FORM 10-K/A

Annual report pursuant to section 13 and 15(d) [amend]

Filing Date: **2005-05-02** | Period of Report: **2004-12-31**
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FILER

ECOST COM INC
CIK:**1287503**| IRS No.: **330843777** | State of Incorp.:**DE** | Fiscal Year End: **1231**
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SIC: **5961** Catalog & mail-order houses

Business Address
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TORRANCE CA 90504
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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM
10-K/A
Amendment No. 1

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

For the fiscal year ended December 31, 2004

☐ **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: 000-50887

eCOST.com, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**33-0843777**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification Number)**

2555 West 190th Street, Suite 106, Torrance, CA 90504

(Address of principal executive offices, including zip code)

(310) 225-4044

(Registrant' s telephone number, including area code)

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

None

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

Common Stock, $0.001 par value per share

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of

Regulation S-K is not contained herein, and will not be contained, to the best of Registrant' s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☒

The aggregate market value of the Registrant' s Common Stock held by non-affiliates of the Registrant as of June 30, 2004 was unavailable because there was no public market for the Registrant' s Common Stock on such date. Such value at March 29, 2005 was approximately $23.0 million, based upon the closing sale price of the Registrant' s Common Stock on such date, as reported on the Nasdaq National Market. Shares of Common Stock held by each executive officer and director and each person owning more than 5% of the outstanding Common Stock of the Registrant have been excluded in that such persons may be deemed to be affiliates of the Registrant. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Number of shares outstanding of each of the issuer' s classes of common stock as of March 29, 2005: 17,465,000 shares of Common Stock, $0.001 par value per share.

EXPLANATORY NOTE

The Registrant is filing this Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2004 filed with the Securities and Exchange Commission on March 31, 2005, for the purpose of providing certain information required by Part III of Form 10-K and to reflect exhibits filed with this Amendment. In addition, the Registrant is correcting a typographical error in the date of the report of PricewaterhouseCoopers LLP included in the original filing. The financial statements of the Registrant identified in Item 15 herein have been included in this Amendment No. 1 solely as a result of the corrected report of PricewaterhouseCoopers LLP with respect to such financial statements. Other than the correction of the date of the report of PricewaterhouseCoopers LLP, no changes have been made to such report or to the financial statements included in the original Form 10-K. Unless otherwise expressly stated, this Amendment No. 1 does not reflect events occurring after the filing of the original Form 10-K, nor does it modify or update in any way the disclosures contained in the original Form 10-K.

eCOST.com, Inc.

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PART II

Item 8. Financial Statements and Supplementary Data.

The information required by this item is contained in the financial statements listed in Item 15(a) of this annual report under the caption "Financial Statements" and appears beginning on page F-1 of this annual report.

PART III

Item 10. Directors and Executive Officers of the Registrant.

Information Regarding Our Board of Directors

Set forth below is certain information, as of April 28, 2005, regarding the members of our board of directors. Each of our directors holds office until our next annual meeting of stockholders, or until his successor is elected and qualified.

Name	Age	Position	Director Since
Adam W. Shaffer	39	Chairman, Chief Executive Officer and Director	2004
Gary W. Guy	35	President and Director	2004
S. Keating Rhoads (1)(2)	54	Director	2004
Mark A. Timmerman	43	Director	2004
Mike Weller (2)	37	Director	2004

(1) Member of our compensation committee

(2) Member of our audit committee

Adam W. Shaffer joined our company as Chief Executive Officer in March 2004 and has served as a director since April 2004. In July 2001, Mr. Shaffer founded Safety-911, LLC, a national direct marketer of public safety equipment, where he served as President and Chief Executive Officer until April 2004. From October 2000 to July 2001, Mr. Shaffer was a consultant to Dennis Publishing Ltd., the publisher of Maxim Magazine, where he served as Director of Brand Management. From April 1992 through July 2000, Mr. Shaffer worked for Micro Warehouse, Inc., a direct reseller of branded information technology products and services, where he held various management positions including Executive Vice President of Marketing, Advertising, Purchasing and International Operations and Executive Vice President of Sales. Prior to that time, Mr. Shaffer served as Product and Catalog Manager of Global Computer Supplies, a direct reseller of computer products and supplies. Mr. Shaffer started his career in 1984 with Logicsoft Inc., a direct marketer of computer products, where he rose to the level of Category and Marketing Manager.

Gary W. Guy has served as our President and a director since October 2001. He also served as our Treasurer from October 2001 through April 2004, as our Secretary from October 2001 through January 2003 and from February 2004 through April 2004, and as a director from October 2001 to April 2004. Mr. Guy joined eCOST.com in June 1999 as Vice President of Sales and Marketing. Prior to joining our company, he served as Vice President of Marketing for PC Mall, Inc. from June 1994 to May 1999, Mr. Guy held various sales, marketing and product management positions within PC Mall.

