets	167.0
Long-term obligations	27.4
Shareholders equity	56.2

16

Table of Contents

UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS OF PFSWEB AND eCOST

The following selected unaudited pro forma condensed combined financial statements give effect to the merger of PFSweb and eCOST under the purchase method of accounting. The pro forma adjustments are made as if the merger had been completed on January 1, 2004 for the results of operations data for the year ended December 31, 2004 and for the nine months ended September 30, 2005, and as of September 30, 2005 for balance sheet purposes.

Under the purchase method of accounting, the aggregate consideration paid is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed on the basis of their fair values on the transaction date. Any excess purchase price is recorded as goodwill. A preliminary valuation was conducted to assist the management of PFSweb in determining the fair values of a significant portion of these assets and liabilities. This preliminary valuation has been considered in management s estimates of the fair values reflected in these unaudited pro forma condensed combined financial statements. A final determination of these fair values cannot be made prior to the completion of the merger. The final valuation will be based on the actual net tangible and intangible assets and liabilities assumed of eCOST that exist as of the date of the completion of the merger.

The unaudited pro forma condensed combined financial statements do not include any adjustments for liabilities resulting from integration planning, as management of PFSweb and eCOST are in the process of making these assessments and estimates of these costs are not currently known. However, costs will ultimately be recorded for costs associated with integration activities that would affect amounts in the pro forma financial statements.

These unaudited pro forma condensed combined financial statements have been prepared based on preliminary estimates of fair values. The actual amounts recorded as of the completion of the merger may differ materially from the information presented in these unaudited pro forma condensed combined consolidated financial statements. In addition, the impact of ongoing integration activities, the timing of completion of the merger and other changes in eCOST s net tangible and intangible assets that occur prior to completion of the merger could cause material differences in the information presented.

These unaudited pro forma condensed combined financial statements should be read in conjunction with the historical consolidated financial statements and accompanying notes of PFSweb and the historical financial statements and accompanying notes of eCOST included in this joint proxy statement/ prospectus. The unaudited pro forma condensed combined financial statements are not necessarily indicative of the consolidated results of operations or financial condition of the combined company that would have been reported had the merger been completed as of the dates presented, and are not necessarily representative of future consolidated results of operations or financial condition of the combined company.

Table of Contents

Unaudited Pro Forma Condensed Combined Balance Sheet
As of September 30, 2005

	PFSweb	eCOST	Pro Forma Adjustments	Notes	Pro Forma Combined
			(In thousands, except share data)		
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	$ 14,681	$ 6,290	$ 965	(a)	$ 21,936
Restricted cash	1,409				1,409
Accounts receivable, net	45,059	5,080			50,139
Inventories, net	38,583	6,737	(952)	(b)	44,368
Other receivables	9,745				9,745
Prepaid expenses and other current assets	3,682	894	(228)	(c)	4,348
Total current assets	113,159	19,001	(215)		131,945
PROPERTY AND EQUIPMENT, net	12,995	1,868			14,863
RESTRICTED CASH	150				150
NET INTANGIBLE ASSETS			7,500	(d)	7,500
GOODWILL			11,176	(e)	11,176
OTHER ASSETS	1,198	179			1,377
Total assets	$ 127,502	$ 21,048	$ 18,461		$ 167,011
LIABILITIES AND SHAREHOLDERS EQUITY					
CURRENT LIABILITIES:					
Current portion of long-term debt and capital lease obligations	$ 20,849	$	$		$ 20,849
Trade accounts payable	58,306	7,015			65,321
Accrued expenses	10,224	3,208	1,500	(f)	14,932
Due to Affiliate, net		1,082			1,082
Deferred revenue		1,167	(1,035)	(b)(g)	132
Total current liabilities	89,379	12,472	465		102,316
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, less current portion	6,551				6,551
DEFERRED TAXES	1,976				1,976
COMMITMENTS AND CONTINGENCIES					
SHAREHOLDERS EQUITY:					
Preferred stock					
Common stock of PFSweb	23		19	(h)	42

APIC PFSweb	58,697		26,553	(h)	85,250
Common stock of eCOST.com		18	(18)	(i)	
APIC eCOST.com		34,152	(34,152)	(i)	
Deferred stock-based compensation		(958)	958	(i)	
Accumulated deficit	(30,290)	(24,636)	24,636	(i)	(30,290)
Accumulated other comprehensive income	1,251				1,251
Treasury stock at cost	(85)				(85)
Total shareholders equity	29,596	8,576	17,996		56,168
Total liabilities and shareholders equity	$ 127,502	$ 21,048	$ 18,461		$ 167,011

The accompanying notes are an integral part of these unaudited pro forma condensed combined financial statements.

Table of Contents

Unaudited Pro Forma Condensed Combined Statements of Operations
For the fiscal year ended December 31, 2004

	PFSweb	eCOST	Pro Forma Adjustments	Notes	Pro Forma Combined
		(In thousands, except per share data)			
Condensed Combined Statements of Operations Data:					
Revenues:					
Product revenue, net	$ 267,470	$ 178,464	$		$ 445,934
Service fee revenue	42,076				42,076
Pass-through revenue	12,119				12,119
Total revenues	321,665	178,464			500,129
Costs of revenues:					
Cost of product revenue	251,968	162,139			414,107
Cost of service fee revenue	28,067				28,067
Cost of pass-through revenue	12,119				12,119
Total costs of revenues	292,154	162,139			454,293
Gross profit	29,511	16,325			45,836
Percent of revenues	9.2%	9.1%			9.2%
Selling, general and administrative expenses	27,091	18,384	917	(j)	46,392
Income (loss) from operations	2,420	(2,059)	(917)		(556)
Percent of revenues	0.8%	(1.2)%			(0.1)%
Interest expense (income), net	1,460	(67)			1,393
Income (loss) before income taxes	960	(1,992)	(917)		(1,949)
Income tax expense (benefit)	734	(784)	784	(k)	734
Net income (loss)	$ 226	$ (1,208)	$ (1,701)		$ (2,683)
Per share data:					
Net income (loss) per share:					
Basic	$ 0.01				$ (0.07)
Diluted	$ 0.01				$ (0.07)
Weighted average number of shares outstanding:					
Basic	21,332		18,980		40,312
Diluted	23,468		18,980		40,312

The accompanying notes are an integral part of these unaudited pro forma condensed combined financial statements.

Table of Contents

Unaudited Pro Forma Condensed Combined Statements of Operations
For the nine months ended September 30, 2005

	PFSweb	eCOST	Pro Forma Adjustments	Notes	Pro Forma Combined
	(In thousands, except per share data)				
Condensed Combined Statements of Operations Data:					
Revenues:					
Product revenue, net	$ 189,352	$ 134,290	$		$ 323,642
Service fee revenue	45,274				45,274
Pass-through revenue	13,601				13,601
Total revenues	248,227	134,290			382,517
Costs of revenues:					
Cost of product revenue	176,651	125,084	(1,339)	(l)	300,396
Cost of service fee revenue	33,860				33,860
Cost of pass-through revenue	13,601				13,601
Total costs of revenues	224,112	125,084	(1,339)		347,857
Gross profit	24,115	9,206	1,339		34,660
Percent of revenues	9.7%	6.9%			9.1%
Selling, general and administrative expenses	23,359	17,393	2,027	(j)(l)	42,779
Income (loss) from operations	756	(8,187)	(688)		(8,119)
Percent of revenues	0.3%	(6.1)%			(2.1)%
Interest expense (income), net	1,325	(139)			1,186
Loss before income taxes	(569)	(8,048)	(688)		(9,305)
Income tax expense (benefit)	644	5,350	(5,350)	(k)	644
Net income (loss)	$ (1,213)	$ (13,398)	$ 4,662		$ (9,949)
Per share data:					
Net loss per share:					
Basic	$ (0.05)				$ (0.24)
Diluted	$ (0.05)				$ (0.24)
Weighted average number of shares outstanding:					
Basic	22,488		18,980		41,468
Diluted	22,488		18,980		41,468

The accompanying notes are an integral part of these unaudited pro forma

condensed combined financial statements.

NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS

1. Basis of Presentation and New Accounting Pronouncements

These unaudited pro forma condensed combined financial statements have been prepared based upon historical financial information of PFSweb and eCOST giving effect to the merger transaction and other related adjustments described in these footnotes. Certain footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted as permitted by SEC rules and regulations. These unaudited pro forma condensed combined financial statements are not necessarily indicative of the results of operations that would have been achieved had the merger transaction actually taken place at the dates indicated and do not purport to be indicative of future financial position or operating results. The unaudited pro forma condensed combined financial statements should be read in conjunction with the historical financial statements.

The merger transaction will be accounted for using the purchase method of accounting, in accordance with accounting principles generally accepted in the United States, with PFSweb treated as the acquiror and eCOST as the acquired company.

The unaudited pro forma condensed combined statements of operations combine the historical consolidated statements of operations of PFSweb and eCOST, for the nine months ended September 30, 2005 and the fiscal year ended December 31, 2004, giving effect to the merger and related events as if they had been consummated on January 1, 2004. The unaudited pro forma condensed combined balance sheet combines the historical consolidated balance sheet of PFSweb and the historical consolidated balance sheet of eCOST, giving effect to the merger and related events as if they had been consummated on September 30, 2005.

The unaudited pro forma condensed combined income statements do not reflect significant operational and administrative cost savings, which are referred to as synergies, that management of the combined company estimates may be achieved as a result of the merger transaction, or other incremental costs that may be incurred as a direct result of the merger transaction.

2. Purchase Price and Financing Considerations

Purchase Price

The merger agreement provides that each outstanding share of eCOST common stock will be converted into the right to receive one share of PFSweb common stock. The merger agreement also provides that upon completion of the merger, all options outstanding under various eCOST s option plans will be canceled.

For purposes of presentation in the unaudited pro forma condensed combined financial information, the preliminary estimate of the purchase price for eCOST is assumed to be as follows:

Number of shares of eCOST common stock outstanding (see Financing Considerations below) (in thousands)		18,980
Exchange ratio		1.00
		18,980
Multiplied by PFSweb s stock price (see Financing Considerations below)	$	1.40
Share consideration (in thousands)	$	26,572
Estimated transaction costs (in thousands)		1,500
Estimated purchase price (in thousands)	$	28,072

The tangible and intangible assets and liabilities assumed of eCOST will be recorded as of the merger transaction date, at their respective fair values, and added to those of PFSweb. The reported financial

21

NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS (Continued)

position and results of operations of PFSweb after completion of the merger will reflect these values, but will not be restated retroactively to reflect the historical financial position or results of operations of eCOST. The allocation is dependent upon certain valuations and other studies that have not progressed to a stage where there is sufficient information to make a definitive allocation. Accordingly, the purchase price allocation pro forma adjustments are preliminary and have been made solely for the purpose of providing unaudited pro forma condensed combined financial information. The final purchase price allocation, which will be determined subsequent to the closing of the merger, and its effect on results of operations, may differ significantly from the pro forma amounts included in this section, although these amounts represent management s best estimate.

For the purpose of this pro forma analysis, the above estimated purchase price has been allocated based on a preliminary estimate of the fair value of tangible and intangible assets and liabilities assumed as follow:

	(In thousands)
Book value of net assets acquired at September 30, 2005	$ 8,576
Remaining allocation:	
Deferred revenue adjustment, net	83
Write-off of prepaid insurance policy	(228)
Proceeds from assumed exercise of stock options	965
Identifiable intangible assets at fair value(1)	7,500
Goodwill	11,176
Estimated purchase price	$ 28,072

(1) PFSweb estimates that substantially all of the acquired identifiable intangible assets will be attributable to the following categories:

	Estimated Fair Value	Estimated Useful Lives	Estimated Annual Amortization
	(In thousands)		(In thousands)
Trademark name	$ 5,000	10 years	$ 500
Customer relationships	2,500	6 years	417

PFSweb recognizes that if the final valuation, which is expected to be completed within three to six months from the completion of the merger, derives different amounts from their estimate, PFSweb will adjust these expected identifiable intangible amounts to those amounts.

In accordance with the requirements of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), the goodwill associated with the merger will not be amortized.

Financing Considerations

The unaudited pro forma condensed combined financial information included herein reflects management s best estimate of the amounts of financing at the time this unaudited pro forma condensed combined financial information was prepared. The actual amounts of financing will not be determined until shortly before the closing date of the merger. The unaudited pro forma condensed combined financial information presented herein assumes the following:

PFSweb will issue approximately 19.0 million shares of PFSweb common stock to eCOST in the transaction. The number of shares to be issued was computed based on the number of shares of

Table of Contents

NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS (Continued)

eCOST common stock outstanding on November 29, 2005 of approximately 17.8 million plus approximately 1.2 million in-the-money stock options outstanding as of November 29, 2005 which will be fully vested prior to the transaction. The number of shares estimated to be issued does not include approximately 3.1 million out-of-the-money stock options with exercise prices ranging from $1.43 to $17.36, a portion of which could be exercised prior to the transaction resulting in the issuance of additional shares of PFSweb common stock. For purposes of computing the purchase price, the price of the PFSweb common stock to be issued is assumed to be $1.40 per common share, based on the recent price range of PFSweb s common stock. The actual purchase price will be determined based on the average closing price of PFSweb s common stock on NASDAQ for the period beginning two days prior to the consummation of the merger and ending on the consummation of the merger.

3. Pro Forma Adjustments

Adjustments included in the column under the heading Pro Forma Adjustments in both the unaudited pro forma combined balance sheet and statements of operations correspond with the following:

Pro Forma Balance Sheet Adjustments

(a) The adjustment represents cash received for approximately 1.2 million in-the-money stock options assumed to be exercised by eCOST option holders prior to the merger.

(b) The adjustment represents the cost of product related to inventory in transit to customers and not legally owned by eCOST as of September 30, 2005.

(c) The adjustment represents a write-off of a prepaid insurance policy that will no longer have value as a result of the merger.

(d) The adjustment represents the estimated value of identifiable intangible assets consisting of $5.0 million for trademark name and $2.5 million for customer relationships.

(e) The adjustment records goodwill from the purchase price allocation of $11.2 million.

(f) The adjustment to accrued expenses represents the accrual of PFSweb s direct merger transaction costs of approximately $1.5 million, which consists primarily of legal and professional fees and have been included in the purchase price. Actual costs may vary from such estimates.

(g) The adjustment represents the elimination of deferred revenue related to inventory in transit to customers as of September 30, 2005.

(h) The adjustments to common stock and additional paid in capital of approximately $19,000 and $26.6 million, respectively, represent the estimated par value and additional paid in capital of the shares to be issued by PFSweb to effect the combination.

(i) The adjustments represent the elimination of acquired historical eCOST shareholders equity.

Pro Forma Statements of Operations Adjustments

(j) The adjustment to depreciation and amortization represents amortization of certain acquired intangibles, such as trademark name and customer relationships. The combined company expects to amortize the estimated fair value of the identifiable intangible assets of approximately $7.5 million with finite lives on a straight-line basis over an estimated average useful life of 6-10 years. Upon finalization of the asset valuations, specific useful lives will be assigned to the acquired assets, and depreciation and amortization will be adjusted accordingly.

Table of Contents

NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS (Continued)

(k) The adjustment represents the reversal of eCOST s income taxes as no income tax expense or benefit would have been recorded for the operations of eCOST had such operations been combined with PFSweb for the periods presented.

(l) Certain of eCOST s fulfillment expenses, totaling approximately $1.3 million for the period from April 2005 to September, 2005 have been reclassified to selling, general and administrative expense from cost of product revenue to be consistent with PFSweb s financial statement presentation. Prior to April 2005, fulfillment services were provided by PC Mall and were included in the cost of product purchased from PC Mall.

The unaudited pro forma condensed combined statements of operations do not reflect compensation expense of approximately $0.3 million, which under SFAS 123R, *Share-Based Payment*, which will be adopted by PFSweb in the first quarter of 2006, is the expected annual impact of granting approximately 700,000 options to purchase PFSweb common stock to officers and key employees of eCOST in 2006 on the effective date of the merger at an estimated fair value of $1.13 per option, which will vest over 3 years.

4. Cost Savings

The unaudited pro forma condensed combined financial statements do not reflect the expected realization of annual recurring cost savings of approximately $4 million to $5 million in the first full year of operations. These savings are expected to result from, among other things, the reduction of overhead expenses, changes in corporate infrastructure and reduced freight costs. Although management expects that cost savings will result from the merger, there can be no assurance these cost savings will be achieved.

5. Pro Forma Net Loss Per Share

Pro forma net loss per common share for the nine months ended September 30, 2005 and the fiscal year ended December 31, 2004 have been calculated based on a pro forma basis which reflects the issuance of 19.0 million PFSweb common shares to eCOST in the merger as described below. (In millions, except per share data)

	September 30, 2005
Pro forma net loss	$ (9.9)
Historical PFSweb basic and diluted weighted average shares	22.5
Incremental shares issued in the merger	19.0
Pro forma combined basic and diluted weighted average shares	41.5
Pro forma basic and diluted net loss per common share	$ (0.24)

	December 31, 2004
Pro forma net loss	$ (2.7)
Historical PFSweb basic weighted average shares	21.3
Incremental shares issued in the merger	19.0
Pro forma combined basic and diluted weighted average shares	40.3
Pro forma basic and diluted net loss per common share	$ (0.07)

Table of Contents

Comparative Per Share Information

The following table sets forth selected historical per share information of PFSweb and eCOST and unaudited pro forma combined per share information after giving effect to the merger between PFSweb and eCOST, under the purchase method of accounting, assuming that one share of PFSweb common stock had been issued in exchange for each outstanding share of eCOST common stock. You should read this information in conjunction with the selected historical financial information, included elsewhere in this document, and the historical financial statements of PFSweb and eCOST and related notes that are included in this joint prospectus/proxy statement. The unaudited PFSweb pro forma combined per share information is derived from, and should be read in conjunction with, the unaudited pro forma condensed combined financial statements and related notes beginning on page 17 of this joint proxy statement/ prospectus. The historical per share information is derived from audited financial statements of PFSweb and eCOST as of and for the year ended December 31, 2004 and unaudited financial statements of PFSweb and eCOST as of and for the nine months ended September 30, 2005.

PFSweb presents the unaudited pro forma combined per share information for informational purposes only. The pro forma information is not necessarily indicative of what the financial position or results of operations actually would have been had PFSweb completed the merger at the dates indicated. In addition, the unaudited pro forma combined per share information does not purport to project the future financial position or operating results of the combined company.

	For the Year Ended December 31, 2004		
	Historical		
	PFSweb	eCOST	Pro Forma Combined
Net income (loss) per share:			
Basic	$ 0.01	$ (0.08)	$ (0.07)
Diluted	$ 0.01	$ (0.08)	$ (0.07)

	For the Nine Months Ended September 30, 2005		
	Historical		
	PFSweb	eCOST	Pro Forma Combined
Net loss per share:			
Basic and Diluted	$ (0.05)	$ (0.76)	$ (0.24)

Neither PFSweb nor eCOST has ever paid any cash dividends on their shares of capital stock.

Comparative Market Price

PFSweb common stock trades on the Nasdaq Capital Market under the symbol PFSW. eCOST common stock trades on the Nasdaq National Market under the symbol ECST. The table below sets forth the high and low sale prices of PFSweb common stock and eCOST common stock for the periods indicated.

	PFSweb Common Stock		eCOST Common Stock	
	High	**Low**	**High**	**Low**
2003				
First Quarter ended March 31, 2003	$ 0.50	$ 0.35		
Second Quarter ended June 30, 2003	0.79	0.34		
Third Quarter ended September 30, 2003	2.86	0.59		
Fourth Quarter ended December 31, 2003	3.25	1.37		
2004				
First Quarter ended March 31, 2004	2.15	1.59		
Second Quarter ended June 30, 2004	1.85	1.30		
Third Quarter ended September 30, 2004*	1.69	1.20	8.19	5.71
Fourth Quarter ended December 31, 2004	3.60	1.45	22.25	6.58
2005				
First Quarter ended March 31, 2005	3.75	2.19	16.69	6.30
Second Quarter ended June 30, 2005	2.67	1.66	6.96	2.62
Third Quarter ended September 30, 2005	2.85	1.53	4.38	1.75
Fourth Quarter (through November 29, 2005)	1.77	1.30	2.05	1.23

* eCOST common stock has been traded on the Nasdaq National Market under the symbol ECST since August 27, 2004.

The above table shows only historical comparisons and may not provide meaningful information to eCOST stockholders in determining whether to adopt the merger agreement or PFSweb stockholders in determining whether to approve the issuance of shares of PFSweb common stock in connection with the merger. PFSweb and eCOST stockholders are urged to obtain current market quotations for PFSweb and eCOST common stock and to carefully review the other information contained in this joint proxy statement/ prospectus and incorporated by reference into this joint proxy statement/ prospectus.

Table of Contents

The following table provides the high and low closing prices per share of PFSweb common stock and eCOST common stock, each as reported on the Nasdaq Capital Market and the Nasdaq National Market, respectively, on November 9, 2005, the last full trading day preceding the public announcement that PFSweb and eCOST were considering entering into a merger agreement, and [ ], 200 , the last full trading day for which closing prices were available at the time of the printing of this joint proxy statement/ prospectus.

	PFSweb Common Stock		eCOST Common Stock		eCOST Common Stock Equivalent(1)	
	High	Low	High	Low	High	Low
November 9, 2005	$ 1.72	$ 1.62	$ 1.80	$ 1.69	$ 1.72	$ 1.62
[ ], 2005	$					

(1) Pro forma equivalent per share values that eCOST stockholders would receive in exchange for each share of eCOST common stock if the merger were completed on these two dates, applying the one for one exchange ratio offered in the merger.

Neither PFSweb nor eCOST has ever paid any cash dividends on their shares of capital stock. Under the merger agreement, eCOST has agreed not to pay dividends pending the completion of the merger without the written consent of PFSweb. If the merger is not consummated, the eCOST board of directors presently intends that it would continue its policy of retaining earnings, if any, to finance the expansion of its business. The PFSweb board of directors presently intends to retain earnings, if any, for use in its business and has no present intention to pay cash dividends before or after the merger.

As of November 21, 2005, there were approximately 6,093 PFSweb shareholders of which approximately 193 were record holders of PFSweb common stock.

As of November 21, 2005, there were approximately 4,971 eCOST shareholders of which 41 were record holders of eCOST common stock.

RISK FACTORS

The merger involves a high degree of risk for PFSweb and eCOST stockholders. eCOST stockholders will be choosing to invest in PFSweb common stock by voting in favor of the approval and adoption of the merger agreement and the transactions contemplated by the merger agreement, including the merger. An investment in shares of PFSweb common stock involves a high degree of risk. In addition to the other information contained in this joint proxy statement/ prospectus, including the matters addressed in Cautionary Statement Concerning Forward-Looking Statements on page 48, you should carefully consider the risks described below before deciding whether to vote for the approval and adoption of the merger agreement and the transactions contemplated by the merger agreement, including the merger, in the case of eCOST stockholders, or for the issuance of shares of PFSweb common stock pursuant to the merger agreement and the charter amendment to increase the number of authorized shares of common stock, in the case of PFSweb stockholders. You should also read and consider the other information in this joint proxy statement/ prospectus. See Where You Can Find More Information on page 171. Additional risks and uncertainties not presently known to PFSweb and eCOST or that are not currently believed to be important to you, if they materialize, also may adversely affect the merger and PFSweb and eCOST as a combined company.

In addition, PFSweb s and eCOST s respective businesses are subject to numerous risks and uncertainties, including the risks and uncertainties described in each company s annual report on Form 10-K for the fiscal year ended December 31, 2004, each company s quarterly report on Form 10-Q for the quarter ended September 30, 2005, and each company s current reports filed on Form 8-K. These risks and uncertainties will continue to apply to PFSweb and eCOST as independent companies if the merger is not consummated.

Risks Related to the Merger

The exchange ratio, which determines the number of shares of PFSweb common stock that eCOST stockholders will receive for each share of eCOST common stock in the merger, is fixed at one for one, and such shares of PFSweb common stock may not maintain their current value or the value they had when the merger agreement was signed.

The value of PFSweb common stock issued in the merger will depend on its market price at the time the merger closes and afterwards. When the merger closes, each share of eCOST common stock will be exchanged for one share of PFSweb common stock. This exchange ratio will not be adjusted for changes in the market price of PFSweb common stock or changes in the value of eCOST common stock, and the merger agreement does not provide for any price-based termination right. Accordingly, the then current dollar value of PFSweb common stock that eCOST stockholders will receive upon the merger s completion will depend entirely upon the market value of PFSweb common stock at the time the merger is completed. The share prices of PFSweb common stock and eCOST common stock are subject to the general price fluctuations in the market for publicly-traded equity securities, and the prices of both companies common stock have experienced volatility in the past. Any reduction in the price of PFSweb common stock will result in eCOST stockholders receiving less value in the merger at the closing. Any increase in PFSweb s stock price will result in eCOST stockholders receiving more value in the merger at the closing. PFSweb and eCOST stockholders will not know the exact value of PFSweb common stock to be issued to eCOST stockholders in the merger at the time of the special meetings of stockholders. PFSweb and eCOST urge you to obtain recent market quotations for PFSweb common stock and eCOST common stock. Neither PFSweb nor eCOST can predict or give any assurances as to the respective market prices of its common stock at any time before or after the completion of the merger.

Table of Contents

PFSweb may fail to realize the anticipated synergies, cost savings, growth opportunities and other benefits expected from the merger, which could adversely affect the value of PFSweb common stock after the merger.

PFSweb and eCOST entered into the merger agreement with the expectation that the merger will result in synergies, cost savings, growth opportunities and other benefits to the combined company. However, the ability to realize these anticipated benefits of the merger will depend, in part, on the ability of PFSweb to integrate the business of eCOST with the businesses of PFSweb. The integration of two independent companies is a complex, costly and time-consuming process. It is possible that these integration efforts will not be completed as smoothly as planned or that these efforts will divert management attention for an extended period of time. Delays encountered in the integration process could have a material adverse effect on the revenues, expenses, operating results and financial condition of PFSweb following the merger. Although PFSweb and eCOST expect significant benefits, such as increased cost savings, to result from the merger, there can be no assurance that PFSweb will realize any of these anticipated benefits.

The market price of the shares of PFSweb common stock may be affected by factors different from those affecting the shares of eCOST common stock.

If the merger is completed, holders of eCOST common stock will become holders of PFSweb common stock. Former holders of eCOST common stock will be subject to additional risks upon exchange of their shares of eCOST common stock for PFSweb common stock in the merger, some of which are described below in the section entitled Risks Related to PFSweb. For a discussion of the business of PFSweb see page 94.

eCOST and PFSweb stockholders may receive a lower return on their investment after the merger.

Although PFSweb and eCOST believe that the merger will create financial, operational and strategic benefits for the combined company and its stockholders, these benefits may not be achieved. The combination of PFSweb s and eCOST s businesses, even if conducted in an efficient, effective and timely manner, may not result in combined financial performance that is better than what each company would have achieved independently if the merger had not occurred.

Uncertainty regarding the merger may cause clients, customers, suppliers and others to delay or defer decisions concerning PFSweb and eCOST, which may harm the results of operations of either or both companies.

In response to the announcement or completion of the merger, PFSweb and eCOST clients, customers and suppliers may delay or defer outsourcing, purchasing or supply decisions or otherwise alter existing relationships with PFSweb and eCOST. Prospective clients and customers could be reluctant to contract for the combined company s services or purchase the combined company s products due to uncertainty about the combined company s ability to efficiently provide products and services. In addition, clients, customers, suppliers and others may also seek to terminate or change existing agreements with PFSweb or eCOST as a result of the merger. These and other actions by clients, customers, suppliers and others could negatively affect the business of the combined company.

The merger agreement restricts eCOST s abilities to pursue alternatives to the merger and may discourage alternative transaction proposals.

The merger agreement contains a no shop provision that, subject to limited fiduciary exceptions, restricts the ability of eCOST to initiate, solicit or knowingly encourage competing third-party proposals to acquire all or a significant part of eCOST. There are only limited exceptions to eCOST s agreement that the eCOST board of directors will not withdraw, modify or amend in a manner adverse to PFSweb the recommendation of the eCOST board of directors to holders of eCOST common stock that they vote in favor of adopting the merger agreement. The eCOST board of directors is generally permitted to

participate in discussions or negotiations with, request clarifications from, or furnish information to a third party that has made an unsolicited acquisition proposal and may withdraw, modify or amend its recommendation in a manner adverse to PFSweb if the eCOST board of directors determines in good faith that failure to take such actions would be inconsistent with its fiduciary duties. If the eCOST board of directors fails to recommend that stockholders of eCOST vote to adopt the merger agreement or withdraws or adversely modifies or changes its recommendation or approves or recommends a competing acquisition proposal or, upon PFSweb s request, within five days of eCOST s receipt of a competing acquisition proposal fails to affirm its recommendation to stockholders, PFSweb generally will be able to terminate the merger agreement and be entitled to reimbursement of all of its out-of-pocket costs and expenses incurred by it in connection with the merger, including the fees and expenses of its legal counsel, accountants and financial advisors, and to be paid a $1.2 million termination fee by eCOST. In addition, in some situations where a competing acquisition proposal has been made and the merger agreement is subsequently terminated, eCOST would be required to pay PFSweb the $1.2 million termination fee if eCOST completes, or enters into a binding agreement with respect to, that competing acquisition proposal during the twelve-month period following the termination. PFSweb required that eCOST agree to these provisions as a condition to PFSweb s willingness to enter into the merger agreement. Such restrictions and termination fees could discourage a third party with an interest in acquiring all or a significant part of eCOST from considering or proposing an alternative or competing transaction. See The Merger Agreement No Solicitation of Other Transactions.

If the merger is not completed, the stock prices and businesses of PFSweb and eCOST may be adversely affected.

If the merger is not completed, PFSweb and eCOST could each suffer a number of consequences that would adversely affect its business, including:

- eCOST may be obligated to pay PFSweb all of its out-of-pocket costs and expenses incurred by it in connection with the merger, including the fees and expenses of its legal counsel, accountants and financial advisors, and a $1.2 million termination fee if the merger agreement is terminated in certain circumstances;

- the price of PFSweb and eCOST common stock may decline if and to the extent that the current market price of PFSweb and eCOST common stock, as applicable, reflects a market assumption that the merger will be completed;

- either company s operations may be harmed to the extent that clients, customers, suppliers and others believe that such company cannot effectively compete in the marketplace without the merger, or there is uncertainty surrounding the future direction of the product and service offerings and strategy of PFSweb or eCOST on a stand-alone basis;

- PFSweb and eCOST would not derive the strategic benefits expected to result from the merger, which could adversely affect their respective businesses; and

- many costs related to the merger, such as legal, accounting and financial advisory fees, must be paid by each company regardless of whether the merger occurs.

Uncertainties associated with the merger may cause PFSweb and eCOST to lose key personnel.

Current and prospective PFSweb employees and eCOST employees may experience uncertainty about their future roles with the combined company until or after strategies with regard to the combined company are announced or executed. In addition, eCOST does not have employment agreements with any of its key employees other than with its Chief Executive Officer, Adam Shaffer. These uncertainties may adversely affect PFSweb s and eCOST s ability to attract and retain key management, sales, marketing and technical personnel. If a substantial number of key employees leave as a result of the announcement of the merger or after completion of the merger, or the combined company fails to attract key personnel, the combined company s business could be adversely affected.

eCOST may be required to indemnify PC Mall for taxes arising as a result of the merger.

It is a condition to the consummation of the merger that eCOST receive a written opinion from its legal counsel to the effect that the merger should not cause Section 355(e) of the Internal Revenue Code to apply to the April 2005 spin-off of eCOST from its former parent, PC Mall. Such opinion will be based on certain factual representations made by PC Mall and eCOST and certain factual and legal assumptions made by eCOST s legal counsel. Such opinion will represent such legal counsel s best judgment regarding the application of the U.S. federal income tax laws, but will not be binding on the IRS or the courts. No assurance can be given that the IRS will not assert a contrary position or that any such contrary position would not be sustained by a court. If the Merger does cause Section 355(e) to apply to the April 2005 spin-off of eCOST from PC Mall, eCOST must indemnify PC Mall for any resulting tax-related liabilities.

Risks Related to PFSweb

PFSweb s historical financial information may not be representative of its future results.

The financial information for the periods October 1, 1999 to October 1, 2002 reflect PFsweb s then agreements with IBM and master distributors of certain IBM products (until July 2001 a third party, and from July 2001 until September 2002, Supplies Distributors, PFSweb s then 49% owned subsidiary). Under these agreements, the master distributors owned and distributed the IBM product and PFSweb provided transaction management and fulfillment services to the master distributors. Under these agreements, PFSweb did not own the IBM product and PFSweb s revenue was service fee revenue (based on product sales volume or other transaction based pricing) and not product revenue.

In October 2002, PFSweb acquired the remaining 51% ownership interest in Supplies Distributors and PFSweb now consolidates 100% of Supplies Distributors financial position and results of operations into its consolidated financial statements. Upon consolidation, effective October 1, 2002, PFSweb owns the IBM product and records product revenue as the product is sold to IBM customers. PFSweb also eliminates the service fee revenue earned from providing transaction management and fulfillment services to its now wholly-owned subsidiary, Supplies Distributors.

As a result of reflecting revenue earned under the master distributor agreements as product revenue in certain historical periods and as service fee revenue in others, PFSweb s historical results of operations may not be indicative of its future operating or financial performance.

PFSweb anticipates incurring significant expenses in the foreseeable future, which may reduce its ability to achieve or maintain profitability.

To reach its business growth objectives, PFSweb may increase its operating and marketing expenses, as well as capital expenditures. To offset these expenses, PFSweb will need to generate additional profitable business. If PFSweb s revenue grows slower than either it anticipates or its clients projections indicate, or if PFSweb s operating and marketing expenses exceed its expectations, PFSweb may not generate sufficient revenue to be profitable or be able to sustain or increase profitability on a quarterly or an annual basis in the future. Additionally, if PFSweb s revenue grows slower than either it anticipates or its clients projections indicate, PFSweb may incur unnecessary or redundant costs and its operating results could be adversely affected. PFSweb also expects to incur additional expenses upon the adoption of Statement on Financial Accounting Standards No. 123R, Accounting for Stock-based Compensation.

PFSweb s service fee revenue and gross margin is dependent upon its clients business and transaction volumes and PFSweb s costs; many of PFSweb s client service agreements are terminable by the client at will; PFSweb may incur financial penalties if it fails to meet contractual service levels under certain client service agreements.

PFSweb s service fee revenue is primarily transaction based and fluctuates with the volume of transactions or level of sales of the products by its clients for whom it provides transaction management services. If PFSweb is unable to retain existing clients or attract new clients or if it dedicates significant

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

PFSweb s operating results are materially impacted by its client mix and the seasonality of their business.

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

PFSweb s systems may not accommodate significant growth in its number of clients.

PFSweb s success depends on its ability to handle a large number of transactions for many different clients in various product categories. PFSweb expects that the volume of transactions will increase significantly as it expands its operations. If this occurs, additional stress will be placed upon the network hardware and software that manages PFSweb s operations. PFSweb cannot assure you of its ability to efficiently manage a large number of transactions. If PFSweb is not able to maintain an appropriate level of operating performance, it may develop a negative reputation, and impair existing and prospective client relationships and its business would be materially adversely affected.

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

PFSweb generally incurs start-up costs in connection with the planning and implementation of business process solutions for its clients. Although PFSweb generally attempts to recover these costs from the client in the early stages of the client relationship, or upon contract termination if the client terminates without cause prior to full amortization of these costs, there is a risk that the client contract may not fully cover the start-up costs. To the extent start-up costs exceed the start-up fees received, excess costs will be expensed as incurred. Additionally, in connection with new client contracts PFSweb generally incurs capital expenditures associated with assets whose primary use is related to the client solution. There is a risk that the contract may end before expected and PFSweb may not recover the full amount of its capital costs.

PFSweb s revenue and margins may be materially impacted by client transaction volumes that differ from client projections and business assumptions.

PFSweb s pricing for client transaction services, such as call center and fulfillment, is often based upon volume projections and business assumptions provided by the client and PFSweb s anticipated costs

Table of Contents

to perform such work. In the event the actual level of activity or cost is substantially different from the projections or assumptions, PFSweb may have insufficient or excess staffing, incremental costs or other assets dedicated for such client that may negatively impact its margins and business relationship with such client. In the event PFSweb is unable to meet the service levels expected by the client, PFSweb s relationship with the client will suffer and may result in financial penalties and/or the termination of the client contract.

PFSweb s business is subject to the risk of customer and supplier concentration.

For the year ended December 31, 2004, a U.S. government agency (via a subcontract agreement with IBM) and Xerox Corporation represented approximately 43%, and 15%, respectively, of PFSweb s total service fee revenue, net of pass-through revenue. For the nine months ended September 30, 2005, a U.S. government agency (via a subcontract agreement with Accenture), a consumer products company and Xerox Corporation represented approximately 29%, and 15% and 13%, respectively, of PFSweb s total service fee revenue, net of pass-through revenue. The loss of, or non-payment of invoices by, any or all of such U.S. agency, consumer products company or Xerox as clients would have a material adverse effect upon PFSweb s business. In particular, the agreement under which PFSweb provides services to such clients are terminable at will upon notice by such clients.

Substantially all of PFSweb s product revenue was generated by sales of product purchased under master distributor agreements with IBM and is dependent on IBM s business. PFSweb s product revenue business is dependent upon its master distributor relationship with IBM and the continuing market for IBM products. A termination of the relationship with IBM or a decline in customer demand for such products could have a material adverse effect on PFSweb s business. Sales to two customers accounted for approximately 12% and 11% of PFSweb s total product revenues for the year ended December 31, 2004. Sales to three customers accounted for approximately 14%, 12% and 11% of PFSweb s total product revenues for the nine months ended September 30, 2005. The loss of any one or more of such customers, or non-payment of any material amount by these or any other customer, would have a material adverse effect upon PFSweb s business.

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

PFSweb prepares its financial statements to conform to generally accepted accounting principles, or GAAP. GAAP are subject to interpretation by the American Institute of Certified Public Accountants, the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on PFSweb s reported results and may even affect its reporting of transactions completed before a change is announced. Accounting rules affecting many aspects of PFSweb s business, including rules relating to accounting for asset impairments, revenue recognition, arrangements involving multiple deliverables, employee stock purchase plans and stock option grants, have recently been revised or are currently under review. Changes to those rules or current interpretation of those rules may have a material adverse effect on PFSweb s reported financial results or on the way it conducts its business.

PFSweb operates with significant levels of indebtedness and is required to comply with certain financial and non-financial covenants; PFSweb is required to maintain a minimum level of subordinated loans to its subsidiary Supplies Distributors; and PFSweb is obligated to repay any over-advance made to Supplies Distributors by its lenders.

As of September 30, 2005, PFSweb s total credit facilities outstanding, including debt, capital lease obligations and its vendor accounts payable related to financing of IBM product inventory, was approximately $62.1 million. Certain of the credit facilities have maturity dates in calendar year 2006 or after, but are classified as current liabilities in PFSweb s consolidated financial statements. PFSweb cannot provide assurance that its credit facilities will be renewed by the lending parties. Additionally, these credit facilities include both financial and non-financial covenants, many of which also include cross default provisions applicable to other agreements. PFSweb cannot provide assurance that it will be able to

maintain compliance with these covenants. Any non-renewal or any default under any of PFSweb s credit facilities would have a material adverse impact upon its business and financial condition. In addition PFSweb has provided $7.0 million of subordinated indebtedness to Supplies Distributors, the minimum level required under certain credit facilities as of September 30, 2005. The maximum level of this subordinated indebtedness to Supplies Distributors that may be provided without approval from PFSweb s lenders is $8.0 million. The restrictions on increasing this amount without lender approval may limit PFSweb s ability to comply with certain loan covenants or further grow and develop Supplies Distributors business. PFSweb has guaranteed most of the indebtedness of Supplies Distributors. Furthermore, PFSweb is obligated to repay any over-advance made to Supplies Distributors by its lenders to the extent Supplies Distributors is unable to do so.

PFSweb faces competition from many sources that could adversely affect its business.

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

PFSweb s sales and implementation cycles are highly variable and its ability to finalize pending contracts may cause its operating results to vary widely.

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

PFSweb is dependent on its key personnel, and PFSweb needs to hire and retain skilled personnel to sustain its business.

PFSweb s performance is highly dependent on the continued services of its executive officers and other key personnel, the loss of any of whom could materially adversely affect PFSweb s business. In addition, PFSweb needs to attract and retain other highly-skilled, technical and managerial personnel for whom there is intense competition. PFSweb cannot assure you that it will be able to attract and retain the personnel necessary for the continuing growth of its business. PFSweb s inability to attract and retain qualified technical and managerial personnel would materially adversely affect PFSweb s ability to maintain and grow its business.

PFSweb is subject to risks associated with its international operations.

PFSweb currently operates a 150,000 square foot distribution center in Liege, Belgium and a 13,000 square foot distribution center in Richmond Hill, Canada, near Toronto, both of which currently have excess capacity. PFSweb cannot assure you that it will be successful in expanding in these or any additional international markets. In addition to the uncertainty regarding PFSweb s ability to generate revenue from foreign operations and expand its international presence, there are risks inherent in doing business internationally, including:

changing regulatory requirements;

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

political instability;

potentially adverse tax consequences;

foreign currency fluctuations; and

cultural differences.

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

PFSweb is uncertain about its need for and the availability of additional funds.

PFSweb s future capital needs are difficult to predict. PFSweb may require additional capital to take advantage of unanticipated opportunities, including strategic alliances and acquisitions and to fund capital expenditures, or to respond to changing business conditions and unanticipated competitive pressures. In addition, if the merger is completed, eCOST will become a wholly-owned subsidiary of PFSweb and eCOST may need additional financing as well. PFSweb may also require additional funds to finance operating losses, including operating losses incurred by eCOST. Should these circumstances arise, PFSweb s existing cash balance and credit facilities may be insufficient and PFSweb may need to raise additional funds either by borrowing money or issuing additional equity. PFSweb cannot assure you that such resources will be adequate or available for all of its future financing needs. PFSweb s inability to finance its growth, either internally or externally, may limit PFSweb s growth potential and its ability to execute its business strategy. If PFSweb is successful in completing an additional equity financing, this could result in further dilution to PFSweb stockholders or reduce the market value of PFSweb common stock.

PFSweb is subject to disputes with clients, customers and other authorities which, if not resolved in PFSweb s favor, may materially adversely affect its results of operations.

In the ordinary course of PFSweb s business, one or more of its clients or customers may dispute PFSweb invoices for services rendered or other charges. As of September 30, 2005, an aggregate of approximately $0.9 million of PFSweb invoices were in dispute. Although PFSweb believes it will resolve these disputes in its favor, the failure to do so may have a material adverse effect on PFSweb s results of operations. PFSweb also receives municipal tax abatements in certain locations. During 2004 PFSweb received notice from a municipality that it did not satisfy certain criteria necessary to maintain the abatements. PFSweb plans to dispute the notice, but if the dispute is not resolved favorably, additional taxes could be assessed against PFSweb for calendar years 2004 and 2005, which through September 30, 2005, could be $0.4 million to $0.5 million for 2004 and $0.4 million for 2005.

PFSweb may engage in future strategic alliances or acquisitions that could dilute its existing stockholders, cause PFSweb to incur significant expenses or harm its business.

PFSweb may review strategic alliance or acquisition opportunities that would complement its current business or enhance its technological capabilities. Integrating any newly acquired businesses, technologies

or services may be expensive and time-consuming. To finance any acquisitions, it may be necessary for PFSweb to raise additional funds through borrowing money or completing public or private financings. Additional funds may not be available on terms that are favorable to PFSweb and, in the case of equity financings, may result in dilution to PFSweb stockholders. PFSweb may not be able to operate any acquired businesses profitably or otherwise implement its growth strategy successfully. If PFSweb is unable to integrate any newly acquired entities or technologies effectively, its operating results could suffer. Future acquisitions by PFSweb could also result in incremental expenses and the incurrence of debt and contingent liabilities, any of which could harm PFSweb s operating results.

