PFSWEB INC
Form 10-K
March 31, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

þ   ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008

or

o   TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-28275
PFSWEB, INC.
(Exact name of registrant as specified in its charter)

Delaware	75-2837058
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*
500 North Central Expressway, Plano, Texas	**75074**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code:
972-881-2900
Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o   Accelerated filer o   Non-accelerated filer o   Smaller reporting company þ
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2008 (based on the closing price as reported by the National Association of Securities Dealers Automated Quotation System) was

$38,855,038.

At March 31, 2009, there were 9,942,140 shares of the registrant s Common Stock issued, $.001 par value, (after giving effect to the 1-for-4.7 common share reverse stock split effective June 2, 2008).

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Annual Report, to the extent not set forth herein, is incorporated herein by reference from the registrant s definitive proxy statement relating to the annual meeting of shareholders, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Annual Report relates.

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Unless otherwise indicated, all references to PFSweb, the Company, we, us and our refer to PFSweb, Inc., a Delaware corporation, and its subsidiaries.

PART I

Item 1. *Business*
General

PFSweb is an international provider of integrated eCommerce and business process outsourcing solutions. PFSweb provides these solutions to major brand name companies seeking to optimize their supply chain efficiencies and to extend their traditional business and e-commerce initiatives. Through our eCOST.com business unit, we are also a leading multi-category online discount retailer of new, close-out and recertified brand-name merchandise. We derive our revenues from three business segments: 1) eCommerce and business process outsourcing, 2) a master distributor and 3) an online discount retailer.

First, in our eCommerce and business process outsourcing business segment operated by our Priority Fulfillment Services subsidiaries (PFS), we derive our revenues from a broad range of services as we process individual business transactions on our clients behalf. 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 deployment of an eCommerce technology platform, the receipt and storage of a client s inventory, the kitting and assembly of products to meet a client 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 eCommerce and business process outsourcing segment, we do not own the inventory or the resulting accounts receivable, but provide management services for these client-owned assets.

In our second business segment operated by our Supplies Distributors subsidiaries we act as a master distributor of product for InfoPrint Solutions Company (IPS), a joint venture company owned by Ricoh and International Business Machines (IBM), and certain other clients. In this capacity, we purchase and resell for our own account, IPS and other manufacturers inventory. Accordingly, in this business segment, we recognize product revenue and own the accounts receivable and inventory.

Our third business segment is eCOST.com (eCOST), an online discount retailer of new, close-out and recertified brand-name merchandise. This web-commerce product revenue model is focused on the sale of products to a broad range of consumer and business customers. We currently offer approximately 200,000 products in several primary merchandise categories, including computers, networking, electronics and entertainment, TV s, plasmas and monitors, cameras and camcorders, memory and storage, For the Home and sports and leisure.

We are headquartered in Plano, Texas where our executive and administrative offices and our primary technology operations and hosting facilities are located. We have an office in El Segundo, CA which consists of sales, marketing and purchasing operations for our online discount retailer segment. We operate state-of-the-art call centers from our U.S. facilities located in Plano, Texas, and Memphis, Tennessee, and from our international facilities located in Toronto, Canada, Liege, Belgium and Manila, Philippines. We lease or manage warehouse facilities of approximately 2.0 million square feet of warehouse space, many containing highly automated and state of the art material handling and communications equipment, in Memphis, TN, Southaven, MS, Grapevine, TX, Toronto, Canada and Liege, Belgium, allowing us to provide global distribution solutions.

ECOMMERCE AND BUSINESS PROCESS OUTSOURCING SEGMENT

PFS is a global provider of end-to-end eCommerce and business process outsourcing solutions. PFS service breadth includes eCommerce technology and integration services, interactive marketing services, global logistics and order fulfillment, freight and transportation management, real-time order management, kitting and assembly, customer care, facility operations and management, turn-key web-commerce infrastructure, payment processing and financial services and more. Collectively, we define our offering as End-to-End eCommerce and 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) sales channels.