S. Keating Rhoads has served as a director since the completion of our initial public offering in September 2004. Mr. Rhoads was Chief Executive Officer and Chairman of the Board of Tartan Textile Services, Inc. from April 2000 through September 2003, and continued on the board of directors through December 2003. From October 1999 to December 1999, Mr. Rhoads was a business consultant with ETC Carpet Mills. Mr. Rhoads served as Executive Vice President and Chief Operating Officer of Creative Computers, Inc. (predecessor to PC Mall, Inc.)

in 1999. From 1991 through 1998, Mr. Rhoads was a senior executive at the Los Angeles Times, a division of the Times Mirror Company, serving from 1995 through 1998 as Senior Vice President, Operations. From 1984 to 1991, Mr. Rhoads was Vice President, Operations and Finance and Chief Financial Officer at The Morning Call, Inc., a subsidiary of the Times Mirror Company. Prior to 1984, Mr. Rhoads worked in several capacities at Harte-Hanks Communications, Inc., the University of San Francisco and Stanford University.

Mark A. Timmerman has served as a director since the completion of our initial public offering in September 2004. Mr. Timmerman has been employed by William Blair & Company, L.L.C. since 1986 and has served as a principal since 1993. From 1994 through 2001, Mr. Timmerman served as a director of Prophet21, Inc., a computer software manufacturer.

Mike Weller has served as a director since October 2004. He is the founder and a director of TopMoxie, Inc., a supplier of online behavioral marketing platforms, and has served as its President and Chief Executive Officer since September 2000. Prior to joining TopMoxie, Mr. Weller was the Vice President of E-commerce at Schoolpop, Inc., an online retailer that utilizes everyday purchases to establish nontraditional fundraising programs for schools and nonprofits. Mr. Weller was employed with Schoolpop, Inc. from April 1999 to September 2000, where he was responsible for establishing and overseeing all online and offline partnerships and managing the development of the e-commerce website. From November 1998 to April 1999, Mr. Weller served as a senior consultant to Netscape Communications Corporation, where he helped develop and oversee the deployment of core e-commerce strategies for the Netscape website.

Identification of Our Audit Committee

We have a separately-designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. The members of our audit committee are S. Keating Rhoads and Mike Weller. Our board of directors has determined that each of the members of our audit committee is "independent" as that term is defined in Rule 10A-3 promulgated under the Exchange Act and is an "independent director" as defined in Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards. Our board of directors has determined that Mr. Rhoads is an "audit committee financial expert" as that term is defined by SEC regulations.

Under Commission and Nasdaq rules, our audit committee must have at least one independent member as of the date of our initial public offering, a majority of independent members within 90 days, and at least three independent members within one year. We expect to appoint one additional independent director to our audit committee prior to September 2005.

Executive Officers

The table below sets forth information as of April 28, 2005 about individuals who serve as our executive officers.

Name	Age	Position
Adam W. Shaffer	39	Chairman, Chief Executive Officer and Director
Gary W. Guy	35	President and Director
Elizabeth S.C.S. Murray	49	Executive Vice President, Treasurer, Secretary and Chief Financial Officer

Elizabeth S.C.S. Murray joined our company in January 2005 as Executive Vice President, Chief Financial Officer, Secretary and Treasurer. Ms. Murray previously served as Executive Vice President and Chief Financial Officer of Digital Insight Corporation, a publicly traded provider of online banking technologies, from March 2002 until January 2005. From 1998 to 2002 Ms. Murray served as Executive Vice President and Chief Financial Officer of Korn/Ferry International, a publicly traded company specializing in executive management recruitment. Ms. Murray served as Executive Vice President and Chief Financial Officer of Tycom Inc. from June 1997 to December 1997, and from 1994 to June 1997 she was the Chief Financial Officer and Vice President of Hughes Communications, Inc., a subsidiary of Hughes Electronics Corporation. Ms. Murray is a Chartered Accountant with the Institute of Chartered Accountants in Scotland and received her BA in business studies from Robert Gordon University.

Biographical summaries of the experience of Adam W. Shaffer and Gary W. Guy are provided above under the heading "Information Regarding Our Board of Directors."

Code of Business Conduct and Ethics

We have adopted a code of ethics that applies to all of our directors, officers and employees, including our principal executive officer, principal financial officer and principal accounting officer. Our code of ethics is posted on our website at www.ecost.com. We will provide to any person without charge, upon request, a copy of such code upon receipt of a written request directed to “Investor Relations” at our principal executive offices.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our executive officers and directors, and persons who own more than ten percent of a registered class of our equity securities, to file reports of ownership on Form 3 and changes in ownership on Forms 4 or 5 with the Securities and Exchange Commission. Those officers, directors and ten percent stockholders are also required by the Commission’ s rules to furnish us with copies of all Section 16(a) forms they file.

Based solely on our review of the copies of the forms we received, or representations from certain reporting persons that no Forms 5 were required for such persons, we believe that during the fiscal year ended December 31, 2004, all Section 16(a) filing requirements applicable to our officers, directors and ten percent stockholders were complied with.

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Item 11. Executive Compensation.

The following table sets forth information concerning the annual and long-term compensation for services rendered in all capacities to us and our affiliates, including PC Mall, Inc., for the fiscal years indicated earned by our Chief Executive Officer and our other most highly compensated executive officers as of December 31, 2004, each of whom earned in excess of $100,000 during the 2004 fiscal year. The individuals listed in the following tables are sometimes referred to as the "named executive officers." For the years 2002 and 2003, and for a part of the year 2004 reported below, we operated as a wholly-owned subsidiary of PC Mall, and the compensation of the individuals named below was determined in accordance with policies established by PC Mall.