PFSweb s business could be adversely affected by a systems or equipment failure, whether that of PFSweb or its clients.

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

PFSweb s clients businesses may also be harmed from any system or equipment failures PFSweb experiences. In that event, PFSweb s relationship with these clients may be adversely affected, PFSweb may lose these clients, PFSweb s ability to attract new clients may be adversely affected and PFSweb could be exposed to liability.

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

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

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

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

PFSweb may be required to expend significant capital and other resources to protect against security breaches or to address any problem they may cause. Because PFSweb s activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage its reputation, cause it to lose clients, impact its ability to attract new clients and PFSweb could be exposed to litigation and possible liability. PFSweb s security measures may not prevent security breaches, and failure to prevent security breaches may disrupt PFSweb s operations. In certain circumstances, PFSweb does not carry insurance against the risk of credit card fraud and other fraud, so the failure to adequately control fraudulent transactions on its client s behalf could increase PFSweb s expenses. To date PFSweb has not suffered material losses due to fraud.

PFSweb may be a party to litigation involving its e-commerce intellectual property rights.

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

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

PFSweb has begun a process to document and evaluate its internal controls over financial reporting to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of PFSweb s internal controls over financial reporting and a report by its independent auditors addressing these assessments. Based on the current requirements, and PFSweb s current public float, PFSweb is not required to comply with Section 404. However, in this regard, PFSweb management has been dedicating internal resources, has engaged outside consultants and has begun to develop a detailed work plan to (i) assess and document the adequacy of internal controls over financial reporting, (ii) take steps to improve control processes, where appropriate, and (iii) validate through testing that controls are functioning as documented. If PFSweb fails to correct any issues in the design or operating effectiveness of internal controls over financial reporting or fail to prevent fraud, current and potential stockholders could lose confidence in PFSweb s financial reporting, which could harm its business and the trading price of PFSweb common stock.

Risks Related to PFSweb s Business Process Outsourcing Industry

If the trend toward outsourcing does not continue, PFSweb s business will be adversely affected.

PFSweb s business could be materially adversely affected if the trend toward outsourcing declines or reverses, or if corporations bring previously outsourced functions back in-house. Particularly during general economic downturns, businesses may bring in-house previously outsourced functions to avoid or delay layoffs. The continued threat of terrorism within the United States and abroad and the potential for sustained military action may cause disruption to commerce and economic conditions, both domestic and foreign, which could have a material adverse effect upon PFSweb s business and new client prospects.

PFSweb s market is subject to rapid technological change and to compete PFSweb must continually enhance its systems to comply with evolving standards.

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

risks. PFSweb may fail to develop new technologies effectively or to adapt its proprietary technology and systems to client requirements or emerging industry standards.

Risks Related to eCOST

eCOST may not be able to achieve or maintain profitability.

eCOST reported a net loss for the quarter ended September 30, 2005 of $2.3 million and had an accumulated deficit of $24.6 million at September 30, 2005. Without giving effect to the merger, eCOST does not expect to achieve profitability until at least 2006 and may not be able to achieve or maintain profitability on a quarterly or annual basis. eCOST s ability to achieve or maintain profitability depends on a number of factors, including its ability to:

reduce the decline in its sales that have occurred over the last three quarters;

maintain or increase sales in the future;

maintain vendor relationships, procure merchandise and fulfill orders in an efficient manner; and

control costs.

eCOST may need additional financing and may not be able to raise additional financing on favorable terms or at all, which could increase its costs, limit its ability to grow and dilute the ownership interests of existing stockholders.

eCOST anticipates that it may need to raise additional capital in the future if the merger with PFSweb does not occur. eCOST cannot be certain that it will be able to obtain additional financing on commercially reasonable terms or at all. If eCOST raises additional funds through the issuance of equity, equity-related or debt securities, such securities may have rights, preferences or privileges senior to those of the rights of eCOST s common stock and eCOST s stockholders will experience dilution of their ownership interests. eCOST s agreements with PC Mall will limit its ability to issue equity securities in the future without PC Mall s consent for up to three years following the distribution. For a description of these limitations, please see Risks Relating to our Relationship with PC Mall. in eCOST s 10-Q filed with the Securities and Exchange Commission on November 14, 2005. eCOST s failure to obtain additional financing or its inability to obtain financing on acceptable terms could require eCOST to incur indebtedness that has high rates of interest or substantial restrictive covenants, issue equity securities that will dilute the ownership interests of existing stockholders, scale back its operations, or fail to address opportunities for expansion or enhancement of its operations.

eCOST s operating results are difficult to predict.

eCOST s operating results have fluctuated in the past and are likely to vary significantly in the future based upon a number of factors, many of which it cannot control. eCOST operates in a highly dynamic industry and future results could be subject to significant fluctuations. Revenue and expenses in future periods may be greater or less than revenue and expenses in the immediately preceding period or in the comparable period of the prior year. Therefore, period-to-period comparisons of eCOST operating results are not necessarily a good indication of its future performance. Some of the factors that could cause eCOST s operating results to fluctuate include:

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

fluctuations in coupon redemption rates;

the amount and timing of advertising and marketing costs;

eCOST s ability to successfully implement new technologies or software systems;

eCOST s ability to obtain sufficient financing;

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

technical difficulties, including system or Internet failures;

fluctuations in the demand for eCOST products or overstocking or understocking of products;

management of the eCOST fulfillment center;

fluctuations in shipping costs, particularly during the holiday season;

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

changes in the mix of products that eCOST sells; and

fluctuations in levels of inventory theft, damage or obsolescence.

If eCOST fails to successfully manage or expand its inventory management and order fulfillment operations, it may be unable to meet customer demand for its products and may incur higher expenses or additional costs.

eCOST order fulfillment and distribution operations are located in Memphis, Tennessee. PC Mall provided inventory management and order fulfillment services to eCOST until the completion of the eCOST spin-off in April 2005. In January 2005, eCOST signed a lease for its own distribution facility located near the FedEx main hub in Memphis, Tennessee and commenced operations in this facility in April 2005. Any failure to manage eCOST s inventory and order fulfillment operations could seriously disrupt its operations and cause it to be unable to meet customer demand for its products. eCOST could incur higher fulfillment expenses than anticipated or incur additional costs as a result of many factors including lost, damaged or mis-shipped inventories.

If eCOST fails to accurately predict its inventory risk, its margins may decline as a result of write-downs of its inventory due to lower prices obtained from older or obsolete products.

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

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

eCOST makes allowances for product returns in its financial statements based on historical return rates. eCOST is responsible for returns of certain products ordered through its website from its distribution center as well as products that are shipped to its customers directly from its vendors. If eCOST s actual product returns significantly exceed its allowances for returns, especially as eCOST expands into new product categories, its revenues and profitability could decrease. In addition, because eCOST s allowances are based on historical return rates, the introduction of new merchandise categories, new products, changes in its product mix, or other factors may cause actual returns to exceed return allowances, perhaps significantly. In addition, any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer repeat customers.

eCOST s ability to offer a broad selection of products at competitive prices is dependent on its ability to maintain existing and build new relationships with manufacturers and vendors. eCOST does not have long-term agreements with its manufacturers or vendors and some of its manufacturers and vendors compete directly with eCOST.

eCOST purchases products for resale both directly from manufacturers and indirectly through distributors and other sources, all of whom eCOST considers its vendors. During 2004, eCOST offered products on its website from over 1,000 third-party manufacturers. eCOST does not have any long-term agreements with any of these vendors. Any agreements with vendors governing eCOST s purchase of products are generally terminable by either party upon 30 days notice or less. In general, eCOST agrees to offer products on its website and the vendors agree to provide eCOST with information about their products and honor eCOST customer service policies. As eCOST has recently transitioned to performing inventory management and order fulfillment functions on its own, it will need to continue to build its own relationships with vendors and obtain favorable product pricing and vendor consideration. If eCOST does not maintain relationships with vendors on acceptable terms, including favorable product pricing and vendor consideration, it may not be able to offer a broad selection of products or continue to offer products at competitive prices, and customers may refuse to shop at the eCOST website. In addition, some vendors may decide not to offer particular products for sale on the Internet, and others may avoid offering their new products to retailers such as eCOST who offer a mix of close-out and refurbished products in addition to new products. From time to time, vendors may terminate eCOST s right to sell some or all of their products, change the applicable terms and conditions of sale or reduce or discontinue the incentives or vendor consideration that they offer. Any such termination or the implementation of such changes could have a negative impact on eCOST s operating results. Additionally, some products are subject to manufacturer or distributor allocation, which limits the number of units of those products that are available to eCOST and other resellers.

eCOST s revenue is dependent in part on sales of HP and HP-related products, which represented 21% of net sales in 2003, 27% in 2004 and 28% for the nine months ended September 30, 2005.

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

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

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

eCOST makes allowances for product returns in its financial statements based on historical return rates. eCOST is responsible for returns of certain products ordered through its website from its distribution center as well as products that are shipped to its customers directly from its vendors. If eCOST actual product returns significantly exceed its allowances for returns, especially as it expands into new product

categories, eCOST s revenues and profitability could decrease. In addition, because eCOST s allowances are based on historical return rates, the introduction of new merchandise categories, new products, changes in product mix, or other factors may cause actual returns to exceed return allowances, perhaps significantly. In addition, any policies intended to reduce the number of product returns may result in customer dissatisfaction and fewer repeat customers.

Because eCOST experiences seasonal fluctuations in its revenues, its quarterly results may fluctuate.

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

eCOST s business may be harmed by fraudulent activities on its website.

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

eCOST s facilities and systems are vulnerable to natural disasters or other catastrophic events.

eCOST s headquarters, customer service center and the majority of its infrastructure, including computer servers, are located in California, an area that is susceptible to earthquakes and other natural disasters. eCOST s new distribution facility located in Memphis, Tennessee, houses or will house substantially all of the product inventory from which a substantial majority of orders are shipped. A natural disaster or other catastrophic event, such as an earthquake, fire, flood, severe storm, break-in, terrorist attack or other comparable problems could cause interruptions or delays in eCOST s business and loss of data or render it unable to accept and fulfill customer orders in a timely manner, or at all. eCOST s systems are not fully redundant, and eCOST does not have duplicate geographic locations or earthquake insurance. California has in the past experienced power outages as a result of limited electrical power supplies. These outages may recur in the future and could disrupt the operation of eCOST s business. Because eCOST s inventory and distribution facility is located in an area that is susceptible to harsh weather, a major storm, heavy snowfall or other similar event could prevent it from delivering products in a timely manner. eCOST currently has no formal disaster recovery plan and its business interruption insurance may not adequately compensate it for losses that may occur.

eCOST s business is subject to political, economic and other risks associated with the Philippines.

In order to reduce costs, eCOST intends to shift certain of its operations to the Philippines, which subjects eCOST to political, economic and other uncertainties, including expropriation, nationalization, renegotiation, or nullification of existing contracts, currency exchange restrictions and international monetary fluctuations. Furthermore, the Philippines has experienced violence related to guerrilla activity.

Delivery of eCOST s products could be delayed or disrupted by factors beyond its control, and it could lose customers as a result.

eCOST relies upon third party carriers for timely delivery of its product shipments. As a result, eCOST is subject to carrier disruptions and increased costs due to factors that are beyond its control, including employee strikes, inclement weather and increased fuel costs. Any failure to deliver products to customers in a timely and accurate manner may damage eCOST s reputation and brand and could cause it to lose customers. eCOST does not have a written long-term agreement with any of these third party carriers, and it cannot be sure that these relationships will continue on terms favorable to eCOST, if at all. If eCOST s relationship with any of these third party carriers is terminated or impaired or if any of these third parties is unable to deliver products, eCOST would be required to use alternative carriers for the shipment of products to customers. eCOST may be unable to engage alternative carriers on a timely basis or on favorable terms, if at all. Potential adverse consequences include:

reduced visibility of order status and package tracking;

delays in order processing and product delivery;

increased cost of delivery, resulting in reduced margins; and

reduced shipment quality, which may result in damaged products and customer dissatisfaction.

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

To remain competitive, eCOST must continue to enhance and improve the functionality and features of its website. If eCOST fails to upgrade its website in a timely manner to accommodate higher volumes of traffic, its website performance could suffer and eCOST may lose customers. In addition, if eCOST fails to expand the computer systems that it uses to process and ship customer orders and process customer payments, it may not be able to fulfill customer orders successfully. As a result, eCOST could lose customers and revenues could decline. The Internet and the e-commerce industry are subject to rapid technological change. If competitors introduce new features and website enhancements embodying new technologies, or if new industry standards and practices emerge, eCOST s existing website and systems may become obsolete or unattractive. Developing the eCOST website and other systems entails significant technical and business risks. eCOST may face material delays in introducing new services, products and enhancements. If this happens, customers may forgo the use of eCOST s website and use those of its competitors. eCOST may use new technologies ineffectively, or it may fail to adapt its website, transaction processing systems and computer network to meet customer requirements or emerging industry standards.

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

eCOST has generated the substantial majority of its revenues during the past five years from the sale of computer hardware, software and accessories and consumer electronics products. In the past 18 months eCOST launched several new product categories, including digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. While its merchandising platform has been incorporated into and tested in the online computer and consumer electronics retail markets, eCOST cannot predict with certainty whether it can be successfully applied to other product categories. In addition, expansion of its business strategy into new product categories may require eCOST to incur significant marketing expenses, develop relationships with new vendors and comply with new regulations. eCOST may lack the necessary expertise in a new product category to realize the expected benefits of that new category. These requirements could strain managerial,

financial and operational resources. Additional challenges that may affect eCOST s ability to expand into new product categories include its ability to:

- establish or increase awareness of new brands and product categories;
- acquire, attract and retain customers at a reasonable cost;
- achieve and maintain a critical mass of customers and orders across all product categories;
- attract a sufficient number of new customers to whom new product categories are targeted;
- successfully market new product offerings to existing customers;
- maintain or improve gross margins and fulfillment costs;
- attract and retain vendors to provide an expanded line of products to customers on terms that are acceptable; and
- manage inventory in new product categories.

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

If eCOST is unable to provide satisfactory customer service, it could lose customers.

eCOST s ability to provide satisfactory levels of customer service depends, to a large degree, on the efficient and uninterrupted operation of its customer service operations. Any material disruption or slowdown in its order processing systems resulting from labor disputes, telephone or Internet failures, power or service outages, natural disasters or other events could make it difficult or impossible to provide adequate customer service and support. Further, eCOST may be unable to attract and retain adequate numbers of competent customer service representatives and relationship managers for its business customers, each of which is essential in creating a favorable interactive customer experience. Due to increased customer service needs during the holiday shopping season, eCOST hires temporary employees during the third and fourth fiscal quarters. As a result, eCOST may have difficulty properly staffing its customer service operations during peak sales season. Further, temporary employees may not have the same levels of training or professional responsibility as full-time employees and, as a result, may be more likely to provide unsatisfactory service to customers and potential customers. If eCOST is unable to continually provide adequate staffing and training for our customer service operations, its reputation could be seriously harmed and eCOST could lose customers. In addition, if eCOST s e-mail and telephone call volumes exceed its present system capacities, eCOST could experience delays in placing orders, responding to customer inquiries and addressing customer concerns. eCOST s customer service facility currently accommodates customer service representatives at close to its capacity during peak sales period, so eCOST may be required to expand its customer service facility in the near future. eCOST may not be able to find additional suitable office space on acceptable terms or at all, which could seriously hinder its ability to provide satisfactory levels of customer service. Because eCOST s success depends in large part on keeping its customers satisfied, any failure to provide high levels of customer service would likely impair its reputation and decrease its revenues.

In addition, as a cost savings measure, eCOST intends to transition certain of its operations to the Philippines, including a portion of its customer service functions. If eCOST is unable to successfully execute its plans in the Philippines, including providing sufficient levels of customer service, its business will be harmed.

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

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

other multi-category online retailers such as Amazon.com and Buy.com;

online discount retailers of computer and consumer electronics merchandise such as Computers4Sure, NewEgg and TigerDirect;

liquidation e-tailers such as Overstock.com and SmartBargains.com;

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

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

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

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

eCOST has six trademarks that it considers to be material to the successful operation of business: eCOST®, eCOST.com®, eCOST.com Bargain Countdown™, eCOST.com Your Online Discount Superstore!™, Bargain Countdown™ and Bargain Countdown Platinum Club™. eCOST currently uses all of these marks in connection with telephone, mail order, catalog and online retail services. eCOST also has several additional pending trademark applications. eCOST relies on trademark and copyright law, trade secret protection and confidentiality agreements with its employees, consultants, suppliers and others to protect its proprietary rights. eCOST s applications may not be granted, and eCOST may not be able to secure significant protection for its service marks or trademarks. eCOST s competitors or others could adopt trademarks or service marks similar to its marks, or try to prevent eCOST from using its marks, thereby impeding its ability to build brand identity and possibly leading to customer confusion. Any claim by another party against eCOST for customer confusion caused by use of eCOST s trademarks or service marks, or eCOST s failure to obtain registrations for its marks, could negatively affect its competitive position and could cause it to lose customers.

eCOST has also filed an application with the U.S. Patent and Trademark Office for patent protection for its proprietary Bargain Countdown™ technology. eCOST may not be granted a patent for this technology and may not be able to enforce its patent rights if its competitors or others use infringing technology. If this occurs, eCOST s competitive position, revenues and profitability could be negatively affected.

Effective trademark, service mark, patent, copyright and trade secret protection may not be available in every country in which eCOST will sell its products and offer its services. In addition, the relationship

between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. Therefore, eCOST may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of its trademarks and other proprietary rights. If eCOST is unable to protect or preserve the value of its trademarks, copyrights, trade secrets or other proprietary rights for any reason, eCOST s competitive position could be negatively affected and it could lose customers.

eCOST also relies on technologies that it licenses from related and third parties. These licenses may not continue to be available to eCOST on commercially reasonable terms, or at all, in the future. As a result, eCOST may be required to develop or obtain substitute technology of lower quality or at greater cost, which could negatively affect its competitive position, cause it to lose customers and decrease its profitability.

If third parties claim eCOST is infringing their intellectual property rights, eCOST could incur significant litigation costs, be required to pay damages, or change its business or incur licensing expenses.

Third parties have asserted, and may in the future assert, that eCOST s business or the technologies it uses infringe on their intellectual property rights. As a result, eCOST may be subject to intellectual property legal proceedings and claims in the ordinary course of business. eCOST cannot predict whether third parties will assert additional claims of infringement in the future or whether any future claims will prevent it from offering popular products or services.

On July 12, 2004, eCOST received correspondence from MercExchange LLC alleging infringement of its U.S. patents relating to e-commerce and offering to license its patent portfolio to eCOST. On July 15, 2004, eCOST received a follow-up letter from MercExchange specifying which of eCOST s technologies it believes infringe certain of its patents, alone or in combination with technologies provided by third parties. Some of those patents are currently being litigated by third parties, and eCOST is not involved in those proceedings. In addition, three of the four patents identified by MercExchange are under reexamination at the U.S. Patent and Trademark Office, which may or may not result in the modification of the claims. In the July 15th letter, MercExchange also advised that it has a number of applications pending for additional patents. MercExchange has filed lawsuits alleging infringement of some or all of its patents against third parties, resulting in settlements or verdicts in favor of MercExchange. At least one such verdict was appealed to the United States Court of Appeals for the Federal Circuit and was affirmed in part.

If eCOST is forced to defend against these or any other third-party infringement claims, whether they are with or without merit or are determined in its favor, eCOST could face expensive and time-consuming litigation, which could result in the imposition of a preliminary injunction preventing it from continuing to operate its business as currently conducted throughout the duration of the litigation or distract eCOST s technical and management personnel. If eCOST is found to infringe, it may be required to pay monetary damages, which could include treble damages and attorneys fees for any infringement that is found to be willful, and either be enjoined or required to pay ongoing royalties with respect to any technologies found to infringe. Further, as a result of infringement claims either against eCOST or against those who license technology to eCOST, eCOST may be required, or deem it advisable, to develop non-infringing technology, which could be costly and time consuming, or enter into costly royalty or licensing agreements. Such royalty or licensing agreements, if required, may be unavailable on terms that are acceptable, or at all. eCOST expects that participants in its market will be increasingly subject to infringement claims as the number of competitors in the industry grows. If a third party successfully asserts an infringement claim against eCOSt and it is enjoined or required to pay monetary damages or royalties or eCOST is unable to develop suitable non-infringing alternatives or license the infringed or similar technology on reasonable terms on a timely basis, eCOST s business, results of operations and financial condition could be materially harmed.

eCOST may be liable for misappropriation of its customers personal information.

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

eCOST relies on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of sensitive customer information such as customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments may result in a compromise or breach of the algorithms that eCOST uses to protect customer transaction data. If any such compromise of security were to occur, it could subject eCOST to liability, damage its reputation and diminish the value of its brand-name. A party who is able to circumvent the security measures could misappropriate proprietary information or cause interruptions in operations. eCOST may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. eCOST s security measures are designed to prevent security breaches, but its failure to prevent such security breaches could subject eCOST to liability, damage its reputation and diminish the value of its brand-name.

Moreover, for the convenience of its customers, eCOST provides non-secured channels for customers to communicate. Despite the increased security risks, customers may use such channels to send personal information and other sensitive data. In addition, phishing incidents are on the rise. Phishing involves an online company s customers being tricked into providing their credit card numbers or account information to someone pretending to be the online company s representative. Such incidents have recently given rise to litigation against online companies for failing to take sufficient steps to police against such activities by third parties, and may discourage customers from using online services.

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

eCOST sells products manufactured and distributed by third parties, some of which may be defective. If any product that eCOST sells were to cause physical injury or damage to property, the injured party or parties could bring claims against eCOST as the retailer of the product. eCOST s insurance coverage may not be adequate to cover every claim that could be asserted. If a successful claim were brought against eCOST in excess of its insurance coverage, it could expose it to significant liability. Even unsuccessful claims could result in the expenditure of funds and management time and could decrease profitability.

Risks Related to eCOST s Industry

eCOST s success is tied to the continued use of the Internet and the adequacy of the Internet infrastructure.

eCOST s future revenues and profits, if any, substantially depend upon the continued widespread use of the Internet as an effective medium of business and communication. If use of the Internet declines or the Internet infrastructure becomes an ineffective medium for business transactions and communication,

eCOST may not be able to effectively implement its growth strategy and it could lose customers. Widespread use of the Internet could decline as a result of disruptions, computer viruses or other damage to Internet servers or users computers. Additionally, if the Internet s infrastructure does not expand fast enough to meet increasing levels of use, it may become a less effective medium of business transactions and communications.

The security risks of e-commerce may discourage customers from purchasing goods over the Internet.

In order for the e-commerce market to develop successfully, eCOST and other market participants must be able to transmit confidential information securely over public networks. Third parties may have the technology or know-how to breach the security of customer transaction data. Any breach could cause customers to lose confidence in the security of eCOST s website and choose not to purchase from the website. If someone is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt operations. Concerns about the security and privacy of transactions over the Internet could inhibit the growth of the Internet and e-commerce. Security measures may not effectively prohibit others from obtaining improper access to information. Any security breach could expose eCOST to risks of loss, litigation and liability and could seriously disrupt its operations.

Credit card fraud could decrease eCOST s revenues and profitability.

eCOST does not currently carry insurance against the risk of credit card fraud, so the failure to adequately control fraudulent credit card transactions could reduce its revenues and gross margin. eCOST may in the future suffer losses as a result of orders placed with fraudulent credit card data even though the associated financial institution approved payment of the orders. Under current credit card practices, eCOST may be liable for fraudulent credit card transactions because it did not obtain a cardholder s signature. If eCOST is unable to detect or control credit card fraud, or if credit card companies require more burdensome terms or refuse to accept credit card charges, eCOST s revenues and profitability could decrease.

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

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

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

eCOST is subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet and e-commerce. Such existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, user privacy, marketing and promotional practices, database protection, pricing, content, copyrights, distribution, electronic contracts, email and other communications, consumer protection, product safety, the provision of online payment services, intellectual property rights, unauthorized access (including the Computer Fraud and Abuse Act), and the characteristics and quality of products and services. It is unclear how existing

laws governing issues such as property ownership, sales and other taxes, libel, trespass, data mining and collection, and personal privacy apply to the Internet and e-commerce. Unfavorable resolution of these issues may expose eCOST to liabilities and costly changes in its business operations, and could reduce customer demand. The growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens on online companies. For example, California law requires notice to California customers if certain personal information about them is obtained by an unauthorized person, such as a computer hacker. These consumer protection laws could result in substantial compliance costs and could decrease profitability.

Laws or regulations relating to privacy and data protection may adversely affect the growth of eCOST s Internet business or its marketing efforts.

eCOST is subject to increasing regulation relating to privacy and the use of personal user information. For example, eCOST is subject to various telemarketing and anti-spam laws that regulate the manner in which it may solicit future suppliers and customers. Such regulations, along with increased governmental or private enforcement, may increase the cost of growing the business. In addition, several jurisdictions, including California, have adopted legislation limiting the uses of personal user information gathered online or require online services to establish privacy policies. Pursuant to the Children s Online Privacy Protection Act, the Federal Trade Commission has adopted regulations regarding the collection and use of personal identifying information obtained from children under 13 years of age. Increasingly, federal, state and foreign laws and regulations extend online privacy protection to adults. Moreover, in jurisdictions where eCOST does business, there is a trend toward requiring companies to establish procedures to notify users of privacy and security policies, to obtain prior consent from users for the collection, use and disclosure of personal information (even disclosure to affiliates), and to provide users with the ability to access, correct and delete personal information stored by companies. These data protection regulations and enforcement efforts may restrict eCOST s ability to collect, use or transfer demographic and personal information from users, which could be costly or harm marketing efforts. Further, any violation of privacy or data protection laws and regulations may subject eCOST to fines, penalties and damages, as well as harm to its reputation, which could decrease its revenues and profitability.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This joint proxy statement/ prospectus contains forward-looking statements that are entitled to the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which PFSweb and eCOST operate and the beliefs and assumptions of PFSweb and eCOST. Words such as anticipate, believe, continue, could, estimate, e goal, intend, may, plan, project, seek, should, target, will, would, variations of such words, and si intended to identify forward-looking statements.

In this joint proxy statement/ prospectus, these forward-looking statements include, among others, statements regarding:

- PFSweb s and eCOST s respective reasons for the merger;
- the completion and timing of the consummation of the merger;
- the anticipated benefits of the merger, including the expectation of greater revenue opportunities and operating efficiencies and cost savings;
- the intention that the merger qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code;
- future financial results of PFSweb, eCOST and the combined company;

- the effect that the public announcement of the merger may have on each company s sales and operating results and on their ability to retain key management and personnel;

- the ability of the merger to increase stockholder value;

- the integration of the two companies;

- the combined company s synergies and the cost savings and growth opportunities relating to such synergies;

- growth and growth opportunities;

- the combined company s competitive and market position;

- opportunities for cross-marketing the products and services of the combined company; and

- the combined company s response to industry shifts, technological changes, increased competition and market demand.

These forward-looking statements involve certain risks and uncertainties. The ability of either PFSweb or eCOST to predict results or the actual effects of its plans and strategies, or those of the combined company, is inherently uncertain. Accordingly, actual results or events may differ materially and adversely from those expressed in any forward-looking statements. For a detailed discussion of the factors that may cause such a difference, see Risk Factors beginning on page 28 of this joint proxy statement/ prospectus.

We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this joint proxy statement/ prospectus. Except to the extent required by applicable law or regulation, neither PFSweb nor eCOST undertakes any obligation to update or revise these forward-looking statements, whether as a result of new information, future events or otherwise.

THE PFSWEB SPECIAL MEETING

This joint proxy statement/ prospectus is being provided to PFSweb stockholders as part of a solicitation of proxies by the PFSweb board of directors for use at a special meeting of PFSweb stockholders. This joint proxy statement/ prospectus provides PFSweb stockholders with the information they need to know to be able to vote or instruct their vote to be cast at the special meeting of PFSweb stockholders.

Date, Time and Place

The special meeting of PFSweb stockholders will be held on , 2006 at 10:00 a.m., local time, at PFSweb s principal offices at 500 North Central Expressway, Plano, Texas 75074.

Matters for Consideration

The PFSweb special meeting is being held for the following purposes:

- to approve the issuance of PFSweb common stock pursuant to the Agreement and Plan of Merger, dated as of November 29, 2005, by and among PFSweb, Red Dog Acquisition Corp., a wholly owned subsidiary of PFSweb, and eCOST;

- to approve the amendment to the PFSweb Amended and Restated Certificate of Incorporation to increase the number of authorized shares of Common Stock, $0.001 par value, from 40 million shares to 75 million shares;

- to grant discretionary authority to adjourn the special meeting, if necessary, to solicit additional proxies with respect to either or both of the preceding two proposals; and

- to transact such other business as may properly come before the special meeting or any adjournment or postponement of the meeting.

The approval of **BOTH** Proposal No. 1 and Proposal No. 2 is required in order for PFSweb to consummate the merger.

Recommendations of the PFSweb Board of Directors

Merger

The PFSweb board of directors has unanimously approved the merger agreement and unanimously recommends that PFSweb stockholders vote FOR the proposal to issue PFSweb common stock pursuant to the merger agreement. See The Merger PFSweb s Reasons for the Merger and The Merger Recommendation of the PFSweb Board of Directors on pages 60 and 62, respectively, for a more detailed discussion of the recommendation of the PFSweb board of directors.

Amendment to Amended and Restated Certificate of Incorporation

The PFSweb board of directors has unanimously approved the amendment to the PFSweb Amended and Restated Certificate of Incorporation to increase the number of authorized shares of Common Stock, $0.001 par value, from 40 million shares to 75 million shares of the Company and recommends a vote FOR the proposed amendment for the reasons set forth below.

The PFSweb board of directors has unanimously adopted a resolution approving and recommending to the stockholders for their approval an amendment to Article Fourth of its amended and restated certificate of incorporation authorizing an increase in the number of authorized shares of common stock from 40,000,000 shares to 75,000,000 shares.

PFSweb is currently authorized to issue 40,000,000 shares of common stock, of which, as of November 21, 2005, 22,526,681 shares were issued and outstanding, 5,449,518 shares were reserved for issuance upon the exercise of outstanding options, 395,486 were reserved for issuance upon the exercise of outstanding warrants and 86,300 were held as treasury stock. If the merger agreement is approved and consummated in accordance with its terms, PFSweb will issue one share of PFSweb common stock in exchange for each outstanding share of eCOST common stock. As of November 29, 2005, there were 17,755,202 shares of eCOST common stock outstanding. In addition, if and to the extent outstanding options to purchase eCOST common stock are exercised prior to the consummation of the merger, the number of shares of PFSweb common stock to be issued in the merger will increase correspondingly. Consequently, in order for PFSweb to have enough authorized shares of common stock to issue in the merger and to satisfy current and future option and warrant exercises, the number of authorized shares of PFSweb common stock must be increased.

Voting Procedures and Revocation of Proxies

Your vote is important. Whether or not you expect to attend the PFSweb special meeting in person, please complete, sign, date and return the enclosed proxy card as soon as possible to ensure that your shares are represented at the special meeting. Returning the proxy card does not deprive you of your right to attend the PFSweb special meeting and to vote your shares in person.

Voting in Person

If you plan to attend the PFSweb special meeting and wish to vote in person, you will be given a ballot at the special meeting. Please note, however, that if your shares are held in street name, which means your shares are held of record by a broker, bank or other nominee, and you wish to vote at the PFSweb special meeting, you must bring to the special meeting a proxy from the record holder authorizing you to vote at the PFSweb special meeting.

Voting by Proxy

The method of voting by proxy differs for shares held as a record holder and shares held in street name. If you hold your shares of PFSweb common stock as a record holder, you may vote by signing and

dating the enclosed proxy card and promptly returning it in the enclosed envelope. If, on the other hand, you hold your shares of PFSweb common stock in street name, then you will receive instructions from your broker, bank or other nominee that you must follow in order to vote your shares. Your broker, bank or other nominee may allow you to deliver your voting instructions over the internet or by telephone. Please see the voting instruction card from your broker, bank or other nominee that accompanies this joint proxy statement/ prospectus.

All properly signed proxies that are received prior to the special meeting and that are not revoked will be voted at the special meeting according to the instructions indicated on the proxies or, if no direction is indicated, they will be voted **FOR** the proposal to issue PFSweb common stock pursuant to the merger agreement and **FOR** the proposal to increase the number of authorized shares of PFSweb common stock.

Revocation

You may revoke your proxy at any time before your proxy is voted at the PFSweb special meeting by taking any of the following actions:

- submitting another proxy card bearing a later date;
- delivering written notice of revocation to PFSweb s Corporate Secretary at 500 North Central Expressway, Plano, Texas 75074; or
- attending the PFSweb special meeting and voting in person, although attendance at the special meeting will not, by itself, revoke a proxy.

If your shares are held in street name, you may change your vote by submitting new voting instructions to your broker, bank or other nominee. You must contact your broker, bank or other nominee to find out how to do so.

Record Date and Shares Entitled to Vote

Only holders of record of PFSweb common stock at the close of business on the record date, , 2006, are entitled to notice of and to vote at the special meeting. These stockholders are entitled to cast one vote for each share of common stock held as of the record date on all matters properly submitted for the vote of stockholders at the special meeting. As of the record date, there were approximately shares of PFSweb common stock outstanding and entitled to vote at the special meeting.

Quorum and Vote Required

A quorum of stockholders is necessary to hold a valid special meeting. The presence, in person or by proxy, of the holders of a majority of the shares of PFSweb common stock issued and outstanding and entitled to be voted at the special meeting is necessary to constitute a quorum at the PFSweb special meeting. The approval of the issuance of common stock in the merger requires the affirmative vote of a majority of the votes cast at the special meeting. The authorization of the amendment to the PFSweb amended and restated certificate of incorporation to increase the number of authorized shares of common stock will require the affirmative vote of the holders of a majority of the outstanding shares of PFSweb common stock entitled to vote thereon. On the record date, the directors and executive officers of PFSweb and their affiliates beneficially owned and were entitled to vote approximately shares of PFSweb common stock, which represent approximately % of the outstanding shares of PFSweb common stock.

Abstentions and Broker Non-Votes

Abstentions and broker non-votes will be counted for the purpose of determining whether a quorum is present, but they will not be counted as votes cast on any matter. Broker non-votes refer to unvoted proxies submitted by brokers who are not able to vote on a proposal absent instructions from the beneficial

owner. Because abstentions and broker non-votes will not be considered votes cast, they will have no effect on the outcome of the proposal to approve the issuance of PFSweb shares in the merger; however, abstentions and broker non-votes will have the same effect as a vote against the proposal to amend the PFSweb charter to increase the number of authorized shares.

Solicitation of Proxies and Expenses

PFSweb is soliciting proxies for the PFSweb special meeting from PFSweb stockholders. PFSweb will bear the entire cost of soliciting proxies from PFSweb stockholders, except that PFSweb and eCOST have each agreed to share equally all expenses incurred in connection with the filing with the SEC of the registration statement of which this joint proxy statement/ prospectus forms a part, and the printing and mailing of this joint proxy statement/ prospectus and related proxy materials. In addition to the solicitation of proxies by mail, PFSweb will request that brokers, banks and other nominees send proxies and proxy materials to the beneficial owners of PFSweb common stock held by them and secure their voting instructions, if necessary. PFSweb will reimburse those record holders for their reasonable expenses. PFSweb has also made arrangements with to assist it in soliciting proxies, and has agreed to pay a fee of approximately $ plus expenses for those services. PFSweb also may use several of its regular employees, who will not be specially compensated, to solicit proxies from PFSweb stockholders, either personally or by telephone, internet, telegram, facsimile or special delivery letter.

Admission to the Special Meeting

All PFSweb stockholders, including stockholders of record and stockholders who hold their shares in street name are invited to attend the PFSweb special meeting. If you plan to attend the special meeting, you must bring a form of personal photo identification with you in order to be admitted. PFSweb stockholders who are not record holders but hold shares in street name should provide proof of beneficial ownership on the record date for the PFSweb special meeting, such as their most recent account statement or other similar evidence of ownership. Anyone who does not provide valid photo identification or comply with the other procedures outlined above upon request may not be admitted to the special meeting.

Other Business

As of the date of this joint proxy statement/ prospectus, PFSweb does not know of any matters that will be presented for consideration at the PFSweb special meeting other than as described in this joint proxy statement/ prospectus. If any other matters are properly presented for voting at the special meeting or any adjournments or postponements of the special meeting, the enclosed proxies will confer discretionary authority on the individuals named as proxies to vote the shares represented by the proxies as to any other matters. The individuals named as proxies intend to vote in accordance with their best judgment as to any other matters.

Householding

The rules promulgated by the SEC permit companies, brokers, banks or other intermediaries to deliver a single copy of a proxy statement to households at which two or more stockholders reside. This practice, known as householding, is designed to reduce duplicate mailings and save significant printing and postage costs as well as natural resources. Stockholders sharing an address who have been previously notified by their broker, bank or other intermediary and have consented to householding, either affirmatively or implicitly by not objecting to householding, will receive only one copy of this joint proxy statement/ prospectus. If you would like to opt out of this practice for future mailings and receive separate proxy statements for each stockholder sharing the same address, please contact your broker, bank or other intermediary. You may also obtain a separate joint proxy statement/ prospectus without charge by sending a written request to PFSweb, Inc., Attention: Investor Relations, 500 North Central Expressway, Plano, Texas 75074, or by calling PFSweb at (972) 881-2900. PFSweb will promptly send additional copies of

this joint proxy statement/ prospectus upon receipt of such request. Householding does not apply to stockholders with shares registered directly in their name.

Assistance

If you need assistance in completing your proxy card or have questions regarding the special meeting, please contact:

PFSweb, Inc.
500 North Central Expressway
Plano, Texas 75074
(972) 881-2900
Attn: Investor Relations

THE eCOST SPECIAL MEETING

This joint proxy statement/ prospectus is being provided to eCOST stockholders as part of a solicitation of proxies by the eCOST board of directors for use at a special meeting of eCOST stockholders. This joint proxy statement/ prospectus provides eCOST stockholders with the information they need to know to be able to vote or instruct their vote to be cast at the special meeting of eCOST stockholders.

Date, Time and Place

The special meeting of eCOST stockholders will be held on , 2006 at 10:00 a.m., local time, at eCOST s principal offices at 2555 West 190th Street, Suite 106, Torrance, California 90504.

Matters for Consideration

The eCOST special meeting is being held for the following purposes:

- to consider and vote upon a proposal to adopt the Agreement and Plan of Merger, dated as of November 29, 2005, by and among eCOST, PFSweb and Red Dog Acquisition Corp., a wholly owned subsidiary of PFSweb and the transactions contemplated by the merger agreement, including the merger. If the merger agreement is approved and the transactions contemplated by the merger agreement are completed, then each outstanding share of eCOST common stock would be converted into one share of PFSweb common stock;

- to grant discretionary authority to adjourn the special meeting, if necessary, to solicit additional proxies with respect to the adoption of the merger agreement; and

- to transact such other business as may properly come before the special meeting or any adjournment or postponement of the meeting.

Recommendation of the eCOST Board of Directors

The eCOST board of directors has unanimously approved the merger agreement and unanimously recommends that eCOST stockholders vote FOR the proposal to approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger. See The Merger eCOST s Reasons for the Merger and The Merger Recommendation of the eCOST Board of Directors on pages 62 and 65, respectively, for a more detailed discussion of the recommendation of the eCOST board of directors.

Voting Procedures and Revocation of Proxies

Your vote is important. Whether or not you expect to attend the eCOST special meeting in person, please complete, sign, date and return the enclosed proxy card as soon as possible to ensure that your shares are represented at the special meeting. Returning the proxy card does not deprive you of your right to attend the eCOST special meeting and to vote your shares in person.

Voting in Person

If you plan to attend the eCOST special meeting and wish to vote in person, you will be given a ballot at the special meeting. Please note, however, that if your shares are held in street name, which means your shares are held of record by a broker, bank or other nominee, and you wish to vote at the eCOST special meeting, you must bring to the special meeting a proxy from the record holder authorizing you to vote at the eCOST special meeting.

Voting by Proxy

The method of voting by proxy differs for shares held as a record holder and shares held in street name. If you hold your shares of eCOST common stock as a record holder, you may vote by signing and dating the enclosed proxy card and promptly returning it in the enclosed envelope. If, on the other hand, you hold your shares of eCOST common stock in street name, then you will receive instructions from your broker, bank or other nominee that you must follow in order to vote your shares. Your broker, bank

or other nominee may allow you to deliver your voting instructions over the internet or by telephone. Please see the voting instruction card from your broker, bank or other nominee that accompanies this joint proxy statement/ prospectus.

All properly signed proxies that are received prior to the special meeting and that are not revoked will be voted at the special meeting according to the instructions indicated on the proxies or, if no direction is indicated, they will be voted **FOR** the proposal to adopt the merger agreement.

Revocation

You may revoke your proxy at any time before your proxy is voted at the eCOST special meeting by taking any of the following actions:

submitting another proxy card bearing a later date;

delivering written notice of revocation to eCOST s Corporate Secretary at 2555 West 190th Street, Suite 106, Torrance, California 90504; or

attending the eCOST special meeting and voting in person, although attendance at the special meeting will not, by itself, revoke a proxy.

If your shares are held in street name, you may change your vote by submitting new voting instructions to your broker, bank or other nominee. You must contact your broker, bank or other nominee to find out how to do so.

Record Date and Shares Entitled to Vote

Only holders of record of eCOST common stock at the close of business on the record date, , 2006, are entitled to notice of and to vote at the special meeting. These stockholders are entitled to cast one vote for each share of common stock held as of the record date on all matters properly submitted for the vote of stockholders at the special meeting. As of the record date, there were approximately shares of eCOST common stock outstanding and entitled to vote at the special meeting.

Quorum and Vote Required

A quorum of stockholders is necessary to hold a valid special meeting. The presence, in person or by proxy, of the holders of a majority of the outstanding shares of eCOST common stock entitled to vote at the special meeting is necessary to constitute a quorum at the eCOST special meeting. The adoption of the merger agreement requires the affirmative vote of a majority of the outstanding shares of eCOST common stock. On the record date, the directors and executive officers of eCOST and their affiliates beneficially owned and were entitled to vote approximately shares of eCOST common stock, which represent approximately % of the outstanding shares of eCOST common stock.

Abstentions and Broker Non-Votes

Abstentions and broker non-votes will be counted for the purpose of determining whether a quorum is present, but they will not be counted as votes cast on any matter. Broker non-votes refer to unvoted proxies submitted by brokers who are not able to vote on a proposal absent instructions from the beneficial owner. Because the affirmative vote of a majority of the outstanding shares of eCOST common stock is required to adopt the merger agreement, abstentions and broker non-votes will have the effect of a vote against the adoption of the merger agreement.

Solicitation of Proxies and Expenses

eCOST is soliciting proxies for the eCOST special meeting from eCOST stockholders. eCOST will bear the entire cost of soliciting proxies from eCOST stockholders, except that PFSweb and eCOST have each agreed to share equally all expenses incurred in connection with the filing with the SEC of the registration statement of which this joint proxy statement/ prospectus forms a part, and the printing and mailing of this joint proxy statement/ prospectus and related proxy materials. In addition to the solicitation of proxies by mail, eCOST will request that brokers, banks and other nominees send proxies and proxy

materials to the beneficial owners of eCOST common stock held by them and secure their voting instructions, if necessary. eCOST will reimburse those record holders for their reasonable expenses. eCOST has also made arrangements with   to assist it in soliciting proxies, and has agreed to pay a fee of approximately $ plus expenses for those services. eCOST also may use several of its regular employees, who will not be specially compensated, to solicit proxies from eCOST stockholders, either personally or by telephone, internet, telegram, facsimile or special delivery letter.