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PFS serves as the brand behind the brand for companies seeking to increase efficiencies, enter new markets or launch optimized sales channels. As an eCommerce and business process outsourcer, we offer scalable and cost-effective solutions for manufacturers, distributors, online retailers and direct marketing organizations across a wide range of industry segments. We provide our clients with seamless and transparent solutions to support their business strategies, allowing them to focus on their core competencies. Leveraging PFS technology, expertise and proven methodologies, 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 their business solution. Together, we not only help our clients define new ways of doing business, but also provide them the technology, physical infrastructure and professional resources necessary to quickly implement this 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. PFS supports clients in a wide array of industries including technology products, consumer goods, aviation, toys/education, collectibles, luxury goods, food and beverage, apparel and home furnishings. These clients turn to PFS for help in addressing a variety of business issues that include profitable eCommerce, customer satisfaction and retention, time-definite logistics, vendor managed inventory and integration, supply chain compression, cost model realignments, transportation management and international expansion, among others. We also act as a constructive agent of change, providing clients the ability to alter their current distribution model, establish direct relationships with end-customers, and reduce the overall time and costs associated with existing distribution channel strategies. Our clients are seeking solutions that will provide them with dynamic supply chain and multi-channel marketing efficiencies, while ultimately delivering a world-class customer service experience.

Our 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.

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 provide 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 online retailers, technology and consumer goods manufacturers, aviation brands as well as other 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 File Transfer Protocol (FTP), and traditional electronic data interchange (EDI);

eCommerce technology solutions with managed hosting and Internet application development services, including web site design, creation, integration and ongoing maintenance, support and enhancement of web sites;

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;

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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 our distribution facilities or co-located in other facilities;

Product management and inspection services, including management of coupon programs, de-kitting and salvage operations and inspection, testing and repackaging services;

Information management, including real-time data interfaces, data exchange services and data mining;

Financial services, including secure online credit card processing related services, fraud protection, invoicing, credit management and collection, and working capital solutions; and

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.

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.

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-customer 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. 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.

Manufacturers, as buyers of materials, are also imposing new business practices and policies on their supplier partners to shift the normal supply chain costs and risks associated with inventory ownership away from their own balance sheets. Through techniques like Vendor Managed Inventory or Consigned Inventory Programs (CIP),

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manufacturers are asking their suppliers, as a part of the supplier selection process, to provide capabilities where the manufacturer need not own, or even possess, inventory prior to the exact moment that unit of inventory is required as a raw material component or for shipping to a customer. To be successful for all parties, business models such as these often require a sophisticated collection of technological capabilities that allow for complete integration and collaboration of the information technology environments of both the buyer and supplier. For example, for an inventory unit to arrive at the precise required moment in the manufacturing facility, it is necessary for the Manufacturing Resource Planning systems of the manufacturer to integrate with the CRM systems of the supplier. When hundreds of supplier partners are involved, this process can become quite complex and technologically challenging. Buyers and suppliers are seeking solutions that utilize XML based protocols like BizTalk, RosettaNet and other traditional EDI standards to ensure an open systems platform that promotes easier technology integration in these collaborative solutions.

Outsourcing Trend

In response to growing competitive pressures and technological innovations, we believe many companies, both large and small, are focusing their critical resources on the core competencies of their business and utilizing eCommerce and business process outsourcing to accelerate their business plans in a cost-effective manner and perform non-core business functions. Outsourcing can provide many key benefits, including the ability to:

    Enter new business markets or geographic areas rapidly;

    Increase flexibility to meet changing business conditions and demand for products and services;

    Enhance customer satisfaction and gain competitive advantage;

    Reduce capital and personnel investments and convert fixed investments to variable costs;

    Improve operating performance and efficiency; and

    Capitalize on skills, expertise and technology infrastructure that would otherwise be unavailable or expensive given the scale of the business.

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

Another vital point for major brand name companies seeking to outsource is the protection of their brand. When looking for an outsourcing partner to provide infrastructure solutions, brand name companies must find a company that can 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 PFS Solution

PFS serves as the   brand behind the brand   for companies seeking high performance sales channels.