Summary Compensation Table

		Annual Compensation (1)		Long-Term Compensation Awards			
Name and Principal Position	Fiscal Year	Salary (1)	Bonus	Securities Underlying Options (#)		All Other Compensation	
Adam W. Shaffer (2)	2004	$192,307	$100,000	560,000		$ 9,000	(3)
Chief Executive Officer							
Gary W. Guy	2004	172,073	21,317	100,000		335	(4)
President	2003	141,761	21,284	–		1,076	(4)
	2002	138,667	26,138	–		1,078	(4)
Theodore R. Sanders (5)	2004	250,451	43,234	40,000	(6)	8,340	(7)
Former Chief Financial Officer	2003	239,610	60,786	–		8,340	(7)
	2002	235,000	44,462	25,000	(6)	8,340	(7)

(1) Includes amounts deferred by executive officers pursuant to PC Mall, Inc.' s 401(k) Savings Plan.

(2) Mr. Shaffer joined our company in March 2004.

(3) Represents relocation expenses.

(4) Consists of matching contributions made by PC Mall, Inc. under the PC Mall, Inc. 401(k) Plan.

(5) Mr. Sanders resigned effective January 2005. Mr. Sanders is the Chief Financial Officer of PC Mall, Inc. and acted as our principal financial officer from our inception until January 2005, when Ms. Murray joined our company. The compensation paid to Mr. Sanders was for services provided to PC Mall, and we were allocated and charged a portion of his compensation for services rendered to us.

(6) These options consist of options to purchase PC Mall common stock granted by PC Mall. In connection with our spin-off from PC Mall on April 11, 2005, these options were converted into adjusted PC Mall options and options to purchase our common stock (multiplied by the distribution ratio of approximately 1.2071).

(7) Represents an automobile allowance provided by PC Mall, Inc.

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Option Grants in Last Fiscal Year

The following table provides information on grants of options to purchase our common stock in fiscal 2004 to the named executive officers:

Options/SAR Grants in Last Fiscal Year

Name	Individual Grants: Number of Securities Underlying Options/ SARs Granted(#)	Percent of Total Options/SARs Granted to Employees in Fiscal Year (1)	Exercise or Base Price ($/Share)	Expiration Date	Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation for Option Term (2): 5%($)	10%($)
Adam W. Shaffer	560,000	62.0 %	$ 6.43	8/18/14	$2,264,524	$5,738,748
Gary W. Guy	100,000	11.1	8.93	11/2/14	561,603	1,423,212
Theodore R. Sanders	–	–	–	–	–	–

(1) Based on options to purchase a total of 903,750 shares granted by us to our employees in 2004. Mr. Guy' s options were granted at fair market value, have 10 year terms and 4 year vesting schedules. An aggregate of 25% of the shares subject to the option vest one year from the date of grant, with the remaining shares vesting in equal quarterly installments over a 3-year period. For the terms of Mr. Shaffer' s options, please see "Employment Agreements and Change-in-Control Arrangements" in this report on Form 10-K/A.

(2) The potential realizable value is calculated based on the term of the option at its time of grant (10 years). It is calculated by assuming that the stock price appreciates at the indicated rate compounded annually for the entire term of the option and that the option is exercised and sold on the last day of its term for the appreciated stock price. No gain to the option holder is possible unless the stock price increases over the exercise price at some time during the term of the option.

The following table provides information on grants of options to purchase PC Mall common stock in fiscal 2004 to the named executive officers:

Options/SAR Grants in Last Fiscal Year

Name	Individual Grants: Number of Securities Underlying Options/ SARs Granted(#)	Percent of Total Options/SARs Granted in Fiscal Year(1)	Exercise or Base Price ($/Share)	Expiration Date	Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation for Option Term (2): 5%($)	10%($)
Adam W. Shaffer	–	– %	$ –	–	$–	$–

Gary W. Guy	–	–	–	–	–	–
Theodore R. Sanders	40,000	7.4	15.70	10/28/14	394,946	1,000,870

(1) Based on options to purchase a total of 538,100 shares granted by PC Mall in 2004. An aggregate of 25% of the shares subject to the option vested immediately, with the remaining shares vesting in equal quarterly installments over a 4-year period.

(2) The potential realizable value is calculated based on the term of the option at its time of grant (10 years). It is calculated by assuming that the stock price appreciates at the indicated rate compounded annually for the entire term of the option and that the option is exercised and sold on the last day of its term for the appreciated stock price. No gain to the option holder is possible unless the stock price increases over the exercise price at some time during the term of the option.

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Aggregated Option Exercises In Last Fiscal Year and Fiscal Year-End Option Values

The following table shows certain information about options to purchase eCOST.com common stock held by the named executive officers on December 31, 2004. No options to purchase our common stock were exercised by the named executive officers in fiscal year 2004.

	Number of Securities Underlying Unexercised Options at Fiscal Year End		Value of Unexercised In-The-Money Options at Fiscal Year End (1)	
Name	Exercisable	Unexercisable	Exercisable	Unexercisable
Adam W. Shaffer	175,000	385,000	$1,666,000	$3,665,200
Gary W. Guy	140,000	100,000	2,173,500	702,000
Theodore R. Sanders	56,000	–	853,440	–

(1) Value based on the closing price of our common stock as reported on the Nasdaq National Market on December 31, 2004, which was $15.95, less the exercise price, times the number of shares issuable pursuant to such options.