Admission to the Special Meeting

All eCOST stockholders, including stockholders of record and stockholders who hold their shares in street name are invited to attend the eCOST special meeting. If you plan to attend the special meeting, you must bring a form of personal photo identification with you in order to be admitted. eCOST stockholders who are not record holders but hold shares in street name should provide proof of beneficial ownership on the record date for the eCOST special meeting, such as their most recent account statement or other similar evidence of ownership. Anyone who does not provide valid photo identification or comply with the other procedures outlined above upon request may not be admitted to the special meeting.

Other Business

As of the date of this joint proxy statement/ prospectus, eCOST does not know of any matters that will be presented for consideration at the eCOST special meeting other than as described in this joint proxy statement/ prospectus. If any other matters are properly presented for voting at the special meeting or any adjournments or postponements of the special meeting, the enclosed proxies will confer discretionary authority on the individuals named as proxies to vote the shares represented by the proxies as to any other matters. The individuals named as proxies intend to vote in accordance with their best judgment as to any other matters.

Householding

The rules promulgated by the SEC permit companies, brokers, banks or other intermediaries to deliver a single copy of a proxy statement to households at which two or more stockholders reside. This practice, known as householding, is designed to reduce duplicate mailings and save significant printing and postage costs as well as natural resources. Stockholders sharing an address who have been previously notified by their broker, bank or other intermediary and have consented to householding, either affirmatively or implicitly by not objecting to householding, will receive only one copy of this joint proxy statement/ prospectus. If you would like to opt out of this practice for future mailings and receive separate proxy statements for each stockholder sharing the same address, please contact your broker, bank or other intermediary. You may also obtain a separate joint proxy statement/ prospectus without charge by sending a written request to eCOST.com, Inc., 2555 West 190th Street, Suite 106, Torrance, California 90504, Attn: Secretary, or by calling eCOST at (310) 225-4044. eCOST will promptly send additional copies of this joint proxy statement/ prospectus upon receipt of such request. Householding does not apply to stockholders with shares registered directly in their name.

Assistance

If you need assistance in completing your proxy card or have questions regarding the special meeting, please contact:

eCOST.com, Inc.
2555 West 190th Street
Suite 106
Torrance, California 90504
(310) 225-4044
Attention: Investor Relations

56

THE MERGER

The following discussion contains material information pertaining to the merger and the merger agreement. This discussion does not purport to be complete and is qualified in its entirety by reference to the merger agreement, voting agreement and financial advisor opinions attached as annexes to this document. We urge you to read and review those documents as well as the discussion in this document.

The merger agreement is included in this joint proxy statement/ prospectus in order to provide you with information regarding its terms. It is not in any way intended to provide you with factual information about the current state of affairs of either PFSweb or eCOST. Such information can be found elsewhere in this joint proxy statement/ prospectus (including the attached annexes) and in the other public filings that PFSweb and eCOST make with the SEC, which are available without charge at www.sec.gov. The merger agreement contains representations, warranties, covenants and other agreements, each as of specific dates. These representations, warranties, covenants and other agreements are qualified by information contained in confidential disclosure memoranda that the parties exchanged in connection with the execution of the merger agreement. The disclosure memoranda contain information that modifies, qualifies and creates exceptions to the representations, warranties, covenants and other agreements set forth in the merger agreement. Although some of the information contained in the disclosure memoranda may be non-public, PFSweb and eCOST do not believe that this information is required to be publicly-disclosed under the federal securities laws. Moreover, certain of these representations, warranties, covenants and/or other agreements may not be accurate or complete as of a specific date because they are subject to a contractual standard of materiality that may be different from the standard generally applied under the federal securities laws and/or were used for the purpose of allocating risk between PFSweb and eCOST rather than establishing matters as facts. Finally, information concerning the subject matter of these representations, warranties, covenants and other agreements may have changed since the date of the merger agreement, which may or may not be fully-reflected in PFSweb s and eCOST s public disclosures. Accordingly, you should not rely on these representations, warranties, covenants and other agreements as statements of fact.

General Structure

Each of the PFSweb board of directors and the eCOST board of directors has unanimously approved the merger agreement pursuant to which the businesses of PFSweb and eCOST will be combined in a stock-for-stock merger. Upon completion of the merger, Red Dog Acquisition Corp., a newly formed and wholly owned subsidiary of PFSweb, will merge with and into eCOST, with eCOST surviving the merger and continuing as a wholly owned subsidiary of PFSweb. Upon completion of the merger, eCOST stockholders will be entitled to receive one share of PFSweb common stock for each share of eCOST common stock owned immediately prior to the closing of the merger.

Upon completion of the merger, each outstanding option to purchase eCOST common stock will be cancelled and terminated and no outstanding eCOST options will be assumed by PFSweb. Instead, PFSweb intends to issue new options to eCOST officers and employees under PFSweb s employee stock option plan. See The Merger Interests of Directors and Officers of eCOST in the Merger.

Background of the Merger

Since 2001, Mark Layton, Chairman and Chief Executive Officer of PFSweb, has been a member of the board of directors of PC Mall, a direct marketer of computer hardware, software, peripheral, electronics and other consumer products and services. Prior to September 2004, eCOST was a wholly-owned subsidiary of PC Mall. In September 2004, eCOST completed an initial public offering of 3,465,000 shares of common stock leaving PC Mall with ownership of 14,000,000 shares or approximately 80.2% of the outstanding shares of eCOST. In April 2005, PC Mall distributed its 14,000,000 shares of eCOST to the stockholders of PC Mall.

As a director of PC Mall, Mr. Layton was familiar with the development and operations of eCOST and participated in the discussions of the strategy to spin off eCOST from PC Mall.

In October 2004, PFSweb and eCOST had preliminary discussions regarding the provision by PFSweb of fulfillment services for eCOST, but these discussions were not pursued.

In June 2005, Mr. Layton and eCOST s then chief financial officer had further discussions regarding the opportunity for PFSweb to provide fulfillment services to eCOST. As a result of these discussions, Mr. Layton and another PFSweb senior executive met at eCOST s office with Adam Shaffer, eCOST s Chief Executive Officer. At this meeting, the executives discussed eCOST s fulfillment and distribution needs, PFSweb s fulfillment and distribution capabilities and the opportunity for PFSweb to provide these services to eCOST.

In July and August 2005, there were several general conversations between executives of PFSweb and eCOST regarding the opportunity for PFSweb to provide fulfillment and distribution services for eCOST and the benefits and cost savings that eCOST could achieve thereby.

In August 2005, PFSweb held a strategic planning session for its senior executives. One of the ideas developed at this session was the possibility of expanding the PFSweb products division which was concentrated on the sale and distribution of IBM products. PFSweb management believed that expanding the breadth of the products offered by the products division could provide further growth opportunities.

On August 3, 2005, eCOST engaged Thomas Weisel Partners to act as its financial advisor in exploring financing or strategic alternatives, including a potential private investment in public equity (PIPE) or sale or merger of eCOST.

On August 26, 2005, Thomas Weisel Partners began contacting parties with a potential interest in pursuing an acquisition or merger transaction with eCOST. Thomas Weisel Partners contacted 21 parties. 14 parties (in addition to PFSweb) signed confidentiality agreements and received preliminary information. No management meetings were held with any of these partes. As of November 29, 2005, PFSweb was the only party that indicated any interest in pursuing an acquisition or merger transaction with eCOST.

In September 2005, Mr. Layton contacted Mr. Shaffer to raise the possibility of a merger or other strategic alliance. On September 20, 2005, the parties exchanged a non-disclosure and confidentiality agreement in order to exchange information.

During September, Thomas Weisel Partners began contacting potential investors for a financing transaction. None of the potential investors contacted indicated an interest in pursuing an acquisition of eCOST common stock. Two potential investors indicated an interest in pursuing an acquisition of eCOST convertible preferred stock. However, eCOST determined not to move forward with either of those potential financings due to, among other things, the dilutive nature of the proposed financial instruments.

On October 5, 2005, at a regularly scheduled eCOST board meeting, Mr. Shaffer updated the board on potential financing and strategic alternatives. In addition, Mr. Shaffer informed the board of preliminary discussions held with PFSweb regarding a potential merger transaction.

On October 14, 2005 the PFSweb board of directors held a special meeting to review the results of the August strategic planning session. At this meeting, the idea of a merger or other strategic alliance with eCOST was raised and discussed in general terms.

On October 21, 2005, Mr. Shaffer met at PFSweb s offices with Mr. Layton and other PFSweb executives to review financial and operational information of both companies. They also discussed the core strengths of each company and the possible synergies that could be achieved in a combined company. On October 24, 2005, Mr. Layton and Mr. Tom Madden, PFSweb s Chief Financial Officer, met at eCOST s offices with Mr. Shaffer and eCOST President Gary Guy to further discuss the merger synergies. Each company shared further information about its customers, suppliers, strengths, weaknesses and detailed cost information. Preliminary terms of a merger were discussed as well as the timeline and steps required to complete a possible merger. During the following week, executives of both companies met to conduct further due diligence and investigate possible cost savings and synergies available to a combined company.

Table of Contents

On October 24, 2005 the eCOST board of directors held a special meeting with Thomas Weisel Partners and Latham & Watkins LLP to discuss the status of the pursuit of financing and strategic alternatives with Thomas Weisel Partners, as well as the status of the discussions with PFSweb.

On November 1 and 2, 2005, Mr. Layton and Mr. Shaffer discussed the terms of the merger and the possibility of entering into a non-binding letter of intent. On November 2, 2005, counsel for PFSweb forwarded a draft letter of intent to counsel for eCOST.

On November 3, 2005, the board of directors of PFSweb held its regularly scheduled quarterly board meeting. Mr. Shaffer was invited to attend a portion of the meeting to describe eCOST and to present with Mr. Layton the opportunities for growth that could be available to a combined company as well as the potential product, distribution and financial synergies between the two companies. During and after the presentations, the PFSweb board of directors asked a number of questions and discussions ensued. After actively discussing the potential merger at length, PFSweb s board of directors authorized Mr. Layton to engage a financial advisor and to pursue negotiations concerning a merger.

On November 4, 2005, the eCOST board held a special meeting to discuss the potential merger transaction with PFSweb and the non-binding letter of intent.

On November 8 and 9, 2005, Mr. Layton and Mr. Shaffer continued discussions regarding the terms of a non-binding letter of intent. On November 10, 2005, both companies signed the letter of intent which was then publicly disclosed.

Between November 8 and November 28, 2005 both companies continued to conduct due diligence, and counsel for both companies drafted and negotiated the terms of the merger agreement.

On November 15, 2005, PFSweb retained Wells Fargo Securities as its financial advisor to render an opinion with respect to the fairness from a financial point of view of the exchange ratio to PFSweb in the potential merger with eCOST.

On November 15 and 16, 2005, management of PFSweb and representatives of Wells Fargo Securities met with senior management of eCOST in eCOST s offices to conduct due diligence on eCOST. On November 14, 2005, senior management of eCOST and representatives of Latham & Watkins LLP met with senior management of PFSweb to conduct due diligence on PFSweb. On November 17, 2005, representatives of Thomas Weisel Partners met telephonically with senior management of PFSweb to conduct due diligence on PFSweb.

On November 23, 2005, the PFSweb board of directors held a special telephonic meeting attended by PFSweb s senior management, PFSweb s legal counsel, Wolff & Samson PC, and representatives of Wells Fargo Securities. Prior to the meeting, the board of directors received a package of information which included drafts of the proposed definitive merger agreement and related documents. PFSweb s senior management and legal counsel reviewed with the board of directors information regarding PFSweb and eCOST and provided an update on its business, legal and financial due diligence investigations of eCOST. Senior management and legal counsel also made presentations on the outcome of final negotiations of the terms of the proposed definitive agreements. They noted that the terms of the proposed definitive agreements were substantially complete, except for the receipt of a satisfactory consent agreement from eCOST s lender. Representatives of Wells Fargo Securities reviewed with the board Wells Fargo Securities fairness analysis of the proposed exchange ratio in the potential merger. Representatives of Wells Fargo Securities also delivered to the PFSweb board of directors Wells Fargo Securities oral opinion, subsequently confirmed in writing, that, as of November 23, 2005, and based upon and subject to the various considerations described in the written opinion, the exchange ratio pursuant to the merger agreement was fair, from a financial point of view, to PFSweb. Following extensive discussions and consideration, the PFSweb board of directors, by unanimous vote, but subject to the receipt of a satisfactory consent agreement from eCOST s lender, Wachovia Capital Finance Corporation (Western), (1) determined that the merger agreement and the transactions contemplated by the merger agreement are advisable, (2) approved and adopted the merger agreement, (3) adopted resolutions recommending that PFSweb s stockholders approve the issuance of PFSweb common stock pursuant to the merger

Table of Contents

agreement, (4) determined that the amendment to the PFSweb charter to increase the number of authorized shares of PFSweb common stock is advisable and (5) adopted resolutions recommending that PFSweb s stockholders approve the charter amendment to increase the number of authorized shares of PFSweb common stock.

On November 25, 2005, the board of directors of eCOST held a special telephonic meeting attended by eCOST s senior management and outside legal advisors. Prior to the meeting, the board of directors received a package of information which included drafts of the proposed definitive merger agreement and related documents. eCOST s senior management and outside legal counsel reviewed with the board the information regarding PFSweb and eCOST, and provided an update on its business, legal and financial due diligence investigations of PFSweb. Due to on-going negotiations with Wachovia Capital Finance Corporation (Western) regarding the execution of a consent agreement necessary under the terms of the Loan and Security Agreement dated August 3, 2004 between eCOST and Wachovia, as amended, the board decided to adjourn the meeting until the senior management of eCOST and Wachovia could reach an agreement on the consent agreement.

On November 29, 2005, eCOST and Wachovia Capital Finance Corporation (Western) executed a consent agreement satisfactory to PFSweb.

On November 29, 2005, the board of directors of eCOST held a special telephonic meeting attended by eCOST s senior management and outside legal and financial advisors. Representatives of Latham & Watkins LLP then reported on the outcome of the final negotiations of the terms of the proposed definitive agreements, including the consent agreement with Wachovia, followed by a presentation by Thomas Weisel Partners of its detailed financial analysis of the proposed transaction. Representatives of Thomas Weisel Partners then rendered their oral opinion to the board of directors of eCOST, subsequently confirmed in writing, that as of November 29, 2005, and based upon the assumptions made, matters considered and limits of review set forth in their written opinion, the exchange ratio was fair to the holders of eCOST common stock from a financial point of view. At that time, the eCOST board of directors, by unanimous vote, (1) determined that the merger agreement and the transactions contemplated by the merger agreement are advisable, (2) approved and adopted the merger agreement, and (3) resolved to recommend that eCOST s stockholders approve and adopt the merger agreement and the transactions contemplated by the merger agreement, including the merger.

Following the approval of each company s board of directors, the merger agreement and related documents were executed by the parties on November 29, 2005 in accordance with their respective board s authorization. The transaction was announced in a joint press release on November 29, 2005.

PFSweb s Reasons for the Merger

In the course of making its decision to approve the merger, the PFSweb board of directors consulted with PFSweb management, as well as its legal counsel, Wolff & Samson PC, and its financial advisor, Wells Fargo Securities. Among the matters considered by the PFSweb board of directors in its deliberations were the following material factors:

- the strategic benefits of the merger, including:
  - the potential to expand the PFSweb products division in the growing web commerce market;
  - the belief that the combination of PFSweb s core strengths in distribution, order fulfillment, call center and technology, and eCOST s core strengths in marketing, customer acquisition, supplier relationships and diversified customer base should result in a stronger, more stable, combined company;
  - the expectation that, as a combined company, eCOST would be able to achieve substantial cost savings, with certain cost savings, such as freight costs, being able to be achieved in a short time period;

the belief that eCOST would have the opportunity to accelerate its growth potential if it were part of a combined company with a stronger financial platform and improved operational and technology infrastructure;

the expectation that the combined company would have the opportunity to realize cost savings from the reduction of operating expenses, such as the elimination of redundant public company expense; and

the expectation that the combined company would have the opportunity to obtain synergies as products and services are cross-marketed and distributed over broader customer bases as well as the potential international expansion of eCOST s business in Canada and Europe using PFSweb s existing operational and distribution capabilities; and

the financial terms of the merger in light of information concerning PFSweb s and eCOST s respective businesses, financial condition, results of operations, earnings, technology positions, managements, competitive positions and prospects on a stand-alone basis and forecasted combined basis, which indicated that combining PFSweb and eCOST would be beneficial to stockholders of the combined company because the combined company would be better positioned to be successful over the long term than either company would be on a stand-alone basis;

current financial market conditions, including the relative valuations of both companies; and

the exchange ratio negotiated with eCOST and the relative valuation of eCOST considering recent and historical market prices of PFSweb common stock, as well as how this compares to prices in recent comparable transactions;

an assessment of alternatives to the merger, including the difficulties in expanding PFSweb s products division internally;

the belief that the terms of the merger agreement, including the parties representations, warranties and covenants, as qualified by the confidential disclosure memoranda, and the conditions to their respective obligations, are reasonable for a transaction of this nature; and

the presentation by Wells Fargo Securities and its oral opinion rendered on November 23, 2005 to the PFSweb board of directors, subsequently confirmed by delivery of its written opinion dated as of November 23, 2005, to the effect that, as of such date, and based upon and subject to the various considerations described in its written opinion, the exchange ratio pursuant to the merger agreement was fair, from a financial point of view, to PFSweb.

The PFSweb board of directors also considered a variety of potentially negative factors in its deliberations concerning the merger, including the following:

the dilution that would result from the issuance of shares of PFSweb common stock as merger consideration;

the risk that the potential benefits sought in the merger, including the synergies and cost-saving opportunities, may not be fully realized;

the projected costs and expenses anticipated to be incurred in the integration of the businesses, operations and workforce of the two companies and the risk that such integration may not be successfully implemented in a timely and efficient manner, or at all;

the significant costs incurred in connection with the merger, including the transaction expenses arising from the merger;

the possibility of eCOST continuing to incur operating losses and eCOST s need to obtain sufficient working capital financing;

the risk that, because the exchange ratio under the merger agreement would not be adjusted for changes in the market price of PFSweb common stock or eCOST common stock, the per share

61

value of the consideration to be paid to eCOST stockholders on completion of the merger could be significantly more than the per share value of the consideration immediately prior to the announcement of the proposed merger;

the possibility that the merger might not be consummated, or that consummation might be unduly delayed;

the possibility that the market price of PFSweb common stock could decrease sharply if the merger was not viewed favorably by stockholders, financial analysts and the press, generally;

the risk of the potential loss of key personnel; and

the other risks described under the caption Risk Factors beginning on page 28.

After due consideration, the PFSweb board of directors concluded that, on balance, the overall potential benefits of the merger to PFSweb and its stockholders outweighed the negative factors associated with the merger.

The above discussion of the factors considered by the PFSweb board of directors is not intended to be exhaustive, but is believed to set forth the principal factors considered by the PFSweb board of directors. The PFSweb board of directors collectively reached the conclusion, by unanimous vote, to approve the merger agreement in light of the various factors described above and other factors that each member of the PFSweb board of directors felt were appropriate. In view of the wide variety of factors considered by the PFSweb board of directors in connection with its evaluation of the merger and the complexity of these matters, the PFSweb board of directors did not consider it practical, and did not attempt, to quantify, rank or otherwise assign relative weights to the specific factors it considered in reaching its decision. Rather, the PFSweb board of directors made its recommendation based on the totality of information presented to, and the investigation conducted by, it. In considering the factors discussed above, individual directors may have given different weights to different factors.

Recommendation of the PFSweb Board of Directors

After careful consideration, the PFSweb board of directors, by unanimous vote, has determined that the merger agreement and the transactions contemplated by the merger agreement are advisable. ACCORDINGLY, THE PFSWEB BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT PFSWEB STOCKHOLDERS VOTE FOR THE PROPOSAL TO ISSUE PFSWEB COMMON STOCK PURSUANT TO THE MERGER AGREEMENT AND FOR THE PROPOSAL TO AMEND THE PFSWEB CHARTER TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF PFSWEB COMMON STOCK.

eCOST s Reasons for the Merger

In the course of making its decision to approve the merger, the eCOST board of directors consulted with eCOST management, as well as its legal counsel, Latham & Watkins LLP, and its financial advisor, Thomas Weisel Partners. Among the matters considered by the eCOST board of directors in its deliberations were the following material factors:

its understanding of the current and prospective business environment in which eCOST and PFSweb operate, including international, national and local economic conditions, the competitive environment in the on-line retailing and web commerce industry generally, the technological trends in the on-line retailing and web commerce industry, and the likely effect of these factors on the combined company or, in the alternative, on eCOST on a stand-alone basis; the eCOST board of directors considered in particular that the competitive nature of the on-line retailing and web commerce industry made it more likely that eCOST s prospects for growth would be enhanced if its businesses were combined with PFSweb s to create a more efficient and operationally sound company;

its understanding of eCOST s business, operations, financial condition, earnings and prospects on a stand-alone basis, in light of relevant factors, including the fact that eCOST has incurred substantial operating losses and needed to gain scale to rationalize its operating economics;

its understanding of PFSweb s business, operations, financial condition, earnings and prospects on a stand-alone basis and a forecasted combined basis with eCOST;

its belief that PFSweb has technological and other expertise in logistics, fulfillment and distribution that would provide the opportunity to improve eCOST s operating margins and enhance customer service and overall business;

the anticipated strategic fit between PFSweb and eCOST, which the eCOST board of directors believed will provide the combined company with significantly greater capabilities than either company has, or could develop, on its own, including the complementary nature of the core strengths of each company; and

the significant cost savings and synergies that the eCOST board of directors believed could result from the transaction, including:

anticipated cost savings from the elimination of duplicate expenses of compliance with public company requirements and various general and administrative corporate functions, including warehousing and freight expenses, and the rationalization of the combined company s management information systems; and

potential sales and marketing synergies, as the combined company offers new and expanded product and service offerings to existing and new customers;

the financial terms of the transaction, including the relative historical trading prices of eCOST common stock and PFSweb common stock, the fixed exchange ratio of one share of PFSweb common stock for each share of eCOST common stock; in particular, the eCOST board of directors noted that the consideration in the form of PFSweb common stock offered eCOST stockholders the ability to become stockholders of PFSweb and participate in the benefit of the significant cost savings and synergies that the eCOST board of directors believed could result from the merger;

the financial analyses of Thomas Weisel Partners, eCOST s financial advisor, and the written opinion dated November 29, 2005 of Thomas Weisel Partners that, as of the date of its opinion and based upon the assumptions made, matters considered and limits of review set forth in its written opinion, the exchange ratio was fair to holders of eCOST common stock from a financial point of view (the opinion is discussed further below under The Merger Opinion of Thomas Weisel Partners LLC). In considering the foregoing opinion, the eCOST board of directors was aware that eCOST had agreed to pay Thomas Weisel Partners a fee upon the delivery of its opinion (the fee is discussed further below under The Merger Opinion of Thomas Weisel Partners LLC);

the evaluation of financing alternatives, which would have been very expensive to eCOST and dilutive to its shareholders;

the results of the contacts that Thomas Weisel Partners had made with other potential acquirers of eCOST;

the terms and conditions of the merger agreement, including the nature of the parties representations, warranties, covenants and agreements; in particular, the eCOST board believed, after reviewing the merger agreement with its legal advisors, that the merger agreement offered eCOST reasonable assurances as to the likelihood of consummation of the merger and did not impose unreasonable burdens on eCOST;

the expectation that the merger would qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code and that, as a result, the exchange of their eCOST

- common stock for PFSweb common stock in the merger generally would be tax-free to holders of eCOST common stock for U.S. federal income tax purposes;
- the fact that no regulatory consents were required for the consummation of the merger; and
- the expectation that the merger could be completed in the first quarter of 2006.

The eCOST board of directors also considered a variety of potentially negative factors in its deliberations concerning the merger, including the following:

- the difficulties and management challenges inherent in completing a merger and integrating the businesses, operations and workforce of eCOST with those of PFSweb;
- the risk that the potential benefits of the merger, including the expected cost savings and synergies, might not be fully achieved;
- the risk that the merger might not be consummated and the possible adverse implications to customers, vendors, investor relations and employee morale under such circumstances;
- the significant costs incurred in connection with the merger, including the transaction expenses arising from the merger;
- that certain members of eCOST s management have interests that were different from or in addition to the interests of eCOST stockholders generally, including the indemnification and directors and officers insurance to be provide to the eCOST board of directors; and
- the risk that, although eCOST has the right under limited conditions to consider and participate in discussions and negotiations with respect to alternative acquisition proposals, the provisions of the merger agreement relating to the potential payment of a termination fee of $1.2 million to PFSweb may have the effect of discouraging such proposals. See Risk Factors Risks Related to the Merger The merger agreement restricts eCOST s abilities to pursue alternatives to the merger and may discourage alternative transaction proposals.

The eCOST board of directors also considered that the fixed exchange ratio would not adjust upwards to compensate for declines, or downwards to compensate for increases, in the price of PFSweb common stock prior to the closing of the merger, and that the terms of the merger agreement did not include termination rights triggered expressly by a decrease in the value of the merger consideration implied by the market price of PFSweb common stock. The eCOST board of directors determined that this structure was appropriate and the risk acceptable in view of: the eCOST board of directors focus on the relative intrinsic values and financial performance of PFSweb and eCOST and the percentage of the combined company to be owned by former holders of eCOST common stock; the inclusion in the merger agreement of other structural protections such as the ability to terminate the merger agreement in the event of a material adverse effect on the business, financial condition or results of operations of PFSweb; and eCOST s ability, under the limited circumstances specified in the merger agreement, to consider and participate in discussions and negotiations with respect to alternative acquisition proposals.

After due consideration, the eCOST board of directors concluded that, on balance, the overall potential benefits of the merger to eCOST and its stockholders outweighed the negative factors associated with the merger.

The above discussion of the factors considered by the eCOST board of directors is not intended to be exhaustive, but is believed to set forth the principal factors considered by the eCOST board of directors. The eCOST board of directors collectively reached the conclusion, by unanimous vote, to approve the merger agreement in light of the various factors described above and other factors that each member of the eCOST board of directors felt were appropriate. In view of the wide variety of factors considered by the eCOST board of directors in connection with its evaluation of the merger and the complexity of these matters, the eCOST board of directors did not consider it practical, and did not attempt, to quantify, rank or otherwise assign relative weights to the specific factors it

considered in reaching its decision. Rather, the eCOST board of directors made its recommendation based on the totality of information presented to, and

the investigation conducted by, it. In considering the factors discussed above, individual directors may have given different weights to different factors.

Recommendation of the eCOST Board of Directors

After careful consideration, the eCOST board of directors, by unanimous vote, has determined that the merger agreement and the transactions contemplated by the merger agreement are advisable. ACCORDINGLY, THE eCOST.COM BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT eCOST STOCKHOLDERS VOTE FOR THE PROPOSAL TO APPROVE AND ADOPT THE MERGER AGREEMENT AND THE TRANSACTIONS CONTEMPLATED BY THE MERGER AGREEMENT, INCLUDING THE MERGER.

Opinion of Wells Fargo Securities, LLC

Wells Fargo Securities was engaged by PFSweb to render a fairness opinion in connection with the merger. As part of its investment banking activities, Wells Fargo Securities is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, offerings of listed and unlisted securities and other corporate transactions. Wells Fargo Securities was selected by PFSweb s board of directors to deliver a fairness opinion based on Wells Fargo Securities qualifications, expertise, reputation and knowledge with respect to the valuation of businesses similar to PFSweb.

At a meeting of the PFSweb board of directors on November 23, 2005, Wells Fargo Securities rendered its oral opinion, subsequently confirmed in writing, to the PFSweb board of directors that, as of such date, and based upon and subject to the various considerations described in its written opinion, the exchange ratio pursuant to the merger agreement is fair, from a financial point of view, to PFSweb. Wells Fargo Securities confirmed its opinion in writing by delivery to the PFSweb board of directors of a written opinion dated November 23, 2005. No limitations were imposed by PFSweb s board of directors upon Wells Fargo Securities with respect to the investigations made or procedures followed in rendering its opinion.

The full text of the written opinion of Wells Fargo Securities, dated November 23, 2005, which sets forth, among other things, the assumptions made, procedures followed, matters considered and limitations on the scope of the review undertaken by Wells Fargo Securities is attached as *Annex C* to this joint proxy statement/ prospectus and is incorporated herein by reference. You are urged to read the opinion in its entirety.

Wells Fargo Securities written opinion is directed to and provided for the information of PFSweb s board of directors in connection with and for the purposes of its evaluation of the merger, and addresses only the fairness from a financial point of view of the exchange ratio pursuant to the merger agreement to PFSweb as of the date of such opinion and does not address any other aspect of the merger. Wells Fargo Securities opinion is not intended to be and does not constitute a recommendation to any stockholder of PFSweb or eCOST as to how such stockholder should vote, or take any other action, with respect to the merger and the stockholders of PFSweb and eCOST are not permitted to rely upon it as such. The summary of Wells Fargo Securities opinion set forth in this joint proxy statement/ prospectus is qualified in its entirety by reference to the full text of such opinion attached as ***Annex C*** to this joint proxy statement/ prospectus, which should be read carefully and in its entirety.

In arriving at its opinion, Wells Fargo Securities, among other things:

- reviewed certain publicly available financial statements, including audited and interim financial statements, and other business and financial information relating to eCOST and PFSweb that Wells Fargo Securities deemed relevant;

- reviewed certain internal financial statements and other financial and operating data, including certain financial forecasts and other forward looking information, concerning eCOST as prepared by and reviewed with the respective managements of eCOST and PFSweb;

reviewed certain internal financial statements and other financial and operating data, including certain financial forecasts and other forward looking information, concerning PFSweb as prepared by and reviewed with the management of PFSweb;

conducted discussions with the respective managements of eCOST and PFSweb concerning the businesses, past and current operations, financial condition and future prospects of both eCOST and PFSweb, independently and combined, including discussions with the respective managements of eCOST and PFSweb concerning cost savings and other synergies and benefits that are expected to result from the merger as well as their views regarding the strategic rationale for the merger;

reviewed a draft merger agreement dated November 11, 2005;

reviewed the publicly available historical stock price and trading activity of eCOST s common stock and PFSweb s common stock;

compared the financial performance of eCOST and the historical stock prices and trading activity of eCOST s common stock with that of certain other publicly traded companies comparable with eCOST;

compared the financial performance of PFSweb and the historical stock prices and trading activity of PFSweb s common stock with that of certain other publicly traded companies comparable with PFSweb;

compared the financial terms of the merger with the financial terms, to the extent publicly available, of other transactions that Wells Fargo Securities deemed relevant;

reviewed the pro forma impact of the merger on PFSweb s earnings per share;

prepared an analysis of the relative contributions of eCOST and PFSweb to selected financial measures of the combined company based on financial forecasts and estimates prepared by the management of PFSweb;

prepared a discounted cash flow analysis of eCOST and PFSweb; and

made such other financial studies and inquiries, and reviewed such other data, as Wells Fargo Securities deemed necessary, including its assessment of general economic, market and monetary conditions.

In Wells Fargo Securities review and analysis, and in arriving at its opinion, Wells Fargo Securities assumed and relied upon the accuracy and completeness of all of the financial and other information provided to it (including information furnished to Wells Fargo Securities orally or otherwise discussed with Wells Fargo Securities by the respective managements of eCOST and PFSweb) or publicly available and neither attempted to verify independently, nor assumed responsibility or liability for verifying, any of such information. Wells Fargo Securities relied upon the assurances of the respective managements of eCOST and PFSweb that they are not aware of any facts that would make such information inaccurate or misleading. Furthermore, Wells Fargo Securities did not obtain, conduct and was not provided with, or assume any responsibility for obtaining or conducting, any independent valuation or appraisal of the properties, assets or liabilities (contingent or otherwise) of eCOST or PFSweb, nor did Wells Fargo Securities evaluate the solvency of eCOST or PFSweb under any state or federal laws relating to bankruptcy, insolvency or similar matters. In relying on the financial forecasts, analyses and projections (and the assumptions and bases therefor) for eCOST and PFSweb (including the synergistic savings and benefits projected to be realized with respect to operations of the combined companies following the merger and the timing thereof) that were provided to Wells Fargo Securities, Wells Fargo Securities assumed, with PFSweb s consent, that such forecasts and projections had been reasonably prepared in good faith on the basis of reasonable assumptions and reflected the best currently available estimates and judgments of their respective managements as to the future financial condition and performance of

eCOST and of PFSweb, respectively, and Wells Fargo Securities further assumed, with PFSweb s consent, that such projections and forecasts will be realized in the amounts and in the time periods currently estimated.

Table of Contents

Wells Fargo Securities assumed no responsibility for, and expressed no view as to such, forecasts, analyses and projections or the assumptions on which they were based. eCOST and PFSweb do not publicly disclose internal management projections of the type provided to Wells Fargo Securities in connection with its analysis of the merger, and such projections were not prepared with a view toward public disclosure. These projections were based on numerous variables and assumptions that are inherently uncertain and may be beyond the control of the respective managements of eCOST and PFSweb, including, without limitation, factors relating to general economic and competitive conditions and prevailing interest rates. Accordingly, actual results could vary significantly from those set forth in such projections.

Wells Fargo Securities also assumed that the merger would be consummated upon the terms set forth in the draft merger agreement that it reviewed without material alteration or waiver thereof, and that the merger would qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code, and would not cause Section 355(e) of the Internal Revenue Code to apply to the spin-off distribution of shares of eCOST s common stock by PC Mall. Wells Fargo Securities assumed in the course of PFSweb and eCOST obtaining the necessary regulatory or other consents and approvals (contractual or otherwise) for the merger, no restrictions, including any amendments or modifications, would be imposed that would have a material adverse effect on the contemplated benefits of the merger to PFSweb. In addition, Wells Fargo Securities assumed that the historical financial statements of each of eCOST and PFSweb reviewed by it had been prepared and fairly presented in accordance with U.S. generally accepted accounting principles consistently applied. Wells Fargo Securities further assumed that as of November 23, 2005 there had been no material adverse change in eCOST s or PFSweb s assets, financial condition, results of operations, business or prospects since the date of the last audited financial statements made available to Wells Fargo Securities, which statements were dated December 31, 2004.

Wells Fargo Securities opinion is necessarily based upon market, economic and other conditions as they exist and can be evaluated on, and on the information made available to it as of, November 23, 2005. It should be understood that subsequent developments may affect the conclusion expressed in Wells Fargo Securities opinion and that Wells Fargo Securities disclaims any undertaking or obligation to update, revise or reaffirm its opinion or otherwise comment upon events occurring after November 23, 2005. Wells Fargo Securities opinion is limited to the fairness, from a financial point of view and as of the date of its opinion, to PFSweb of the exchange ratio. Wells Fargo Securities did not express any opinion as to (i) the value of any employee agreement or other arrangement entered into in connection with the merger, (ii) any tax or other consequences that might result from the merger or (iii) what the value of PFSweb common stock will be when issued to eCOST s stockholders pursuant to the merger or the price at which shares of PFSweb common stock may be traded in the future. Wells Fargo Securities was not retained to advise PFSweb with respect to, nor does its opinion address, the relative merits of the merger compared with any other business strategy that PFSweb s board of directors has considered or may be considering, nor does it address the underlying business decision of PFSweb to engage in the merger. Furthermore, Wells Fargo Securities opinion does not address any legal or accounting matter, as to which it understands that PFSweb obtained such advice as it deemed necessary from qualified professionals.

In accordance with customary investment banking practice, Wells Fargo Securities employed generally accepted valuation methods in reaching its opinion. The following is a summary of the material analyses performed by Wells Fargo Securities in connection with providing its oral opinion and the preparation of Wells Fargo Securities written opinion. Certain of the summaries of financial analyses presented herein include information presented in tabular format. In order to fully understand the financial analyses used by Wells Fargo Securities, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. These analyses are not part of Wells Fargo Securities opinion.

Comparable Public Company Analysis

As part of its analysis, Wells Fargo Securities reviewed certain financial information and calculated commonly used valuation measurements for each of eCOST and PFSweb, as applicable, to corresponding information and measurements for groups of selected comparable publicly traded companies.

The selected companies forming the group to which eCOST was compared were:

- Blue Nile, Inc.
- Drugstore.com, Inc.
- Overstock.com, Inc.
- Provide Commerce, Inc.
- RedEnvelope, Inc.

This group is referred to in this joint proxy statement/ prospectus as the eCOST selected comparables. While noting that none of the comparable public companies listed above are identical to eCOST, Wells Fargo Securities selected these companies because they are publicly traded companies with market capitalizations and internet retail operations that for purposes of this analysis may be considered similar to those of eCOST.

The selected companies forming the group to which PFSweb was compared were:

- Brightpoint, Inc.
- Digital River, Inc.
- GSI Commerce, Inc.
- Innotrac Corporation
- StarTek, Inc.
- Zomax Inc.

This group is referred to in this joint proxy statement/ prospectus as the PFSweb selected comparables. While noting that none of the comparable public companies listed above are identical to PFSweb, Wells Fargo Securities selected these companies because they are publicly traded companies with market capitalizations and business process outsourcing operations that for purposes of this analysis may be considered similar to those of PFSweb.

The financial information and valuation measurements reviewed by Wells Fargo Securities included, among other things:

- the closing share price as of November 22, 2005;
- total enterprise value, or TEV; and
- ratio of total enterprise value to calendar year 2006 estimated earnings before interest, taxes, depreciation and amortization, referred to in this proxy statement as EBITDA.

The following table presents, as of November 22, 2005, the total enterprise value of eCOST comparable companies as a multiple of 2006 estimated EBITDA:

Selected Comparable Companies	**TEV/2006E EBITDA Multiple**
Blue Nile, Inc.	25.99x
Drugstore.com, Inc.	31.78x
Overstock.com, Inc.	62.08x

Provide Commerce, Inc.	13.38x
RedEnvelope, Inc.	NMF

The following table presents, as of November 22, 2005, the total enterprise value of PFSweb comparable companies as a multiple of 2006 estimated EBITDA:

Selected Comparable Companies	TEV/2006E EBITDA Multiple
Brightpoint, Inc.	11.75x
Digital River, Inc.	8.31x
GSI Commerce, Inc.	17.42x
Innotrac Corporation	NA
StarTek, Inc.	7.59x
Zomax, Inc.	NA

To calculate the applicable multiples for the eCOST selected comparables and the PFSweb selected comparables, Wells Fargo Securities used publicly available information concerning historical and estimated financial performance. To calculate the applicable multiples for eCOST and PFSweb, Wells Fargo Securities used projections prepared by PFSweb management.

Based on its selected comparable companies analysis and its assessment of the resulting data, Wells Fargo Securities determined that, in its judgment, the relevant range of multiples for total enterprise value to 2006 estimated EBITDA to apply to eCOST was 13.0x to 32.0x, which resulted in an implied enterprise value for eCOST of $17.6 to $43.3 million. In addition, based on this selected comparable companies analysis, Wells Fargo Securities determined that eCOST common stock had an implied per share value of $1.30 to $2.71, which yielded an implied exchange ratio for the transaction ranging from 0.8817x to 1.8311x.

No company utilized in the comparable company analysis is identical to eCOST or PFSweb. In identifying the relevant peer groups, Wells Fargo Securities made judgments and assumptions with regard to the nature of the companies business and industry segment, general business, economic, market and financial conditions and other matters, many of which are beyond the control of eCOST or PFSweb. These other matters include the impact of competition on the business of eCOST or PFSweb and the industry generally, industry growth and the absence of any adverse material change in the financial condition and prospects of eCOST or PFSweb or in the industry or financial markets in general. Accordingly, Wells Fargo Securities believes the analysis is not simply mathematical. Rather, it involves complex considerations and qualitative judgments, reflected in Wells Fargo Securities opinion, concerning differences in financial and operating characteristics of the selected companies and other factors that could affect the public trading value of the selected companies. Mathematical analysis, such as determining the average or median, is not in itself a meaningful method of using peer group data.

Precedent Transactions Analysis

Wells Fargo Securities reviewed and compared the proposed financial terms of the merger to corresponding publicly available financial terms of selected precedent transactions in the e-commerce industry. These transactions were chosen because they involve public and private companies that have

Table of Contents

operations that are similar to those of eCOST and PFSweb. The related transactions that Wells Fargo Securities reviewed consisted of the following:

Announcement Date	Target	Acquirer
06/01/2005	Shopping.com	eBay
05/04/2005	LowerMyBills.com Inc.	Experian Ltd.
04/06/2005	Ciao AG	Greenfield Online, Inc.
03/21/2005	Ask Jeeves, Inc.	IAC/InterActive Corporation
02/17/2005	About, Inc.	The New York Times Company
11/15/2004	MarketWatch, Inc.	Dow Jones & Company, Inc.
08/03/2004	Pricerunner AB	ValueClick, Inc.
07/31/2004	Lycos, Inc.	Daum Communications Corporation
06/24/2004	Advertising.com, Inc.	America Online, Inc.
03/26/2004	Kelkoo S.A.	Yahoo! Inc.
03/26/2004	Switchboard Incorporated	Infospace, Inc.
03/03/2004	Interactive Search Holdings, Inc.	Ask Jeeves, Inc.
02/23/2004	Comet Securities, Inc.	FindWhat.com, Inc.
07/14/2003	Overture Services, Inc.	Yahoo! Inc.
06/18/2003	Espotting Media Inc.	FindWhat.com, Inc.
02/25/2003	Fast Search and Transfer ASA	Overture Services, Inc.
02/18/2003	AltaVista Company	Overture Services, Inc.
12/22/2002	Inktomi Corporation	Yahoo! Inc.
07/08/2002	PayPal, Inc.	eBay Inc.

The information analyzed by Wells Fargo Securities for the precedent transactions included the total enterprise value implied by the offer price to eCOST s next twelve months EBITDA based on publicly available historical and projected financial information. The following table reflects the total enterprise

Table of Contents

value implied by the offer price as a multiple of eCOST s next twelve months estimated EBITDA for each of the selected transactions:

Precedent Transactions	TEV as a Multiple of Next Twelve Months Estimated EBITDA
Shopping.com/eBay	17.48x
LowerMyBills.com Inc./Experian Ltd.	8.35x
Ciao AG/Greenfield Online, Inc.	16.11x
Ask Jeeves, Inc./IAC/ InterActive Corporation	17.74x
About, Inc./The New York Times Company	23.00x
MarketWatch, Inc./Dow Jones & Company, Inc.	34.58x
Pricerunner AB/ValueClick, Inc.	8.14x
Lycos, Inc./Daum Communications Corporation	NA
Advertising.com, Inc./America Online, Inc.	NA
Kelkoo S.A./Yahoo! Inc.	19.22x
Switchboard Incorporated/Infospace, Inc.	23.25x
Interactive Search Holdings, Inc./Ask Jeeves, Inc.	16.11x
Comet Securities, Inc./FindWhat.com, Inc.	NA
Overture Services, Inc./Yahoo! Inc.	9.00x
Espotting Media Inc./FindWhat.com, Inc	NA
Fast Search and Transfer ASA/Overture Services, Inc	NA
AltaVista Company/Overture Services, Inc	NA
Inktomi Corporation/Yahoo! Inc.	NA
PayPal, Inc./eBay Inc.	30.23x

Based on this analysis and its assessment of the resulting data, Wells Fargo Securities determined that, in its judgment, the relevant range of multiples for total enterprise value in a change-in-control context to 2006 estimated EBITDA to apply to eCOST was 10.0x to 30.0x, which resulted in an implied enterprise value for eCOST of $13.5 to $40.6 million and an implied value per share of $1.08 to $2.56, which, in turn, yielded an implied exchange ratio for the transaction ranging from 0.7318x to 1.7311x.