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

Quickly Capitalize on Market Opportunities. Our solutions empower clients to rapidly implement their supply chain and eCommerce strategies and to take advantage of opportunities without lengthy integration and implementation efforts. We have readily available advanced technology and physical infrastructure that is flexible in

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its design, which facilitates quick integration and implementation. The PFS solution is designed to allow our clients to deliver consistent quality service as transaction volumes grow and also to handle daily and seasonal peak periods. Through our international locations, our clients can sell their products throughout the world.

Improve the Customer Experience. We enable our clients to provide their customers with a high-touch, positive buying experience thereby maintaining and promoting brand loyalty. Through our use of advanced technology, we can respond directly to customer inquiries by e-mail, voice or data communication and assist them with online ordering and product information. We offer our clients a world-class level of service, including 24-hour, seven-days-a-week, Web-enabled customer care service centers, detailed CRM reporting and exceptional order accuracy. We have significant experience in the development of eCommerce storefronts 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 can provide 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, we are able to quickly deploy additional resources. We provide services to multiple clients, which enables us to offer our clients economies of scale, and resulting cost efficiency, that they may not have been able to obtain on their own. Additionally, because of the large number of daily transactions we process, we have been able to justify investments in levels of automation, security surveillance, quality control processes and transportation carrier interfaces that are typically outside the scale of investment that our clients might be able to cost justify on their own. These additional capabilities can provide our clients the benefits of enhanced operating performance and efficiency, 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(SM), 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.

PFS 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.

Technology Collaboration. We have created the Entente Suite(SM), 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 encompasses a wide range of business functions from order processing and inventory reporting to total e-commerce design and implementation. The Entente Suite(SM) comprises five key services EntenteWeb®, EntenteDirect®, EntenteMessage®, EntenteReport® and EntentePartnerConnect .

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, web service enabled user-friendly interface between their system and our 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.

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EntentePartnerConnect is a data repository and retrieval service for providing our clients with access to comprehensive product and service information across a wide variety of product and service categories. This information is aggregated from multiple sources including PFS business partners such as Etilize that specialize in creating product content in certain categories. We also rely on other relationships and public-domain information sources to supply raw data for this service. Access to this information will be provided through the other Entente Suite(SM) components including web sites created using EntenteWeb® and real-time or batch interfaces available through EntenteDirect® and EntenteMessage®. We provide the EntentePartnerConnect service to our wholly-owned subsidiary eCOST via the eCOST.com web site. The content available for the wide-range of products offered on eCOST.com is provided by EntentePartnerConnect . The information available from EntentePartnerConnect for additional product categories offers eCOST the opportunity to increase revenues through an expanded product offering and potential future product category expansion. We use EntentePartnerConnect when we host our clients web sites using our EntenteWeb® hosted web service and GlobalMerchant Commerceware platform.

The Entente Suite(SM) operates in an open systems environment and features the use of industry-standard XML and SOA web services, 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. The Entente Suite(SM) offers companies a more robust electronic information transfer option over the traditional methods. FTP or EDI, MQ Series, ALE, HTTP, and HTTPS transfer methods are also 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.

End-to-End eCommerce. PFS integrated its world-class services for contact center management, warehousing, logistics and fulfillment with Demandware eCommerce, a leading on-demand eCommerce platform, to provide a single, flexible best-of-breed solution spanning the eCommerce storefront, delivery of goods and ongoing customer care. This new offering redefines end-to-end eCommerce by enabling retailers and branded consumer goods manufacturers with the ability to employ a total outsourcing solution customized to their particular eCommerce strategy, without the loss of site or brand control associated with earlier end-to-end outsourcing solutions.

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 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. 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 solution is the warehousing and distribution of inventory either owned by our clients or owned by us. We currently have approximately two million square feet of leased or managed warehouse space domestically and internationally to store and process our and our clients inventory. We receive client inventory in our distribution centers, verify shipment accuracy, unpack and audit packages (a process that includes spot-checking a small percentage of the client s 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. For many clients, we provide gift-wrapping services including customized gift-wrapping paper, ribbon, gift-box and gift-messaging.

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 and in-line scales. 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.