The following table shows certain information about options to purchase PC Mall common stock held by the named executive officers on December 31, 2004 and exercises by such individuals of options to purchase PC Mall common stock in fiscal year 2004.

			Number of Securities Underlying Unexercised Options at Fiscal Year End		Value of Unexercised In-The-Money Options at Fiscal Year End (2)	
Name	Shares Acquired on Exercise	Value Realized(1)	Exercisable	Unexercisable	Exercisable	Unexercisable
Adam W. Shaffer	–	$–	–	–	$–	$–
Gary W. Guy	–	–	15,917	2,500	308,992	50,550
Theodore R. Sanders	24,000	433,242	123,550	36,250	2,333,395	326,150

(1) Calculated by determining the difference between the fair market value of the PC Mall common stock underlying the options on the date each option was exercised and the exercise price of the options.

(2) Value based on the closing price of PC Mall common stock as reported on the Nasdaq National Market on December 31, 2004, which was $22.38, less the exercise price, times the number of shares issuable pursuant to such options.

Compensation of Directors

We currently pay each director who is not one of our employees an annual retainer of $24,000 (paid quarterly), $2,500 for each board meeting attended in person, $1,000 for each committee meeting attended in person and $500 for each board or committee meeting attended by telephone. Additionally, we pay each chairman of our board committees an annual fee of $2,500 for service in that capacity. Directors who are our employees are not paid any additional compensation for their service on our board of directors. We reimburse each of our directors for reasonable out-of-pocket expenses that they incur in connection with attending board and committee meetings.

Additionally, our non-employee directors are eligible to participate in our 2004 Non-Employee Director Stock Option Program, which is part of our 2004 Stock Incentive Plan. Both of our 2004 Non-Employee Director Stock Option Program and our 2004 Stock Incentive Plan are administered by the compensation committee of our board of directors. Under our 2004 Non-Employee Director Stock Option Program, our non-employee directors are eligible to receive annual, automatic, non-discretionary grants of nonqualified stock options under our 2004 Stock Incentive Plan at an exercise price equal to the fair market value of our common stock on the date of grant. Each new non-employee director is automatically granted an option to acquire 30,000 shares of our common stock, which vests quarterly over three years. Each non-employee director who has been a board member for at least six months on the date of each annual stockholder' s meeting, beginning with the 2005 annual meeting, receives an automatic grant of an option to acquire 10,000 shares of our common stock, which vests quarterly over one year. Thus, Messrs Rhoads, Timmerman and Weller will each receive a grant of an option to acquire 10,000 shares of our common stock in connection with our June annual meeting. All options granted under our 2004 Non-Employee Director Stock Option Program will become fully vested in the event of certain corporate transactions.

In addition to grants pursuant to our 2004 Non-Employee Director Stock Option Program, our non-employee directors are also eligible to receive additional grants under our 2004 Stock Incentive Plan, as determined from time to time by the compensation committee. The terms and conditions of grants to our non-employee directors under our 2004 Stock Incentive Plan are determined in the discretion of the compensation committee.

Our 2004 Non-Employee Director Stock Option Program and our 2004 Stock Incentive Plan are filed as exhibits to our Annual Report on Form 10-K. The compensation arrangements we have with our directors are reviewed and may be modified from time to time by our board of directors.

Compensation Committee Interlocks and Insider Participation

S. Keating Rhoads and Thomas A. Maloof served as members of our compensation committee in fiscal year 2004. Mr. Maloof resigned from the board of directors on April 11, 2005. None of our executive officers serves as a director or member of the compensation committee or other board committee performing equivalent functions of another entity that has one or more executive officers serving on our compensation committee or board.

Employment Agreements and Change-in-Control Arrangements

We have entered into employment agreements with Adam W. Shaffer, our Chief Executive Officer, and with Elizabeth S.C.S. Murray, our Executive Vice President, Treasurer, Secretary and Chief Financial Officer.

Our employment agreement with Mr. Shaffer became effective March 2004. Under the terms of this agreement, we will pay Mr. Shaffer an annual base salary of $250,000. Mr. Shaffer is eligible to earn annual bonuses of up to $100,000, and was entitled to a one-time bonus of up to $25,000 upon the completion of our initial public offering. Additionally, we granted Mr. Shaffer an option to purchase 560,000 shares of our common stock at an exercise price of $6.43 per share pursuant to the terms of the employment agreement. An aggregate of 25% of the shares of common stock subject to Mr. Shaffer' s option vested upon the completion of our initial public offering. The remainder of the shares of common stock subject to Mr. Shaffer' s option vest in equal quarterly installments over a three-year period following the initial public offering. Notwithstanding the foregoing, Mr. Shaffer' s option agreement provides that the vesting of his options may, subject to certain exceptions specified in the agreement, partially accelerate if we are a party to certain corporate transactions, as defined in our 1999 Stock Incentive Plan, including certain mergers and acquisitions. Mr. Shaffer' s employment with us is at will, which means that he or we can terminate his employment at any time with or without cause, as defined in his employment agreement, and generally without prior notice. If we terminate Mr. Shaffer' s employment without cause at any time after we complete an initial public offering, we will be required to pay him an equivalent of six months of his base salary if he executes a severance and release agreement that is reasonably acceptable to our board of directors. If we terminate Mr. Shaffer' s employment for cause, we will not be obligated to pay him any severance compensation.