No transaction utilized as a comparison in the precedent transactions analysis is identical to the merger. In evaluating the precedent transactions, Wells Fargo Securities made judgments and assumptions regarding industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond the control of eCOST, such as the impact of competition on eCOST and the industry generally, industry growth and the absence of any material adverse change in the financial condition and prospects of eCOST or the industry or in the financial markets in general. Mathematical analysis such as determining the average or median is not in itself a meaningful method of using comparable transaction data.

Discounted Cash Flow Analysis

Wells Fargo Securities performed discounted cash flow analyses for eCOST as a stand-alone entity and for PFSweb as a stand-alone entity. Wells Fargo Securities calculated the discounted cash flow values for each of eCOST and PFSweb as the sum of (a) the present value of the estimated future free cash flows that eCOST or PFSweb, as the case may be, would generate for the fiscal years 2005 through 2010, plus (b) the present value of the perpetuity value of eCOST or PFSweb, as applicable. The estimated future cash flows for eCOST and PFSweb were based solely on PFSweb s management projections, and do not reflect any synergies or the final impact of the ownership of eCOST by

PFSweb.

The range of estimated perpetuity values was calculated by applying growth rate percentages ranging from 6.0% to 8.0% for eCOST and 5.0% to 7.0% for PFSweb to estimated 2010 after tax free cash flow

provided by the management of PFSweb. The growth rate ranges were selected based on an assessment of likely growth rates in the economy overall and Wells Fargo Securities views on the likely growth rate for companies comparable to eCOST and PFSweb in a maturing industry. The present value of the cash flows and perpetuity values were calculated using discount rates ranging from 16.0% to 24.0% for eCOST and 11.0% to 15.0% for PFSweb. The discount rate ranges were selected after analyzing a weighted average cost of capital, analysis of the eCOST and PFSweb selected comparables.

Based on the discounted cash flow analysis and its assessment of the resulting data, Wells Fargo Securities determined that, in its judgment, the implied enterprise value, using a market value approach, for eCOST was $13.5 to $31.1 million, using the midpoint of the growth rate in perpetuity for the high and low discount rates of 16.0% to 24.0%. In addition, based on this analysis, Wells Fargo Securities determined that eCOST common stock had an implied value per share of $0.79 to $1.75, which yielded an implied exchange ratio for the transaction ranging from 0.5361x to 1.1842x. Wells Fargo Securities also analyzed the transaction using an intrinsic value approach to discounted cash flow. Based on this analysis, Wells Fargo Securities determined that, in its judgment, the implied enterprise value for eCOST was $25.0 to $33.4 million, using the midpoint of the growth rates for the high and low discount rates of 16.0% to 24.0%. In addition, based on this analysis, Wells Fargo Securities determined that eCOST common stock had an implied value per share of $1.42 to $1.88, which yielded an implied exchange ratio for the transaction ranging from 0.9617x to 1.2699x, using the midpoint of the high and low discount cash flow valuation ranges for eCOST and PFSweb.

Exchange Ratio Analysis

Wells Fargo Securities reviewed the ratios of the closing prices of eCOST common stock to the corresponding closing prices of PFSweb common stock over various periods ending November 22, 2005. These ratios are referred to as average exchange ratios. Wells Fargo Securities examined these average exchange ratios and found them to be as follows:

Period Ending November 22, 2005	Moving Averages eCOST	Moving Averages PFSweb	Average Exchange Ratio (x)
November 22, 2005	$ 1.43	$ 1.48	0.9662
30-day average	$ 1.56	$ 1.53	1.0230
60-day average	$ 1.82	$ 1.61	1.1269
90-day average	$ 2.23	$ 1.80	1.2093
12-month average	$ 3.52	$ 2.29	2.4933
12-month high	$ 21.60	$ 3.42	8.4047
12-month low	$ 1.23	$ 1.38	0.8239

Based on the exchange ratio analysis and its assessment of the resulting data, Wells Fargo Securities determined that the implied exchange ratio for the transaction ranged from 0.9662x to 1.2093x. In determining the relevant range, Wells Fargo Securities focused its analysis on a comparison of more recent trading prices, in light of a variety of factors it considered relevant, including significant declines in eCOST s trading price in the first six months of the year that made comparisons of the two companies prices for such period less meaningful.

Contribution Analysis

Based on various operating and financial measurement factors of the equity contribution of eCOST to the combined company, Wells Fargo Securities performed a contribution analysis to determine the implied enterprise value of eCOST, the implied per share value of eCOST common stock and an implied exchange ratio for the transaction. In performing this analysis, Wells Fargo Securities compared pro forma contribution of each of PFSweb and eCOST based on certain operating and financial information provided by the management of PFSweb. The

measurement factors that Wells Fargo Securities considered for the

period 2006 through 2010 included the estimated gross margin, EBITDA and net income. The contribution analysis was based on projections provided to Wells Fargo Securities by the management of PFSweb and did not reflect any synergies or the final impact of the ownership of eCOST by PFSweb.

Based on the contribution analysis and its assessment of the resulting data, Wells Fargo Securities determined that, in its judgment, the relevant range of the implied exchange ratio for the transaction ranged from 1.0000x to 1.5000x. Wells Fargo Securities made this determination after considering a variety of factors that it considered relevant to assess the relative importance of the various data points.

Pro Forma Analysis of the Merger

Wells Fargo Securities analyzed the pro forma impact of the merger on earnings per share for PFSweb for the estimated fiscal years 2006 and 2010. The pro forma results were calculated as if the merger had closed on December 31, 2005 and were based on estimated earnings derived from projections provided by the management of PFSweb.

Based on this analysis, Wells Fargo Securities noted, relying upon pretax synergies identified, estimated and provided by the management of PFSweb, that the merger would be accretive to earnings per share for fiscal year 2006.

The preparation of a financial opinion is a complex process and is not necessarily susceptible to a partial analysis or summary description. In arriving at its opinion, Wells Fargo Securities considered the results of all of its analyses as a whole and did not attribute any particular weight to any particular analysis or factor considered by it. Furthermore, Wells Fargo Securities believes that selecting any portion of Wells Fargo Securities analyses, without considering all its analyses, would create an incomplete view of the process underlying Wells Fargo Securities analysis and opinion. In addition, Wells Fargo Securities may have deemed various assumptions more or less probable than other assumptions, so that the ranges of valuations resulting from any particular analysis described above should not be taken to be Wells Fargo Securities view of the actual value of eCOST or PFSweb.

Wells Fargo Securities was engaged by PFSweb to render a fairness opinion in connection with the exchange ratio of the merger and it received a retainer fee and received a fee upon the delivery of its opinion. In addition, PFSweb agreed to reimburse the expenses of Wells Fargo Securities and to indemnify Wells Fargo Securities for certain liabilities that may arise out of its engagement by PFSweb. No portion of the fee or reimbursement of expenses to Wells Fargo Securities is contingent on the consummation of the merger, nor is any of Wells Fargo Securities fee or expense reimbursement contingent on the conclusions reached in the Wells Fargo Securities opinion. In the ordinary course of business, Wells Fargo Securities and its affiliates may actively trade in the equity securities of PFSweb or eCOST for its own account or the accounts of its customers and, accordingly, may at any time hold a long or short position in such securities.

Opinion of Thomas Weisel Partners LLC

The board of directors of eCOST engaged Thomas Weisel Partners to act as its financial advisor and to render a fairness opinion in connection with the proposed merger of Red Dog Acquisition Corp. with and into eCOST. eCOST selected Thomas Weisel Partners to act as its financial advisor in connection with the merger based on Thomas Weisel Partners experience, expertise and reputation.

On November 29, 2005, Thomas Weisel Partners delivered to the board of directors of eCOST its written opinion that, as of that date, and based upon the assumptions made, matters considered and limits of review set forth in Thomas Weisel Partners written opinion, the exchange ratio pursuant to the merger was fair to the holders of eCOST common stock from a financial point of view.

The full text of Thomas Weisel Partners written opinion, which sets forth, among other things, the assumptions made, procedures followed, matters considered and limitations on the scope of the review undertaken by Thomas Weisel Partners in delivering its opinion, is attached as Annex D to this proxy statement/ prospectus. Stockholders should read the opinion carefully and in its entirety. The following

Table of Contents

description of Thomas Weisel Partners opinion is only a summary of the written opinion and is qualified in its entirety by the written opinion and is not a substitute for the written opinion.

Thomas Weisel Partners directed its opinion to the board of directors of eCOST in its consideration of the merger. The opinion does not constitute a recommendation to the stockholders of eCOST as to how they should vote with respect to the merger. The opinion addresses only the financial fairness of the exchange ratio to the stockholders of eCOST as of the date of the opinion. It does not address the relative merits of the merger or any alternatives to the merger. Further, it does not address eCOST s underlying decision to proceed with or effect the merger, or any other aspect of the merger.

In connection with its opinion, Thomas Weisel Partners, among other things:

reviewed certain publicly available financial and other data, including financial forecasts, with respect to eCOST and PFSweb, including the consolidated financial statements for recent years and interim periods to September 30, 2005, and certain other relevant financial and operating data relating to eCOST and PFSweb made available to Thomas Weisel Partners from published sources and from the internal records of eCOST and PFSweb;

reviewed the financial terms and conditions of the merger agreement draft dated as of November 23, 2005;

reviewed certain publicly available information concerning the trading of, and the trading market for, eCOST s common stock and PFSweb s common stock;

compared eCOST and PFSweb from a financial point of view with certain other publicly traded companies which Thomas Weisel Partners deemed to be relevant;

considered the financial terms, to the extent publicly available, of selected recent business combinations of companies which Thomas Weisel Partners deemed to be comparable, in whole or in part, to the merger;

reviewed and discussed with representatives of the management of eCOST and PFSweb certain information of a business and financial nature regarding eCOST and PFSweb, furnished to Thomas Weisel Partners by eCOST and PFSweb, including financial forecasts and related assumptions of eCOST and PFSweb;

made inquiries regarding and discussed the merger and the merger agreement and other matters related thereto with eCOST s counsel; and

performed such other analyses and examinations as Thomas Weisel Partners deemed appropriate.

In preparing its opinion, Thomas Weisel Partners did not assume any responsibility independently to verify the foregoing information and have relied on its being accurate and complete in all material aspects. Thomas Weisel Partners also made the following assumptions:

with respect to the financial forecasts for eCOST and PFSweb provided to Thomas Weisel Partners by their respective management, Thomas Weisel Partners assumed, upon the advice of and with the consent of eCOST, for purposes of its opinion that such forecasts (including the assumptions regarding cost synergies) have been reasonably prepared on bases reflecting the best available estimates and judgments of their respective management at the time of preparation as to the future financial performance of eCOST and PFSweb and that they provide a reasonable basis on which Thomas Weisel Partners can form its opinion;

that there have been no material changes in the assets, financial condition, results of operations, business or prospects of eCOST or PFSweb since the respective dates of their last financial statements made available to Thomas Weisel Partners;

that the merger will be consummated in a manner that complies in all respects with the applicable provisions of the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and all other applicable federal and state statutes, rules and regulations;

that the merger will be recorded as a purchase under generally accepted accounting principles;

that the merger will be treated as a tax-free reorganization for federal income tax purposes and will not cause Section 355(e) of the Internal Revenue Code to apply to the spin-off distribution of shares of eCost common stock by PC Mall, Inc.; and

that the merger will be consummated in accordance with the terms described in the merger agreement, that the final merger agreement will not differ in any respect material to Thomas Weisel Partners opinion from the November 23, 2005 draft review by Thomas Weisel Partners, and without waiver by eCOST of any of the conditions to its obligations thereunder.

In addition,

Thomas Weisel Partners relied on advice of counsel and independent accountants to eCOST as to all legal and financial reporting matters with respect to eCOST, the merger, and the merger agreement;

Thomas Weisel Partners did not assume responsibility for making an independent evaluation, appraisal or physical inspection of any of the assets or liabilities (contingent or otherwise) of eCOST or PFSweb, nor was Thomas Weisel Partners furnished with any such appraisals; and

Thomas Weisel Partners opinion was based on economic, monetary and market and other conditions as in effect on, and the information made available to Thomas Weisel Partners as of, the date of its opinion. Accordingly, although subsequent developments may affect its opinion, Thomas Weisel Partners has not assumed any obligation to update, revise or reaffirm its opinion.

The following represents a brief summary of the material financial analyses performed by Thomas Weisel Partners in connection with providing its opinion to the board of directors of eCOST. Some of the summaries of financial analyses performed by Thomas Weisel Partners include information presented in tabular format. In order to fully understand the financial analyses performed by Thomas Weisel Partners, you should read the tables together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Considering the data set forth in the tables without considering the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of the financial analyses performed by Thomas Weisel Partners.

Selected publicly traded company analysis

Thomas Weisel Partners calculated the implied per share value of eCOST and implied exchange ratio based on multiples of enterprise value, which Thomas Weisel Partners defined as market capitalization plus net debt plus convertible preferred stock, to (1) the last twelve months revenues and gross profit, (2) calendar year 2005 and 2006 estimated revenues, and (3) calendar year 2005 and 2006 estimated gross profit, for four consumer electronics resellers with a primary online distribution channel. Projected 2005 and 2006 information for eCOST was based on projections of eCOST management. Projections for the selected companies was based on public filings, published Wall Street research analysts reports and forecasts and other publicly available third party sources. Thomas Weisel Partners believes that the four companies listed below have operations similar to some of eCOST s operations, but noted that none of these companies has the same management, composition, size or combination of businesses as eCOST:

Insight Enterprises;

PC Connection Inc.;

PC Mall Inc.; and

Zones Inc.

Table of Contents

The following table sets forth the range of multiples, implied per share value of eCOST and implied exchange ratios (based on the $1.39 per share market price of PFSweb on November 28, 2005) indicated by this analysis:

	Enterprise Value/ LTM Revenue	Enterprise Value/ LTM Gross Profits
Third Quartile	0.2x	1.6x
Mean	0.2x	1.4x
Median	0.1x	1.1x
First Quartile	0.1x	1.0x
Implied eCOST Enterprise Value (millions)	$22.0-$33.1	$14.8-$21.7
Implied eCOST Equity Value (millions)	$28.3-$38.4	$21.1-$27.9
Implied eCOST Per Share Value	$1.57-$2.13	$1.17-$1.55
Implied eCOST Exchange Ratio	1.1308x-1.5328x	0.8439x-1.1163x

	Enterprise Value/ Revenue 2005E	Enterprise Value/ Gross Profits 2005E
Third Quartile	0.2x	1.8x
Mean	0.2x	1.5x
Median	0.1x	1.0x
First Quartile	0.1x	0.9x
Implied eCOST Enterprise Value (millions)	$19.7-$32.2	$12.5-$20.0
Implied eCOST Equity Value (millions)	$26.0-$38.5	$18.8-$26.3
Implied eCOST Per Share Value	$1.44-$2.13	$1.04-$1.46
Implied eCOST Exchange Ratio	1.0374x-1.5347x	0.7513x-1.0488x

	Enterprise Value/ Revenue 2006E	Enterprise Value/ Gross Profits 2006E
Third Quartile	0.2x	1.7x
Mean	0.2x	1.3x
Median	0.1x	1.0x
First Quartile	0.1x	0.8x
Implied eCOST Enterprise Value (millions)	$22.4-$36.7	$18.2-$29.2
Implied eCOST Equity Value (millions)	$28.7-$43.0	$24.5-$35.5
Implied eCOST Per Share Value	$1.59-$2.38	$1.36-$1.97
Implied eCOST Exchange Ratio	1.1476x-1.7164x	0.9772x-1.4154x

The implied exchange ratios above were each based on a range of multiples of first quartile to mean. The quartiles were calculated using statistical interpolation to divide the probability distribution into four equal areas.

The multiples derived from the implied estimated enterprise values, revenues and gross profit of the companies listed above were calculated using data that excluded all extraordinary items, non recurring charges, and merger-related expenses. In each case, Thomas Weisel Partners multiplied the ratios derived from its analysis by eCOST s applicable historical and projected estimated revenues and gross profit to calculate the resulting price ranges

listed above.

While the selected publicly traded company analysis compared eCOST to consumer electronics resellers with a primary online distribution channel, Thomas Weisel Partners did not include every company that could be deemed to be a participant in this same industry, or in any specific sectors of this industry.

Table of Contents

Contribution analysis

Thomas Weisel Partners analyzed the relative contributions of eCOST and PFSweb to the pro forma combined company with respect to estimated revenue and gross profit for the 2005 and 2006 fiscal years and estimated earning before interest, tax, depreciation and amortization (EBITDA) for the 2006 fiscal year. Thomas Weisel Partners then calculated a per share valuation for eCOST based on its percentage contribution to the combined company for each operating metric. The following table shows the implied percentage contributions of eCOST and PFSweb to revenue, gross profit and EBITDA for such periods:

	% Contribution					
	eCOST	PFSweb	Implied Enterprise Value	Implied Equity Value	Implied Per Share Value	Implied Exchange Ratio
FY 2005 ($ millions)						
Revenue	36.2%	63.8%	$ 26.0	$ 32.2	$ 1.79	1.2871x
Gross Profit	30.1%	69.9%	$ 19.8	$ 26.1	$ 1.45	1.0411x
EBITDA	NM	NM%	$ NM	$ NM	$ NM	NMx
FY 2006 ($ millions)						
Revenue	41.0%	59.0%	$ 31.8	$ 38.1	$ 2.11	1.5205x
Gross Profit	41.4%	58.6%	$ 32.3	$ 38.6	$ 2.14	1.5410x
EBITDA	10.3%	89.7%	$ 5.2	$ 11.5	$ 0.64	0.4629x

Based on the market equity value of PFSweb, these contributions translate into per share equity valuations for eCOST ranging from $1.45 to $1.79 in 2005 and from $0.64 to $2.14 in 2006. Based on the $1.39 per share market price of PFSweb on November 28, 2005, these contributions translate into an implied exchange ratio for eCOST of NM (not meaningful) to 1.2871x in 2005 and of 0.4629x to 1.5410x in 2006.

Discounted cash flow analysis

Thomas Weisel Partners used cash flow forecasts of eCOST for calendar years 2005 through 2009, as projected by eCOST s management, to perform a discounted cash flow analysis. In conducting this analysis, Thomas Weisel Partners assumed that eCOST would perform in accordance with these forecasts. Thomas Weisel Partners also assumed $10 million of convertible preferred equity (net of transaction expenses) would be issued by eCOST in 2006 in order to capitalize the business through 2009. Thomas Weisel Partners first estimated the discounted value of the projected cash flows using discount rates ranging from 15.0% to 25.0%, which range of discounted rates were selected based upon a weighted average cost of capital analysis for eCOST and other companies used in the selected publicly traded companies analysis. Thomas Weisel Partners then estimated the terminal value by applying exit multiples to eCOST s estimated 2009 EBITDA, which multiples ranged from 6.0x to 9.0x. Thomas Weisel Partners then discounted the terminal value to present values using discount rates ranging from 15.0% to 25.0%. This analysis indicated a range of enterprise values, from which net debt was subtracted, to calculate a range of equity values. Thomas Weisel Partners performed this analysis assuming $10 million in equity was converted at the market price of eCOST on November 29, 2005 (the as-converted analysis) and assuming the $10 million in equity was not converted (the non-converted analysis). The non-converted analysis implied per share values ranging from $1.23 to $2.38 and the as-converted analysis implied per share values of $1.27 to $2.10. Based on the $1.39 per share market price of PFSweb on November 28, 2005, this analysis implies an exchange ratio for eCOST ranging from 0.8896x to 1.7147x in the non-converted analysis and 0.9174x to 1.5086x in the as-converted analysis.

Selected transactions analysis

Based on public and other available information, Thomas Weisel Partners calculated enterprise value, which Thomas Weisel Partners defined as market capitalization plus net debt plus redeemable convertible preferred stock, as a multiple of revenue and gross profit for the last 12 months and the next 12 months in nine selected acquisitions of

consumer electronics resellers and eCommerce companies with a transaction

Table of Contents

value below $100 million that have been announced since January 1, 2001. Projected financial information for eCOST was based on projections of eCOST management. The acquisitions reviewed in this analysis were the following:

Announcement Date	Name of acquiror	Name of target
June 29, 2004	Sportsman s Guide	The Golf Warehouse
July 1, 2004	eBay Inc.	Baazee.com
January 29, 2004	Blyth Inc.	Walter Drake
December 17, 2002	Alloy Inc.	Old Glory Boutique
November 11, 2002	Network Engines	TidalWire
March 26, 2002	PC Connection	MoreDirect.com
December 4, 2001	Global Sports	Ashford.com
July 24, 2001	Forsyth Technology	Enterprise Computing
May 30, 200	PC Connection	Cyberian Outpost

The following table sets forth the range of multiples, implied per share value of eCOST and implied exchange ratios (based on the $1.39 per share market price of PFSweb on November 28, 2005) indicated by this analysis:

	Announced Enterprise Value/Revenue		Announced Enterprise Value/Gross Profit	
	LTM	NTM	LTM	NTM
Third Quartile	0.7x	0.3x	1.3x	1.0x
Mean	0.4x	0.2x	1.1x	0.8x
Median	0.5x	0.1x	0.9x	0.4x
First Quartile	0.1x	0.1x	0.7x	0.3x
Implied eCOST Enterprise Value (millions)	$21.0-$76.7	$16.0-$47.8	$9.6-$15.6	$7.0-$16.6
Implied eCOST Equity Value (millions)	$27.3-$83.0	$22.3-$54.1	$15.9-$21.9	$13.3-$22.9
Implied eCOST Per Share Value	$1.52-$4.59	$1.24-$3.00	$0.89-$1.22	$0.74-$1.27
Implied eCOST Exchange Ratio	1.0918x-3.3064x	0.8931x-2.1568x	0.6382x-0.8749x	0.5331x-0.9147x

The implied values of eCOST above were each based on a range of multiples of first quartile to mean. In each case, Thomas Weisel Partners multiplied the ratios derived from its analysis by eCOST s estimated revenue and gross profit to calculate the resulting price ranges listed above.

No company or transaction used in the selected company or selected transactions analyses is identical to eCOST or the merger. Accordingly, an analysis of the results of the foregoing is not mathematical; rather, it involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies and other factors that could affect the public trading value of the companies to which eCOST, PFSweb, and the merger are being compared.

Premiums paid analysis

Based on public information, Thomas Weisel Partners reviewed the consideration paid in 24 stock-for-stock acquisitions announced since January 1, 2002 with transaction values between $10 and $100 million. Thomas Weisel Partners calculated the implied per share value of eCOST and implied exchange ratios based on premiums paid in the transactions over the exchange ratio for the acquiror and the acquired company as of one day prior to the announcement of the acquisition and over the one week and thirty day periods prior to the announcement of the acquisition.

Table of Contents

The following table sets forth the range of premiums, implied per share value of eCOST and implied exchange ratios (based on the $1.39 per share market price of PFSweb on November 28, 2005) indicated by this analysis:

	Average Exchange Ratio		
Transactions Since 1/1/02	**1 Day**	**1 Week**	**30 Days**
3rd Quartile	28.3%	30.3%	25.7%
Mean	17.9%	18.4%	20.4%
Median	22.0%	19.7%	14.5%
1st Quartile	2.8%	4.7%	7.1%
Implied eCOST Enterprise Value (millions)	$22.1-$22.9	$23.9-$31.3	$21.9-$26.8
Implied eCOST Equity Value (millions)	$28.4-$35.4	$30.2-$37.6	$28.2-$33.1
Implied eCOST Per Share Value	$1.57-$1.96	$1.68-$2.09	$1.56-$1.84
Implied eCOST Exchange Ratio	1.1326x-1.4121x	1.2060x-1.5013x	1.1265x-1.3214x

The implied values of eCOST above were each based on a range of multiples of first quartile to third quartile.

The foregoing description is only a summary of the analyses and examinations that Thomas Weisel Partners deems material to its opinion. It is not a comprehensive description of all analyses and examinations actually conducted by Thomas Weisel Partners. The preparation of a fairness opinion necessarily is not susceptible to partial analysis or summary description. Thomas Weisel Partners believes that its analyses and the summary set forth above must be considered as a whole and that selecting portions of its analyses and of the factors considered, without considering all analyses and factors, would create an incomplete view of the process underlying the analyses set forth in its presentation to the board of directors of eCOST. In addition, Thomas Weisel Partners may have given some analyses more or less weight than other analyses, and may have deemed various assumptions more or less probable than other assumptions. The fact that any specific analysis has been referred to in the summary above is not meant to indicate that this analysis was given greater weight than any other analysis. Accordingly, the ranges of valuations resulting from any particular analysis described above should not be taken to be the view of Thomas Weisel Partners with respect to the actual value of eCOST.

In performing its analyses, Thomas Weisel Partners made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond the control of eCOST and PFSweb. The analyses performed by Thomas Weisel Partners are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than those suggested by these analyses. These analyses were prepared solely as part of the analysis performed by Thomas Weisel Partners with respect to the financial fairness of the exchange ratio to be received by holders of shares of eCOST common stock pursuant to the merger as of the date of the opinion, and were provided to the board of directors of eCOST in connection with the delivery of the Thomas Weisel Partners opinion. The analyses do not purport to be appraisals or to reflect the prices at which a company might actually be sold or the prices at which any securities may trade at any time in the future. The consideration to be received by the holders of shares of eCOST common stock in the merger is based upon a fixed exchange ratio and, accordingly, the market value of the consideration may vary significantly from the price on the date of Thomas Weisel Partners opinion.

As described above, Thomas Weisel Partners opinion and presentation were among the many factors that the board of directors of eCOST took into consideration in making its determination to approve the merger agreement, and to recommend that eCOST s stockholders approve the merger agreement.

Thomas Weisel Partners is acting as eCOST s exclusive financial advisor in connection with the merger. Pursuant to the terms of the engagement, eCOST has paid Thomas Weisel Partners a fee equal to $600,000. Thomas Weisel Partners may be entitled to receive a fee in the event that the merger is not

Table of Contents

consummated but eCOST consummates an alternative transaction within 12 months of the expiration or termination of Thomas Weisel Partners engagement, which fee is contingent upon the consummation of such alternative transaction. In addition, eCOST has agreed to reimburse Thomas Weisel Partners for its expenses incurred in connection with its engagement, including the reasonable fees and expenses of its legal counsel and any other professionals retained by Thomas Weisel Partners. eCOST has also agreed to indemnify Thomas Weisel Partners and related persons against certain liabilities in connection with its engagement, including liabilities under the federal securities laws. In the ordinary course of its business, Thomas Weisel Partners actively trades the equity securities of eCOST and PFSweb for its own account and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities. Thomas Weisel Partners has performed various investment banking services for eCOST.

Regulatory Approvals Required for the Merger

PFSweb s acquisition of eCOST is not subject to review by the Antitrust Division of the United States Department of Justice or the United States Federal Trade Commission. Neither PFSweb nor eCOST believes that any governmental or regulatory approvals are required to complete the merger.

Material United States Federal Income Tax Consequences of the Merger

The following discussion describes the material U.S. federal income tax consequences of the merger to eCOST, U.S. holders (as defined below) of eCOST common stock, PFSweb and its stockholders. This discussion is not a complete analysis of all potential U.S. federal income tax consequences, nor does it address any tax consequences arising under any state, local or foreign tax laws, or any other federal tax laws. This discussion is based on the Internal Revenue Code of 1986, as amended (the Code), Treasury Regulations promulgated thereunder, judicial opinions, and administrative pronouncements and published rulings of the IRS, all as in effect on the date of this joint proxy statement/ prospectus. These authorities may change, possibly retroactively, resulting in U.S. federal income tax consequences different from those discussed below. No ruling has been or will be sought from the IRS with respect to the matters discussed below, and there can be no assurance that the IRS will not take a contrary position regarding the tax consequences of the merger, or that any such contrary position would not be sustained by a court.

This discussion is limited to U.S. holders who hold their shares of eCOST common stock as a capital asset within the meaning of Section 1221 of the Code (generally, property held for investment). This discussion does not address all U.S. federal income tax considerations that may be relevant to a particular stockholder in light of the stockholder s particular circumstances. This discussion also does not consider any specific facts or circumstances that may be relevant to stockholders subject to special rules under the U.S. federal income tax laws, including U.S. expatriates, partnerships and other pass-through entities, controlled foreign corporations, passive foreign investment companies, corporations that accumulate earnings to avoid U.S. federal income tax, financial institutions, insurance companies, brokers, dealers or traders in securities, commodities or currencies, tax-exempt organizations, tax-qualified retirement plans, persons subject to the alternative minimum tax, persons holding eCOST common stock as part of a hedge, straddle or other risk reduction strategy or as part of a conversion transaction or other integrated investment, and persons who acquired their shares of eCOST common stock upon the exercise of stock options or as compensation.

For purposes of this discussion, the term U.S. holder means a beneficial owner of eCOST common stock who is treated for U.S. federal income tax purposes as:

an individual citizen or resident of the United States;

a corporation (or other entity taxed as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia;

an estate, the income of which is subject to U.S. federal income tax regardless of its source; or

- a trust that (1) is subject to the primary supervision of a U.S. court and the control of one or more U.S. persons or (2) has validly elected to be treated as a U.S. person for U.S. federal income tax purposes.

If a partnership (or other entity or arrangement taxed as a partnership for U.S. federal income tax purposes) holds eCOST common stock, the tax treatment of a partner in the partnership generally will depend upon the status of the partner and the activities of the partnership. Partnerships and partners in such partnerships should consult their tax advisors regarding the tax consequences of the merger to them.

We recommend that eCOST stockholders consult their tax advisors regarding the U.S. federal income tax consequences of the merger to them in light of their particular circumstances, as well any tax consequences arising under any state, local or foreign tax laws or any other federal tax laws.

Structure of the Merger

As a condition to completing the merger, eCOST must receive from Latham & Watkins LLP an opinion dated as of closing that the merger qualifies as a reorganization within the meaning of Section 368(a) of the Code. The opinion will be based on customary factual assumptions and representations, as set forth in representation letters to be delivered by each of eCOST and PFSweb at the time of closing, which assumptions and representations must continue to be true and accurate in all respects as of the closing. The opinion also will assume that the merger will be completed according to the terms of the merger agreement. An opinion of counsel represents such counsel s best legal judgment and is not binding on the IRS or any court.

Tax Consequences of the Merger

If the merger qualifies as a reorganization within the meaning of Section 368(a) of the Code, the material U.S. federal income tax consequences to eCOST stockholders who participate in the merger will be as follows.

- You generally will not recognize any gain or loss on the receipt of PFSweb common stock in exchange for your eCOST common stock in the merger.

- Your aggregate tax basis in (i) the shares of PFSweb common stock received in the merger and (ii) any fractional shares of PFSweb common stock for which you receive cash, will be the same as your aggregate tax basis in the eCOST common stock exchanged in the merger.

- Your holding period in the shares of PFSweb common stock received in the merger will include the holding period of the eCOST common stock exchanged therefor.

- If you receive cash in lieu of a fractional share of PFSweb common stock, you generally will recognize capital gain or loss in an amount equal to the difference between the amount of cash received and your tax basis in the fractional share.

No gain or loss will be recognized by eCOST, PFSweb or its stockholders as a result of the merger.

Backup Withholding

Non-corporate holders of eCOST common stock may be subject to backup withholding on any cash payments received in the merger. However, backup withholding may be avoided if a stockholder (1) furnishes a correct taxpayer identification number and certifies that it is not subject to backup withholding on IRS Form W-9 or any substitute form included in the letter of transmittal to be delivered to eCOST stockholders following the completion of the merger, (2) provides a certification of foreign status on the applicable IRS Form W-8, or (3) is otherwise exempt from backup withholding and properly establishes such exemption. Backup withholding is not an additional tax, and any amounts withheld may be allowed as a refund or credit against a stockholder s U.S. federal income tax liability, provided the stockholder furnishes the required information to the IRS.

The tax consequences of the merger to each eCOST stockholder will depend on each stockholder s particular circumstances. We recommend eCOST stockholders consult their tax advisors regarding the U.S. federal income tax consequences of the merger to them in light of their individual circumstances, as well as any tax consequences arising under any state, local or foreign tax laws or any other federal tax laws.

Accounting Treatment

The merger will be accounted for using the purchase method of accounting under U.S. generally accepted accounting principles. Under the purchase method of accounting, the purchase price in the merger is allocated among the eCOST assets acquired and the eCOST liabilities assumed to the extent of their fair market value, with any excess purchase price being allocated to goodwill. The allocation of the purchase price to the assets and liabilities of eCOST contained in this document is preliminary. The final allocation of the purchase price will be determined after the merger is completed and after completion of an analysis to determine the assigned fair values of eCOST s assets and liabilities. See Unaudited Pro Forma Condensed Combined Consolidated Financial Statements of PFSweb and eCOST beginning on page 17.

Public Trading Markets

PFSweb has agreed to use reasonable best efforts to cause the shares of PFSweb common stock to be issued in the merger to be approved for listing on the Nasdaq Capital Market prior to the completion of the merger. It is a condition to the completion of the merger that the shares of PFSweb common stock issuable in the merger be approved for listing on the Nasdaq Capital Market.

If the merger is completed, eCOST common stock will be delisted from the Nasdaq National Market.

Resales of PFSweb Common Stock

In general, shares of PFSweb common stock issued to eCOST stockholders pursuant to the merger will be freely transferable, except for any shares received by persons who may be deemed to be affiliates of the parties under the Securities Act of 1933, as amended. Persons who may be deemed to be affiliates include individuals or entities that control, are controlled by, or are under common control with a person, and may include officers and directors, as well as significant stockholders. Affiliates may sell their shares of PFSweb common stock only pursuant to an effective registration statement under the Securities Act covering the resale of those shares, an exemption under Rule 145(d) of the Securities Act or any other applicable exemption under the Securities Act. PFSweb s registration statement on Form S-4, of which this joint proxy statement/ prospectus constitutes a part, does not cover the resale of PFSweb common stock received by affiliates in the merger.

Interests of Directors and Officers of eCOST in the Merger

In considering the recommendation of the eCOST board of directors regarding the merger, eCOST stockholders should be aware that certain executive officers and directors of eCOST have interests in the transactions contemplated by the merger agreement that may be different from, or in addition to, the interests of eCOST stockholders generally. The eCOST board of directors was aware of these interests and considered them, among other matters, in making its recommendation.

Indemnification; Directors and Officers Insurance

Pursuant to the merger agreement, the indemnification provided to eCOST s directors and officers in eCOST s certificate of incorporation, bylaws and any indemnification agreements will continue in full force and effect for a period of six years after the completion of the merger. In addition, for a period of six years, PFSweb must obtain directors and officer insurance for eCOST s directors and officers, with coverage that is no less favorable than eCOST s existing policy, or if the annual cost of such a policy

exceeds 150% of the cost of eCOST s current policy, then the maximum coverage available for such a premium.

PFSweb Stock Options

The board of directors of PFSweb has authorized and approved the granting of approximately 700,000 options to purchase shares of PFSweb common stock to various officers and key employees of eCOST. These options will:

- be issued under the PFSweb stock option plan as of the closing date of the merger;
- have an exercise price equal to the closing price of the PFSweb common stock on the Nasdaq Capital Market as of the date of issuance; and
- be subject to cumulative quarterly vesting over a three year period commencing on the date of grant.

Adam Shaffer, the Chief Executive Officer of eCOST, will receive 350,000 PFSweb options and Gary Guy, President of eCOST, will receive 200,000 PFSweb options.

Management and Operations Following the Merger

Upon completion of the merger, eCOST will be a wholly-owned subsidiary of PFSweb, and the sole member of the board of directors of eCOST will be Mark Layton, Chairman and Chief Executive Officer of PFSweb, all of the executive officers of PFSweb will remain with PFSweb in their current capacities, and Adam Shaffer will continue as Chief Executive Officer of eCOST, subject to the terms of his employment agreement with eCOST. Under the terms of his employment agreement, Mr. Shaffer serves as an employee at will, subject to his right to receive a severance payment equal to six months base salary in the event his employment is terminated by eCOST without cause.

Appraisal Rights

Appraisal rights are statutory rights that enable stockholders to dissent from an extraordinary transaction, such as a merger, and to demand that the corporation pay the fair value for their shares as determined by a court in a judicial proceeding instead of receiving the consideration offered to stockholders in connection with the extraordinary transaction. Appraisal rights are not available in all circumstances, and exceptions to these rights are provided under the laws of Delaware, which is the state of incorporation of PFSweb and eCOST. As a result of these exceptions, neither PFSweb stockholders nor eCOST stockholders are entitled to appraisal rights in the merger.

THE MERGER AGREEMENT

The following summary describes specified aspects of the merger agreement. This discussion does not purport to be complete and is qualified in its entirety by reference to the merger agreement, which is attached as ***Annex A*** *and incorporated herein by reference. We urge you to read the merger agreement carefully and in its entirety.*

Structure of the Merger

In accordance with the terms and subject to satisfaction or waiver of the conditions set forth in the merger agreement, Red Dog Acquisition Corp., a newly formed and wholly owned subsidiary of PFSweb, will merge with and into eCOST. The separate corporate existence of Red Dog will then cease, and eCOST will then continue as the surviving corporation in the merger and will be a wholly owned subsidiary of PFSweb.

Table of Contents

Effective Time of the Merger

The closing of the merger will take place when all of the conditions contained in the merger agreement are satisfied or waived. The merger will become effective upon the filing of a certificate of merger with the Secretary of State of the State of Delaware or at such later time as is specified in the certificate of merger.

Conversion of Securities

Upon completion of the merger of Red Dog with and into eCOST, each share of eCOST common stock issued and outstanding immediately prior to the completion of the merger will automatically be converted into the right to receive one share of PFSweb common stock. Each share of eCOST common stock held in the treasury by eCOST or by PFSweb or Red Dog, immediately prior to the completion of the merger will be canceled without any payment of consideration.

The exchange ratio, which equals one share of PFSweb common stock for each share of eCOST common stock, will be equitably adjusted for any stock dividend, stock split, subdivision, reclassification, recapitalization, combination, exchange of shares or similar event with respect to shares of PFSweb common stock or eCOST common stock effected between the date of the merger agreement and the completion of the merger.

Promptly after completion of the merger, PFSweb s transfer agent will mail to former eCOST stockholders a letter of transmittal and instructions to be used in surrendering stock certificates that represented shares of eCOST common stock prior to the completion of the merger. When a former eCOST stockholder delivers these certificates to the exchange agent along with a properly executed letter of transmittal and any other required documents, the former eCOST stockholder will receive PFSweb stock certificates representing the number of whole shares of PFSweb common stock to which the stockholder is entitled under the merger agreement and cash in lieu of any fractional shares of PFSweb common stock.

Treatment of eCOST Stock Options

Upon completion of the merger, all options to purchase eCOST common stock then outstanding under eCOST s stock option plans and option agreements, if not sooner exercised in accordance with their terms, will be cancelled.

Representations and Warranties

In the merger agreement, eCOST and PFSweb (along with Red Dog) made representations and warranties to each other about their respective companies consistent with representations and warranties made by companies engaging in similar transactions. The representations and warranties given by eCOST, PFSweb and Red Dog will not survive completion of the merger.

These representations and warranties are qualified by information in confidential disclosure memoranda that the parties exchanged in connection with signing the merger agreement. The merger agreement is attached as ***Annex A*** to provide you with information regarding its terms and conditions. It is not intended to provide any other factual information about the parties. Such information can be found elsewhere in this joint proxy statement/ prospectus and in the other public filings each of the parties makes with the SEC, which are available without charge at www.sec.gov.

Conduct of Business by eCOST Prior to Completion of the Merger

eCOST has agreed that, subject to certain specified exceptions, prior to the completion of the merger, it will conduct operations only in the ordinary and usual course of business consistent with past practice. In

Table of Contents

addition, eCOST will not, between the date of the merger agreement and the completion of the merger, do any of the following without PFSweb s prior written consent:

amend its certificate of incorporation or bylaws;

issue, sell, pledge, dispose of, grant, transfer or encumber any of its capital stock, convertible securities, or options, warrants or other rights to acquire any capital stock or convertible securities, other than the issuance of eCOST common stock upon the exercise of options outstanding as of the date of the merger agreement;

sell, pledge, dispose, transfer, lease, license, guarantee or encumber any material property or assets, except pursuant to existing contracts or commitments or the sale or purchase of goods in the ordinary course of business consistent with past practice;

enter into any commitment or transaction outside the ordinary course of business consistent with past practice;

declare or pay any dividends or make other distributions;

enter into any agreement with respect to the voting of its capital stock;

reclassify, combine, split, subdivide or redeem, purchase or otherwise acquire any of its capital stock;

acquire any interest in any person or any assets, other than acquisitions of assets in the ordinary course of business consistent with past practice;

incur any indebtedness for borrowed money or issue any debt securities or assume, guarantee or endorse the obligations of any person for borrowed money, except for indebtedness for borrowed money incurred pursuant to agreements in effect at the time of the merger agreement;

terminate, cancel or agree to any material change in any material contract;

increase the compensation or benefits of directors, officers or employees, except as otherwise required by existing commitments or policies;

grant any rights to severance or termination pay to, or enter into any employment or severance agreement with, any director, officer or other employee, or establish, adopt, enter into or amend any collective bargaining, bonus, profit sharing, thrift, compensation, stock option, restricted stock, pension, retirement, deferred compensation, employment, termination, severance or other plan, agreement, trust, fund, policy or arrangement for the benefit of any director, officer or employee;

amend or waive any performance or vesting criteria or accelerate vesting, exercisability or funding under any benefit plan;

pay, discharge or satisfy any material claims, liabilities or obligations, except in the ordinary course of business;

accelerate or delay collection of material notes and accounts receivable in advance or beyond their regular due dates;

delay or accelerate payment of material accounts payable in advance of their due dates;

make any material change in accounting policies or procedures other than in the ordinary course of business consistent with past practice or as required by United States generally accepted accounting principles or by a government entity;

waive, release, assign, settle or compromise any material claims, litigation or arbitration;

make any material tax election, settle or compromise any material tax liability, amend any material tax return or file any tax refund for any material amount;

modify, amend or terminate, or waive, release or assign any material rights or claims with respect to any confidentiality or standstill agreement;

knowingly act in a manner intended or reasonably expected to materially delay the consummation of the merger or result in any of the conditions to the merger not being satisfied; or

authorize or enter into any agreement or otherwise make any commitment to do any of the foregoing.

Conduct of Business by PFSweb Prior to Completion of the Merger

PFSweb has agreed that it will not, between the date of the merger agreement and the completion of the merger, do any of the following without eCOST s prior written consent:

amend its certificate of incorporation or bylaws;

issue, sell, pledge, dispose of, grant, transfer or encumber any of its capital stock, convertible securities, or options, warrants or other rights to acquire any capital stock or convertible securities, other than the issuance of PFsweb common stock upon the exercise of options outstanding as of the date of the merger agreement and the issuance of PFSweb common stock options in the ordinary course of business;

sell, pledge, dispose, transfer, lease, license, guarantee or encumber any material property or assets, except pursuant to existing contracts or commitments or the sale or purchase of goods in the ordinary course of business consistent with past practice;

enter into any commitment or transaction outside the ordinary course of business consistent with past practice;

declare or pay any dividends or make other distributions;

enter into any agreement with respect to the voting of its capital stock;

reclassify, combine, split, subdivide or redeem, purchase or otherwise acquire any of its capital stock;

acquire any interest in any person or any assets, other than acquisitions of assets in the ordinary course of business consistent with past practice;

incur any indebtedness for borrowed money or issue any debt securities or assume, guarantee or endorse the obligations of any person for borrowed money, except for indebtedness for borrowed money incurred pursuant to agreements in effect at the time of the merger agreement;

terminate, cancel or agree to any material change in any material contract;

increase the compensation or benefits of directors, officers or employees, except as otherwise required by existing commitments or policies;

grant any rights to severance or termination pay to, or enter into any employment or severance agreement with, any director, officer or other employee, or establish, adopt, enter into or amend any collective bargaining, bonus, profit sharing, thrift, compensation, stock option, restricted stock, pension, retirement, deferred compensation, employment, termination, severance or other plan, agreement, trust, fund, policy or arrangement for the benefit of any director, officer or employee;

amend or waive any performance or vesting criteria or accelerate vesting, exercisability or funding under any benefit plan;

pay, discharge or satisfy any material claims, liabilities or obligations, except in the ordinary course of business;

accelerate or delay collection of material notes and accounts receivable in advance or beyond their regular due dates;

delay or accelerate payment of material accounts payable in advance of their due dates;

make any material change in accounting policies or procedures other than in the ordinary course of business consistent with past practice or as required by United States generally accepted accounting principles or by a government entity;

waive, release, assign, settle or compromise any material claims, litigation or arbitration;

make any material tax election, settle or compromise any material tax liability, amend any material tax return or file any tax refund for any material amount;

modify, amend or terminate, or waive, release or assign any material rights or claims with respect to any confidentiality or standstill agreement;

knowingly act in a manner intended or reasonably expected to materially delay the consummation of the merger or result in any of the conditions to the merger not being satisfied; or

authorize or enter into any agreement or otherwise make any commitment to do any of the foregoing.