In addition to our advanced distribution systems, our pick-to-light carts and conveyor system controls provide real time productivity reporting, thereby providing our management team with the tools to implement productivity standards. Our fleet of pick-to-light carts also fully integrates with our Vertical Lift Module (VLM), which is capable of stocking more than two thousand SKUs. This combination of computer-controlled equipment provides the seamless integration of our pick-to-light and mass storage capabilities. This unique combination of technologies ensures high order accuracy for each and every customer order.

Our primary B2B facility is in Southaven, MS, containing almost 400,000 square feet of space. The Southaven facility has clear height added cubic space utilization, state-of-the-art lighting that increases the quality and volume of light while reducing energy costs, and certain long-term tax incentives offered by the State of Mississippi. Southaven maintains the same proximity to all modes of transportation compared with our Memphis facilities.

During 2008, we warehoused, managed and fulfilled more than $2.8 billion in merchandise and transactions. Much of this does not represent our revenue, but rather the revenue of our clients for whom we provided eCommerce and business process outsourcing solutions. See Management s Discussion and Analysis of Financial Condition and Results of Operations.

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, including issuing return authorizations, receipt of product, crediting customer accounts, and disposition of returned product.

Our domestic clients enjoy the benefits of having their inventory assets secured by trained law enforcement professionals from our security headquarters in Memphis, TN and Southaven, MS. Continual validation ensures that we employ the latest in security processes and procedures to further enhance our surveillance and detection capabilities. Our security program continues to gain trust and confidence from our clients as we protect their product and assets.

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 operations in Mississippi and Tennessee, we also manage an aircraft parts distribution center in Grapevine, TX on behalf of Hawker Beechcraft Corp. 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

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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. Our kitting and assembly services include light assembly, specialized kitting and supplier-consigned inventory hub either in our distribution facilities or co-located elsewhere. We also offer customized light manufacturing and Supplier Relationship Management.

We 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 us from domestic or overseas manufacturers, and we will build the finished SKUs to stock for the client. Also included is the custom configuration of high-end printers and servers. This strategy allows manufacturers to make a smaller investment in base unit inventory while meeting changing customer demand for highly customizable product.

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 we receive the appropriate inventory quantities at just the right time and we then turn them 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.

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

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

Information Management. We have the ability to communicate with and transfer information to and from our clients through a wide variety of technology services, including real-time web service enabled data interfaces, file transfer methods and electronic data interchange. Our systems are designed to capture, store and electronically forward to our clients critical information regarding customer inquiries and orders, product shipments, inventory status (for example, levels of inventory on hand, on backorder, on purchase order and inventory due dates to our warehouse), product returns and other information. We maintain for our clients detailed product databases that can be seamlessly integrated with their web sites utilizing the capabilities of the Entente Suite(SM). 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.

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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 offer high levels of security and reduce the 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.

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 eCommerce, customer care, logistics and distribution expertise. They have built solutions for Fortune 1000 and Global 2000 market leaders in a wide range of industries, including multi-channel retailers, 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 interactive marketing eCommerce, supply chain management, distribution and fulfillment, technology interfacing, logistics and customer support.

Clients and Marketing

Our target clients include online retailers as well as leading technology, consumer goods and aviation brands 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. Our solutions are applicable to a multitude of industries and company types and we have provided solutions for such companies as:

IBM (printer supplies in several geographic areas), Xerox (printers and printer supplies), Roots Canada LTD. (apparel), Hewlett-Packard (printers and computer networking equipment), Hawker Beechcraft Corp. (FOM and time-definite logistics supporting parts distribution), Riverbed Technologies (a wide-area data services provider) and LEGO Brand Retail (a toy manufacturer) amongst many others.

We target potential clients through an extensive integrated marketing program that is comprised of 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 eCommerce and 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

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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.

Competition

We face competition from many different sources depending upon the type and range of services requested by a potential client. Many other companies offer one or more of the same services we provide on an individual basis. Our competitors include vertical outsourcers, which are companies that offer a single function solution, such as call centers, public warehouses or credit card processors. We occasionally compete with transportation logistics providers, known in the industry as 3PL s and 4PL s (third or fourth party logistics providers), who offer product management functions as an ancillary service to their primary transportation services. We also compete against other eCommerce and business process outsourcing providers, who perform various services similar to our solution offerings.