Ms. Murray was appointed as our Executive Vice President, Treasurer, Secretary and Chief Financial Officer effective January 2005. Under the terms of our employment agreement with Ms. Murray, we will pay her an annual base salary of $235,000. Ms. Murray is eligible to earn an annual bonus of up to 50% of her base salary pursuant to a bonus plan to be adopted by us; provided, however, for the calendar year of 2005, Ms. Murray is entitled to receive a minimum bonus of 25% of her base salary. Additionally, Ms. Murray was granted an option to purchase 250,000 shares of our common stock at an exercise price of $12.15 (the closing price of our common stock on the date her employment commenced). The option vests in equal quarterly installments over a four year period. However, the option will partially accelerate, subject to certain exceptions specified in the agreement, upon certain corporate transactions. Ms. Murray' s employment with us is at will, which means that she or we can terminate her employment at any time with or without cause, as defined in her employment agreement, and generally without prior notice. In the event we terminate Ms. Murray' s employment without cause, we will be required to pay her an equivalent of six months of her base salary if she executes a severance and release agreement that is reasonably acceptable to our board of directors.

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Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The following table sets forth certain information regarding the beneficial ownership of our common stock as of April 15, 2005 by:

each of the named executive officers;

each of our current directors;

all of our current directors and executive officers as a group; and

each person known to us to be the beneficial owner of more than 5% of the outstanding shares of our common stock.

Percentage ownership is based on an aggregate of 17,465,000 shares of our common stock outstanding on April 15, 2005. The table is based upon information provided by officers, directors and principal stockholders, as well as upon information contained in Schedules 13D and 13G filed with the SEC. Except as otherwise indicated, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all of the shares of our common stock beneficially owned by them. Unless otherwise indicated, the address for each person is 2555 W. 190th Street, Suite 106, Torrance, California 90504.

Name of Beneficial Owner	Number of Shares Beneficially Owned	Percentage of Shares Beneficially Owned	
5% or Greater Stockholders:			
Khulusi Revocable Family Trust (1)	2,563,442	14.2	%
Directors and Executive Officers:			
Adam W. Shaffer (2)	260,000	1.5	%
Gary W. Guy (3)(4)	159,211	*	
S. Keating Rhoads (5)	7,500	*	
Theodore R. Sanders (4)(6)	214,693	1.2	%
Mark A. Timmerman (7)	7,500	*	
Mike Weller (8)	7,500	*	

All directors and executive officers as a group (6 persons) (9)	457,336	2.6	%

* Less than 1%.

(1) Based on information contained in the Schedule 13G filed April 21, 2005 by Frank F. Khulusi and Mona C. Khulusi as joint trustees of the Khulusi Revocable Family Trust dated November 3, 1993. Includes 574,629 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

(2) Includes 245,000 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

(3) Includes 159,211 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

(4) Includes options to purchase our common stock granted in connection with adjustments to outstanding PC Mall options as a result of our spin-off from PC Mall on April 11, 2005.

(5) Includes 7,500 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

(6) Mr. Sanders resigned effective as of January 17, 2005. Includes 214,693 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

(7) Includes 7,500 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

(8) Includes 7,500 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

(9) Includes 442,336 shares underlying options which are presently vested or will vest within 60 days of April 15, 2005.

Equity Compensation Plan Information

The following table sets forth information about shares of our common stock that may be issued upon exercise of options under all of our equity compensation plans as of December 31, 2004:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans(1)
Equity Compensation Plans Approved by Security Holders	1,349,900	$ 5.63	5,870,750
Equity Compensation Plans Not Approved by Security Holders	–	–	–
Total	1,349,900	$ 5.63	5,870,750

(1) Represents shares available for issuance under our 2004 Stock Incentive Plan as of December 31, 2004. The 2004 Stock Incentive Plan contains an evergreen formula pursuant to which on January 1 of each year, the aggregate number of shares reserved for issuance under the 2004 Stock Incentive Plan will increase by a number of shares equal to 3% of the outstanding shares on December 31 of the preceding year. On January 1, 2005, an additional 523,950 shares became available under this Plan pursuant to the evergreen provision. Our board of directors suspended the use of our 1999 Stock Incentive Plan effective upon the completion of our initial public offering, and no further grants will be made under the 1999 plan.

Item 13. Certain Relationships and Related Transactions.