Additional Agreements

Stockholder Meetings

PFSweb has agreed to call and hold a meeting of its stockholders for the purpose of voting upon the approval of the issuance of PFSweb common stock pursuant to the merger agreement and the charter amendment to increase the number of authorized shares of PFSweb common stock as promptly as reasonably practicable after the date on which the registration statement covering those shares of PFSweb common stock becomes effective with the SEC. In connection with the PFSweb stockholder meeting, the PFSweb board of directors will use its reasonable best efforts to obtain PFSweb stockholder approval, will recommend that PFSweb stockholders approve the issuance of the PFSweb common stock pursuant to the merger agreement and approve the charter amendment to increase the number of authorized shares, and will not withdraw or adversely modify its recommendation.

eCOST has agreed to call and hold a meeting of its stockholders for the purpose of voting on the adoption of the merger agreement as promptly as reasonably practicable after the date on which the registration statement covering the shares of PFSweb common stock to be issued in the merger becomes effective with the SEC. Subject to the fiduciary duty exceptions described in the merger agreement and other applicable laws, the eCOST board of directors will use its reasonable best efforts to obtain eCOST stockholder approval, will recommend that the eCOST stockholders approve the merger agreement, and will not withdraw or adversely modify its recommendation.

Access to Information and Confidentiality

Each of PFSweb and eCOST has agreed to provide access to its books and records to the other party and its officers, employees and other representatives, and to comply with its obligations under confidentiality agreements among the parties.

Consents and Filings

PFSweb and eCOST have agreed to use their reasonable best efforts to take all necessary action to consummate the transactions contemplated by the merger agreement, obtain any required consents and licenses, and make all necessary filings.

Employee Benefits

With respect to each PFSweb employee benefit plan in which eCOST employees participate after the merger (other than stock option plans), eCOST employees will be granted credit for service with eCOST for purposes of determining vesting and entitlement to benefits, except to the extent such service credit

will result in the duplication of benefits or to the extent that service was not recognized under the eCOST employee benefit plan.

Indemnification of Officers and Directors

The merger agreement provides that all rights to indemnification in effect as of the date of the merger agreement as provided in eCOST s certificate of incorporation, bylaws and any indemnification agreements will survive the merger and will continue in full force and effect and be honored, without any amendment, for a period of six years after the completion of the merger.

In addition, for a period of six years, PFSweb must obtain director and officer insurance policy for eCOST s directors and officers, with coverage that is no less favorable than eCOST s existing policy, or if the annual cost of such a policy exceeds 150% of the cost of eCOST s current policy, then the maximum coverage available for such a premium.

Tax-Free Reorganization Treatment

PFSweb and eCOST intend for the merger to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code. Each party and their respective subsidiaries will use their reasonable best efforts to take any action necessary for the merger to qualify as a reorganization, and neither party or their respective subsidiaries will take any action that could reasonably be expected to prevent the merger from qualifying as a reorganization. For a description of the material U.S. federal income tax consequences of the merger, see The Merger Material United States Federal Income Tax Consequences on page 80.

No Solicitation of Other Transactions

The merger agreement provides that eCOST and its subsidiaries will not, through any representatives or otherwise:

initiate, solicit, knowingly encourage, or take any other action to facilitate any acquisition proposal (as defined below);

participate or engage in any discussions or negotiations regarding, or furnish any nonpublic information with respect to, or facilitate any inquiries or proposals that may reasonably be expected to lead to an acquisition proposal;

engage in discussions with any person with respect to any acquisition proposal;

approve, endorse or recommend any acquisition proposal; or

enter into any agreement, commitment or understanding contemplating or relating to any acquisition proposal;

provided that, eCOST may, in response to an acquisition proposal that was not solicited after the date of the merger agreement or in violation of the terms of the merger agreement, participate in discussions or negotiations with or furnish information to any person that makes an acquisition proposal if:

the discussions, negotiations or furnishing of information to that person is subject to a confidentiality agreement containing customary terms and conditions;

the eCOST board of directors reasonably determines in good faith, after consultation with its outside legal counsel and financial advisor, that the acquisition proposal could reasonably be expected to lead to a superior proposal (as defined below); and

the eCOST board of directors reasonably determines in good faith, after consultation with its outside legal counsel, that a failure to participate in the discussions or negotiations or furnish information to that person would be inconsistent with its fiduciary duties under applicable law.

Table of Contents

In addition, eCOST has agreed that the eCOST board of directors will not withdraw, modify or amend in a manner adverse to PFSweb its recommendation of the approval of the merger agreement by eCOST stockholders. However, the eCOST board of directors may withdraw, modify or amend its recommendation of the merger if, following receipt of a superior proposal:

- eCOST has complied with the non-solicitation provisions of the merger agreement;
- the eCOST board of directors reasonably determines in good faith, after consultation with its outside legal counsel, that a failure to withdraw, modify or amend its recommendation would be inconsistent with its fiduciary duties under applicable laws; and
- prior to withdrawing, modifying or amending its recommendation, the eCOST board of directors has given PFSweb at least five days notice of its intention to take such action and the opportunity to meet with eCOST and its outside counsel and financial advisor.

In addition, eCOST has agreed to promptly advise PFSweb of any request for information with respect to any acquisition proposal or any inquiries, proposals, discussions or negotiations with respect to any acquisition proposal, and promptly provide to PFSweb copies of any written materials received in connection with the foregoing. With respect to any superior proposal, eCOST must provide PFSweb with an opportunity during the five-day period described above to negotiate revisions to the terms of the merger agreement for the good faith consideration by eCOST s board of directors.

The merger agreement defines an acquisition proposal as any offer or proposal concerning any of the following:

- a merger, consolidation, business combination or similar transaction involving eCOST;
- a sale, lease or other disposition by merger, consolidation, business combination, share exchange, joint venture or otherwise of assets of eCOST that represent 20% or more of the consolidated assets of eCOST and its subsidiaries;
- an issuance, sale, or other disposition of (including by way of merger, consolidation, business combination, share exchange, joint venture or any similar transaction) securities (or options, rights or warrants to purchase, or securities convertible into or exchangeable for such securities) representing 20% or more of voting power of eCOST;
- a transaction in which any person or group acquires beneficial ownership, or the right to acquire beneficial ownership, of 20% or more of eCOST s outstanding voting capital stock; or
- any combination of the foregoing (other than the merger contemplated by the merger agreement).

The merger agreement defines a superior proposal as a bona fide written offer made by any person other than PFSweb or Red Dog that:

- is not solicited by eCOST in violation of the non-solicitation provisions of the merger agreement;
- concerns an acquisition proposal involving eCOST, except that for purposes of this definition references in the above definition of acquisition proposal to 20% are changed to 50% ;
- is on terms that the eCOST board of directors in good faith concludes (following consultation with its financial advisors and outside legal counsel) are more favorable to eCOST stockholders than the transactions contemplated by the merger agreement; and
- is, in the good faith judgment of the eCOST board of directors, reasonably likely to be financed and completed on the terms proposed, taking into account the various legal, financial and regulatory aspects of the proposal.

Conditions to Completion of the Merger

The respective obligations of PFSweb and eCOST to effect the merger are subject to the satisfaction or waiver, prior to the completion of the merger, of customary conditions, including the following:

the registration statement covering the shares of PFSweb common stock to be issued to eCOST stockholders in the merger has been declared effective by the SEC and no stop order suspending the effectiveness of the registration statement has been issued or threatened by the SEC;

the merger agreement, the merger and the other transactions contemplated by the merger agreement (including the issuance of the shares of PFSweb common stock and the PFSweb charter amendment to increase the number of authorized shares) have been approved by the requisite vote of the stockholders of PFSweb and eCOST;

no governmental agency or court has issued any order, decree, judgment or injunction that prevents or prohibits consummation of the completion of the merger or any other transaction contemplated by the merger agreement;

all material consents, approvals and authorizations of any governmental entity have been obtained; and

the shares of PFSweb common stock issuable to the eCOST stockholders in the merger have been approved for listing on the Nasdaq Capital Market.

In addition, the obligations of PFSweb and Red Dog to effect the merger are subject to the satisfaction or waiver, prior to the completion of the merger, of each of the following conditions:

the representations and warranties of eCOST will be true and correct as of the date the merger is to be completed, except where the failure of those representations and warranties to be true and correct would not have a material adverse effect on eCOST;

eCOST has performed or complied in all material respects with all material agreements and covenants required by the merger agreement to be performed or complied with prior to the date the merger is to be completed;

eCOST has obtained all material consents, approvals and authorizations required pursuant to the merger agreement;

since the date of the merger agreement, no event will have occurred that has a material adverse effect on eCOST;

eCOST s chief executive officer and chief financial officer have not failed to provide, with respect to eCOST s filings with the SEC after the date of the merger agreement, any necessary certification required by the Sarbanes-Oxley Act;

no suit, claim, action, proceeding or investigation shall be or have been instituted, commenced, pending or threatened that is reasonably likely to (i) impose material limitations on the ability of PFSweb effectively to exercise full rights of ownership of eCOST or (ii) restrain, enjoin, prevent, prohibit or make illegal, or impose material limitations on, the ability of eCOST to operate its business in the manner presently conducted; and

eCOST shall not be in breach of, and no condition, event or act which with the giving of notice or lapse of time, or both, would become an event of default, shall have occurred and be continuing under, any indebtedness for borrowed money.

In addition, the obligations of eCOST to effect the merger are subject to the satisfaction or waiver, prior to the completion of the merger, of each of the following conditions:

the representations and warranties of PFSweb and Red Dog will be true and correct as of the date the merger is to be completed, except where the failure of those representations and warranties to be true and correct would not

have a material adverse effect on PFSweb;

PFSweb has performed or complied in all material respects with all material agreements and covenants required by the merger agreement to be performed or complied with prior to the date the merger is to be completed;

PFSweb has obtained all material consents, approvals and authorizations, required pursuant to the merger agreement;

since the date of the merger agreement, no event will have occurred that has a material adverse effect on PFSweb;

PFSweb s chief executive officer and chief financial officer have not failed to provide, with respect to PFSweb s filings with the SEC after the date of the merger agreement, any necessary certification required by the Sarbanes-Oxley Act;

eCOST has received a written opinion of Latham & Watkins LLP to the effect that the merger will not cause Section 355(e) of the Internal Revenue Code to apply to the April 2005 spin-off distribution of shares of eCOST common stock; and.

eCOST has received a written opinion of Latham & Watkins LLP to the effect that the merger qualifies as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code.

Termination of the Merger Agreement

The merger agreement may be terminated and the merger may be abandoned at any time prior to the completion of the merger:

by mutual written consent of the PFSweb and eCOST boards of directors;

by PFSweb or eCOST if:

the merger has not been completed prior to February 14, 2006, unless it is the terminating party s failure to fulfill any obligation under the merger agreement that resulted in the failure of the merger to occur on or before that date;

any governmental entity has issued an order or ruling permanently restraining, enjoining or otherwise prohibiting the transactions contemplated by the merger agreement, and such order or ruling has become final and nonappealable; or

the approval by the stockholders of PFSweb and eCOST required for consummation of the merger is not obtained, unless it is the terminating party s failure to fulfill any obligation under the merger agreement that resulted in the failure to obtain the approval of such party s stockholders;

by PFSweb if:

the eCOST board of directors has: (i) failed to make, or withdrawn or adversely modified its recommendation of the merger, (ii) approved or recommended to its stockholders an acquisition proposal other than that contemplated by the merger agreement or entered into any agreement with respect to an acquisition proposal, (iii) after an acquisition proposal has been made, failed to affirm its recommendation of the merger within five days of any request by PFSweb to do so or (iv) recommended that its stockholders tender their shares in any tender offer or exchange offer that is commenced (other than by PFSweb) which, if successful, would result in any person or group becoming a beneficial owner of 20% or more of its outstanding shares of capital stock; or

there has been a breach by eCOST of any representation, warranty or covenant contained in the merger agreement that (i) would result in eCOST s failure to satisfy specified merger conditions and (ii) is not cured within 20 days or prior to February 14, 2006, if sooner; *provided* that PFSweb is not in material breach of its obligations or its representations and warranties under the merger agreement and PFSweb has given eCOST at least 20 days prior written notice;

91

Table of Contents

by eCOST if:

it receives a superior proposal and eCOST has complied with certain obligations under the merger agreement, including (i) giving PFSweb five days written notice of the eCOST board of directors decision to terminate; (ii) renegotiating in good faith with PFSweb during this five-day period without receiving a competing proposal from PFSweb that eCOST s board of directors has determined to be as favorable to eCOST s stockholders as the superior proposal, and (iii) paying PFSweb the termination fee required under the merger agreement (as described below);

the PFSweb board of directors has failed to make, or has withdrawn or adversely modified its recommendation of the issuance of shares of PFSweb common stock; or

there has been a breach by PFSweb of any representation, warranty or covenant contained in the merger agreement that (i) would result in PFSweb s failure to satisfy specified merger conditions and (ii) is not cured within 20 days or prior to February 14, 2006, if sooner; *provided* that eCOST is not in material breach of its obligations or its representations and warranties under the merger agreement and eCOST has given PFSweb at least 20 days prior written notice.

Expenses

Generally, all fees and expenses incurred in connection with the merger agreement and the transactions contemplated by the merger agreement will be paid by the party incurring those expenses. However, PFSweb and eCOST will share equally all expenses related to printing, filing and mailing the registration statement and the joint proxy statement/ prospectus and all SEC filing fees incurred in connection therewith.

Termination Fee

Under the terms of the merger agreement, eCOST has agreed to pay PFSweb a termination fee of $1.2 million in the event that the merger agreement is terminated:

by eCOST because it receives a superior proposal; or

by PFSweb because the eCOST board of directors: (1) fails to make, or withdraws or adversely modifies its recommendation to the eCOST stockholders of the merger agreement, (2) approves or recommends an acquisition proposal other than that contemplated by the merger agreement or enters into any agreement with respect to an acquisition proposal, (3) following an acquisition proposal, fails to affirm its recommendation to the eCOST stockholders of the merger agreement within five days of any request by PFSweb to do so or (4) recommends that its stockholders tender their shares in a tender offer or exchange offer that is commenced (other than by PFSweb) which, if successful, would result in any person or group becoming a beneficial owner of 20% or more of eCOST s outstanding shares of capital stock.

eCOST will also be required to pay PFSweb the $1.2 million termination fee if all of the following conditions are met:

PFSweb or eCOST terminates the merger agreement because the merger has not been completed prior to February 14, 2006 or the eCOST stockholders failed to approve the adoption of the merger:

at any time after the date of the merger agreement but before its termination, an acquisition proposal has been publicly made, proposed or communicated; and

within twelve months following the termination of the merger agreement, eCOST consummates or enters into an agreement with respect to the acquisition proposal which is subsequently consummated.

Amendment and Waiver

Subject to applicable law, the parties may amend the merger agreement in writing at any time prior to the completion of the merger. In addition, at any time prior to the completion of the merger, any party to the merger agreement may (1) extend the time for performance of any of the obligations of the other party, (2) waive any inaccuracies in the representations and warranties of the other party and (3) waive compliance by the other party with any of the agreements or conditions in the merger agreement. However, after a party has received the approval of its stockholders, no amendment, extension or waiver can be made that by law or in accordance with the rules of the Nasdaq National Market requires further stockholder approval without such further approval.

VOTING AGREEMENT

The following summary describes specified aspects of the voting agreement. This discussion does not purport to be complete and is qualified in its entirety by reference to the voting agreement, which is attached as ***Annex B*** *and incorporated herein by reference. We urge you to read the voting agreement carefully and in its entirety.*

As an inducement to PFSweb and Red Dog to enter into the merger agreement, Frank Khulusi, the Chairman and Chief Executive Officer of PC Mall, the former parent corporation of eCOST, has entered into a voting agreement pursuant to which he has agreed to vote his shares in favor of the adoption of the merger agreement. As of November 29, 2005, Mr. Khulusi beneficially owned 1,988,813 shares of eCOST common stock (representing approximately 11.2% of the voting power of the eCOST common stock outstanding as of such date).

Pursuant to the terms of the voting agreement, Mr. Khulusi has agreed to vote (1) in favor of the merger, the adoption of the merger agreement and the approval of transactions contemplated by the merger agreement, (2) against any acquisition proposal other than contemplated by the merger agreement with PFSweb, and (3) against any proposal, action or transaction that would impede, frustrate, prevent or nullify the merger, the merger agreement or the transactions contemplated by the merger agreement. Mr. Khulusi has also agreed not to sell, transfer or otherwise dispose of such stockholder s shares of eCOST common stock to any person making a competing acquisition proposal.

In addition, similar to the non-solicitation provisions in the merger agreement, he has agreed not to (1) solicit, initiate or knowingly encourage or take any other action to facilitate any competing acquisition proposal, (2) participate or engage in any discussions or negotiations or furnish nonpublic information to any person with respect to any inquiry or proposal that could reasonably be expected to lead to a competing acquisition proposal, or (3) engage in any discussions with any person with respect to a competing acquisition proposal.

The voting agreement terminates upon the earlier to occur of (1) the completion of the merger or (2) the termination of the merger agreement in accordance with its terms. See The Merger Agreement Termination of the Merger Agreement on page 91.

AMENDMENT OF PC MALL AGREEMENTS

eCOST and its former parent corporation, PC Mall, are parties to an agreement under which PC Mall provides eCOST with usage of its telecommunications systems, hardware and software systems, information technology services and related support services under an agreement with a term of two years expiring in September 2006, which either party may terminate with six months prior notice. PFSweb, eCOST and PC Mall have agreed to amend this agreement, effective upon the closing date of the merger, to permit either of PC Mall or eCOST to terminate this agreement upon 90 days prior notice. eCOST and PC Mall are also parties to a sublease under which eCOST subleases its Torrance, California, headquarters from PC Mall. PFSweb, eCOST and PC Mall have similarly agreed to amend this sublease, effective upon the closing date of the merger, to permit either of PC Mall or eCOST to terminate this

sublease upon 90 days prior notice. In addition, PFSweb, eCOST and PC Mall have agreed, effective upon the closing date of the merger, to amend certain software licenses under which eCOST licenses certain technology from PC Mall to permit the use of such technology by PFSweb.

INFORMATION REGARDING PFSWEB

As used in this Section Information Regarding PFSweb, references to we , us , our and ours refer to PFSweb a consolidated subsidiaries.

General

PFSweb is a leading provider of outsourcing and supply chain solutions. PFSweb s service breadth includes logistics and fulfillment, freight and transportation management, real-time order management, kitting and assembly, customer care (CRM), facility operations and management, web-commerce design and hosting, payment processing and financial services and more. Collectively, we define our offering as Business Process Outsourcing because we extend our clients infrastructure and technology capabilities, addressing an entire business transaction cycle from demand generation to product delivery. Our solutions support both business-to-business (B2B) and business-to-consumer (B2C) segments of the supply chain.

PFSweb serves as the brand behind the brand for companies seeking to increase their supply chain efficiencies. As a business process outsourcer, we offer scalable and cost-effective solutions for manufacturers, distributors, retailers and direct marketing organizations across a wide range of industry segments, from consumer goods to aviation. We provide our clients with seamless and transparent solutions to support their business strategies, allowing them to focus on their core competencies. Leveraging PFSweb s technology, expertise and proven methodology, we enable client organizations to develop and deploy new products, and implement new business strategies or address new distribution channels rapidly and efficiently through our optimized solutions. Our clients engage us both as a consulting partner to assist them in the design of a business solution as well as a virtual and physical infrastructure partner providing the mission critical operations required to build and manage that business solution. Together, we not only help our clients define new ways of doing business, but also provide them the technology, physical infrastructure and professional resources necessary to quickly implement this new business model. We allow our clients to quickly and dramatically change how they go-to-market.

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

Our technology and business infrastructure offering is flexible, reliable and fully scalable. This flexibility allows us to design custom, variable cost solutions to fit the business requirements of our clients strategies. We earn revenue from two distinct business segments, yet operationally similar business models:

First, we earn service fee revenues from charges to process individual business transactions on our clients behalf through our technology and infrastructure capabilities. These business transactions may include the answering of a phone call or an e-mail, the design and hosting of a client web-site, the receipt and storage of a client s inventory, the kitting and assembly of products to meet a client s customer s specifications, the shipping of products to our client s customer base, the

management of a complex set of electronic data transactions designed to keep our client s suppliers and customers accounting records in balance, or the processing of a returned package. In the service fee revenue business segment, we do not own the inventory or the resulting accounts receivable, but provide management services for these client-owned assets.

Secondly, we earn product revenue through our master distributor relationship with certain clients. In the product revenue business segment, we purchase inventory and upon sale of the product, own the accounts receivable. Our merger with eCOST will provide us with the opportunity to further develop and expand our product revenue business segment.

Our capabilities are expansive. To offer the most necessary and resourceful solutions to our clients, we are continually developing capabilities to meet the pressing business issues in the marketplace. Our business objective is to focus on Leading the Evolution of Outsourcing. As our tagline suggests, we will continue to evolve our service offering to meet the needs of the marketplace and the demands of unique client requirements. We are most successful when we develop a new capability to enable a client to pursue a new initiative and we are then able to leverage that revolutionary development across other client or prospect solutions, as it becomes best practice in the marketplace. Our team of experts design and build diverse solutions for Fortune 1000, Global 2000 and major brand name clients around a flexible core of technology and physical infrastructure that includes:

Technology collaboration provided by our suite of technology services, called the Entente Suite^{sm}, that are e-commerce and collaboration services that enable buyers and suppliers to fully automate their business transactions within their supply chain. Entente supports industry standard collaboration techniques including XML based protocols such as Biztalk and RosettaNet, real-time application interfaces, text file exchanges via secured FTP, and traditional electronic data interchange (EDI);

Managed hosting and Internet application development services, including web site design, creation, integration and ongoing maintenance, support and enhancement of web site;

Order management, including order processing from any source of entry, back order processing and future order processing, tracking and tracing, credit management, electronic payment processing, calculation and collection of sales tax and VAT, comprehensive freight calculation and email notification, all with multiple currency and language options;

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

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

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

Kitting and assembly services, including light assembly, procurement services, Supplier Relationship Management, specialized kitting, and supplier consigned inventory hub in PFSweb s distribution facilities or co-located in other facilities;

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

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

Table of Contents

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

We are headquartered in Plano, Texas where our executive and administrative offices are located as well as our primary technology laboratories and hosting facilities. We operate state-of-the-art call centers from our U.S. facilities located in Plano, Texas, Memphis, Tennessee, and from our international facility located in Liege, Belgium. We have more than 1.6 million square feet of warehouse space in our leased and managed facilities in Memphis, TN, Southaven, MS, Grapevine, TX, Toronto, Canada and Liege, Belgium allowing us to provide global distribution solutions. The majority of these distribution facilities are highly automated and contain state of the art material handling and communications equipment. We provide solutions to clients that are often regarded as market leaders in a variety of different industries.

Industry Overview

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

Manufacturers strive to restructure their supply chains to maximize efficiency and reduce costs in both B2B and B2C markets and to create a variable-cost supply chain able to support the multiple unique needs of each of their initiatives, including traditional and electronic commerce.

Government agencies are increasingly focused on improved citizen usability and interaction, as well as the need to manage government initiatives from an efficiency perspective. With revisions to the United States Government s Competitive Sourcing Program (A-76), the government is mandated to obtain commercially available goods and services from the private sector when it makes economic sense to do so.

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

Supply Chain Management Trend

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

A key business challenge facing many manufacturers and retailers as they evaluate their supply chain efficiency is in determining how the trend toward increased direct-to-consumer business activity will impact their traditional B2B and B2C commerce business models. Order management and small package fulfillment and distribution capabilities are becoming increasingly important processes as this trend evolves. We believe manufacturers will look to outsource their non-core competency functions to support this modified business model. Forrester Research reports US online retail sales will almost double over the next five years, reaching $329 billion by 2010. They attribute this growth to the growing population for online shopping households, combined with effective multi-channel integration and site improvements from retailers. We believe that companies will continue to strategically plan for the impact that e-commerce and other new technology advancements will have on their traditional commerce business models and their existing technology and infrastructure capabilities.

Our merger with eCOST will provide us with the opportunity to expand our products divisions and to gain market share in the growing online retail sales industry.

Table of Contents

Manufacturers, as buyers of materials, are also imposing new business practices and policies on their supplier partners in order to shift the normal supply chain costs and risks associated with inventory ownership away from their own balance sheets. Through techniques like Vendor Managed Inventory (VMI) or Consigned Inventory Programs (CIP), manufacturers are asking their suppliers, as a part of the supplier selection process, to provide capabilities where the manufacturer need not own, or even possess, inventory prior to the exact moment that unit of inventory is required as a raw material component or for shipping to a customer. To be successful for all parties, business models such as these often require a sophisticated collection of technological capabilities that allow for complete integration and collaboration of the information technology environments of both the buyer and supplier. For example, for an inventory unit to arrive at the precise required moment in the manufacturing facility, it is necessary for the Manufacturing Resource Planning (MRP) systems of the manufacturer to integrate with the CRM systems of the supplier. When hundreds of supplier partners are involved, this process can become quite complex and technologically challenging. Buyers and suppliers are seeking solutions that utilize XML based protocols like Biztalk, RosettaNet and other traditional EDI standards in order to ensure an open systems platform that promotes easier technology integration in these collaborative solutions.

Government Outsourcing Trend

In 2001, a task force was launched to identify priority actions to achieve strategic improvements in government and set in motion a transformation of government around citizens needs. The federal government formulated an E-Government strategy in 2002, which was created to support multi-agency projects that improve citizen services and yield performance gains. Also, government mandate A-76 states that Government agencies must conduct thorough audits to determine the lowest cost and most efficient method of doing business, and to outsource to the public sector when in-house operations are unable to compete.

As stated in the February 2002 E-Government Strategy document developed by the U.S. Office of Management and Budget (OMB) E-Government task force, the primary goals for this initiative are to:

Make it easy for citizens to obtain service and interact with the federal government;

Improve government efficiency and effectiveness; and

Improve the government s responsiveness to citizens.

According to the E-Government Strategy document for fiscal year 2006, the federal government s investment in information technology (IT) is estimated to be $65 billion. The continued investment made in IT spending provides opportunities for the government to continue to transform itself into a citizen-centered E-Government and provide additional opportunities for the government to work with the private sector to develop more user friendly methods of interaction. Past agency-centered IT approaches have limited the government s productivity gains and ability to serve citizens.

In addition to the E-government strategy, the Administration announced its intentions to open commercial activities performed by the government to the dynamics of competition between the public and private sectors, known as Competitive Sourcing. According to Competitive Sourcing, Conducting Public-Private Competition in a Reasoned and Responsible Manner; Executive Office of the President OMB July 2004, the OMB estimates that approximately 26% of the 1.6 million workforce from government agencies are engaged in commercial activities that should be available for competition. Activities that fall into the Competitive Sourcing agenda include data center services, information technology services, financial management and logistics.

Other opportunities within the government sector include Business Process Outsourcing initiatives. According to the U.S. Federal Government Business Process Outsourcing 2004-2008 Forecast by IDC, BPO in general, and spare parts supply chain management in particular, is a growing opportunity within the federal government. Growth is expected to continue through 2008 and beyond, as more government agencies see the success for both the Defense Department and civilian BPO efforts.

Table of Contents

Through the E-Government Strategy, Government agencies are currently faced with pressure to upgrade technology capabilities and to better interface with their audiences. Combined with the A-76 initiative that directs Government agencies to pursue the most cost-effective method of doing business, current federal strategy now enforces government s need to better understand public alternatives, submit to extensive requests for proposals to an array of government and non-government providers, and to perform complex evaluations of existing operations and functions. An ongoing requirement is to migrate the management of systems, data and business processes from multiple agencies to a joint solution, supported by one or two service providers. We believe these initiatives will continue to drive government usage of outside sources.

Outsourcing Trend

In response to growing competitive pressures and technological innovations, we believe many companies, both large and small, are focusing their critical resources on the core competencies of their business and utilizing business process outsourcing to accelerate their business plans in a cost-effective manner and perform non-core business functions. Outsourcing provides many key benefits, including the ability to:

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

As a result, the market for business process outsourcing services continues to grow. IDC predicts that the worldwide business process outsourcing market will reach $641.2 billion in 2009, an 11% annual increase from the estimated $382.5 spent in 2004.

According to IDC s Worldwide and U.S. Business Process Outsourcing Forecast, the market has gone through profound changes in recent years that have forced companies to reevaluate their business operations. Many companies have begun to explore and evaluate the applicability of BPO to their business operations and its role in helping them achieve the new goals they are thinking about. This process is causing unprecedented demand for BPO services across an ever-expanding list of business functions.

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

Another vital point for major brand name companies seeking to outsource is the protection of their brand. When looking for an outsourcing partner to provide infrastructure solutions, brand name companies must find a company that can ensure the same quality performance and superior experience that their customers expect from their brands. Working with an outsourcing partner requires finding a partner that

can maintain the consistency of their brand image, which is one of the most valuable intangible assets that recognized brand name companies possess.

The PFSweb Solution

PFSweb serves as the brand behind the brand for companies seeking to increase the efficiencies of all aspects of their supply chain.

Our value proposition is to become an extension of our clients businesses by delivering a superior experience that increases and enhances sales and market growth, customer satisfaction and customer retention. We act as both a virtual and a physical infrastructure for our clients businesses. By utilizing our services, our clients are able to:

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

Improve the Customer Experience. We enable our clients to provide their customers with a positive buying experience thereby maintaining and promoting brand loyalty. Through our use of advanced technology, we can respond directly to customer inquiries by e-mail, voice or data communication and assist them with on-line ordering and product information. We offer our clients a world-class level of service, including 24-hour, seven-day-a-week, Web-enabled customer care service centers, detailed CRM reporting and exceptional order accuracy. We have significant experience in the development of Internet web sites that allows us to recommend features and functions that are easily navigated and understood by our client s customers. Our technology platform is designed to ensure high levels of reliability and fast response times for our clients customers. Because our technology is world-class, our clients benefit from being able to offer the latest in customer communication and response conveniences to their customers.

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

Access a Sophisticated Technology Infrastructure. We provide our clients with ready access to a sophisticated technology infrastructure through our Entente Suite, which is designed to interface seamlessly with their systems. We provide our clients with vital product and customer information that can be immediately available to them on their own systems or through web based graphic user interfaces for use in data mining, analyzing sales and marketing trends, monitoring inventory levels and performing other management functions.

Table of Contents

The PFSweb Strategy

Our strategy is based on QGP. This acronym stands for Quality, Growth and Profit. We believe that if we can achieve outstanding performance on these three basic elements, they will provide for a stable foundation for the future of PFSweb. As the evolution of our business model continues, we will remain focused on these three fundamentals:

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

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

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

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

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

PFSweb Services

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

Technology Collaboration. We have created the Entente Suite, which illustrates the level of electronic cooperation that is possible when we construct solutions with our clients using this technology service offering. This set of technology services enables everything from order processing and inventory reporting to total e-commerce design and implementation. The Entente Suite comprises four key services EntenteWeb®, EntenteDirect®, EntenteMessage® and EntenteReport®.

EntenteWeb is a one-stop shop for the entire e-commerce process, particularly for companies with unusual needs or specific requests that are not easily met by the typical e-commerce development packages. EntenteWeb is a service utilizing our revolutionary GlobalMerchant Commerceware™ e-commerce software platform that is particularly focused to enable global commerce strategies with its extensive currency and language functionality. EntenteDirect provides clients with a real-time, user-friendly interface between their system and PFSweb order processing, warehouse management and related functions. Using real-time or batch processes, EntenteMessage is a file exchange service for clients using our warehousing and distribution facilities. EntenteReport is a reporting and inquiry service particularly suited to companies that need to put key e-commerce information into the hands of business users, but do not have the IT resources to facilitate the necessary data extraction, manipulation and presentation. EntenteReport consists of an industry-standard browser-based report writer and a client-customized data warehouse configuration.

The Entente Suite operates in an open systems environment and features the use of industry-standard XML, enabling customized e-commerce solutions with minimal changes to a client s systems or our Enterprise Resource Planning (ERP) systems. The result is a faster implementation process. Additionally, by using XML, the Entente Suite offers companies a more robust electronic information transfer option than text file FTP or EDI, although the text file FTP, EDI and other transfer methods are still supported.

EntenteWeb Managed Hosting and Internet Application Development. Our EntenteWeb service provides a complete e-commerce website solution for our clients. We engage collaboratively with our clients to design, build, host, and manage fully branded, fully customized and fully integrated e-commerce web applications for B2C and B2B channels. As with all major brand name companies, consistency within the brand image is vital; therefore, our web designers create online stores that seamlessly integrate and mirror the exact brand image of our clients.

We offer a broad range of hosting and support plans that can be tailored to fit the needs of each client. Utilizing IBM s eServer xSeries servers, Microsoft s.NET Technologies and our proprietary GlobalMerchant Commerceware platform, we maintain a robust hosting environment for our hosted client web site properties. Additionally, our EntenteWeb service includes state-of-the-art web analytics via Web Trends OnDemand Enterprise Edition. This highly advanced and flexible analytics tool delivers the critical e-business information that our clients need to maximize the effectiveness of their online store.

EntenteWeb is a complete front-to-back e-commerce service that incorporates components ranging from the look of the user interface to specific business purchasing, warehousing and shipping needs, enabling companies to define in exact terms their desired e-commerce site functionality.

Order Management. Our order management solutions provide clients with interfaces that allow for real-time information retrieval, including information on inventory, sales orders, shipments, delivery, purchase orders, warehouse receipts, customer history, accounts receivable and credit lines. These solutions are seamlessly integrated with our web-enabled customer contact centers, allowing for the processing of orders through shopping cart, phone, fax, mail, email, web chat, and other order receipt methods. As the information backbone for our total supply chain solution, order management services can be used on a stand alone basis or in conjunction with our other business infrastructure offerings, including customer contact, financial or distribution services. In addition, for the B2B market, our technology platform provides a variety of order receipt methods that facilitate commerce within various stages of the supply chain. Our systems provide the ability for both our clients and their customers to track the status of orders at any time. Our services are transparent to our clients customers and are seamlessly integrated with our clients internal systems platforms and web sites. By synchronizing these activities, we can capture and provide critical customer information, including:

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

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

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

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

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

Customer Relationship Management. We offer a completely customized CRM solution for clients. Our CRM solution encompasses a full-scale customer contact management service offering, as well as a fully integrated customer analysis program. All customer contacts are captured and customer purchases are documented. Full-scale reporting on all customer transactions is available for evaluation purposes. Through each of our customer touch-points, information can be analyzed and processed for current or future use in business evaluation, product effectiveness and positioning, and supply chain planning.

An important feature of evolving commerce remains the ability for the customer to speak with a live customer service representative. Our experience has been that a majority of consumers tell us they visited

101

the web location for information, but not all of those consumers chose to place their order online. Our customer care services utilize features that integrate voice, e-mail, standard mail, data and Internet chat communications to respond to and handle customer inquiries. Our customer care representatives answer various questions, acting as virtual representatives of our client s organization, regarding order status, shipping, billing, returns and product information and availability as well as a variety of other questions. For certain clients, we handle Level I and Level II technical support. Level I technical support involves assisting clients customers with basic technical issues, i.e. computer application issues. Level II support may involve a more in-depth question and answer session with the customer. These customer care representatives are certified in the appropriate applications and have the ability to evaluate hardware, compatibility and software installation issues. Our web-enabled customer care technology identifies each customer contact automatically and routes it to the available customer care representative who is individually certified in the client s business and products. Our web-enabled customer care centers are designed so that our customer care representatives can handle several different clients and products in a shared environment, thereby creating economy of scale benefits for our clients as well as highly customized dedicated support models that provide the ultimate customer experience and brand reinforcement. Our advanced technology also enables our representatives to up-sell, cross-sell and inform customers of other products and sales opportunities. The web-enabled customer care center is fully integrated into the data management and order processing system, allowing full visibility into customer history and customer trends. Through this fully integrated system, we are able to provide a complete CRM solution.

With the need for efficiency and cost optimization for many of our clients, we have integrated IVR as another option for customer contacts. IVR creates an electronic workforce with virtual agents that can assist customers with vital information at any time of the day or night. IVR allows for our clients customers to deal interactively with our system to handle basic customer inquiries, such as account balance, order status, shipment status, catalog requests, product and price inquiries, and routine order entry for established customers. The inclusion of IVR to our service offering allows us to offer a cost effective way to handle high volume, low complexity calls.

International Fulfillment and Distribution Services. An integral part of our business process outsourcing solutions is the warehousing and distribution of inventory either owned by our clients or owned by us through our master distributor relationships. We currently have more than 1.6 million square feet of leased or managed warehouse space domestically and internationally to store and process our clients inventory. We receive client inventory in our distribution centers, verify shipment accuracy, unpack and audit (a process that includes spot-checking a small percentage of the clients inventory to validate piece counts and check for damages that may have occurred during shipping, loading and unloading). Upon request, we inspect for other damages or defects, which may include checking fabric, stitching and zippers for soft goods, or testing power-up capabilities for electronic items. We generally stock for sale within one business day of unloading. On behalf of our clients, we pick, pack and ship their customer orders and can provide customized packaging, inserts and promotional literature for distribution with customer orders.

Our distribution facilities contain computerized sortation equipment, highly mobile pick-to-light carts, powered material handling equipment, scanning and bar-coding systems and automated conveyors, in-line scales and x-ray equipment used to inspect shipment contents for automatic accuracy checking. Our international distribution complexes include several advanced technology enhancements, such as radio frequency technology in product receiving processing to ensure accuracy, as well as an automated package routing and a pick-to-light paperless order fulfillment system. Our advanced distribution systems provide us with the capability to warehouse an extensive number of stock keeping units (SKUs) for our clients, ranging from large high-end laser printers to small cosmetic compacts. Our facilities are flexibly configured to process B2B and single pick B2C orders from the same central location.

During 2004, we warehoused, managed and fulfilled more than $1.5 billion in client merchandise and transactions. Much of this does not represent our revenue, but rather the revenue of our clients transactions for whom we provided business process outsourcing solutions.

Based upon our clients needs, we are able to take advantage of a variety of shipping and delivery options, which range from next day service to zone skipping to optimize transportation costs. Our facilities and systems are equipped with multi-carrier functionality, allowing us to integrate with all leading package carriers and provide a comprehensive freight and transportation management offering. In addition, an increasingly important function that we provide for our clients is reverse logistics management. We offer a wide array of product return services for our clients, including issuing return authorizations, receipt of product, crediting customer accounts, and disposition of returned product.

Domestic clients of PFSweb enjoy the benefits of having their inventory assets secured by a network of trained law enforcement professionals, who have developed and continue to operate a world-class security network from our security headquarters in Memphis, TN. As part of our services are for the United States Government, our security plans and procedures are under constant evaluation and evolution. Continual validation ensures that we employ the latest in security processes and procedures to further enhance our surveillance and detection capabilities.

Facility Operations and Management. Our FOM service offering includes distribution facility design and optimization, business process reengineering and ongoing staffing and management. Along with our high-volume fulfillment center in Mississippi and our automated fulfillment center in Tennessee, we also manage an aircraft parts distribution center in Grapevine, Texas on behalf of Raytheon Aircraft Company. Our expertise in supply chain management, logistics and customer-centric fulfillment operations extends through our management of client-owned facilities, resulting in cost reductions, process improvements and technology-driven efficiencies.

Kitting and Assembly Services. Our expanded kitting and assembly services enable our clients to reduce the time and costs associated with managing multiple suppliers, warehousing hubs, and light manufacturing partners. As a single source provider, we provide clients with the advantage of convenience, accountability and speed. Our comprehensive kitting and assembly services provide a quality one-stop resource for any international channel. PFSweb s kitting and assembly service includes light assembly, specialized kitting and supplier-consigned inventory hub either in our distribution facilities or co-located elsewhere. We also offer customized light manufacturing and Supplier Relationship Management (SRM) for Fortune 1000 and Global 2000 manufacturers.

We will work with clients to re-sequence certain supply chain activities to aid in an inventory postponement strategy. We can provide kitting and assembly services and build-to-stock thousands of units daily to stock in a Just-in-Time (JIT) environment. This service, for example, can entail the procurement of packaging materials including retail boxes, foam inserts and anti-static bags. These raw material components would be shipped to PFSweb from domestic or overseas manufacturers, and PFSweb will build the finished SKU units to stock for the client. This strategy allows manufacturers to make a smaller investment in inventory while meeting changing customer demand.

Combining our assembly services with our supplier-owned inventory hub services allows our clients to reduce cycle times, to compress their supply chains and to consolidate their operations and supplier management functions. We have supplier inventory management, assembly and fulfillment services all in one place, providing greater flexibility in product line utilization, as well as rapid response to change orders or packaging development. Our standard capabilities include: build-to-order, build-to-stock, expedited orders, passive and active electrostatic discharge (ESD) controls, product labeling, serial number generation, marking and/or capture, lot number generation, asset tagging, bill of materials (BOM) or computer automated design (CAD) engineering change processing, SKU-level pricing and billing, manufacturing and metrics reporting, first article approval processes, and comprehensive quality controls.

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

Kitting and inventory hub services enable clients to collapse supply chains into the minimal steps necessary to prepare product for distribution to any channel, including wholesale, mass merchant retail, or

direct to consumer. Clients no longer have to employ multiple providers or require suppliers to consign multiple inventory caches for each channel. We offer our clients the opportunity to consolidate operations from a channel standpoint, as well as from a geographic perspective. Our integrated, global information systems and international locations support client business needs worldwide.

Information Management. We have the ability to communicate with and transfer information to and from our clients through a wide variety of technology services, including real-time data interfaces, file transfer methods and electronic data interchange. Our systems are designed to capture, store and electronically forward to our clients critical information regarding customer inquiries and orders, product shipments, inventory status (for example, levels of inventory on hand, on backorder, on purchase order and inventory due dates to our warehouse), product returns and other information. We maintain for our clients detailed product databases that can be seamlessly integrated with their web sites utilizing the capabilities of the Entente Suite. Our systems are capable of providing our clients with customer inventory and order information for use in analyzing sales and marketing trends and introducing new products. We also offer customized reports and data analyses based upon specific client needs to assist them in their budgeting and business decision process.

Financial Services. Our financial services are divided into two major areas: 1) billing, credit and collection services for B2B and B2C clients and 2) working capital solutions, where we act as a virtual and physical financial management department to fulfill our clients needs.