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

Although many of our competitors offer one or more of our services, we believe our primary competitive advantage is our ability to offer a wide array of customized services that cover a broad spectrum of eCommerce and business processes, including web-site design and hosting, kitting and assembly, order processing and shipment, credit card payment processing and customer service, thereby eliminating any need for our clients to coordinate these services from many different providers. We believe we can differentiate ourselves by offering our clients a very broad range of eCommerce and business process services that address, in many cases, the entire value chain, from demand to delivery.

We also compete on the basis of many other important additional factors, including:

operating performance and reliability;

ease of implementation and integration;

experience of the people required to successfully and efficiently design and implement solutions;

experience operating similar solutions dynamically,

leading edge technology capabilities;

global reach; and

price.

We believe that we can compete favorably with respect to many 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.

MASTER DISTRIBUTOR SEGMENT

Our Supplies Distributors subsidiaries act as a master distributor of product for IPS and certain other clients. In this capacity, we purchase and resell for our own account IPS and other manufacturers inventory.

Through Supplies Distributors, we can create and implement client inventory solutions, which may enable manufacturers to remove inventory and receivables from their balance sheets through the use of third party financing. We have years of experience in dealing with the issues related to inventory ownership, secure inventory management, replenishment and product distribution. We 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

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end user. All interfaces are done electronically and almost all processes regarding the financial transactions are automated, creating significant supply chain advantages.

We are 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.

While we recognize product revenue as a result of our inventory ownership through these relationships, operationally this segment is virtually the same as our eCommerce and Business Process Outsourcing Segment. See the preceding discussion for an overview of that segment.

ONLINE DISCOUNT RETAILER SEGMENT

Through eCOST.com, we operate a leading multi-category online discount retailer of high quality new, close-out and recertified brand-name merchandise. We currently offer approximately 200,000 products in several primary merchandise categories, including computers, networking, electronics and entertainment, TV s, plasmas and monitors, cameras and camcorders, memory and storage, For the Home and sports and leisure. Additionally, we offer several other categories of products and services to 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 Sony, JVC, Canon, Hewlett-Packard, Denon, Dyson, Sennheiser, Garmin, Panasonic, Toshiba and Microsoft and have access to a broad and deep selection of merchandise, including new and deeply discounted close-out and recertified brand-name merchandise.

Our Strengths

We have developed a differentiated business model, which provides our customers and vendors with numerous benefits. We provide consumers and businesses with quick and convenient access to high quality, new, close-out and recertified 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 many 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®.

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 approximately 200,000 different products in several 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 recertified 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.

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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®. 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 recertified merchandise, we market products using our Bargain Countdown® format, which features time- and quantity-limited offers of selected merchandise that are more deeply discounted.

Rapid response order fulfillment. We ship a majority of customer orders from inventory at our distribution facility located in Memphis, Tennessee. Substantially all orders in stock at the Memphis facility placed before 4:00 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 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 dedicated relationship managers to provide personalized service to their unique business needs.

We provide manufacturers and other vendors with a convenient channel to sell both large and small quantities of new, close-out and recertified 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, recertified 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® 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 Customers

We focus on consumers and business customers who often display similar consumer buying characteristics. We believe our consumer customers are savvy, online shoppers, who are brand and price conscious, and interested in

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new technology. Our business customers include small and medium sized businesses that we believe are currently underserved by other multi-category online retailers. While our business customer relationship managers focus on sales to small and medium sized businesses who are seeking to purchase products for use in their business, they also service certain resellers of technology products. We offer these small and medium sized business customers superior and personalized customer service and new and current, close-out and recertified merchandise at competitive prices.