Relationships with PC Mall and its Affiliates

Prior to our initial public offering in September 2004, we were a wholly owned subsidiary of PC Mall. In connection with our initial public offering and our separation from PC Mall, we entered into a Master Separation and Distribution Agreement with PC Mall that contains many of the key provisions related to our initial public offering and our spin-off from PC Mall. The other agreements referenced in the Master Separation and Distribution Agreement govern certain aspects relating to the separation and various interim and ongoing relationships between us and PC Mall following the completion of the IPO

The following is a summary of the material terms of the Master Separation and Distribution Agreement between us and PC Mall and other key agreements that we entered into with PC Mall or its affiliates relating to our separation from and our ongoing relationships with PC Mall following our initial public offering. For a complete description of these agreements, you should refer to the full text of these agreements, which have been filed with the Commission. On April 11, 2005, PC Mall completed the distribution of our outstanding common stock to its stockholders, which we refer to as the distribution or spin-off.

The Master Separation and Distribution Agreement contains the key provisions related to our separation from, and our ongoing relationship with, PC Mall, our initial public offering and PC Mall' s divestiture of our company through the distribution. Other agreements referenced in the Master Separation and Distribution Agreement govern various prior, interim and ongoing relationships between us and PC Mall. These agreements include:

- the Tax Allocation and Indemnification Agreement;
- the Employee Benefit Matters Agreement;
- the Administrative Services Agreement;
- the Product Sales, Inventory Management and Order Fulfillment Agreement;
- the Information Technology Systems Usage and Services Agreement;
- the License Agreements;
- the Sublease Agreement;
- the Registration Rights Agreement between us and PC Mall; and
- the Registration Rights Agreement between us and Frank F. Khulusi.

Master Separation and Distribution Agreement

The Master Separation and Distribution Agreement contains the key provisions relating to the separation of our business from PC Mall' s other businesses, the general terms and conditions and corporate transactions required to effect our initial public offering and the distribution and the general intent of the parties as to how these matters would be undertaken and completed.

The Contribution. The Master Separation and Distribution Agreement describes generally the assets that were contributed and transferred to us by PC Mall and the liabilities assumed by us from PC Mall, which we refer to as the contribution. These assets include substantially all of the assets, properties and rights exclusively used or held for use exclusively in the operation of our business. The liabilities include substantially all debts, liabilities, commitments and obligations of any nature, whether known, unknown, contingent or otherwise, to the extent arising out of or relating to our business prior to, on or after the contribution date.

Mutual Release of Pre-Offering Claims. The agreement generally provides for a full release and discharge of all liabilities existing or arising from all acts and events prior to our initial public offering. The liabilities released or discharged include liabilities arising under any contractual agreements or arrangements existing or alleged to exist between us and PC Mall, and our respective affiliates, on or before our initial public offering.

Indemnification. Under the Master Separation and Distribution Agreement, we indemnify PC Mall and its representatives and affiliates from all losses suffered by PC Mall or its representatives or affiliates arising out of or related to any of the following:

- our failure to pay, perform or discharge in due course any of our liabilities;
- our business or liabilities related to our business;
- our failure to comply with the terms of the Master Separation and Distribution Agreement or any of the ancillary agreements;
- any untrue statement of a material fact or material omission in this prospectus or any similar documents relating to our initial public offering or the distribution to PC Mall' s stockholders.

PC Mall indemnifies our company and our representatives and affiliates from any and all losses suffered by our company or our representatives or affiliates arising out of or related to any of the following:

- PC Mall' s failure to pay, perform or discharge in due course PC Mall' s liabilities that are not assumed by us in connection with the distribution or our separation from PC Mall;
- the operation of PC Mall' s business or liabilities relating to PC Mall' s business, other than our business; or
- PC Mall' s failure to comply with the terms of the Master Separation and Distribution Agreement or any of the other agreements between PC Mall and our company entered into in connection with the separation and the distribution.

Any rights to indemnification for tax liabilities are governed solely by the Tax Allocation and Indemnification Agreement.

Access to Information. Under the Master Separation and Distribution Agreement, we and PC Mall are obligated to provide each other access to information as follows:

- subject to applicable confidentiality obligations and other restrictions, we and PC Mall will give each other any information within each other' s possession that the requesting party reasonably needs to comply with requirements imposed on the requesting party by a governmental authority, for use in any proceeding or to satisfy audit, accounting or similar requirements, or to comply with its obligations under the Master Separation and Distribution Agreement or any ancillary agreement;
- for so long as PC Mall is required to consolidate our results of operation and financial position or account for its investment in our company on the equity method of accounting, we will provide to PC Mall, at no charge, all financial and other data and information that PC Mall determined necessary or advisable in order to prepare its financial statements and reports or filings with any governmental authority, including copies of all quarterly and annual financial information and other reports and documents we intended to file with the Securities and Exchange Commission prior to such filings (as well as final copies upon filing), and copies of our budgets and financial projections;
- we and PC Mall will use reasonable efforts to make available to each other' s past and present directors, officers, other employees and agents as witnesses in any legal, administrative or other proceedings in which the other party may become involved;
- the company providing information, consultant or witness services under the Master Separation and Distribution Agreement will be entitled to reimbursement from the other for reasonable expenses incurred in providing this assistance;
- we will have access to documents and objects relating to our business that are contained within PC Mall' s records; and
- we and PC Mall each agree to hold in strict confidence all information concerning or belonging to the other party.

Termination. The Master Separation and Distribution Agreement may be terminated by the mutual consent of PC Mall and us.