We offer secure credit and collections services for both B2B and B2C businesses. Specifically, for B2C clients, we offer secure credit card processing related services for orders made via a client web site or through our customer contact center. We offer manual credit card order review as an additional level of fraud protection. We also calculate sales taxes, goods and services taxes or value added taxes, if applicable, for numerous taxing authorities and on a variety of products. Using third-party leading-edge fraud protection services and risk management systems, we can assure the highest level of security and the lowest level of risk for client transactions.

For B2B clients, we offer full-service accounts receivable management and collection capabilities, including the ability to generate customized computer-generated invoices in our clients names. We assist clients in reducing accounts receivable and days sales outstanding, while minimizing costs associated with maintaining an in-house collections staff. We offer electronic credit services in the format of EDI X.12 and XML communications direct from our clients to their vendors, suppliers and retailers.

Our subsidiary, Supplies Distributors, Inc. provides working capital solutions, which enable manufacturers to remove inventory and receivables from their balance sheets through the use of third party financing. This service offering is available to clients operating in North America and Europe.

While the majority of our clients maintain ownership of their own inventory, through Supplies Distributors, we can create and implement client inventory solutions as well. PFSweb has years of experience in dealing with the issues related to inventory ownership, secure inventory management, replenishment and product distribution. PFSweb and Supplies Distributors can offer prospective clients a management solution for the entire customer relationship, including ownership of inventory and receivables. Through CIP, we utilize technology resources to time the replenishment purchase of inventory with the simultaneous sale of product to the end user. All interfaces are done electronically and almost all processes regarding the financial transactions are automated, creating significant supply chain advantages.

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

Professional Consulting Services. As part of the tailored solution for our clients, we offer a full team of experts specifically designated to focus on our clients businesses. Team members play a consultative role, providing constructive evaluation, analysis and recommendations for the client s business. This team

creates customized solutions and devises plans that will increase efficiencies and produce benefits for the client when implemented.

Comprised of industry experts from top-tier consulting firms and industry market leaders, our team of professional consultants provides client service focus and logistics and distribution expertise. They have built solutions for Fortune 1000 and Global 2000 market leaders in a wide range of industries, including apparel, technology, telecommunications, cosmetics, aviation, housewares, high-value collectibles, sporting goods, pharmaceuticals and several more. Focusing on the evolving infrastructure needs of major corporations and their business initiatives, our team has a solid track record providing consulting services in the areas of supply chain management, distribution and fulfillment, technology interfacing, logistics and customer support.

Clients and Marketing

Our target clients include Fortune 1000 and major brand name technology and consumer goods companies looking to quickly and efficiently implement or enhance business initiatives, adapt their go-to-market strategies, or introduce new products or programs, without the burden of modifying or expanding their technology, customer care, supply chain and logistics infrastructure. We also provide FOM solutions that include Process Reengineering, Facility Design and Employee Administration services. Our solutions are applicable to a multitude of industries and company types and we have provided solutions for such companies as: International Business Machines (IBM) (printer supplies in several geographic areas), Adaptec (computer accessories), the United States Government as a sub-contractor (high-value collectibles), Avaya Communication, Emtec Magnetics (a manufacturer of BASF-branded data media and audio visual products), CHiA SSO (a contemporary home furnishings and decor cataloguer), Xerox (printers and printer supplies), Pfizer (pharmaceuticals), Lancôme (a cosmetic division of L Oreal), NokiaUSA.com (cell phone accessories), Roots Canada (apparel), Hewlett-Packard (printers and computer networking equipment), Flavia (a beverage division of Mars), Raytheon Aircraft Company (FOM and time-definite logistics supporting parts distribution) and The Smithsonian Business Ventures (a collectibles cataloger), amongst many others. We target potential clients through an extensive integrated marketing program that comprises a variety of direct marketing techniques, trade event participation, search engine marketing, public relations and a sophisticated outbound tele-sales lead generation model. We have also developed an intricate messaging matrix that defines our various business process outsourcing solutions and products, the vehicles we utilize to deliver marketing communication on these solutions/products and the target audience segments that display a demand for these solutions/products. This messaging matrix allows us to deploy highly targeted solution messages to selected key vertical industry segments where we feel that we are able to provide significant service differentiation and value. We also pursue strategic marketing alliances with consulting firms, software manufacturers and other logistics providers to increase market awareness and generate referrals and customer leads.

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

Technology

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

We employ technology from a selected group of partners, some of whom are also our clients. For example, we deploy IBM e-servers and network printers in appropriate models to run web site functions as well as order management and distribution functions. We utilize Avaya Communication for telephone switch and call center management functions and to interact with customers via voice, e-mail or chat. Avaya Communication technology also allows us to share web pages between customers and our service representatives. We have the ability to transmit and receive voice, data and video simultaneously on a single network connection to a customer to more effectively serve that customer for our client. Clients interest in using this technology stems from its ability to allow shoppers to consult with known experts in a way that the customer chooses prior to purchasing. Our sophisticated computer-telephony integration has been accomplished by combining systems software from IBM and Avaya Communication together with our own application development. We use AT&T for our private enterprise network and long distance carrier. We use J.D. Edwards as the software provider for the primary ERP applications that we use in our operational areas and financial areas. We use Ecometry as the software provider for the primary multi-channel direct marketing application we deploy for our catalog and direct marketing clients. We use Siemens Dematic/ Rapistan Materials Handling Automation for our automated order selection, automated conveyor and pick-to-light (inventory retrieval) systems, and Symbol Technologies/ Telxon for our warehouse radio frequency applications. Our Warehouse Management System (WMS) and Distribution Requirements Planning (DRP) system have been developed in-house to meet the varied unique requirements of our vertical markets. Both the WMS and DRP are tightly integrated to both the North American and European deployments of our J.D. Edwards system.

Many internal infrastructures are not sufficient to support the explosive growth in e-business, e-marketplaces, supply chain compression, distribution channel realignment and the corresponding demand for real-time information necessary for strategic decision-making and product fulfillment. To address this need, we have created the Entente Suite, which is a comprehensive suite of technology services, with supporting software and hardware infrastructure, that enables companies with little or no e-commerce infrastructure to speed their time to market and minimize resource investment and risk, and allows all companies involved to improve the efficiency of their supply chain. The Entente Suite is comprised of four distinct service offerings EntenteWeb, EntenteDirect, EntenteMessage, and EntenteReport that can stand alone or be combined for a fully customized e-commerce solution depending on the level of direct involvement a company wants to maintain in their e-commerce initiative.

The components of the Entente Suite provide the open platform service infrastructure that allows us to create complete e-commerce solutions with our customers. Using the various services of the Entente Suite, we can assist our clients in easily integrating their web sites or ERP systems to our systems for real-time transaction processing without regard for their hardware platform or operating system. This high-level of systems integration allows our clients to automatically process orders, customer data and other e-commerce information. We also can track information sent to us by the client as it moves through our systems in the same manner a carrier would track a package throughout the delivery process. Our systems enable us to track, at a detailed level, information received, transmission timing, any errors or special processing required and information sent back to the client. The transactional and management information contained within our systems is made available to the client quickly and easily through the Entente Suite.

The Entente Suite serves as a transparent interface to our back-office productivity applications including our customized J.D. Edwards order management and fulfillment application and our Ecometry multi-channel direct marketing application that runs on IBM s e-Server xSeries servers. It also is designed to integrate with marketplace technologies offered by major marketplace software companies. PFSweb utilizes Gentran Integration Suite^{tm} (GIS) as our technology platform for Enterprise Application Integration with our clients and client s trading partners. With GIS, we have greatly increased our ability to quickly design and deploy customized B2B e-commerce solutions for our clients by utilizing a robust business process modeling tool and a highly scalable operating infrastructure. This platform facilitates the efficient and secure exchange of electronic business transactions/documents in a wide variety of formats (i.e. XML, X.12 EDI, delimited text, IDOCS, RosettaNet) and communication protocols (i.e. FTP/ SFTP, HTTP/ HTTPS, SMTP).

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

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

Our information technology operations and infrastructure are built on the premise of reliability and scalability. We maintain diesel generators and un-interruptible power supply equipment to provide constant availability to computer rooms, call centers and warehouses. Multiple Internet service providers and redundant web servers provide for a high degree of availability to web sites that interface with our systems. Capacity planning and upgrading is performed regularly to allow for quick implementation of new clients and avoid time-consuming infrastructure upgrades that could slow growth rates. We also have a disaster recovery plan for our information systems and maintain a hot site under contract with a major provider.

Competition

Many companies offer, on an individual basis, one or more of the same services we do, and we face competition from many different sources depending upon the type and range of services requested by a potential client. Our competitors include vertical outsourcers, which are companies that offer a single function solution, such as call centers, public warehouses or credit card processors. We compete against transportation logistics providers, known in the industry as 3PL s and 4PL s, who offer product management functions as an ancillary service to their primary transportation services. We also compete against other business process outsourcing providers, who perform many similar services as us. Many of these companies have greater capabilities than we do for the single or multiple functions they provide. In many instances, our competition is the in-house operations of our potential clients themselves. The in-house operations departments of potential clients often believe that they can perform the same services we do, while others are reluctant to outsource business functions that involve direct customer contact. We cannot be certain that we will be able to compete successfully against these or other competitors in the future.

Although many of our competitors can offer one or more of our services, we believe our primary competitive advantage is our ability to offer a wide array of customized services that cover a broad spectrum of business processes, including web-site design and hosting, kitting and assembly, order processing and shipment, credit card payment and customer service, thereby eliminating any need for our clients to coordinate these services from many different providers. We believe we are unique in offering our clients a very broad range of business process services that addresses, in many cases, the entire business transaction, from demand to delivery.

We also compete on the basis of many other important additional factors, including:

- operating performance and reliability;
- ease of implementation and integration;
- experience of the people required to successfully and efficiently design and implement solutions;
- leading edge technology capabilities;
- global reach; and
- price.

Table of Contents

We believe that we compete favorably with respect to each of these factors. However, the market for our services is competitive and still evolving, and we may not be able to compete successfully against current and future competitors.

Employees

As of November 16, 2005, we had 937 employees, of which 877 were located in the United States. We are not a party to any collective bargaining agreements, and we have never suffered an interruption of business as a result of a labor dispute. We consider our relationship with our employees to be good.

Our success in recruiting, hiring and training large numbers of skilled employees and obtaining large numbers of hourly employees during peak periods for distribution and call center operations is critical to our ability to provide high quality distribution and support services. Call center representatives and distribution personnel receive feedback on their performance on a regular basis and, as appropriate, are recognized for superior performance or given additional training. Generally, our clients provide specific product training for our customer service representatives and, in certain instances, on-site client personnel to provide specific technical support. To maintain good employee relations and to minimize employee turnover, we offer competitive pay, hire primarily full-time employees who are eligible to receive a full range of employee benefits, and provide employees with clear, visible career paths.

Regulation

Our business may be affected by current and future governmental regulation, both foreign and domestic. For example, the Internet Tax Freedom Act bars state and local governments from imposing taxes on internet access or that would subject buyers and sellers in electronic commerce to taxation in multiple states. This act is in effect until November 1, 2006. If legislation to extend this act or similar legislation is not enacted, internet access and sales across the Internet may be subject to additional taxation by state and local governments, thereby discouraging purchases over the Internet and adversely affecting the market for our services.

Properties

Our business is headquartered in a central office facility located in Plano, Texas, a Dallas suburb.

In the U.S., we operate a distribution facility in Memphis, Tennessee, which includes floor and mezzanine space of approximately 800,000 square feet. We also operate more than 900,000 square feet of distribution facilities in Southaven, Mississippi. These complexes are located approximately five miles from the Memphis International Airport, where both Federal Express and United Parcel Service operate large hub facilities. We also manage a 200,000 square foot distribution facility in Grapevine, Texas.

We operate a 150,000 square foot distribution center in Liege, Belgium, which contains advanced distribution systems and equipment. We also operate a 13,000 square foot distribution center in Richmond Hill, Canada, near Toronto. We operate customer service centers in Memphis, Tennessee; Plano, Texas; and Liege, Belgium. Our call center technology permits the automatic routing of calls to available customer service representatives in several of our call centers.

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

Legal Proceedings

On May 9, 2005, a lawsuit was filed in the District Court of Collin County, Texas, by J. Gregg Pritchard, as Trustee of the D.I.C. Creditors Trust, naming the former directors of Daisytek International Corporation and PFSweb as defendants. Daisytek filed for bankruptcy in May 2003 and the Trust was created pursuant to Daisytek s Plan of Liquidation. The complaint alleges, among other things, that the spin-off of PFSweb from Daisytek in December 1999 was a fraudulent conveyance and that Daisytek was

damaged thereby in the amount of at least $38 million. PFSweb believes the claim has no merit and intends to vigorously defend the action.

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on our website at www.pfsweb.com when such reports are available on the Securities and Exchange Commission website. The contents of our website are not incorporated into this proxy statement/ prospectus.

Red Dog Acquisition Corp.

Red Dog Acquisition Corp. is a recently formed Delaware corporation and a wholly-owned subsidiary of PFSweb and was organized solely for the purpose of functioning as an acquisition vehicle and has not conducted any business operations.

Table of Contents

PFSWEB MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of PFSweb s financial condition and results of operations in conjunction with PFSweb s consolidated financial statements and the related notes included elsewhere in this proxy statement/ prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. As a result of many factors, including those set forth under the section entitled Risk Factors and elsewhere in this proxy statement/ prospectus, PFSweb s actual results may differ materially from those anticipated in these forward-looking statements. As used in this Section, references to we , us , our and ours refer to PFSweb and its consolidated subsidiaries.

Forward-Looking Information

We have made forward-looking statements herein. 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, antici predict, potential, continue, will, may, could, intend, plan, target and estimate or similar expressio forward-looking statements. You should understand that the following important factors, in addition to those set forth under the section entitled Risk factors, could cause our results to differ materially from those expressed in our forward-looking statements. These factors include:

- our ability to retain and expand relationships with existing clients and attract and implement new clients;
- our reliance on the fees generated by the transaction volume or product sales of our clients;
- our reliance on our clients projections or transaction volume or product sales;
- our dependence upon our agreements with IBM;
- our dependence upon our agreements with our major clients;
- our client mix, their business volumes and the seasonality of their business;
- our ability to finalize pending contracts;
- the impact of strategic alliances and acquisitions;
- trends in the market for our services;
- trends in e-commerce;
- whether we can continue and manage growth;
- changes in the trend toward outsourcing;
- increased competition;
- our ability to generate more revenue and achieve sustainable profitability;
- effects of changes in profit margins;
- the customer and supplier concentration of our business;

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

trends in government regulation both foreign and domestic;

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

potential litigation;

our dependency on key personnel;

- the impact of new accounting standards and rules regarding revenue recognition, stock options and other matters;
- changes in accounting rules or the interpretations of those rules;
- our ability to raise additional capital or obtain additional financing; and
- our ability or the ability of our subsidiaries to borrow under current financing arrangements and maintain compliance with debt covenants.

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

Overview

We are an international provider of integrated business process outsourcing solutions to major brand name companies seeking to maximize their supply chain efficiencies and to extend their traditional business and e-commerce initiatives. We derive our revenues from a broad range of services, including professional consulting, technology collaboration, order management, managed web hosting and web development, customer relationship management, financial services including billing and collection services and working capital solutions, kitting and assembly services, information management and international fulfillment and distribution services. We offer our services as an integrated solution, which enables our clients to outsource their complete infrastructure needs to a single source and to focus on their core competencies. Our distribution services are conducted at warehouses that we lease or manage and include real-time inventory management and customized picking, packing and shipping of our clients customer orders. We currently offer the ability to provide infrastructure and distribution solutions to clients that operate in a range of vertical markets, including technology manufacturing, computer products, printers, cosmetics, fragile goods, high security collectibles, pharmaceuticals, contemporary home furnishings, apparel, aviation, telecommunications and consumer electronics, among others.

We provide these services, and earn our revenue, through two separate business segments, which have operationally similar business models. The first business segment is a service fee revenue model. In this segment, we do not own the underlying inventory or the resulting accounts receivable, but provide management services for these client-owned assets. We typically charge our service fee revenue on a cost-plus basis, a percent of shipped revenue basis or a per-transaction basis, such as a per-minute basis for web-enabled customer contact center services and a per-item basis for fulfillment services. Additional fees are billed for other services and special projects. 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 and other out-of-pocket expenses include travel, shipping and handling costs and telecommunication charges are included in pass-through revenue.

Our second business segment is a product revenue model. In this segment, we are a master distributor of product for IBM and certain other clients. In this capacity, we purchase, and thus own, inventory and recognize the corresponding product revenue. As a result, upon the sale of inventory, we own the accounts receivable. Freight costs billed to customers are reflected as components of product revenue. This business segment requires significant working capital requirements, for which we have senior credit facilities to provide for more than $80 million of available financing.

Table of Contents

Growth is a key element to achieving our future goals, including maintaining sustainable profitability. Growth in our service fee business is driven by two main elements: new client relationships and organic growth from existing clients. During 2004, we were successful in winning new service fee contracts with new and existing clients. We currently believe these new contracts, once fully operational, will generate annual service fee revenue of more than $20 million. We expect to invoice 85% 90% of the estimated annual run-rate revenue of these new contracts during 2005. Our results for the three months and nine months ended September 30, 2005 include approximately $5.5 million and $14.3 million, respectively, of new service fee revenue.

We continue to monitor and control our costs to focus on profitability. While we expect our new service fee contracts to yield increased gross profit, we expect this profit to be somewhat offset by incremental investments to implement new contracts, investments in infrastructure and sales and marketing to support our targeted growth and increased public company professional fees.

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

Cost of product revenue 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 IBM to Supplies Distributors or its customers to cover price protection and certain special bids, the cost of products provided to replace defective product returned by customers and certain other expenses as defined under the master distributor agreements.

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

SG&A expenses consist primarily of compensation and related expenses for sales and marketing staff, executive, management and administrative personnel and other overhead costs, including certain occupancy and information technology costs and depreciation and amortization expenses. In addition, certain direct contract costs related to our IBM and other master distributor agreements are reflected as selling and administrative expenses.

Monitoring and controlling our available cash balances 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. In recent years we have added to our available cash and liquidity positions through various transactions. First we have a working capital financing agreement with a bank that currently provides financing for up to $7.5 million of eligible accounts receivable and has provided financing for $2.5 million of eligible capital expenditures. Secondly, in 2003 we completed a private placement of approximately 1.6 million shares of our common stock to certain investors that provided net proceeds of approximately $3.2 million. In January 2005, we issued an additional 0.4 million shares of common stock to certain of these investors who exercised warrants issued in the private placement. The warrants exercised provided $1.3 million of additional proceeds. Thirdly, in 2004 we received proceeds of $5 million of taxable revenue bonds to finance capital additions to one of our new facilities in Southaven, MS.

Table of Contents

Results of Operations

The following table sets forth certain historical financial information from our unaudited interim condensed consolidated statements of operations expressed as a percent of revenue.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Product revenue, net	76.4%	79.9%	76.3%	83.3%
Service fee revenue	18.3	15.1	18.2	12.7
Pass-through revenue	5.3	5.0	5.5	4.0
Total revenues	100.0	100.0	100.0	100.0
Cost of product revenue (as % of product revenue)	92.2	94.4	93.3	94.3
Cost of service fee revenue (as % of service fee revenue)	73.8	65.9	74.8	65.9
Cost of pass-through revenue (as % of pass-through revenue)	100.0	100.0	100.0	100.0
Total costs of revenues	89.2	90.4	90.3	90.9
Gross profit	10.8	9.6	9.7	9.1
Selling, general and administrative expenses	10.4	8.4	9.4	8.7
Income (loss) from operations	0.4	1.2	0.3	0.4
Interest expense, net	0.6	0.5	0.5	0.5
Income (loss) before income taxes	(0.2)	0.7	(0.2)	(0.1)
Income tax expense	0.3	0.2	0.3	0.2
Net income (loss)	(0.5)%	0.5%	(0.5)%	(0.3)%

Table of Contents

The following table sets forth certain historical financial information from our consolidated statements of operations expressed as a percent of net revenues.

	Year Ended December 31,		
	2004	**2003**	**2002**
Product revenue, net	83.1%	87.0%	59.3%
Service fee revenue	13.1	11.8	31.9
Service fee revenue, affiliate			5.0
Pass-through revenue	3.8	1.2	3.8
Total revenues	100.0	100.0	100.0
Cost of product revenue (as % of product revenue)	94.2	94.4	94.5
Cost of service fee revenue (as % of service fee revenue)	66.7	68.6	63.3
Cost of pass-through revenue (as % of pass-through revenue)	100.0	100.0	100.0
Total costs of revenues	90.8	91.4	83.2
Gross profit	9.2	8.6	16.8
Selling, general and administrative expenses	8.4	8.9	27.8
Severance and other termination costs			1.3
Asset and lease impairments		0.1	1.0
Income (loss) from operations	0.8	(0.4)	(13.3)
Equity in earnings of affiliate			1.2
Interest expense	0.5	0.7	1.0
Interest income			(0.8)%
Income (loss) before income taxes and extraordinary gain	0.3	(1.1)	(11.9)
Income tax expense (benefit)	0.2	0.2	0.1
Income (loss) before extraordinary gain	0.1	(1.3)	(12.0)
Extraordinary gain			0.2
Net income (loss)	0.1%	(1.3)%	(11.8)%

Three and Nine Months Ended September 30, 2005 and 2004

Product Revenue. Product revenue was $62.3 million for the three months ended September 30, 2005, as compared to $61.6 million for the three months ended September 30, 2004, an increase of $0.7 million, or 1.2%. This increase was primarily due to the impact of certain product price increases in 2005 offset by a decrease in sales volume. Product revenue was $189.4 million for the nine months ended September 30, 2005, as compared to $195.4 million for the nine months ended September 30, 2004, a decrease of $6.0 million, or 3.1%. The nine-month decrease in product revenue resulted primarily from the decreased sales volume of certain product partially offset by the impact of certain product price increases and the effect of exchange rates in our European and Canadian operations.

Service Fee Revenue. Service fee revenue was $14.9 million for the three months ended September 30, 2005 as compared to $11.6 million for the three months ended September 30, 2004, an increase of $3.3 million or 28.4%. For the nine month period ended September 30, 2005 and 2004, service

fee revenue was $45.3 million and $29.8 million respectively, an increase of $15.5 million or 52.1%. The change in service fee revenue is shown below ($ millions):

	Three Months	Nine Months
Period ended September 30, 2004	$ 11.6	$ 29.8
New service contract relationships, including certain incremental projects under new contracts	5.5	14.3
Increase (decrease) in existing client service fees including impact of certain incremental projects with existing clients	(2.1)	2.6
Terminated clients not included in 2005 revenue	(0.1)	(1.4)
Period ended September 30, 2005	$ 14.9	$ 45.3

The decrease in existing client service fees during the three months ended September 30, 2005 primarily resulted from one of our large clients modifying its product release schedule as well as lower project revenue in 2005.

Cost of Product Revenue. Cost of product revenue was $57.4 million for the three months ended September 30, 2005, as compared to $58.1 million for the three months ended September 30, 2004, a decrease of $0.7 million or 1.2%. Cost of product revenue as a percent of product revenue was 92.2% and 94.4% during the three months ended September 30, 2005 and 2004, respectively. The resulting gross profit margin was 7.8% and 5.6% for the three months ended September 30, 2005 and 2004, respectively. For the nine month period ended September 30, 2005 and 2004, cost of product revenue was $176.7 million and $184.3 million, respectively, a decrease of $7.6 million or 4.1%. Cost of product revenue as a percent of product revenue was 93.3% and 94.3% during the nine months ended September 30, 2005 and 2004, respectively. The resulting gross profit margin was 6.7% and 5.7% for the three and nine months ended September 30, 2005 and 2004, respectively. Cost of product revenue for the three and nine months ended September 30, 2005 was reduced by certain incremental inventory cost reductions and also the result of decreased sales volumes of certain products. In addition, for the three and nine months ended September 30, 2004, gross margin included higher provisions for excess and obsolete inventory of $0.3 million and $1.0 million, respectively, as compared to the comparable periods in 2005.

Cost of Service Fee Revenue. Cost of service fee revenue was $11.0 million for the three months ended September 30, 2005, as compared to $7.6 million during the three months ended September 30, 2004, an increase of $3.4 million or 43.7%. The resulting service fee gross profit was $3.9 million, or 26.2% of service fee revenue, during the three months ended September 30, 2005 as compared to $4.0 million, or 34.1% of service fee revenue for the three months ended September 30, 2004. Cost of service fee revenue was $33.9 million for the nine months ended September 30, 2005, as compared to $19.6 million during the nine months ended September 30, 2004, an increase of $14.3 million or 72.6%. The resulting service fee gross profit was $11.4 million, or 25.2% of service fee revenue, during the nine months ended September 30, 2005 as compared to $10.2 million, or 34.1% of service fee revenue for the nine months ended September 30, 2004. Our gross profit as a percent of service fees decreased in the current periods primarily due to lower gross margins on certain new contracts partially due to higher costs incurred during the implementation and initial operating periods of these new contracts. The three and nine months ended September 30, 2004 also reflects the higher gross margin benefit related to certain project revenue that has not occurred at a similar level in the corresponding period of 2005. As we add new service fee revenue in the future, we currently intend to target the underlying contracts to earn an average gross profit percentage of 25-35%, but we have and may continue to accept lower gross margin percentages on certain contracts depending on contract scope and other factors.

Selling, General and Administrative Expenses. SG&A expenses were $8.4 million for the three months ended September 30, 2005, or 10.4% of total revenues, as compared to $6.5 million, or 8.4% of total revenues, for the three months ended September 30, 2004. SG&A expenses were $23.4 million for the nine months ended September 30,

2005, or 9.4% of total revenues, as compared to $20.5 million, or

8.7% of total revenues, for the nine months ended September 30, 2004. The increase in SG&A expenses is primarily due to approximately $1.2 and $1.4 million for the three and nine months ended September 30, 2005, respectively, of incremental costs incurred to relocate certain of our operations from Memphis, TN to a new facility in Southaven, MS, the increase in legal fees related to the Daisytek lawsuit filed in May 2005, incremental sales and marketing expenses and certain personnel related costs.

Income Taxes. We recorded an income tax provision of $0.3 million and $0.1 million for the three months ended September 30, 2005 and 2004, respectively. For the nine months ended September 30, 2005 and 2004, we recorded a tax provision of $0.6 million and $0.5 million, respectively. The tax provision is primarily associated with our subsidiary Supplies Distributors Canadian and European operations. We did not record an income tax benefit associated with our consolidated net loss in our U.S. operations. A valuation allowance has been provided for our net deferred tax assets as of September 30, 2005, which are primarily related to our net operating loss carryforwards. We did not record an income tax benefit for our PFSweb Canadian pre-tax losses in the current or prior periods. We anticipate that we will continue to record an income tax provision associated with Supplies Distributors Canadian and European results of operations.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Product Revenue, Net. Product revenue was $267.5 million for the year ended December 31, 2004, as compared to $249.2 million for the year ended December 31, 2003, an increase of $18.3 million or 7.3%. The increase in annual product revenue resulted primarily from the favorable impact of exchange rates on our European and Canadian operations, increased sales volumes of certain existing products and the addition of certain new products.

Service Fee Revenue. Service fee revenue was $42.1 million for the year ended December 31, 2004 as compared to $33.7 million for the year ended December 31, 2003, an increase of $8.4 million or 24.6%. Service fee revenue for the period included increased service fees generated from incremental projects with certain client relationships. The change in service fee revenue is shown below ($ millions):

Year ended December 31, 2003	$ 33.7
New service contract relationships, including projects	5.3
Increase in existing client service fees from organic growth and certain incremental projects	4.7
Terminated clients not included in 2004 revenue	(1.6)
Year ended December 31, 2004	$ 42.1

Service fee revenue for the year ended December 31, 2004 included approximately $1.0 million of fees earned from client contracts terminated during 2004.

Cost of Product Revenue. Cost of product revenue was $252.0 million for the year ended December 31, 2004, as compared to $235.3 million for the year ended December 31, 2003, an increase of $16.7 million or 7.1%. Cost of product revenue as a percent of product revenue was 94.2% during the year ended December 31, 2004 and 94.4% during the year ended December 31, 2003. The increase in annual cost of product revenue from the prior year resulted primarily from the impact of exchange rates on our European and Canadian operations, increased sales volumes of certain existing products and the addition of certain new products partially offset by a reduction in our provision for excess and obsolete inventory. In both years, the cost of product revenue was also partially offset by other inventory cost reductions from a vendor. The resulting gross profit margin was 5.8% and 5.6% for the year ended December 31, 2004 and 2003, respectively.

Cost of Service Fee Revenue. Cost of service fee revenue was $28.1 million for the year ended December 31, 2004, as compared to $23.2 million during the year ended December 31, 2003, an increase of $4.9 million or 21.2%. The resulting service fee gross profit was $14.0 million or 33.3% of service fee revenue, during the year ended December 31, 2004 as compared to $10.6 million, or 31.4% of service fee

revenue for the year ended December 31, 2003. Our gross profit as a percent of service fee revenue increased in the current period primarily due to incremental projects with certain client relationships partially offset by lower gross margins on certain new contracts, including certain start up costs. As we add new service fee revenue in the future, we currently intend to target the underlying contracts to earn an average gross profit percentage of 25-35%, but we have and may continue to accept lower gross margin percentages on certain contracts depending on contract scope and other factors.

Selling, General and Administrative Expenses. SG&A expenses were $27.1 million for the year ended December 31, 2004 or 8.4% of total net revenues, as compared to $25.4 million, or 8.9% of total revenues, for the year ended December 31, 2003. SG&A expenses increased from the prior year primarily due to additional expenses incurred in preparation of complying with the Sarbanes-Oxley Act of 2002 and incremental sales and marketing expenses.

Interest Expense. Interest expense was $1.6 million for the year ended December 31, 2004 as compared to $2.1 million for the year ended December 31, 2003. The decrease in interest expense is primarily due to lower average loan balances as a result of reduced inventory levels.

Income Taxes. For the years ended December 31, 2004 and 2003, we recorded a tax provision of $0.7 million and $0.6 million, respectively, primarily associated with Supplies Distributors Canadian and European operations. We did not record an income tax benefit associated with our consolidated net loss in our U.S. operations. A valuation allowance has been provided for certain of our net deferred tax assets as of December 30, 2004, which are primarily related to our net operating loss carryforwards. We did not record an income tax benefit for our PFSweb European pre-tax losses in the current or prior periods. Due to the consolidation of Supplies Distributors, in the future we anticipate that we will continue to record an income tax provision associated with Supplies Distributors Canadian and European results of operations.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Product Revenue. Product revenue was $249.2 million for the year ended December 31, 2003, as compared to $57.5 million for the year ended December 31, 2002, which reflects product sales for Supplies Distributors subsequent to its consolidation effective October 1, 2002. Supplies Distributors had $163.6 million of product revenue for the nine months ended September 30, 2002 prior to consolidation, or a total of $221.1 million of product revenue for the year ended December 31, 2002. The increase in annual product revenue resulted primarily from the favorable impact of exchange rates on our European and Canadian operations and increased sales volumes of many existing products. In addition, product revenue was favorably impacted by the addition of certain new products and increased sales prices for certain products.

Service Fee Revenue (including service fee revenue, affiliate). Service fee revenue was $33.8 million for the year ended December 31, 2003 as compared to $35.8 million for the year ended December 31, 2002, a decrease of $2.0 million or 5.7%. The change in service fee revenue is shown below ($ millions):

Year ended December 31, 2002	$ 35.8
New service contract relationships	0.2
Increase in existing client service fees from organic growth and certain incremental projects	3.7
Elimination of service fees earned from our affiliate, Supplies Distributors	(4.7)
Terminated clients not included in 2003 revenue	(1.2)
Year ended December 31, 2003	$ 33.8

Service fee revenue for the year ended December 31, 2003 included approximately $0.9 million of fees earned from client contracts terminated during 2003.

Cost of Product Revenue. Cost of product revenue was $235.3 million for the year ended December 31, 2003, as compared to $54.3 million for the year ended December 31, 2002, which reflects

cost of product sales for Supplies Distributors subsequent to its consolidation effective October 1, 2002. Cost of product revenue as a percent of product revenue was 94.4% during the year ended December 31, 2003 and 94.5% during the year ended December 31, 2002. Supplies Distributors had $154.3 million of cost of product revenue, prior to consolidation, or a total of $208.6 million of cost of product revenue for the year ended December 31, 2002. Annual cost of product revenue increased from the prior year from the impact of exchange rates on our European and Canadian operations, increased volumes of many existing products, the addition of certain new products and additional reserves for inventory impairment for the year ended December 31, 2003. The impact of these increases and additional reserves were partially offset by other inventory cost reductions from a vendor. The resulting gross profit margin was 5.6% and 5.5% for the year ended December 31, 2003 and the three months ended December 31, 2002, respectively.

Cost of Service Fee Revenue. Cost of service fee revenue was $23.2 million for the year ended December 31, 2003, as compared to $22.7 million during the year ended December 31, 2002, an increase of $0.5 million or 2.2%. The resulting service fee gross profit was $10.6 million or 31.4% of service fee revenue, during the year ended December 31, 2003 as compared to $13.2 million, or 36.7% of service fee revenue for the year ended December 31, 2002. Our gross profit as a percent of service fee revenue decreased in the current period primarily as a result of the elimination of the service fee revenue affiliate and resulting gross profit from services provided under our arrangements with Supplies Distributors due to our consolidation in October 2002.

Selling, General and Administrative Expenses. SG&A expenses were $25.4 million for the year ended December 31, 2003 or 8.9% of total revenues, as compared to $27.0 million, or 27.8% of total revenues, for the year ended December 31, 2002. SG&A expenses decreased from the prior year primarily due to certain restructuring actions, including personnel reductions, which occurred in September 2002. In addition, the prior year SG&A expense included certain incremental sales and marketing costs. These items were partially offset as due to the consolidation of Supplies Distributors, we now reclassify certain costs previously characterized as cost of service fee revenue to SG&A. SG&A expenses as a percentage of total net revenues decreased from the prior year due to the increase in total net revenues, resulting from the inclusion of product sales subsequent to the consolidation of Supplies Distributors effective October 1, 2002.

Asset and Lease Impairments. In December 2003, we relocated our Canadian operations within Toronto. In conjunction with this relocation, we recorded an impairment expense for an operating lease and the write-down of certain assets. For the year ended December 31, 2002, we recorded $0.9 million of expense for asset impairment and abandonment charges. This charge relates to an older warehouse management system that was upgraded to a new system, as well as the disposition of certain other assets no longer used in the business.

Equity in Earnings of Affiliate. For the year ended December 31, 2002, we recorded $1.2 million of equity in earnings of affiliate that represents our allocation of Supplies Distributors earnings prior to October 1, 2002. Due to the consolidation of Supplies Distributors, effective October 1, 2002, we no longer report equity in earnings of affiliate, on a consolidated basis, for our ownership of Supplies Distributors.

Interest Expense. Interest expense was $2.1 million for the year ended December 31, 2003 as compared to $0.8 million for the year ended December 31, 2002. The increase in interest expense is due to the consolidation of Supplies Distributors, which, as a distributor, requires substantial borrowings to fund its working capital needs.

Interest Income. Interest income was $0.1 million for the year ended December 31, 2003 as compared to $1.0 million for the year ended December 31, 2002. Effective October 1, 2002 we now report lower consolidated interest income resulting from the elimination of interest income from the subordinated note due to PFS from Supplies Distributors upon consolidating Supplies Distributors, which caused the reduction in interest income for the year ended December 31, 2003. Interest income decreased as compared to the year ended December 31, 2002 attributable to lower interest rates earned by our cash and cash equivalents and lower balances of cash and cash equivalents.

Income Taxes. For the years ended December 31, 2003 and 2002, we recorded a tax provision of $0.6 million and $0.1 million, respectively, primarily associated with Supplies Distributors Canadian and European operations. We did not record an income tax benefit associated with our consolidated net loss in our U.S. operations or the net loss from our Canadian and European service fee segments. A valuation allowance has been provided for our net deferred tax assets as of December 31, 2003, which are primarily related to our net operating loss carryforwards.

Liquidity and Capital Resources

For the nine months ended September 30, 2005 and 2004

Net cash used in operating activities was $0.1 million for the nine months ended September 30, 2005 resulting from an increase in accounts receivable of $4.7 million, an increase in prepaid expenses, other receivables and other costs of $2.3 million, and a $1.2 million decrease in accounts payable, accrued expenses and other liabilities offset by net income, as adjusted for non-cash items, of $3.4 million and a $4.7 million decrease in inventories. The increase in accounts receivable was primarily due to increased service fee billings for certain client relationships, the timing of payments received by certain clients and timing of certain product sales in September 2005. Net cash provided by operating activities was $0.9 million for the nine months ended September 30, 2004, and primarily resulted from net income, as adjusted for non-cash items of $3.8 million and an increase in accounts payable, accrued expenses and other liabilities of $5.0 million partially offset by increases in accounts receivable of $5.8 million and prepaid expenses, other receivables and other assets of $2.5 million.

Net cash used in investing activities for the nine months ended September 30, 2005 totaled $2.1 million, representing capital expenditures partially offset by a decrease in restricted cash. Net cash used in investing activities for the nine months ended September 30, 2004 totaled $3.2 million, primarily representing capital expenditures.

Net cash provided by financing activities was approximately $3.2 million for the nine months ended September 30, 2005, primarily representing $2.0 million from the issuance of common stock pursuant to our employee stock purchase and stock option programs and warrant exercises and $1.6 million of proceeds from debt. Net cash provided by financing activities was approximately $2.5 million for the nine months ended September 30, 2004, primarily representing $2.3 million of proceeds from debt.

During the nine months ended September 30, 2005, our working capital increased to $23.8 million from $22.6 million at December 31, 2004, primarily as a result of the issuance of common stock due to the exercise of certain warrants.

For the years ended December 31, 2004, 2003 and 2002

Net cash provided by operating activities was $5.5 million for the year ended December 31, 2004 and primarily resulted from cash generated from operations along with increases in accounts payable and accrued expenses of $15.1 million partially offset by an increase in accounts receivable of $9.8 million, an increase in prepaid expenses and other current assets of $5.8 million. Net cash provided by operating activities was $1.3 million for the year ended December 31, 2003, and primarily resulted from cash generated from operations plus decreases in inventory of $2.5 million and in prepaid expenses and other current assets of $0.9 million partially offset by a decrease in accounts payable and accrued expenses of $5.6 million. The December 31, 2004, accounts payable balance was higher than normal primarily due to the timing of invoice processing by one of our master distribution vendors. Net cash used in operating activities was $15.0 million for the year ended December 31, 2002, and primarily resulted from cash used to fund operating losses and the net impact of increases in Supplies Distributors inventories of $8.1 million from October 1, 2002 to December 31, 2002 and accounts payable and accrued expenses of $4.6 million, partially offset by decreases in accounts receivable of $2.1 million and prepaid expenses and other current assets of $1.6 million.

Table of Contents

Net cash used in investing activities for the year ended December 31, 2004 totaled $8.8 million, resulting from capital expenditures of $7.7 million and an increase in restricted cash of $1.1 million. The increase in restricted cash resulted primarily from Mississippi taxable bond proceeds that are restricted specifically for payment on capital additions or as repayment on the outstanding bonds. Net cash used in investing activities for the year ended December 31, 2003 totaled $0.2 million, resulting from capital expenditures of $2.0 million partially offset by a decrease in restricted cash of $1.7 million. The decrease in restricted cash resulted from a refinancing of certain of our previous debt and lease balances to remove the associated letter of credit cash restrictions. Net cash provided by investing activities for the year ended December 31, 2002 totaled $1.5 million, representing the net repayment of $2.9 million by Supplies Distributors of our subordinated loan, which totaled $8.8 million at September 30, 2002, but which is now eliminated due to the consolidation of Supplies Distributors, and net cash acquired in our acquisition of the remaining 51% interest of Supplies Distributors, offset by capital expenditures of $1.8 million.

Net cash provided by financing activities was approximately $2.2 million for the year ended December 31, 2004, primarily representing $3.3 million of proceeds from debt and $0.5 million of proceeds from the issuance of common stock pursuant to our employee stock purchase and stock option programs partially offset by $1.1 million of payments on our capital lease obligations. Net cash provided by financing activities was approximately $5.2 million for the year ended December 31, 2003, primarily representing $4.1 million of proceeds from the issuance of common stock pursuant to our employee stock purchase and stock option programs and the sale of 1,581,944 shares of our common stock to certain institutional investors in a private placement transaction and $1.8 million of proceeds from debt partially offset by $1.0 million of payments on our capital lease obligations. Net cash provided by financing activities was $11.4 million for the year ended December 31, 2002, primarily representing $11.3 million of proceeds from debt.

During the year ended December 31, 2004, our working capital increased to $22.6 million from $21.4 million at December 31, 2003 primarily as a result of cash flow from operations plus incremental debt, partially offset by capital expenditures.

Liquidity

Capital expenditures have historically consisted primarily of additions to upgrade our management information systems, and general expansion of 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 that our total investment in upgrades and additions to facilities and information technology services for the upcoming twelve months will be approximately $7 to $10 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 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 or achieve the revenue necessary to support such investments.

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, entering into new debt agreements or transferring to third parties a portion of our subordinated loan balance due from Supplies Distributors. In conjunction with certain of these alternatives, we may be required to provide certain letters of credit to secure these arrangements. No assurances can be given that we will be successful in obtaining any additional financing or the terms thereof. We currently believe that our cash position, financing available under our credit facilities and funds generated from operations (including our anticipated revenue growth and/or cost reductions to offset lower than anticipated revenue growth) will satisfy our presently known operating cash needs, our working capital and capital expenditure requirements, our lease obligations, and additional subordinated loans to our subsidiary Supplies Distributors, if necessary, for at least the next twelve months.

Table of Contents

The following is a schedule of our total contractual cash obligations as of September 30, 2005, which is comprised of operating leases, debt (including vendor financing) and capital leases, including interest (in millions):

		Payments Due by Period			
Contractual Obligations	Total	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
Debt	$ 59,360	$ 54,363	$ 1,797	$ 3,200	$
Capital lease obligations	2,975	1,312	1,443	220	
Operating leases	22,325	7,442	10,689	3,394	800
Total	$ 84,660	$ 63,117	$ 13,929	$ 6,814	$ 800

In support of certain debt instruments and leases, as of September 30, 2005, we had $0.9 million of cash restricted as collateral for letters of credit. The letters of credit expire at various dates through March 2007, the related debt and lease obligations termination dates. In addition, as described above, we have provided collateralized guarantees to secure the repayment of certain Supplies Distributors credit facilities. Many of our debt facilities include both financial and non-financial covenants, and also include cross default provisions applicable to other agreements. To the extent we fail to comply with our debt covenants, including the monthly financial covenant requirements and our required level of shareholders equity, and the lenders accelerate the repayment of the credit facility obligations, we would be required to repay all amounts outstanding thereunder. Any requirement to accelerate the repayment of the credit facility obligations would have a material adverse impact on our financial condition and results of operations. We can provide no assurance that we will have the financial ability to repay all of such obligations. As of September 30, 2005, we were in compliance with all debt covenants and we believe that we will maintain such compliance throughout calendar year 2005. Other than those noted herein, 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.

In the future, we may attempt to acquire other businesses or seek an equity or strategic partner to generate capital or expand our services or capabilities in connection with our efforts to grow our business. Acquisitions involve certain risks and uncertainties and may require additional financing. Therefore, we can give no assurance with respect to whether we will be successful in identifying businesses to acquire or an equity or strategic partner, whether we or they will be able to obtain financing to complete a transaction, or whether we or they will be successful in operating the acquired business.

Supplies Distributors has a short-term credit facility with IBM Credit LLC (IBM Credit) and its European subsidiaries have a short-term credit facility with IBM Belgium Financial Services S.A. (IBM Belgium) to finance their distribution of IBM products. We have provided a collateralized guaranty to secure the repayment of these credit facilities. The asset-based credit facilities provide financing for up to $30.5 million and up to 12.5 million Euros (approximately $15.1 million) with IBM Credit and IBM Belgium, respectively. These agreements expire in March 2006.