Our Website

Our website is comprehensive, easy to use and provides an exciting shopping experience that encourages customer loyalty and repeat visits. We strive to 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 several primary product categories: computers, networking, electronics and entertainment, TV s, plasmas and monitors, cameras and camcorders, memory and storage, For the Home and sports and leisure. Additionally, we offer several other categories of products and services through various affiliate relationships. We also offer the same products, if they meet certain criteria, on the proprietary Bargain Countdown® section of our website where we feature more than 100 limited time and limited quantity product deals across our broad merchandise categories. 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 more than 100 close-out, recertified and highly allocated deal products in limited quantities for a limited time. The Bargain Countdown® feature is designed as a purchasing marketplace for consumers that creates purchase urgency by uniquely indicating the quantity of items remaining for a 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 deals, the 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. 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 service agreement recommendations.

As a commitment to our small and medium sized business customers, we offer them access to our business customer relationship management team, up to net 30-day credit terms for qualified customers, software licensing, computer system configurations and extended payment term alternatives.

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Our Merchandise

We strive to offer our customers an expansive selection of varied types of merchandise and currently offer approximately 200,000 products in several 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.

Computers and Networking. Our computers and networking product categories contains several subcategories including systems, software and networking equipment. 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 business, education and entertainment software.

Electronics and Entertainment. Our electronics and entertainment product category contains subcategories for DVD movies and gaming, audio systems, video systems and accessories. Within these subcategories, customers can find products such as DVD players; DVD movies and gaming; personal audio systems; speakers; 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.

TV s Plasmas and Monitors. Our TV s, plasmas and monitors product category contains subcategories for monitors, projectors and accessories.

Cameras and Camcorders. Our cameras and camcorders 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.

Memory and Storage. Our memory and storage product category contains products including media formats such as Blu Ray, CD and DVD R/W as well as flash and system memory.

For the Home. Our For the Home product category offers customers the ability to shop in subcategories dedicated to home and housewares, personal care, home improvement, outdoor, automotive and apparel including watches and sunglasses. 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.

Sports and Leisure. Our Sports and Leisure product category offers products that range from various sports accessories for baseball, hockey, football and numerous other activities to toys, musical instruments and wedding accessories.

We continually evaluate expanding 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 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 online prospecting activities may include cost-per-click arrangements that include displaying our products within various price comparison sites and search engines such as Shopzilla, Microsoft Live Search Cashback and Google, strategic online banner advertising, affinity e-mail programs and participation in various online affiliate marketing programs. From time to time we test other prospecting vehicles including radio and magazine advertising. 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.

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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 recertified 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 recertified products. We also have arrangements with third-party providers through which we receive commissions for products in certain categories, such as 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 approximately 700 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.

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 and liquidation e-tailers;

online discount retailers of computer and consumer electronics merchandise such as Buy.com, NewEgg and TigerDirect;

consumer electronics and office supply superstores such as Best Buy, 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.

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 trademarks, service marks and/or 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 five trademarks and/or service marks that we consider to be material to the successful operation of our business: eCOST®, eCOST.com®, eCOST.com Your Online Discount Superstore! ®, Bargain Countdown® and Bargain Countdown Platinum Club®. We currently use these marks in connection with telephone, mail order, catalog, and online retail services. We have registrations in the United States for eCOST®, and

eCOST.com® for telephone, mail order, catalog, and online retail order services, and a registration for Bargain Countdown® for online retail order services. We also have a registration in the United

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States for Bargain Countdown Platinum Club® for business services, namely, promoting the goods and services of others by means of a customer loyalty program featuring information, incentives, discounts and rewards. We have a pending United States Service Mark Application for eCOST$^{SM.}$ We have registrations in Canada and in the United Kingdom for eCOST®, eCOST.com®, and Bargain Countdown®. We own an additional registration in the United Kingdom for eCOST.com Your Online Discount Superstore!®. Additionally, we own a pending application in Canada for eCOST.com Your Online Discount Superstore! and an additional registration for Bargain Countdown Platinum Club®. In the event that our applications are not granted, we may not be able to obtain protection for our trademarks and/or service marks with the Trademark Offices in the United States and in Canada. We would still potentially have common law rights in and to our trademarks and/or service marks based on use of the marks in these respective territories.