Expenses. In general, we and PC Mall are each responsible for our own costs (including all associated third-party costs) incurred in connection with the transactions contemplated by the Master Separation and Distribution Agreement. However, we paid all costs and expenses relating to our initial public offering, including the underwriting discounts and all financial, legal, accounting and other expenses. Each party bears its own costs (including all associated third-party costs) and expenses relating to the distribution.

Tax Allocation and Indemnification Agreement

We entered into a Tax Allocation and Indemnification Agreement with PC Mall, which governs the respective rights, responsibilities, and obligations of PC Mall and us after our initial public offering with respect to tax liabilities and benefits, tax attributes, tax contests and other matters regarding income taxes, non-income taxes and related tax returns.

In general, under the Tax Allocation and Indemnification Agreement:

PC Mall is responsible for any U.S. federal, state or local income taxes that are determined on a consolidated, combined or unitary basis on a return that includes PC Mall (and/or one or more of its subsidiaries), on the one hand, and us (and/or one or more of our subsidiaries), on the other hand. However, in the event that we or one of our subsidiaries are included in such a return for a period (or portion thereof) beginning after the date of our initial public offering, we are responsible for our portion of the income tax liability in respect of the period as if we and our subsidiaries had filed a separate tax return that included only us and our subsidiaries for that period (or portion thereof);

PC Mall is responsible for any U.S. federal, state or local income taxes due with respect to returns that include only PC Mall and/or its subsidiaries (excluding us and our subsidiaries), and we are responsible for any U.S. federal, state or local income taxes due with respect to returns that include only us and/or our subsidiaries;

PC Mall is responsible for any foreign income taxes of PC Mall and its subsidiaries (excluding us and our subsidiaries), and we are responsible for any foreign income taxes of us and our subsidiaries; and

PC Mall is responsible for any non-income taxes attributable to its own business for any period. We are responsible for any non-income taxes attributable to our own business for any period.

As a result of our being included in the PC Mall consolidated federal income tax return until completion of the spin-off, losses incurred by us prior to the distribution are reduced by any profits of the PC Mall group for 2005. Any remaining unused operating loss allocable to us under federal tax law will carry forward to our separate federal income tax returns and will be available to offset our operating profits earned as a stand-alone company. Under the Tax Allocation and Indemnification Agreement, we are not allocated any remaining unused operating loss under state or local law unless required under applicable state or local law.

The Tax Allocation and Indemnification Agreement assigns responsibilities for administrative matters, such as the filing of returns, payment of taxes due, retention of records and conduct of audits, examinations or similar proceedings. In addition, the Tax Allocation and Indemnification Agreement provides for cooperation and information sharing with respect to tax matters. Finally, the Tax Allocation and Indemnification Agreement provides that all tax refunds for periods in which we are included in the PC Mall consolidated, combined or unitary group shall be paid to PC Mall, including tax refunds attributable to taxes which we initially paid.

Preservation of the Tax-Free Status of the Distribution. PC Mall and we intend that the contribution of assets by PC Mall to us and the distribution, taken together, will qualify as a reorganization pursuant to which no gain or loss is recognized by PC Mall or its stockholders for federal income tax purposes under Sections 355, 368(a)(1)(D) and related provisions of the Internal Revenue Code. PC Mall received an opinion from its tax counsel to such effect. In either case, we made certain representations regarding our company and our business and PC Mall made certain representations regarding it and its business. We are subject to certain restrictions for a three year period after the distribution that are intended to preserve the tax-free status of the contribution and the distribution. We may take a certain action or certain actions otherwise prohibited by these covenants if, prior to taking any such action, we have obtained (and provided to PC Mall) a written opinion of tax counsel reasonably acceptable to PC Mall, or a ruling from the Internal Revenue Service, that such action or actions would not jeopardize the tax-free status of the contribution and the distribution. These covenants include restrictions on our ability to:

engage in certain stock issuance transactions that, when combined with the shares issued in our initial public offering, comprise 40% of our stock;

merge or consolidate with another corporation;

- liquidate or partially liquidate;
- sell or transfer all or substantially all of our assets;
- redeem or repurchase our stock (except in certain limited circumstances); or
- take any other action which could reasonably be expected to cause Section 355(e) to apply to the distribution.

Indemnification for Tax Liability. We will indemnify PC Mall and its affiliates against any and all tax-related liabilities incurred by them that relate to the contribution and the distribution to the extent caused by our act or failure to act after the distribution, or as a result of our breach of a representation or a covenant relating to an act or an omission by us that occurs after the distribution, in a manner that causes the distribution to fail to qualify under Section 355 of the Internal Revenue Code or from the application of Section 355(e) of the Internal Revenue Code. PC Mall and its affiliates indemnify us against any and all tax-related liabilities incurred by us that relate to the contribution and the distribution to the extent caused by their act or failure to act before or after the distribution, or as a result of their breach of a representation or a covenant in a manner that causes the contribution and the distribution, taken together, to fail to qualify as a reorganization under Sections 355, 368(a)(1)(D) and related provisions of the code of the Internal Revenue Code or from the application of Section 355(e) of the Internal Revenue Code. These liabilities include the substantial tax-related liability that would result if the contribution and the distribution failed to qualify as a tax-free reorganization in which all members of the consolidated, unitary or combined group of PC Mall would have joint and several liability. This indemnification applies even if PC Mall has permitted us to take an action that would otherwise have been prohibited under the tax-related covenants described above.