Supplies Distributors also has a loan and security agreement with Congress Financial Corporation (Southwest) (Congress) to provide financing for up to $25 million of eligible accounts receivables in the United States and Canada. The Congress facility expires on the earlier of March 29, 2007 or the date on which the parties to the IBM master distributor agreement no longer operate under the terms of such agreement and/or IBM no longer supplies products pursuant to such agreement.

Supplies Distributors European subsidiary has a factoring agreement with Fortis Commercial Finance N.V. (Fortis) to provide factoring for up to 7.5 million Euros (approximately $9.0 million) of eligible accounts receivables

through March 29, 2006. Borrowings under this agreement can be either cash advances or straight loans, as defined.

These credit facilities contain cross default provisions, various restrictions upon the ability of Supplies Distributors and its subsidiaries to, among other things, merge, consolidate, sell assets, incur indebtedness,

make loans and payments to related parties, 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 cash flow from operations, annualized revenue to working capital, net profit after tax to revenue, minimum net worth 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 of no less than $7.0 million, maintain restricted cash of less than $5.0 million, are restricted with regard to transactions with related parties, indebtedness and changes to capital stock ownership structure and a minimum shareholders equity of at least $18.0 million. 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 the obligations of Supplies Distributors and its subsidiaries to IBM, excluding the trade payables that are financed by IBM credit.

Our subsidiary, Priority Fulfillment Services, Inc. (PFS), has entered into a Loan and Security Agreement with Comerica Bank (Comerica), which, as amended, provides for up to $7.5 million of eligible accounts receivable financing through March 2007, and up to $2.5 million of eligible equipment purchases through June 2008. As of September 30, 2005, there were $4.2 million of funds available for accounts receivable financing and no available credit under the equipment purchasing financing. We entered this Agreement to supplement our existing cash position, and provide funding for our future operations, including our targeted growth. The 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 related parties, make investments and loans, pledge assets, make changes to capital stock ownership structure, as well as financial covenants of a minimum tangible net worth of $20 million, as defined, and a minimum liquidity ratio, as defined. The agreement also limits our ability to increase the subordinated loan to Supplies Distributors to more than $8.0 million without the lender s approval. The agreement is secured by all of the assets of PFS, as well as a guarantee of PFSweb.

In 2003, we entered into a Securities Purchase Agreement with certain institutional investors in a private placement transaction pursuant to which we issued and sold an aggregate of 1.6 million shares of our common stock, par value $.001 per share (the Common Stock), at $2.16 per share, resulting in gross proceeds of $3.4 million. After deducting expenses, the net proceeds were approximately $3.2 million. In addition to the Common Stock, the investors received one-year warrants to purchase an aggregate 525,692 shares of Common Stock at an exercise price of $3.25 per share and four-year warrants to purchase an aggregate of 395,486 shares of Common Stock at an exercise price of $3.30 per share. In January 2005, 394,865 of the one-year warrants were exercised prior to their expiration, generating net proceeds to us of $1.3 million.

In 2004, to fulfill our obligations under certain new client relationships, we entered into a three-year operating lease arrangement for a new distribution facility in Southaven, MS, near our existing distribution complex in Memphis, TN. We have incurred approximately $5 million in capital expenditures to support the incremental business in this new distribution center. We financed a significant portion of these expenditures via a Loan Agreement with the Mississippi Business Finance Corporation (the MBFC) pursuant to which the MBFC issued $5 million MBFC Taxable Variable Rate Demand Limited Obligation Revenue Bonds, Series 2004 (Priority Fulfillment Services, Inc. Project) (the Bonds). The MBFC loaned us the proceeds of the Bonds for the purpose of financing the acquisition and installation of equipment, machinery and related assets located in our new Southaven, Mississippi distribution facility. The primary source of repayment of the Bonds is a letter of credit (the Letter of Credit) in the initial face amount of $5.1 million issued by Comerica pursuant to a Reimbursement Agreement between us and Comerica under which we are obligated to pay to Comerica all amounts drawn under the Letter of Credit. The Letter of Credit has an initial maturity date of December 2006 at which time, if not renewed or replaced, will result in a draw on the undrawn face amount thereof.

We receive municipal tax abatements in certain locations. During 2004 we received notice from a municipality that we did not satisfy certain criteria necessary to maintain the abatements. We plan to dispute the notice. If the dispute is not resolved favorably, we could be assessed additional taxes for

calendar years 2004 and 2005. We have not accrued for the additional taxes, which through September 30, 2005 could be $0.4 million to $0.5 million for 2004 and $0.4 million for 2005, as we do not believe that it is probable that an additional assessment will be incurred.

In April 2005, we entered into a five-year operating lease arrangement for a new distribution facility in Southaven, MS, near our existing facility in Southaven, MS. We completed the move to the new facility in September 2005, and in doing so incurred incremental costs of approximately $1.54 million, which includes approximately $0.4 million related to a lease termination.

On May 9, 2005, a lawsuit was filed in the District Court of Collin County, Texas, by J. Gregg Pritchard, as Trustee of the D.I.C. Creditors Trust, naming the former directors of Daisytek International Corporation and the Company as defendants. Daisytek filed for bankruptcy in May 2003 and the Trust was created pursuant to Daisytek s Plan of Liquidation. The complaint alleges, among other things, that the spin-off of the Company from Daisytek in December 1999 was a fraudulent conveyance and that Daisytek was damaged thereby in the amount of at least $38 million. We believe the claim has no merit and intend to vigorously defend the action.

In the ordinary course of business, one or more of the Company s clients may dispute Company invoices for services rendered or other charges. As of September 30, 2005, an aggregate of approximately $0.9 million of client invoices were in dispute. The Company believes it will resolve these disputes in its favor and has not recorded any reserve for such disputes.

Seasonality

The seasonality of our business is dependent upon the seasonality of our clients business and sales of their products. Accordingly, our management must rely upon the projections of our clients in assessing quarterly variability. We believe that with our current client mix and their current business volumes, our service fee business activity was at it lowest in the quarter ended March 31. However due to product release schedule changes from certain of our clients, we believe this seasonal impact will not be as significant in 2005 as it has been in prior years. We anticipate that our product revenue will be highest during the quarter ended December 31.

We believe that results of operations for a quarterly period may not be indicative of the results for any other quarter or for the full year.

Inflation

Management believes that inflation has not had a material effect on our operations.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the U.S. These accounting principles require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of our financial statements and the reported amounts of revenues and expenses during the reporting period. While we do not believe the reported amounts would be materially different, application of these policies involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. If there is a significant unfavorable change to current conditions, it would likely result in a material adverse impact to our business, operating results and financial condition. We evaluate our estimates and assumptions on an ongoing basis. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances. All of our significant accounting policies are disclosed in the notes to our consolidated financial statements.

We have defined a critical accounting estimate as one that is both important to the portrayal of our financial condition and results of operations and requires us to make difficult, subjective or complex judgments or estimates about matters that are uncertain. During the past three fiscal years, we have not made any material changes in accounting methodology used to establish the critical accounting estimates

discussed below, unless otherwise noted. All of our significant accounting policies are disclosed in the notes to our consolidated financial statements. The following represent certain critical accounting policies that require us to exercise our business judgment or make significant estimates. In addition, there are other items within our consolidated financial statements that require estimation but are not deemed critical as defined above.

Cost of Service Fee Revenue

Our service fee revenues primarily relate to our distribution services and order management/customer care services. Distribution services relate primarily to inventory management, product receiving, warehousing and fulfillment (i.e., picking, packing and shipping). Order management/customer care services relate primarily to taking customer orders for our client s 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 cross-selling/up-selling activities.

Our cost of service fee revenue represents the cost to provide the services described above, primarily compensation and related expenses and other fixed and variable expenses directly related to providing the services. These include certain occupancy and information technology costs and depreciation and amortization expenses. Certain of these costs are allocated from general and administrative expenses. For these allocations, we estimate the amount of direct expenses based on a client-specific number of transactions processed. We believe our allocation methodology is reasonable, however a change in assumptions would result in a different gross profit in our statement of operations, yet no change to the resulting net income or loss.

Allowance for Doubtful Accounts

The determination of the collectibility of amounts due from our customers requires us to use estimates and make judgments regarding future events and trends, including monitoring our customers payment history and current credit worthiness to determine that collectibility is reasonably assured, as well as consideration of the overall business climate in which our customers operate. Inherently, these uncertainties require us to make frequent judgments and estimates regarding our customers ability to pay amounts due us to determine the appropriate amount of valuation allowances required for doubtful accounts. Provisions for doubtful accounts are recorded when it becomes evident that the customer will not make the required payments at either contractual due dates or in the future. At September 30, 2005, December 31, 2004 and 2003, reserves for doubtful accounts totaled $0.4 million, $0.5 million and $0.3 million, respectively. We believe that our reserve for doubtful accounts is adequate to cover anticipated losses under current conditions; however, uncertainties regarding changes in the financial condition of our customers, either adverse or positive, could impact the amount and timing of any additional provisions for doubtful accounts that may be required.

Inventory Reserves

Inventories (merchandise, held for resale, all of which are finished goods) are stated at the lower of weighted average cost or market. Supplies Distributors and its subsidiaries assume responsibility for slow-moving inventory under certain master distributor agreements, subject to certain termination rights, but have the right to return product rendered obsolete by engineering changes, as defined. We review inventory for impairment on a periodic basis, but at a minimum, annually. Recoverability of the inventory on hand is measured by comparison of the carrying value of the inventory to the fair value of the inventory. This requires us to record provisions and maintain reserves for excess or obsolete inventory. To determine these reserve amounts, we regularly review inventory quantities on hand and compare them to estimates of future product demand and market conditions. These estimates and forecasts inherently include uncertainties and require us to make judgments regarding potential outcomes. At September 30, 2005, December 31, 2004 and 2003, our allowance for slow moving inventory totaled $1.7 million, $2.5 million and $1.3 million, respectively. We believe that our reserves are adequate to cover anticipated losses under current conditions. Significant or unanticipated changes to our estimates and forecasts, either adverse or

positive, could impact the amount and timing of any additional provisions for excess or obsolete inventory that may be required.

Income Taxes

The liability method is used for determining our income taxes, under which current and deferred tax liabilities and assets are recorded in accordance with enacted tax laws and rates. Under this method, the amounts of deferred tax liabilities and assets at the end of each period are determined using the tax rate expected to be in effect when taxes are actually paid or recovered. Valuation allowances are established to reduce deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. In determining the need for valuation allowances, we have considered and made judgments and estimates regarding estimated future taxable income. These estimates and judgments include some degree of uncertainty and changes in these estimates and assumptions could require us to adjust the valuation allowances for our deferred tax assets. The ultimate realization of the certain of our deferred tax assets depends on the generation of sufficient taxable income in the applicable taxing jurisdictions. Although we believe our estimates and judgments are reasonable, actual results may differ, which could be material.

As we operate in multiple countries, we are subject to the jurisdiction of multiple domestic and foreign tax authorities. Determination of taxable income in any jurisdiction requires the interpretation of the related tax laws and regulations and the use of estimates and assumptions regarding significant future events such as the amount, timing and character of deductions, permissible revenue recognition methods under the tax law and the sources and character of income and tax credits. Changes in tax laws, regulations, foreign currency exchange restrictions or our level of operations or profitability in each taxing jurisdiction could have an impact on the amount of income taxes that we provide during any given year.

Capitalized Software

Our capitalized software includes internal and external costs incurred in developing or obtaining computer software for internal use and to implement new or expanded client relationships. We make judgments to determine if each project will satisfy its intended use. Additionally, we estimate the average internal costs incurred for payroll related benefits for the employees who directly devote time relating to the design, development and testing phase of the project. On an ongoing basis, we perform an impairment analysis on various technologies. If the carrying value of the various technologies exceeds the fair value, impairment charges are recorded.

Long-Lived Assets

Long-lived assets include property, intangible assets and certain other assets. We make judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. Additionally, we review long-lived assets for impairment periodically or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We record impairment losses in the period in which we determine that the carrying amount is not recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. This may require us to make judgments regarding long-term forecasts of our future revenues and costs related to the assets subject to review.

Self Insurance

We are self-insured for medical insurance benefits up to certain stop-loss limits. Each reporting period we record the costs, including paid claims, an estimate for the change in incurred but not reported (IBNR) claims and administrative fees as an expense in the consolidated statement of operations. We base the estimated IBNR claims upon both (i) a recent level of monthly paid claims; and (ii) historical lag information provided by claims administrators based on recent paid claims, to provide for those claims

that have been incurred but not yet paid. We believe the use of recent claims activity is representative of incurred and paid trends during the reporting period. Using the historical lag information involves a significant level of judgment. Accordingly, an increase (or decrease) in the estimated IBNR liability would result in a corresponding decrease (or increase) to net income.

Quantitative and Qualitative Disclosure about Market Risk

We are exposed to various market risks including interest rates on its financial instruments and foreign exchange rates.

Interest Rate Risk

Our interest rate risk is limited to our outstanding balances on our inventory and working capital financing agreements, taxable revenue bonds, loan and security agreements and factoring agreement for the financing of inventory, accounts receivable and certain other receivables and certain equipment, which amounted to $59.1 million at September 30, 2005. A 100 basis point movement in interest rates would result in approximately $0.3 million annualized increase or decrease in interest expense based on the outstanding balance of these agreements at September 30, 2005.

Foreign Exchange Risk

Currently, our foreign currency exchange rate risk is primarily limited to the Canadian Dollar and the Euro. In the future, our foreign currency exchange risk may also include other currencies applicable to certain of our international operations. We have and may continue, from time to time, to employ derivative financial instruments to manage our exposure to fluctuations in foreign currency rates. To hedge our net investment and intercompany payable or receivable balances in foreign operations, we may enter into forward currency exchange contracts.

MANAGEMENT OF PFSWEB

Directors

The following information, which has been provided by the individuals named, sets forth for each member of the PFSweb board of directors, such person s name, age, principal occupation or employment during at least the past five years, the name of the corporation or other organization, if any, in which such occupation or employment is carried on and the period during which such person has served as a director of PFSweb.

David I. Beatson, age 58, has served as a non-employee Director since November 2000. Mr. Beatson is Principal and Founder of Ascent Advisors, LLC, a consulting practice directed at strategic positioning and corporate business development plans and strategy. Mr. Beatson is a recognized leader in the field of transportation, logistics and supply chain management having served as Chairman and CEO of several leading companies in this industry. From July 2003 to April 2005, Mr. Beatson served as Regional CEO North America and Member of the Executive Board of Panalpina, Inc., a leading provider of intercontinental airfreight and seafreight forwarding and transportation, specializing in global integrated logistics and comprehensive supply chain management solutions. From June 2000 to July 2001, Mr. Beatson served as president, CEO and chairman of Supply Links, Inc., an Internet-based B2B global supply chain network that links customers to multiple transportation modes and service providers through a single platform. From July 1998 to June 2000, Mr. Beatson served as chairman, president and CEO of Circle International Group, Inc., a global transportation and logistics company. From 1991 to June 1994, Mr. Beatson served as vice-president of sales and marketing and then from June 1994 until July 1998 as president and CEO of Emery Worldwide, a global transportation and logistics company. Prior to 1991, Mr. Beatson held several management positions in the logistics and transportation industry, including American Airlines and CF Airfreight. Mr. Beatson also currently serves as an industry representative member of the Executive Advisory Committee to the National Industrial Transportation League, to which the Air Freight Association elected him in 1995. He also serves on several industry boards including the Council of Logistics Management.

James F. Reilly, age 46, has served as a non-employee Director of PFSweb since its inception. Mr. Reilly has been an investment banker since 1983 and is currently a Managing Director and Head of West Coast Investment Banking of Needham & Company, Inc., a nationally recognized investment banking and asset management firm focused primarily on serving emerging growth industries and their investors, a position he assumed in January 2004. Previously he was a Managing Director of J.P. Morgan Securities, Inc., an investment banking firm, and a Managing Director in the Technology Group of Warburg Dillon Read, the global investment banking division of UBS AG. From 1983 to 1999, Mr. Reilly was associated with Warburg Dillon Read or one of its predecessor companies and specialized in corporate finance advisory work for a broad range of technology companies.

Dr. Neil W. Jacobs, age 70, has served as a non-employee Director of PFSweb since July 2000. Dr. Jacobs is a professor of computer information systems and management at Northern Arizona University (NAU) and a technology industry veteran. Dr. Jacobs academic area of expertise includes strategic management issues and the role information technology plays in support of strategy and operations. From 1996 to 1999, Dr. Jacobs served as associate dean of the College of Business Administration at NAU. Prior to his academic career, he served as an officer in the United States Air Force and held management positions in manufacturing and information technology at IBM and Memorex.

Mark C. Layton, age 46, has served as Chairman of the Board, President and Chief Executive Officer of PFSweb since its inception. Mr. Layton previously held the following positions with Daisytek International Corporation (Daisytek), a leading global distributor of consumable computer supplies and office products and the former parent corporation of PFSweb: Chairman of the Board from September 1999 to October 2000; President, Chief Executive Officer and Chief Operating Officer from April 1997 to February 2000; Director from 1988 to October 2000; President, Chief Operating Officer and Chief Financial Officer from 1993 to April 1997; Executive Vice President from 1990 to 1993; and Vice

President Operations from 1988 to 1990. Prior to joining Daisytek, Mr. Layton served as a management consultant with Arthur Andersen & Co., S.C. for six years through 1988 specializing in wholesale and retail distribution and technology. Mr. Layton is also a director of PC Mall a direct marketer of computer products.

Timothy M. Murray, age 53, has served as a non-employee Director of PFSweb since its inception. Mr. Murray is a partner of Chicago Growth Partners (a private equity firm) and is a managing director of several private equity funds related to William Blair Capital Partners (a private equity firm). From 1979 to 2004, Mr. Murray was employed at William Blair & Company (an investment banking firm) and was a Principal of that firm from 1984 to 2004. Mr. Murray is a director of several privately held corporations.

Executive Officers and Officers

In addition to the individuals named above, the following are the names, ages and positions of the other executive officers and officers of PFSweb:

Executive Officers

Steven S. Graham, age 53, has served as Executive Vice President and Chief Technology Officer of PFSweb since its inception. Mr. Graham previously served as Senior Vice President of Information Technologies and Chief Information Officer of Daisytek, a position he held from 1996 to 2000. Prior to joining Daisytek, Mr. Graham was employed by Ingram Micro, a major microcomputer distributor. Mr. Graham has over 25 years of experience in the information-technology field.

Thomas J. Madden, age 44, has served as Executive Vice President, Chief Financial and Accounting Officer of PFSweb since its inception. Mr. Madden previously served as Chief Financial Officer of Daisytek from 1997 to 2000, as Vice President Finance, Treasurer and as Chief Accounting Officer of Daisytek from 1994 to 2000 and as Controller of Daisytek from 1992 to 1994. From 1983 to 1992, Mr. Madden served in various capacities with Arthur Andersen & Co., S.C., including financial consulting and audit manager.

Michael C. Willoughby, age 42, has served as Executive Vice President and Chief Information Officer since October 2001 and served as Vice President E-Commerce Technologies of PFSweb since 1999. Mr. Willoughby served as President and Chief Executive Officer of Design Technologies, Inc., an e-commerce software development firm from 1994 to 1999. Prior to founding Design Technologies, Inc., Mr. Willoughby served as President and Chief Executive Officer of Integration Services, Inc., a mid-sized development services company.

Harvey H. Achatz, age 64, has served as Vice President Administration and Secretary of PFSweb since its inception. Mr. Achatz previously served as Vice President Administration and Secretary of Daisytek from 1993 and 1984 to 2000, respectively, as Vice President Finance from 1985 to 1993, as Controller from 1981 to 1985 and as a Director from 1984 to 1990.

Officers

Scott R. Talley, age 41, has served as Vice President International Distribution for PFSweb since its inception. Mr. Talley previously served in various capacities for Daisytek since 1991, most recently as Vice President Distribution.

Cynthia D. Almond, age 37, has served as Vice President Client Services of PFSweb since March 2001. From 1999 to 2001, Ms. Almond served as Director of Account Management. From 1991 to 1999, Ms. Almond served in various marketing, product management and sales capacities for Daisytek.

Bruce E. McClung, age 68, has served as Vice President Sales of PFSweb since October 2001. From 1999 to 2001, Mr. McClung served in various marketing and sales capacities for PFSweb. Mr. McClung has spent more than 25 years in sales, marketing and management roles in systems and solutions organizations, including Daisytek, IBM, Boeing and Perdata.

David B. Reese, age 43, has served as Vice President Business Solutions of PFSweb since November 2004. From 2000 to 2004, Mr. Reese served as Director of Implementation Services. Mr. Reese was Director of European Operations from January 1999 to May 2000. From 1995 to 1998, Mr. Reese served in various capacities for Daisytek.

Compensation Committee Interlocks and Insider Participation

The current members of the PFSweb Compensation Committee are Messrs. Murray and Reilly, neither of whom are employees of PFSweb and all of whom are considered independent directors under the applicable NASDAQ rules. There were no interlocks or insider participation between any member of the Board or Compensation Committee and any member of the board of the directors or Compensation Committee of another company.

Compensation of Directors

In June 1999 PFSweb Company adopted a Non-Employee Director Stock Option and Retainer Plan (the Non-Employee Director Plan). As of the date of the adoption of the Non-Employee Director Plan, each non-employee director received an option to purchase 35,000 shares of common stock. The Non-Employee Director Plan also provides for the future issuance to each non-employee director of options to purchase 10,000 shares of common stock as of the date of each annual meeting of stockholders. During calendar year 2004, each non-employee director received an option to purchase 10,000 shares of common stock with an exercise price of $1.77 per share. In addition, currently, non-employee directors receive an annual retainer fee of $10,000, payable quarterly, a director meeting fee of $2,500 for each board meeting attended and a committee meeting fee of $1,500 for each quarterly Audit Committee meeting attended. The Non-Employee Director Plan permits the payment of such non-employee director retainer fees in shares of Common Stock in lieu of cash.

All options to be issued to non-employee directors under the Non-Employee Director Plan are non-qualified options for federal income tax purposes and have an exercise price equal to the fair market value of a share of common stock as of the date of the annual meeting upon which such option is granted. All options have a ten year term and are subject to a one year vesting schedule.

Generally, unless the Non-Employee Director Plan administrator otherwise provides, options are non-transferable other than by will or the laws of descent and distribution. At the time of any merger, consolidation, reorganization, recapitalization, stock dividend, stock split, or other change in the corporate structure or capitalization affecting the Company s common stock, the Non-Employee Director Plan administrator will make appropriate adjustments to the exercise price, number and kind of shares to be issued under the Non-Employee Director Plan and any outstanding options. Unless terminated earlier, the Non-Employee Director Plan will terminate ten years from its adoption, and no stock options will be granted after the Non-Employee Director Plan terminates. The Board of Directors has the authority to amend, modify, suspend or terminate the Non-Employee Director Plan at any time.

Directors who are also employees of PFSweb or any of its subsidiaries receive no remuneration for serving as directors or Committee members.

Table of Contents

Executive Compensation

The following table sets forth the compensation paid or accrued by PFSweb to the Chief Executive Officer and to each of the four most highly compensated executive officers for services rendered during the years ended December 31, 2004, 2003 and 2002:

Summary Compensation Table

				Long-Term Compensation Awards	
		Annual Compensation		Number of Securities Underlying	All Other
Name and Principle Position	**Period**	**Salary**	**Bonus**	**Options**	**Compensation(1)**
Mark C. Layton	2004	$ 332,423	$ 41,000	43,000	$ 16,289
Chairman, President,	2003	304,500	83,076	82,000	23,531
Chief Executive Officer	2002	328,991			14,613
Steven S. Graham	2004	223,200	38,500	43,000	7,603
Executive Vice President	2003	213,298	58,431	82,000	8,798
Chief Technology Officer	2002	226,684		15,000	5,748
Michael C. Willoughby	2004	216,845	38,000	43,000	270
Executive Vice President	2003	205,000	52,307	82,000	248
Chief Information Officer	2002	220,846		80,000	240
Thomas J. Madden	2004	186,154	37,000	43,000	7,358
Executive Vice President	2003	165,000	42,307	82,000	5,905
Chief Financial Officer	2002	176,923		15,000	6,361
Harvey H. Achatz	2004	111,277	16,500	7,000	7,188
Vice President	2003	107,299	18,461	15,000	6,948
Administration and Secretary	2002	109,530		3,000	5,600

(1) All Other Compensation represents compensation in respect of one or more of the following: personal use of Company automobiles; life insurance premiums paid by the Company for the benefit of the named executive officer; income tax return preparation services paid by the Company; contributions to 401(k) accounts paid by the Company and personal travel expenses.

The following table sets forth information with respect to grants of stock options by PFSweb to purchase shares of common stock during the year ended December 31, 2004 to the named executive officers reflected in the Summary Compensation Table.

Option Grants during the Year Ended December 31, 2004

	Individual Grants			Potential Realizable Value at Assumed
	Number of Securities	% of Total Options		Annual Rates of Stock Price Appreciation for
	Underlying	Granted to	Exercise	Option Terms(2)

Name	Options Grants(1)	Employees in Year	Price per Share	Expiration Date	5%	10%
Mark C. Layton	43,000	5.7%	$ 1.61	3/28/14	$ 43,538	$ 110,335
Steven S. Graham	43,000	5.7%	1.61	3/28/14	43,538	110,335
Michael C. Willoughby	43,000	5.7%	1.61	3/28/14	43,538	110,335
Thomas J. Madden	43,000	5.7%	1.61	3/28/14	43,538	110,335
Harvey H. Achatz	7,000	0.9%	1.61	3/28/14	7,088	17,961

(1) Subject to quarterly vesting schedule over a three-year period.

(2) These are hypothetical values using assumed annual rates of stock price appreciation as prescribed by the rules of the SEC.

The following table sets forth information concerning the aggregate PFSweb stock option exercises during the year ended December 31, 2004 and PFSweb stock option values as of December 31, 2004 for unexercised options held by each of the named executive officers.

Aggregated Option Exercises during the Year Ended December 31, 2004
And Option Values as of December 31, 2004

			Number of Securities Underlying Unexercised Options at Year End		Value of Unexercised In-the-Money Options at Fiscal Year End(1)	
Name	**Number of Shares Acquired on Exercise**	**Value Received**	**Exercisable**	**Unexercisable**	**Exercisable**	**Unexercisable**
Mark C. Layton		$	690,431	78,625	$ 1,299,589	$ 146,729
Steven S. Graham			682,573	79,876	1,300,536	149,231
Michael C. Willoughby			114,703	85,297	205,917	160,073
Thomas J. Madden			439,797	79,876	831,978	149,231
Harvey H. Achatz			94,099	13,875	169,941	26,409

(1) Amounts were calculated using the closing price of the common stock on the last trading day of the fiscal year ($2.84), as reported by the Nasdaq Capital Market.

Change in Control and Severance Agreements

PFSweb and each of the executive officers named above have entered into Change in Control and Severance Agreements. Under these agreements, and in consideration of certain commitments of the officer to continue employment, upon the occurrence of a change in control, all unvested options held by the officer immediately vest and become exercisable. During the two year period following a change in control (whenever occurring), if the employment of the officer is terminated (other than for cause, death, disability or retirement), or if there is a material adverse change in the officer s responsibilities, compensation or benefits to which the officer does not consent, then, in each case, the officer is entitled to receive all salary and bonus amounts accrued through the date of termination plus a severance payment equal to twice the officer s salary and bonus. If applicable, the officer is also entitled to receive an additional payment to compensate the officer for any additional excise tax liability arising by reason of the receipt of such severance or bonus payment. The agreement terminates upon the voluntary resignation or termination of employment by the officer.

PFSweb and each of the executive officers named above have also entered into Executive Severance Agreements. Under these agreements, and in consideration for, among other things, the agreement by the executive to be bound by a restrictive covenant, in the event of the termination of the employment of the executive other than for cause (including a material adverse change in the officer s responsibilities or the failure to re-nominate to the Board of Directors any executive also serving on the Board), the executive is entitled to a severance payment up to a maximum of twice the executive s salary and bonus. In addition, in the event of termination without cause, the executive is entitled to a continuation of benefits and to the accelerated vesting of all options then held by the executive. The severance payment and benefits are reduced by any compensation or benefits received by the executive from any subsequent employer.

SECURITY OWNERSHIP OF CERTAIN PFSWEB BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth as of November 21, 2005, certain information regarding the beneficial ownership of the PFSweb common stock effect and the effect of the merger on the percentage of present holdings of the PFSweb common stock owned beneficially by (i) any person (including any group as that term is used in section 13(d)(3) of the Exchange Act) who is known to PFSweb to be the beneficial owner of more than five percent of the PFSweb common stock, (ii) each director and executive officer of PFSweb individually and (iii) all directors and executive officers of PFSweb as a group. The information contained in this table reflects beneficial ownership as defined in Rule 13d-3 of the Securities Exchange Act of 1934, as amended (the Exchange Act) and, as such, also includes shares acquirable within 60 days. Unless otherwise indicated, the stockholders identified in this table have sole voting and investment power with respect to the shares owned of record by them. The merger will have no effect on the number of shares of PFSweb beneficially owned by the stockholders in this table, except to the extent such stockholder may also be a holder of eCOST common stock.

Name and Address of Beneficial Owner	Number of Shares	Percent Before Merger(1)	Percent After Merger(5)
Gilder, Gagnon, Howe & Co. LLC(2)	2,954,471	13.1%	7.1%
1775 Broadway, 26th Floor			
New York, NY 10019			
Mark C. Layton(3)	1,271,492	5.5%	3.0%
Steven S. Graham(3)	808,718	3.5%	1.9%
Thomas J. Madden(3)	610,529	2.7%	1.5%
Timothy M. Murray(3)	202,256	0.9%	0.5%
Harvey H. Achatz(3)	171,654	0.8%	0.4%
Michael C. Willoughby(3)	152,027	0.7%	0.4%
James F. Reilly(3)	131,405	0.6%	0.3%
David I. Beatson(3)	55,000	0.2%	0.1%
Dr. Neil W. Jacobs(3)	75,312	0.3%	0.2%
All directors and executive officers As a group (9 persons)(4)	3,478,393	19.1%	10.4%

* Represents less than 1%

(1) This table is based on 22,526,681 shares of PFSweb common stock outstanding on November 21, 2005.

(2) Based upon a Schedule 13G, filed by Gilder, Gagnon, Howe & Co. LLC, stating beneficial ownership and shared voting and dispositive power as of September 30, 2005.

(3) Includes the following outstanding options to purchase the specified number of shares of Common Stock, which are fully vested and exercisable: Mark C. Layton 753,299; Steven S. Graham 746,692; Thomas J. Madden 503,916; Timothy M. Murray 116,167; Harvey H. Achatz 105,431; Michael C. Willoughby 150,082; James F. Reilly 45,000; David I. Beatson 55,000; and Dr. Neil W. Jacobs 55,000.

(4) Includes outstanding options to purchase 2,530,587 shares of Common Stock, which are fully vested and exercisable.

(5) Based on an estimate of 18,980,000 shares of PFSweb common stock to be issued in the merger.

Except for (i) currently issued and outstanding options to purchase shares of PFSweb common stock held by PFSweb directors and executive officers and (ii) an annual grant to PFSweb non-employee directors of options to purchase 10,000 shares of PFSweb common stock pursuant to the terms of the PFSweb Non-Employee Director Stock Option and Retainer Plan, PFSweb has no present commitments to the persons listed in the above table with respect to the issuance of shares of PFSweb common stock.

Table of Contents

INFORMATION REGARDING eCOST

As used in this Section Information Regarding eCOST, references to we , us , our and ours refer to eCOST.

General

We are a leading multi-category online discount retailer of high quality new, close-out and refurbished brand-name merchandise. We currently offer over 100,000 products in twelve primary merchandise categories, including computer hardware and software, home electronics, digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. Additionally, we offer several other categories of products and services, including pet supplies and flowers, through various affiliate relationships. We appeal to a broad range of consumer and small business customers through what we believe is a unique and convenient buying experience, offering two shopping formats: every day low price and our proprietary Bargain Countdown™. This combination of shopping formats helps attract value-conscious customers to our eCOST.com website who are looking for high quality products at low prices. Additionally, we offer a fee-based membership program to develop customer loyalty by providing subscribers exclusive access to preferential offers. We also provide rapid response customer service utilizing a strategically located distribution center and third-party fulfillment providers, as well as customer support from online and on-call sales representatives. We offer suppliers an efficient sales channel for merchandise in all stages of the product life cycle. We carry products from leading manufacturers such as Apple, Canon, Citizen, Denon, Hewlett-Packard, Nikon, Onkyo, Seiko and Toshiba and have access to a broad and deep selection of merchandise, including new and deeply discounted close-out and refurbished merchandise.

We were incorporated in Delaware in February 1999, as a wholly-owned subsidiary of PC Mall. We have operated as a reporting segment of PC Mall s business since April 1999. In September 2004, we completed an initial public offering of 3,465,000 shares of our common stock, leaving PC Mall with ownership of approximately 80.2% of the outstanding shares of our common stock. On April 11, 2005, PC Mall distributed its remaining ownership interest in our company to its common stockholders (referred to as the distribution or the spinoff).

Industry Overview

Industry research indicates that the market for online retail sales is growing, an increasing share of the population is relying on the Internet to purchase products, and the average online buyer is spending more each year. The Internet offers consumers several advantages over traditional shopping channels. Consumers have no limitations from store location and are able to shop throughout the day and evening from their offices and homes. Consumers also benefit from increased merchandise selection on the Internet. Difficult-to-find accessories and obsolete models are often available at specialized online retailers. In addition, due to the relationship marketing focus of many online retailers, consumers benefit from personalized services and advertising.

Suppliers are attracted to the Internet for a variety of reasons. First, the Internet provides suppliers significant merchandising flexibility because of their ability to communicate detailed product information, editorial content and pricing information. In addition, the lack of any limitation on shelf space and the ability to display their full product portfolio through online retailers is also an attractive feature. Through the receipt of instant feedback on product sell-through, suppliers and manufacturers can monitor channel relationships more efficiently. Also, suppliers can more efficiently sell close-out merchandise through the Internet without having to allocate the merchandise among many physical brick-and-mortar locations. Manufacturers also benefit from the ability to advertise more effectively on the Internet than in traditional print media. The capability to reach a large group of customers from a central location and the potential for low-cost customer interaction create significant advantages.

Table of Contents

Our Strengths

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

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

Broad and deep product selection. We sell high quality products across a broad selection of merchandise categories. Most of the products offered on our website are from well-known, brand-name manufacturers. We currently offer over 100,000 different products in twelve categories. Our product offerings are updated continually to reflect new product trends, keeping our merchandise selection relevant for our customers so they continue to visit our website.

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

Two shopping formats on our website. We appeal to a broad customer base by offering two shopping formats designed to attract frequent visits to our website: every day low price and our proprietary Bargain Countdown^{tm}. For the shopper who wants new and recently released products from leading manufacturers, we offer discounted merchandise in an every day low price format. For the bargain shopper interested in close-out and refurbished merchandise, we market products using our Bargain Countdown^{tm} format which features time- and quantity-limited offers of selected merchandise that are more deeply discounted.

Rapid response order fulfillment. We ship substantially all of our customer orders from inventory at our distribution facility located near the FedEx main hub in Memphis, Tennessee. Substantially all orders in stock at the Memphis facility placed as late as 10:15 p.m. Eastern Time ship the same day and can be delivered at the customer s request by 10:30 a.m. the next day for most domestic locations. We also utilize virtual warehouse technology to access merchandise that is not in stock at our distribution facility.

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

Appealing features for small business customers. We offer our small business customers a convenient and differentiated way to purchase products through their own secure personalized website, which enables them to receive customized pricing and product offerings and which increases the efficiency of their shopping experience. Other helpful features for our business customers include purchasing and payment history, software licensing, custom hardware configurations and flexible payment alternatives, including up to net 30-day payment terms for qualified customers and lease financing through third-party sources. We also assign relationship managers to provide personalized service to many of our business customers.

134

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

Single point of distribution. Manufacturers and other vendors often use separate channels to sell new, refurbished and close-out products because most retailers offer products in only one stage of the product life cycle. Through our two shopping formats, we offer manufacturers and other vendors the flexibility to use eCOST.com to sell products in a brand sensitive manner in any stage of the product life cycle. For example, our Bargain Countdown[tm] capabilities allow our vendors to liquidate smaller, residual quantities of merchandise without disappointing customers due to the limited availability of such products.

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

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

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

Our Growth Strategy

Our objective, as a leading online discount retailer, is to develop our brand both nationally and internationally, offer high quality merchandise across multiple categories and provide a superior customer experience. Key elements of our growth strategy include:

expanding our product offerings and merchandise categories to attract new customers and offer an increased variety of merchandise to our existing customers;

acquiring new customers through continued online marketing campaigns as well as through new techniques involving online and traditional offline advertising, including print, media and direct mail;

expanding our sales to existing customers by encouraging them to visit our website repeatedly, to browse through additional merchandise categories, product offerings, new merchandise assortments, and new promotions; and

increasing eCOST.com brand awareness through strategic online and offline advertising programs.

Our Customers

We focus on consumers and small business customers. Our consumer customers are savvy, online shoppers, who are brand and price conscious, and interested in new technology. Our business customers include small businesses that we believe are currently underserved by other multi-category online retailers. While our business customer relationship managers focus on sales to small businesses, they also service businesses of all types and sizes. Our small business customers appreciate our superior and personalized customer service and our ability to offer new and current, close-out and refurbished merchandise at

competitive prices. For the years ended December 31, 2003 and 2004 and for the nine months ended September 30, 2005, consumer sales represented approximately 72%, 66% and 58%, respectively, of our total net sales, and business sales represented approximately 28%, 34% and 42%, respectively, of our total net sales.

Our Website

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

Currently, the products available on the every day low price portion of our website are organized into twelve primary product categories: computer hardware and software, home electronics, digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. Additionally, we offer several other categories of products and services, including pet supplies and flowers, through various affiliate relationships. We also offer the same products, if they meet certain criteria, on the proprietary Bargain Countdown™ section of our website. In addition to being able to use keyword searches to locate specific products on our website, customers can browse or search the products available on the every day low price portion of our website by navigating the subcategories contained in our primary product categories and our featured manufacturer product showcases. Products that fall within more than one subcategory on our website are often posted on more than one web page, which we believe increases the visibility of the products and assists the customer in finding desired merchandise.

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

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

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

As a commitment to our small business customers, we have created a customized information area available as a link from our website which features services, benefits and information for our small business customers. Such additional features and services include access to our business customer relationship management team, the ability to set up a customized corporate extranet site with custom

pricing and product catalogs, up to net 30-day credit terms for qualified customers, software licensing, computer system configurations, and leasing alternatives.

Our Merchandise

We strive to offer our customers an expansive selection of varied types of merchandise and currently offer more than 100,000 products on our website in twelve primary merchandise categories. While our product offerings change on a regular basis due to product availability and customer demand, we continually offer a wide variety of merchandise.

Computer hardware and software. Our computer hardware and software product category contains subcategories for computer systems, computer hardware and computer software. In these subcategories customers can find products such as desktop, notebook and handheld computers; servers; personal digital assistants; various hardware including CD and DVD drives and burners, flat screen monitors, color laser printers, scanners and networking equipment and business, education and entertainment software.

Home electronics. Our home electronics product category contains subcategories for camcorders, DVD players, audio systems, speakers, big screen and plasma televisions, VCR and digital video recorders, portables and accessories. Within these subcategories, customers can find products such as video cameras in popular formats like DVD players; surround sound audio systems; subwoofers, center channel and bookshelf speakers; LCD, plasma and projection screen televisions; digital video recorders that pause, rewind and replay live television; digital music players and a variety of accessories such as cables, remote controls and headphones.

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

Watches and jewelry. Our watches and jewelry product category offers customers the ability to shop in subcategories dedicated to watches, jewelry and pens. Within these subcategories, customers can find brand name men s and women s watches; gold, silver, platinum and diamond jewelry such as rings, necklaces, pendants, earrings and bracelets and fountain and ballpoint pens.

Housewares. Our housewares product category is dedicated to household appliances, kitchenware, personal care appliances, home decor and luggage. Within this portion of our website consumers can find products such as traditional household appliances including blenders, toasters and vacuum cleaners; professional quality cookware and gourmet kitchen appliances such as coffee grinders.

DVD movies. Our DVD movies product category offers consumers an array of new release and classic DVDs in a wide range of genres, including action and adventure; animated; comedy; documentary; drama; family; horror; music video and concerts; musicals and performing arts; mystery and suspense; sci-fi and fantasy; sports and fitness and television.

Video games. Our video game product category includes hardware and software products based on popular gaming platforms. Within subcategories dedicated to Sony PlayStation, Microsoft Xbox, Nintendo GameCube and PC gaming, customers can find hardware products and accessories, as well as action and adventure, role playing, simulation, sports, strategy and other types of video games.

Travel. Our travel category is dedicated to serve customer travel requirements such as booking arrangements for flights, hotels and cars, with the opportunity for customers to benefit from special offers. For our travel category, we have an arrangement with a third party travel services provider under which we receive commissions for travel arrangements made through our website.

Bed and bath. Our bed and bath product category is dedicated to bed and bath products and we have organized the website to allow customers to shop by subcategory. Within these subcategories we offer a variety of bed linens, pillows, blankets, comforters, towels and other select items.

Apparel and accessories. Our apparel and accessories product category features select clothing, footwear and accessories. Included in the product offering are subcategories of products allowing customers to access a variety of brand name garments such as men s and women s coats and jackets, sleepwear, ties, footwear such as suede boots, and recognized brand name purses and handbags.

Licensed sports gear. Our licensed sports gear product category is dedicated to sportswear apparel and memorabilia and includes a variety of products such as collector items, gifts, novelties, clothing and car mats. The website allows customers to access select professional sports team stores.

Cellular/ Wireless. Within our cellular/wireless category, we offer customers select cellular phones and service and a variety of cellular/wireless accessories including batteries, headsets, vehicle adaptors and battery chargers. For the cellular phones and service portion of this category, we have an arrangement with a third party cellular service provider under which we receive commissions for service plans and phones purchased by linking through our eCOST.com website.

We plan to expand into additional categories in order to attract new customers and offer a broader variety of merchandise to our existing customers. Categories currently under consideration include books, music, sporting goods/health and fitness and luggage. We also plan to increase our depth in our current categories by adding new subcategories, brands and products and continuing to develop and increase the number of affiliate categories.

Sales and Marketing

We currently focus our advertising efforts on efficient and effective marketing campaigns aimed at acquiring new customers, encouraging repeat purchases and establishing the eCOST.com brand. Our current online prospecting activities are primarily cost-per-click arrangements which include displaying our products within various price comparison sites and search engines such as CNET, PriceGrabber, Shopping.com and Google, strategic online banner advertising, affinity e-mail programs and participation in various online affiliate marketing programs. We send our current customers targeted e-mails focused on new product and category launches, special promotions, and product-related add-on and accessory offers, as well as cooperative manufacturer branding campaigns. We also mail an eCOST.com branded catalog to selected customers. Additional marketing campaigns have also included eCOST.com or manufacturer coupon offers and promotional shipping discounts.

We intend to continue to develop our small business customer base. We seek to provide personalized service for these customers and build deeper relationships which will lead to a growing share of the customer s overall purchases. We believe small business customers respond favorably to a one-to-one relationship model with personalized, well-trained, relationship managers. By contacting existing business customers on a systematic basis, we believe we have the opportunity to increase overall sales to those customers. We also offer our business customers the option to use a customized eCOST.com business website which provides customer-specific pricing, account history, password security and product catalog features. In addition, our business customers have multiple payment options including leasing and up to net 30-day credit terms for qualified customers. High volume customers may also qualify for special volume pricing.

Vendors

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

We offer products on our website from over 1,000 third-party vendors. In general, we agree to offer products on our website and the manufacturers agree to provide us with information about their products and honor our customer service policies. We have established direct vendor relationships with many key suppliers and intend to continue to seek direct relationships with vendors and suppliers.

Fulfillment Operations

We use a hybrid order fulfillment model that reduces inventory carrying cost while assuring that our customers experience rapid delivery and a high level of customer service. Our distribution center stocks faster selling products as well as special purchases of refurbished and close-out merchandise. For slower selling products not stocked in inventory, we have access to merchandise that can be drop shipped from 13 major distributors through our virtual warehouse technology. We do not have any contractual agreements with these vendors to guarantee availability of merchandise. Our hybrid fulfillment system allows us to ship orders quickly while limiting our exposure to excess and obsolete inventory charges. When customers place orders on our website, orders are fulfilled through our distribution center or through vendors electronically linked to our order management system. We monitor both sources for accurate order fulfillment and timely shipment.

We ship a substantial majority of our customer orders from inventory at our warehouse facility located near the FedEx main hub in Memphis, Tennessee. For the years ended December 31, 2003 and 2004 and for the nine months ended September 30, 2005, we derived 84%, 89% and 85%, respectively of our gross sales from products sold out of our own inventory, or prior to the spin-off, PC Mall s inventory. Our warehouse is operated with an automated warehouse management system that tracks the receipt of the inventory items, distributes order fulfillment assignments to warehouse employees and obtains rates for various shipping options to ensure low-cost outbound shipping. Our website relays orders to the warehouse management system throughout each day, and the warehouse management system in turn confirms to our website the shipment of each order. Our website provides customers with links to our freight providers to track the delivery status of a shipment.

Shipping and Handling. Customers can choose various shipping services at their expense ranging from next day by 10:30 a.m. to deferred ground delivery. Shipping costs are determined through a number of variables, including the type of delivery service requested, shipping distance, package dimensions, delivery location and other factors. Most in stock orders at the Memphis facility placed as late as 10:15 p.m. Eastern Time ship the same day and can be delivered at the customer s request by 10:30 a.m. the next day for most domestic locations.

Return Policy. We offer up to a 30-day return policy for qualified customers on selected items based on manufacturer return policies; otherwise all purchases are final. Upon receiving a return authorization number from an eCOST customer service representative, products may be returned within 30 days from the date of the invoice. Defective software products are eligible for exchange only. We charge a 15% restocking fee plus applicable shipping & handling charges for shipments refused by the customer. Returns of defective items, whether new or refurbished, will be accepted for exchange or repair, at our discretion, within 30 days of the invoice date. The customer is responsible for original and return shipping and handling charges on all approved returns.

Payment Terms. We offer our customers the following payment options: credit card, debit card, net 30-day payment terms for approved small business customers, bank money wire or third party business leasing through an approved lessor. We require verification of receipt of payment or credit card authorization before we ship any products to our customers who do not have pre-approved credit.

Handling and Processing Fee. We charge a handling and processing fee on most transactions consisting of a fixed fee for orders up to $500 or a percentage of the total order value for orders over $500.

Customer Service

Our business strategy has been to develop, cultivate and satisfy our growing customer base. As such, we focus on providing our customers with superior customer service in an effort to facilitate the best

possible shopping experience and to encourage repeat business. Our customer service capabilities include our website functionality, personalized inbound call-center support and a business relationship sales team. In addition, we offer FedEx and UPS delivery service with multiple delivery options. Our team of inbound customer service representatives currently assists our customers via telephone and e-mail. We staff our customer service department with dedicated professionals who respond to phone and e-mail inquiries for product information, order processing, returns and other general questions. Our customer service staff receives up to approximately 16,000 inbound calls and 6,000 e-mail messages each week. To maintain a rapid response time for our e-mail and phone inquires, we often use automated e-mail and phone systems to help route the customer to the appropriate customer service representatives. Relationship managers are assigned to many of our business customers to better service their needs and increase future sales opportunities.

Technology

We use our website, which was internally developed with PC Mall, and a combination of proprietary technologies and commercially available licensed technologies and solutions to support our operations, including Ecometry software for order processing, advertising and sales, fraud detection, purchasing, telemarketing and order management, virtual warehousing, and warehousing and shipping. We connect to the Internet over DS-3 lines through services provided by SBC and Qwest Communications. We regularly make improvements to our overall technology infrastructure to improve our customers shopping experiences.

Our information technology systems are located in our corporate headquarters in Torrance, California. PC Mall currently provides us with information technology support services to maintain our management information and reporting systems and owns or licenses substantially all of the infrastructure on which these systems operate. PC Mall also hosts our website using HP/ Compaq web servers that are configured for redundancy and high availability. The servers operate in a load-balanced environment designed to accommodate large volumes of Internet traffic, and we have immediate access to standby servers that can provide additional traffic capacity if necessary. The servers are optimized for scalability to permit future growth in traffic volumes.

We use Cisco network components, including routers, local directors, switches and hubs, and our network is redundant and configured with auto fail-over for high availability. Furthermore, our data is currently stored on hardware that is backed up by a high-speed redundant storage system. All customer credit card numbers and financial and credit information are secured using secure server software, and we maintain credit card numbers behind appropriate firewalls.

Under our Information Technology Systems Usage and Services Agreement with PC Mall, PC Mall provides us with usage of telecommunications systems and hardware and software systems, information technology services and related support services, including maintaining our management information and reporting systems and hosting our website. We pay PC Mall a monthly fee of $40,000 for the services and usage of the hardware and software systems and we reimburse PC Mall for our actual telecommunications systems usage charges. To the extent we need to upgrade or expand the capacity of our systems, we will be responsible for purchasing any such additional capacity or hardware. The agreement has a term of two years, but either party may terminate the agreement earlier by providing the other party 180 days prior written notice of such termination. As part of our transition to becoming a stand-alone company, we will need to create our own operational and administrative infrastructure to replace the services PC Mall currently provides to us. For a discussion of certain amendments to our agreements with PC Mall which will go into effect following the merger, see Amendment of PC Mall Agreements.

Competition

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

- price;
- product selection, quality and availability;
- shopping convenience;
- customer service; and
- brand recognition.

We currently or potentially compete with a variety of companies that can be divided into several broad categories:

- other multi-category online retailers such as Amazon.com and Buy.com;
- online discount retailers of computer and consumer electronics merchandise such as Computers4Sure, NewEgg and TigerDirect;
- liquidation e-tailers such as Overstock.com and SmartBargains;
- consumer electronics and office supply superstores such as Best Buy, Circuit City, CompUSA, Office Depot, OfficeMax and Staples; and
- manufacturers such as Apple, Dell, Gateway, Hewlett-Packard and IBM, who sell directly to customers.

Our largest manufacturers have sold, and continue to intensify their efforts to sell, their products directly to customers. To the extent additional manufacturers adopt this selling format or this trend becomes more prevalent, it could adversely affect our sales growth and profitability. In addition, PC Mall currently offers many of the same products for sale as we offer, and PC Mall is not restricted from competing with us.

Intellectual Property

We rely on a combination of laws and contractual restrictions with our employees, customers, suppliers, affiliates and others to establish and protect our proprietary rights. Despite these precautions, it is possible that third parties may copy or otherwise obtain and use our intellectual property, including our domain names, without authorization. Although we regularly assert our intellectual property rights when we learn that they are being infringed, these claims can be time-consuming and may require litigation and/or administrative proceedings to be successful. We have six trademarks and/or service marks which we consider to be material to the successful operation of our business: eCOST®, eCOST.com®, eCOST.com Bargain Countdown™, eCOST.com Your Online Discount Superstore!™, Bargain Countdown™ and Bargain Countdown Platinum Club™. We currently use all of these marks in connection with telephone, mail order, catalog, and online retail services. We have registrations for eCOST® and eCOST.com® in the United States for online retail order services and have seven pending applications for eCOST®, eCOST.com®, eCOST.com Bargain Countdown™ and Bargain Countdown™, eCOST.com Your Online Discount Superstore!™ and Bargain Countdown Platinum Club™ in the United States and three pending applications for eCOST™, eCOST.com™ and Bargain Countdown™ in Canada and the United Kingdom. Our applications may not be granted and we may not be able to secure significant protection for our service marks and trademarks.

We have filed an application with the U.S. Patent and Trademark Office seeking patent protection for our proprietary Bargain Countdown™ technology. We cannot provide any assurance that a patent will be issued from this patent application. In addition, effective patent and trademark protection may not be

available or may not be sought by us in every country in which our products and services are made available online, including the United States.

From time to time, we may be subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of the patents, trademarks and other intellectual property rights of third parties by our company. Third parties have asserted, and may in the future assert, that our business or the technologies we use infringe their intellectual property rights. Although we have not been subject to legal proceedings in the past, we may be subject to intellectual property legal proceedings and claims in the ordinary course of our business. We cannot predict whether third parties will assert additional claims of infringement against us in the future, or whether any future claims will prevent us from offering popular products or operating our business as planned. For a discussion of risks associated with our trademarks, patents and other intellectual property, please see Risk Factors If the protection of our trademarks and proprietary rights is inadequate, our brand and reputation could be impaired and we could lose customers and Risk Factors If third parties claim we are infringing their intellectual property rights, we could incur significant litigation costs, be required to pay damages, change our business or incur licensing expenses.

Government Regulation

We are subject to federal, state, local and foreign consumer protection laws, including laws protecting the privacy of our customers personally identifiable information and other non-public information and regulations prohibiting unfair and deceptive trade practices. Furthermore, the growth and demand for online commerce has and may continue to result in more stringent consumer protection laws that impose additional compliance burdens and greater penalties on online companies. Moreover, there is a trend toward regulations requiring companies to provide consumers with greater information regarding, and greater control over, how their personal data is used, and requiring notification where unauthorized access to such data occurs. For example, California law currently requires us to notify each of our California customers who is affected by any data security breach in which an unauthorized person, such as a computer hacker, obtains such customer s social security number, driver s license number or California Identification Card number, account number, credit or debit card number, in combination with any required security code, access code, or password that would permit access to a customer s account. In addition, several jurisdictions, including foreign countries, have adopted privacy-related laws that restrict or prohibit unsolicited email promotions, commonly known as spam, and that impose significant monetary and other penalties for violations. One such law, the CAN-SPAM Act of 2003, became effective in the United States on January 1, 2004 and imposes complex, burdensome and often ambiguous requirements in connection with our sending commercial email to our customers and potential customers. Moreover, in an effort to comply with these laws, Internet service providers may increasingly block legitimate marketing emails. These consumer protection laws may become more stringent in the future and could result in substantial compliance costs and could interfere with the conduct of our business.

We collect sales or other similar taxes for shipments of goods in California and Tennessee. One or more local, state or foreign jurisdictions may seek to impose sales tax collection obligations on us and other out-of-state companies that engage in online commerce. If sales tax obligations are successfully imposed upon us by a state or other jurisdiction, we could be exposed to substantial tax liabilities for past sales and fines and penalties for failure to collect sales taxes and we could suffer decreased sales in that state or jurisdiction as the effective cost of purchasing goods from us increases for those residing in that state or jurisdiction.

In many states, there is currently great uncertainty whether or how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet and commercial online services. These issues may take years to resolve. For example, tax authorities in a number of states, as well as a Congressional advisory commission, are currently reviewing the appropriate tax treatment of companies engaged in online commerce, and new state tax regulations may subject us to additional state sales and income taxes. New legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business or the application of

existing laws and regulations to the Internet and commercial online services could result in significant additional taxes or regulatory restrictions on our business. These taxes could have an adverse effect on our cash flows and results of operations. Furthermore, there is a possibility that we may be subject to significant fines or other payments for any past failures to comply with these requirements.

Employees

We currently have 107 full-time employees, including 10 in inbound sales, 13 in customer service, 20 in business customer relationship management, 22 in sales and marketing, 25 in warehouse administration, 13 in finance/accounting and 4 in our executive and administrative department. During the holiday shopping season, we have historically hired a number of temporary employees. We have never had a work stoppage, and our employees are not represented by a labor union. We consider our employee relationships to be positive.

Table of Contents

ECOST MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This Management s Discussion and Analysis contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are not historical facts but rather are based on current expectations, estimates and projections about our industry, our beliefs and assumptions. Forward looking statements in this report include, without limitation, statements regarding: our merger with PFSweb and the expected benefits of the merger; our deferred tax assets; the establishment of operations in the Philippines; the measures our management focuses on in evaluating the progress of our business; the principal drivers of our revenue; the critical accounting policies that affect the more significant judgments and estimates used in preparing our financial statements; the adequacy of our current working capital and other sources of liquidity to support our operations; future impacts of inflation on our operating results; our anticipated need to raise additional capital in the future for expansion of our operations and other purposes; and our future hiring needs and advertising and marketing expenditures. Words such as anticipate, expect, intend, plan, believe, seek, estimate, and variations of these words and similar expressions generally forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. These risks and uncertainties include those described in Risk Factors on page 28. All forward-looking statements are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update or revise any of these forward-looking statements even if experience or future changes show that the indicated results or events will not be realized.

Overview

eCOST.com, Inc. (we or our) is a leading multi-category online discount retailer of high quality new, close-out and refurbished brand-name merchandise. We currently offer over 100,000 products in twelve primary merchandise categories, including computer hardware and software, home electronics, digital imaging, watches and jewelry, housewares, DVD movies, video games, travel, bed and bath, apparel and accessories, licensed sports gear and cellular/wireless. Additionally, we offer several other categories of products and services, including pet supplies and flowers through various affiliate relationships. We appeal to a broad range of consumer and small business customers through what we believe is a unique and convenient buying experience offering two shopping formats: every day low price and our proprietary Bargain Countdown™. This combination of shopping formats helps attract value-conscious customers looking for high quality products at low prices to our eCOST.com website. Additionally, we offer a fee-based membership program to develop customer loyalty by providing subscribers exclusive access to preferential offers. We also provide rapid response customer service utilizing a strategically located distribution center and third-party fulfillment providers, as well as customer support from online and on-call sales representatives. We offer suppliers an efficient sales channel for merchandise in all stages of the product life cycle. We carry products from leading manufacturers such as Apple, Canon, Citizen, Denon, Hewlett-Packard (HP), Nikon, Onkyo, Seiko and Toshiba and have access to a broad and deep selection of merchandise, including new, deeply discounted close-out and refurbished merchandise.

We were originally formed in February 1999 as a subsidiary of PC Mall, which is a rapid response supplier of technology solutions for businesses, government and educational institutions, as well as consumers. Our initial strategy was to establish a retail website focused primarily on new and current release computer hardware, software, peripherals and networking products priced aggressively to achieve higher sales volumes. We were also focused on building brand awareness and growing our customer base. In mid 2000, we changed our focus to emphasize profitability over growth by reducing our advertising expenditures, reducing customer acquisition costs, improving product margins, expanding our product

categories and introducing a greater level of close-out and refurbished products to our merchandise mix. From November 2002 until April 2004, we also offered our products through an auction format, from which we derived net sales of $226,450 from the beginning of 2003 through April 2004 when we discontinued our auction format.

We operated as a reporting segment of PC Mall s business from April 1999 to April 2005. In September 2004, we completed an initial public offering of 3,465,000 shares our common stock, leaving PC Mall with ownership of approximately 80.2% of the outstanding shares of our common stock. On April 11, 2005 PC Mall distributed its remaining ownership interest in our company to its common stockholders through the form of a spin-off by means of a special dividend to its common stockholders of all of our common stock owned by PC Mall.

Our financial results are influenced by factors in the marketplace in which we operate and our successful execution of our business strategy. Marketplace factors include competition for customers, product pricing, online advertising costs, growth in online shopping, and promotional offers such as coupons and free shipping. We expect that the online marketplace environment will remain a price competitive and promotion-driven environment where companies that run efficient, high volume operations thrive. Our ability to execute our business strategy successfully will require us to meet a number of challenges, particularly our ability to:

- remain price competitive while maintaining or increasing our gross margins;
- maintain vendor relationships;
- manage our inventory and fulfillment functions effectively;
- continue to find efficient ways to invest in advertising as we grow our customer base;
- maintain or increase our levels of vendor marketing and co-op advertising funds; and
- develop and grow new merchandise categories.

Basis of Presentation

Prior to September 2004, our financial statements were derived from the consolidated financial statements and accounting records of PC Mall, in which we were reported as a separate segment, using the historical results of operations, and historical basis of assets and liabilities of our business. Our statements of operations for periods prior to September, 2004 include expense allocations for certain corporate functions historically provided to us by PC Mall, including administrative services (accounting, human resources, tax services, legal and treasury), inventory management and order fulfillment, credit card processing, information systems operation and administration, advertising services, and use of office space. These allocations were made on a specifically identifiable basis or using the relative percentages, as compared to PC Mall s other businesses, of net sales, payroll, net cost of goods sold, square footage, headcount or other. We have not made a determination of whether these expenses are comparable to those we could have obtained from an unrelated third party. Our expenses as a separate, stand-alone company may be higher or lower than the amounts reflected in the statements of operations. In connection with our IPO, we entered into agreements with an Affiliate to provide similar services under a fee arrangement for a specific term and these services included inventory management and fulfillment through date of distribution, administrative services such as accounting through date of distribution, human resources, payroll and information services. The scope and cost of some of these services was reduced commensurate with the spin-off. The financial results for the three and nine months ended September 30, 2005 reflect these contractual service arrangements, as amended.

We believe the assumptions underlying the financial statements are reasonable. However, the financial statements may not necessarily reflect our results of operations, financial position and cash flows in the future or what our results of operations, financial position and cash flows would have been had we been a separate, stand-alone company during the periods presented. The historical financial information presented

in this Report does not reflect the many significant changes that will occur in our funding and operations as a result of our becoming a public company or our spin-off from PC Mall.

Financial Operations Overview

Our management monitors a variety of financial and non-financial metrics on a daily, weekly and monthly basis in order to track the progress of our business and make adjustments as necessary. We believe that the most important of these measures include sales, orders shipped, website traffic, active customers, new customers, number of orders, average order value, gross margin, co-op advertising revenues, customer acquisition costs, advertising expense, personnel costs, fulfillment costs, relationship manager productivity, and accounts receivable aging for our business customers. Management compares the various metrics against goals and budgets, and takes appropriate action to enhance our performance. Our management also monitors additional measures such as liquidity and cash resources. As we transition to becoming an independent company, we anticipate that management will focus on further measures such as inventory turnover.

We derive our revenue from sales of products and services to consumers and businesses. Consumer sales consist of orders placed through our eCOST.com website or by inbound telephone orders. Business sales consist of sales made to customers assigned a customer relationship manager. In addition, business sales include orders placed through customized corporate websites. Sales to unassigned business customers are included in consumer sales. Through our affiliate categories we have arrangements with third party service providers and receive commissions for products and services purchased by linking through our eCOST.com website. We further generate revenue from handling fees and shipping fees we charge our customers, as well as other services. We record our revenue net of returns, coupons, credit card fraud and chargebacks, and other discounts. Our revenues may fluctuate from period to period as a result of special offers we provide such as free shipping, coupons and other special promotions.

Consumer sales represented 72% and 66% of our total net sales for the 2003 and 2004 fiscal years, respectively, and 58% of our total net sales for the nine months ended September 30, 2005. Business sales represented 28% and 34% of our total net sales for the 2003 and 2004 fiscal years, respectively, and 42% of our total net sales for the nine months ended September 30, 2005. No single customer accounted for more than 3% of our total net sales for 2003, 2004 or for the nine months ended September 30, 2005.

Our revenue is dependant in part on sales of HP and HP-related products which represented 21% and 27% of our net sales in 2003 and 2004, respectively, and 28% of our net sales for the nine months ended September 30, 2005.

We believe that the principal drivers of our revenue consist of the average order value placed by our customers, the number of orders placed by both existing and new customers, special offers we make available that result in incremental orders, our ability to attract new customers and advertising that impacts the aforementioned drivers of our revenue.

Our net sales are derived primarily from the sale of computer hardware, software, peripherals, electronics, and other consumer products to individual consumers and businesses through the internet, dedicated telemarketing sales executives, relationship-based telemarketing techniques, direct response catalogs and advertisements. We also generate commission-based revenue for certain products and other marketing and promotional services generated through our eCOST.com website. We use third party fulfillment partners to supply travel services (such as flights, hotels and rental cars), cellular phones and service and other affiliate categories. For these products and services, we do not have inventory risk or pricing control, and do not provide customer service. Therefore, for these sales we are not considered to be the primary obligor, and record only our commission as revenue. We believe there is a moderate level of seasonality in our business, reflecting fluctuations in online commerce and the general pattern of peak sales for the retail industry during the holiday shopping season. Sales in the traditional retail industry are generally higher in the first and fourth calendar quarters of the year. We believe that our historical revenue growth makes it difficult to predict the effect of seasonality on our future revenues and results of operations.

Cost of goods sold primarily consists of the cost of the product, inbound and outbound shipping, and fixed and variable fulfillment costs charged to us by PC Mall through the spin-off and directly incurred by us through the utilization of our Memphis distribution facility. Cost of goods sold is reduced by certain vendor consideration, such as co-op advertising funds. For our 2003 and 2004 fiscal years and for the nine months ended September 31, 2005, we derived approximately 84%, 89% and 85%, respectively, from products sold out of our own inventory or prior to the spin-off, PC Mall s inventory. We purchased the remaining inventory from virtual warehouse distribution suppliers.

Our gross profit margins are impacted by a number of factors. Product margins are typically higher for consumer sales than for business sales and vary by category of merchandise. Gross profit margins may also be impacted by various additional factors, including the introduction of new product categories, the relative mix of sales among our product categories, pricing of products by our vendors, fluctuations in key vendor support programs and price protection, pricing strategies, promotional programs including freight, market conditions, packaging, excess and obsolete inventory charges, and other factors.

Selling, general and administrative (SG&A) expenses consist primarily of advertising expenses, including online marketing activities and the costs of catalog production; personnel costs; fixed costs such as rent, common area maintenance and depreciation; variable costs such as credit card processing charges, bad debt expenditures, legal and accounting fees, and service fees from PC Mall; and other costs. As a result of our IPO and our recent spin-off from PC Mall, we have incurred and expect that we will continue to incur additional general and administrative expenses related to operating as a stand-alone public company, such as increased legal and accounting expenses, increased executive compensation, personnel and employee benefit costs; investor relations costs; non-employee director costs and higher insurance premiums.

Until completion of our initial public offering, we were a co-borrower under PC Mall s $75 million commercial line of credit, which included a $5 million flooring facility. The lenders for these lines released us from all obligations under these credit facilities upon completion of our initial public offering. PC Mall directly received all proceeds under this line of credit, and directly paid all principal and interest with respect thereto. Although we did not directly utilize proceeds from this line of credit and separately account for amounts we borrowed from PC Mall, because we were a co-borrower, along with all of the other PC Mall subsidiaries, with joint and several liability under such line of credit, the outstanding balance under the PC Mall commercial line of credit included in PC Mall s consolidated financial statements was included for financial reporting purposes in our stand-alone financial statements. As described below, our financial statements reflect offsetting interest expense and interest income with respect to such line of credit for periods prior to completion of our initial public offering.

Interest (income) expense represents a charge by PC Mall for advances to us for working capital through 2003. We calculated the amount of this interest expense monthly using the prime rate in effect at such time multiplied by the cumulative balance due to PC Mall, net of an amount equal to the amount of approximately one month s inventory purchases (to approximate standard vendor terms). Interest income in 2004 is a result of our investment of the net proceeds of our initial public offering proceeds in investment grade, interest-bearing marketable securities.

Interest expense PC Mall commercial line of credit represents PC Mall s consolidated interest expense for advances under its commercial line of credit made to PC Mall to fund the operations of its consolidated group.

Interest income PC Mall commercial line of credit represents our recognition of interest income from PC Mall to reimburse us for the consolidated debt obligation that we record in our financial statements and that reflects PC Mall s cost to fund the operations of its consolidated group. All costs associated with PC Mall s borrowings to fund our operations have been recorded under Interest expense PC Mall.

PC Mall will file a consolidated federal income tax return and a combined state income tax return that will include our operating results for the fiscal year ending December 31, 2005. This will no longer be

Table of Contents

the practice after this year end. We assess the recoverability of deferred tax assets and the need for a valuation allowance on an ongoing basis. In making this assessment, we consider all available positive and negative evidence to determine whether, based on such evidence, it is more likely than not that all of the net deferred assets will be realized in future periods. This assessment requires significant judgment and is based upon a number of factors including recent operating results, estimates involving projections of future taxable income, the nature of current and deferred income taxes, tax attributes relating to the interpretation of various tax laws, historical bases of tax attributes associated with certain tangible and intangible assets and limitations surrounding the availability of deferred tax assets. During 2003, we released the valuation allowance based on an assessment of both positive and negative evidence with respect to our ability to realize our deferred tax benefits. Specifically, at that time, our management considered current forecasts and projections supporting the future utilization of its deferred tax benefits, recent operating results and the fact that net operating losses were not limited with respect to their utilization and are available over a remaining carryover period of approximately 15 to 18 years. Over the latter half of fiscal 2004 and into the first half of 2005, we incurred significant operating losses which to some extent were driven by costs and expenses associated with out IPO and spin-off from our former Parent. As of the second quarter of 2005, our revised forecasts indicated a deferral in the timing of profitability, and this caused greater uncertainty with respect to our ability to generate sufficient taxable income to utilize our deferred tax assets. As required under the provisions of SFAS 109, *Accounting for Income Taxes*, we evaluated both positive and negative evidence to determine whether the utilization of the deferred tax assets is more likely than not. Given our recent losses incurred and quarterly trend of operating losses and the inherent risk and uncertainty associated with our forecasts and projections, it was determined that under the criteria of SFAS 109 it was not more likely than not that our deferred tax assets would be realized. Accordingly, we recorded a full valuation allowance against our net deferred tax assets during the second quarter of 2005, which resulted in a tax provision in that quarter of $6.5 million. We will continue to monitor all available evidence in accounting for this estimate and evaluate it on an ongoing basis.

In 1999 and 2000, we granted non-qualified stock options to certain of our and PC Mall s employees. These options were exercisable only upon the earlier to occur of an initial public offering or sale of our company or a period of five to seven years following the grant date of the options. Certain awards contain repurchase rights at the original exercise price in the event of employee termination, which right would terminate in the event of an initial public offering or sale of our company. As a result of the contingent nature of these options, a new measurement date for options granted to our employees occurred upon the consummation of our initial public offering, and we recorded non-cash stock-based compensation expense equal to the difference between the exercise prices of these options and the initial public offering price for these options. Based on the initial public offering price of $5.80 per share, we recorded a non-cash stock-based compensation charge of $0.8 million in connection with these options upon completion of our initial public offering.

In March 2004, we granted an option to purchase 560,000 shares of common stock to our Chief Executive Officer at an exercise price of $6.43 per share. This grant resulted in the recognition of deferred non-cash stock-based compensation based on the estimated deemed fair value of the common stock on the date of grant of $10.00. An aggregate of 25% of the shares of common stock subject to this option vested upon the completion of our initial public offering. The remainder of the shares of common stock subject to this option will vest in equal quarterly installments over a three year period following the offering. We recorded a non-cash stock-based compensation charge of $0.7 million in the year ended December 31, 2004 to reflect compensation expense related to the accelerated vesting of shares under this option as a result of our initial public offering. We are amortizing the additional $1.3 million of compensation expense relating to the March 2004 option over the remainder of the three-year vesting period. We recognized total compensation expense of $1.5 million in connection with all of our outstanding options in the year ended December 31, 2004

Critical Accounting Policies and Estimates

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, net sales and expenses, as well as the disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of our assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates, and we include any revisions to our estimates in our results for the period in which the actual amounts become known.

Our management considers an accounting estimate to be critical if:

- it requires assumptions to be made that were uncertain at the time the estimate was made; and

- changes in the estimate or different estimates that could have been selected could have a material impact on our results of operations or financial condition.

We believe the critical accounting policies described below affect the more significant judgments and estimates used in the preparation of our financial statements:

Revenue Recognition. We adhere to the revised guidelines and principles of sales recognition described in Staff Accounting Bulletin No. 104, Revenue Recognition, issued as a revision to Staff Accounting Bulletin No. 101, Revenue Recognition. While the wording of SAB 104 has revised the original SAB 101, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. Under SAB 104, sales are recognized when the title and risk of loss are passed to the customer, there is persuasive evidence of an arrangement for the sale, delivery has occurred and/or services have been rendered, the sales price is fixed or determinable and collectability is reasonably assured. Under these guidelines, we recognize a majority of our sales, including revenue from product sales and gross outbound shipping and handling charges, upon receipt of the product by the customer. For all product sales shipped directly from suppliers to customers, we are the primary obligor in the transaction, and we take title to the products sold upon shipment, bear credit risk, and bear inventory risk for returned products that are not successfully returned to suppliers; therefore, we recognize these revenues at gross sales amounts.

Sales are reported net of estimated returns and allowances, coupon redemptions and credit card fraud and chargebacks, all of which are estimated based upon recent historical information such as return and redemption rates, and fraud and chargeback experience. Management also considers any other current information and trends in making estimates. Our coupon redemptions are based upon the quantity of eligible orders transacted during the period and the estimated redemption rate, using historical experience rates for similar products or coupon amounts. Estimated redemption rates and the related coupon expense and liability are regularly adjusted as actual coupon redemptions for the program are processed. If actual sales returns, allowances, discounts, coupon redemptions and credit card fraud and chargebacks are greater than estimated by management, additional expense may be incurred.

Allowance for Doubtful Accounts Receivable. We maintain an allowance for doubtful accounts receivable based upon estimates of future collection using the specific identification method. We extend credit to our business customers based upon an evaluation of each business customer s financial condition and credit history, and generally do not require collateral. Our business customers financial conditions and credit and payment histories are evaluated in determining the adequacy of our allowance for doubtful accounts. We also maintain an allowance for uncollectible vendor receivables which arise from vendor rebate programs, price protections and other promotions. We determine the sufficiency of the vendor receivable allowance based upon various factors, including payment history. Amounts received from vendors may vary from amounts recorded because of potential non-compliance with certain elements of vendor programs. If our estimated allowances for uncollectible accounts or vendor receivables subsequently prove insufficient, additional allowance may be required.

Reserve for Inventory Obsolescence. We maintain allowances for the valuation of inventory by estimating the obsolete or unmarketable inventory based on the difference between inventory cost and market value determined by general market conditions, nature, age and type of each product. We regularly evaluate the adequacy of our inventory reserve and if the inventory reserve subsequently proves insufficient, additional inventory write-downs may be required, which would be recorded as an increase in cost of goods sold.

Income Taxes. PC Mall will file a consolidated federal income tax return and a combined state income tax return that will include our operating results for year ending December 31, 2005. This will no longer be the practice after this year end. We assess the recoverability of deferred tax assets and the need for a valuation allowance on an ongoing basis. In making this assessment, we consider all available positive and negative evidence to determine whether, based on such evidence, it is more likely than not that all of the net deferred assets will be realized in future periods. This assessment requires significant judgment and is based upon a number of factors including recent operating results, estimates involving projections of future taxable income, the nature of current and deferred income taxes, tax attributes relating to the interpretation of various tax laws, historical bases of tax attributes associated with certain tangible and intangible assets and limitations surrounding the availability of deferred tax assets. During 2003, we released the valuation allowance based on an assessment of both positive and negative evidence with respect to our ability to realize our deferred tax benefits. Specifically, at that time, our management considered current forecasts and projections supporting the future utilization of its deferred tax benefits, recent operating results and the fact that net operating losses were not limited with respect to their utilization and are available over a remaining carryover period of approximately 15 to 18 years. Over the latter half of fiscal 2004 and into the first half of 2005, we incurred significant operating losses which to some extent were driven by costs and expenses associated with our IPO and spin-off from our former Parent. As of the second quarter of 2005, our revised forecasts indicated a deferral in the timing of profitability, and this caused greater uncertainty with respect to our ability to generate sufficient taxable income to utilize our deferred tax assets. As required under the provisions of SFAS 109, *Accounting for Income Taxes*, we evaluated both positive and negative evidence to determine whether the utilization of the deferred tax assets is more likely than not. Given our recent losses incurred and quarterly trend of operating losses and the inherent risk and uncertainty associated with our forecasts and projections, we determined that under the criteria of SFAS 109 it was not more likely than not that our deferred tax assets would be realized. Accordingly, we recorded a full valuation allowance against our net deferred tax assets during the second quarter of 2005, which resulted in a tax provision in that quarter of $6.5 million. We will continue to monitor all available evidence in accounting for this estimate and evaluate it on an ongoing basis.

Our Relationship with and Separation from PC Mall

As a subsidiary of PC Mall, we were allocated a charge for services provided by PC Mall, including administrative services (accounting, human resources, tax services, legal and treasury), inventory management and order fulfillment, credit card processing, information systems operation and administration, advertising services, and use of office space. Immediately prior to the closing of the IPO, we entered into fixed-term, fee agreements with PC Mall to provide for these services and, commensurate with the distribution, reduced the scope of some of these services. The administrative services agreement was amended effective as of the date of the spin-off to reduce the scope of services and monthly fees and though it expired in August 2005, we continue to receive certain administrative services under this agreement. PC Mall provides us with usage of its telecommunications systems, hardware and software systems, information technology services and related support services under an agreement with a term of two years expiring in September 2006, which either party may terminate with six months prior notice. The inventory management and order fulfillment agreement terminated upon completion of the spin-off.

Additionally, we entered into certain product purchase arrangements with PC Mall which afforded us the facility for a limited time, to procure certain products from PC Mall under agreed contractual terms.

Table of Contents

For a discussion of certain amendments to our agreements with PC Mall which will go into effect following the merger, see Amendment of PC Mall Agreements.

Results of Operations

Three and Nine months ended September 30, 2005 compared to Three and Nine months ended September 30, 2004

Consumer sales represented 51% and 65% of total net sales for the three months ended September 30, 2005 and 2004, respectively, and 58% and 64% for the nine months ended September 30, 2005 and 2004, respectively. Business sales represented 49% and 35% of our total net sales for the three months ended September 30, 2005 and 2004, respectively, and 42% and 36% for the nine months ended September 30, 2005 and 2004, respectively. The business sales growth was due to increased sales per account relationship manager compared to the same periods a year ago. No single customer accounted for more than 3% of our total net sales for the nine months ended September 30, 2005. Our revenue is dependant in part on sales of HP and HP-related products which represented 27% of our net sales in 2004 and 28% of our net sales for the nine months ended September 30, 2005.

Our net sales have declined sequentially for the last three quarters, primarily as a result of declines in the number of orders placed, less efficient advertising, fulfillment center issues and seasonality. Our ability to achieve profitability and maintain adequate liquidity is substantially dependant on improving gross margins and improving sales.

Cost of goods sold primarily consists of the cost of the product, inbound and outbound shipping, and fixed and variable fulfillment costs charged to us by PC Mall through the spin-off and directly incurred by us through the utilization of our Memphis distribution facility. Cost of goods sold is reduced by certain vendor consideration, such as co-op advertising funds. For the three months ended September 30, 2005 and 2004, we derived approximately 82% and 88% of our net sales, respectively, from products sold out of our own inventory or, prior to the spin-off, PC Mall s inventory. For the nine months ended September 30, 2005 and 2004, we derived approximately 85% and 88% of our net sales, respectively, from products sold out of our own inventory, or prior to the spin-off, PC Mall s inventory. We purchased the remaining inventory from virtual warehouse distribution suppliers.

Selected Operating Data

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Total customers(1)	1,343,989	949,056	1,343,989	949,056
Active customers(2)	507,029	389,133	507,029	389,133
New customers(3)	56,668	88,147	257,128	228,634
Number of orders(4)	102,022	140,468	415,417	376,828
Average order value(5)	$ 389	$ 320	$ 338	$ 331
Advertising expense(6)	$ 1,307,000	$ 1,377,000	$ 4,784,000	$ 3,878,000

(1) Total customers have been calculated as the cumulative number of customers for which orders have been taken from our inception to the end of the reported period.

(2) Active customers consist of the number of customers who placed orders during the 12 months prior to the end of the reported period.

(3) New customers represent the number of persons who established a new account and placed an order during the reported period.

(4) Number of orders represents the total number of orders shipped during the reported period (not reflecting returns).

(5) Average order value has been calculated as gross sales divided by the total number of orders during the period presented. The impact of returns is not reflected in average order value.

(6) Advertising expense includes the total dollars spent on advertising during the reported period, including Internet, direct mail, print and e-mail advertising, as well as customer list enhancement services.

Three Months Ended September 30, 2005 Compared to the Three Months Ended September 30, 2004

Net Sales. Net sales for the three months ended September 30, 2005 were $38.2 million, a decrease of $5.2 million, or 12%, from the comparable prior year period. The sales decline was primarily due to a 27% decrease in the number of orders, partially offset by a 22% increase in the average order value. Additionally, consumer sales decreased 30% from the three months ended September 30, 2004 when compared to the same period in 2005. On a product category level, the sales decline was primarily due to a $4.7 million decrease in the computer hardware and software category, a $0.9 million decrease in home electronics, offset by a $0.3 million increase in video games.

Gross Profit. Gross profit for the three months ended September 30, 2005 was $2.7 million, a decrease of $1.4 million, or 33% from the comparable prior year period. The decrease in gross profit resulted from the increased costs of running our own distribution center, increased freight costs and increased customer returns. Gross profit as a percentage of sales decreased to 7.1% from 9.5% in the comparable prior year period, primarily due to the result of a higher proportion of sales to business customers which carry lower gross margins than consumer sales, increased freight costs, and the fulfillment operation issues cited above. Gross profit may be influenced from period to period by changes in vendor support programs (including price protection, rebates and return policies), product mix, pricing strategies, competition and other factors.

Selling, General and Administrative Expenses. SG&A expenses for the three months ended September 30, 2005 were $5.1 million, a decrease of $0.4 million, or 8% from the comparable prior year period. SG&A expense for the three months ended September 30, 2005 and 2004 included approximately $0.1 million and $1.3 million, respectively, of stock-based compensation charges. Excluding these stock-based compensation charges, SG&A expense for the three months ended September 30, 2005 increased $0.7 million, or 17% over the comparable prior year period. The increase was primarily due to additional personnel costs of $0.7 million (excluding the stock-based compensation charges discussed previously) related to operating as a stand-alone company. As a percentage of net sales, SG&A expenses for the three months ended September 30, 2005 were 13%, versus 10% in the comparable prior year period (excluding the stock-based compensation charges discussed previously) and was primarily due to the increased personnel costs.

Interest Income. Interest income for the three and nine months ended September 30, 2005 reflects interest earned on the investment of our net IPO proceeds in investment-grade, interest-bearing, marketable securities. Interest expense-PC Mall commercial line of credit is offset in the reported period by Interest income-PC Mall commercial line of credit. These amounts were calculated based on the monthly applicable prime rate multiplied by the cumulative balance due to PC Mall, net of approximately one month s inventory purchases (to approximate standard vendor terms).

Income Tax Provision. As we recorded a valuation allowance for the full amount of our deferred tax asset at June 30, 2005, no additional income tax benefit was recorded during the three months ended September 30, 2005. We recorded an income tax benefit for the three months ended September 30, 2004 of $0.5 million. The tax benefit in September 30, 2004 was calculated utilizing an effective tax rate of 37.1%.

Net Loss. Our net loss was $2.3 million, or $0.13 per share, for the three months ended September 30, 2005, compared to a net loss of $0.9 million, or $0.06 per share, for the three months ended September 30, 2004.

Nine Months Ended September 30, 2005 Compared to the Nine Months Ended September 30, 2004

Net Sales. Net sales for the nine months ended September 30, 2005 were $134.3 million, an increase of $13.9 million, or 12%, over the comparable prior year period. The sales increase was primarily the result of an increase of 10% in the number of orders. Additionally, business sales increased 31% from the nine months ended September 30, 2004 when compared to the same period in 2005. On a product category level, the sales increase was primarily due to a $10.2 million increase in the computer hardware and software category, a $5.0 million increase in home electronics, a $0.9 million increase in video games, offset by a $2.0 million decrease in digital imaging.

Gross Profit. Gross profit for the nine months ended September 30, 2005, was $9.2 million, a decrease of $2.1 million, or 18.8% from the comparable prior year period. The decrease in gross profit resulted from the additional costs of running our own distribution center, the increase in customer returns and additional freight costs. Gross profit as a percentage of sales decreased to 6.9% from 9.4% in the comparable prior year period, primarily due to the result of a higher proportion of sales to business customers, which carry lower gross margins than consumer sales, increased freight costs, and the fulfillment operation issues cited above. Gross profit may be influenced from period to period by changes in vendor support programs (including price protection, rebates and return policies), product mix, pricing strategies, competition and other factors.

Selling, General and Administrative Expenses. SG&A expenses for the nine months ended September 30, 2005 were $17.4 million, an increase of $4.6 million, or 36% over the comparable prior year period. SG&A expense for the nine months ended September 30, 2005 and 2004 included approximately $0.4 million and $1.4 million, respectively, of stock-based compensation charges. Excluding these stock-based compensation charges, SG&A expense for the nine months ended September 30, 2005 increased $5.6 million, or 49% over the comparable prior year period. The increase was primarily related to our operating as a stand-alone company, including additional personnel costs of $3.6 million (excluding the stock-based compensation charges discussed previously), an increase of $1.2 million in fixed costs such as rent, common area maintenance and depreciation, and an increase of $0.9 million in advertising costs. As a percentage of net sales, SG&A expenses in the nine months ended September 30, 2005 were 13% compared to 9% in the comparable prior year period (excluding the stock-based compensation charges discussed previously).

Interest Income or Expense. Interest income for the nine months ended September 30, 2005 reflects interest earned on the investment of our net IPO proceeds in investment-grade, interest-bearing, marketable securities. Interest expense-PC Mall commercial line of credit is offset in the reported period by Interest income-PC Mall commercial line of credit. These amounts were calculated based on the monthly applicable prime rate multiplied by the cumulative balance due to PC Mall, net of approximately one month s inventory purchases (to approximate standard vendor terms).

Income Tax Provision. We recorded an income tax provision for the nine months ended September 30, 2005 of $5.4 million and a tax benefit of $0.5 million for the nine months ended September 30, 2004. Under FAS 109, we continuously evaluate whether the utilization of our deferred tax assets is more likely than not. Based upon the review of both positive and negative evidence, during the second quarter of 2005, we provided a valuation allowance of $6.5 million against our net operating losses included in our deferred tax asset. This offsets the prior tax benefit recorded during the first quarter of 2005 of $1.1 million, included in our deferred tax asset. We will continue to evaluate this asset on an ongoing basis. The tax benefit in September 30, 2004 was calculated utilizing an effective tax rate of 37.1%.

Net Loss. Our net loss after taking the income tax provision discussed above was $13.4 million, or $0.76 per share, for the nine months ended September 30, 2005 compared to a net loss of $0.9 million, or $0.06 per share, for the nine months ended September 30, 2004.

The following table sets forth our results of operations expressed as a percentage of total net sales for the periods indicated.

	Year Ended December 31,		
	2002	2003	2004
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	89.2	90.6	90.9
Gross profit	10.8	9.4	9.1
Selling, general and administrative expenses	10.1	9.0	10.3
Income from operations	0.7	0.4	(1.2)
Interest (income) expense	0.5	0.1	(0.1)
Interest expense-PC Mall commercial line of credit	1.2	1.3	0.7
Interest income-PC Mall commercial line of credit	(1.2)	(1.3)	(0.7)
Income (loss) before income taxes	0.2	0.3	(1.1)
Income tax benefit		(5.4)	(0.4)
Net income (loss)	0.2%	5.7%	(0.7)%