Employee Benefit Matters Agreement

We entered into an Employee Benefit Matters Agreement with PC Mall which allocates to us some of the assets, liabilities and responsibilities relating to our current and former employees. The agreement provides for our employees' continued participation in some of the benefit plans that PC Mall sponsors, at our cost.

Pursuant to the Employee Benefit Matters Agreement, all PC Mall stock options that were outstanding on the record date for the distribution and that had not been exercised prior to the distribution date were converted into two stock options: (1) an option to purchase the number of previously unexercised PC Mall stock options as of the record date, and (2) an option to purchase a number of shares of our common stock equal to the number of previously unexercised PC Mall stock options times a fraction, the numerator of which is the total number of shares of our common stock distributed to PC Mall stockholders in the distribution and the denominator of which is the total number of PC Mall shares outstanding on the record date for the distribution. Any outstanding warrants to purchase PC Mall common stock were similarly adjusted under the terms of the Master Separation and Distribution Agreement.

We and PC Mall also agreed that, without the other's consent, for a period of two years following our initial public offering, neither party nor its affiliates will solicit or hire any employee of the other party who was employed by the other party or its affiliates within six months prior to such solicitation or hiring.

Administrative Services Agreement

We entered into an Administrative Services Agreement with a subsidiary of PC Mall to provide us with certain general and administrative services, including but not limited to, the following:

- general accounting and finance services;
- tax services;
- human resources administration;

record maintenance;

credit card processing; and

database management.

As consideration for the services, we paid PC Mall a monthly fee of $101,600. In only limited circumstances will PC Mall or its affiliates be liable to us with respect to the provision of services under this agreement. The agreement has a term of one year, but either party may terminate the agreement earlier by providing the other party 90 days prior written notice of such termination. PC Mall has the right, in its sole discretion, to subcontract its rights and responsibilities under the agreement.

This Administrative Services Agreement was amended in March 2005. The amendment reduced the scope of the services covered by the agreement and the monthly service charges to $19,000, effective as of the date of the distribution. Under the amended agreement, services consist of:

- payroll administration;
- tax return preparation;
- human resources administration;
- product information management;
- catalog advertising;
- production services; and
- accounting and finance services necessary for the preparation of our financial statements for periods through the date of the distribution.

Product Sales, Inventory Management and Order Fulfillment Agreement

We entered into a Product Sales, Inventory Management and Order Fulfillment Agreement with a subsidiary of PC Mall to provide us with product sales, inventory management and order fulfillment services at the same levels PC Mall has historically provided to us. Under the agreement, PC Mall provided the following services to us:

- Purchasing services, including purchasing for its own account inventory to meet the projected sales requirements we provide to PC Mall;
- Inventory management, including receiving, processing and analyzing data, maintaining sufficient inventory, packing materials, warehouse facilities, equipment, employees, vendor relationships and information technology to monitor, maintain, receive, inspect, record, manage, track and access efficiently the receipt and processing of inventory; and
- Order fulfillment, including picking, packing, shipping tracking and processing returns.

As consideration for such services, we paid PC Mall the following fees:

- $4.00 fulfillment charge per shipment;
- shipping expenses at cost;
- a restocking fee of 10% of cost; and
- a monthly inventory management fee of $9,700.

Pursuant to the terms of the agreement, our cost for products was net of any discounts, incentives or vendor consideration obtained by PC Mall in amounts determined consistent with past practices. PC Mall has the right to demand that we purchase all or any portion of excess inventory acquired based on our inventory requirement projections at the end of each sales season. In only limited circumstances will PC Mall of its affiliates be liable to us with respect to the provision of services under this agreement. The agreement terminated pursuant to its terms upon the consummation of the distribution.

In March 2005, we entered into an Inventory Location Agreement with a subsidiary of PC Mall pursuant to which PC Mall delivered to us, and we housed at our new distribution facility, certain inventory from time to time to facilitate purchases of inventory under the Product Sales, Inventory Management and Order Fulfillment Agreement. The Inventory Location Agreement was amended in April 2005 to clarify that as of April 7, 2005, all inventory delivered by PC Mall to our facility during the term was done so at our request. Consistent with the terms of the Product Sales, Inventory Management and Order Fulfillment Agreement, we agreed to purchase such inventory at PC Mall' s request, and we agreed to make payment for certain inventory within two business days after such request. This agreement terminated according to its terms upon the distribution.

Information Technology Systems Usage and Services Agreement

We entered into a Information Technology Systems Usage and Services Agreement with a subsidiary of PC Mall to provide 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. As consideration for the services and the usage of the hardware and software systems, we pay a monthly fee of $40,000. We also are required to provide reimbursement for our actual telecommunications systems usage charges. To the extent we need to upgrade or expand the capacity of our systems, we are responsible for purchasing any such additional capacity or hardware. In only limited circumstances will PC Mall or its affiliates be liable to us with respect to the provision of services under this agreement. Further, we expect to pay PC Mall approximately an additional $20,000 per month for the use of equipment we requested under the agreement. 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.

License Agreements

We have entered into two software license agreements with PC Mall and one of its subsidiaries to govern the respective rights, responsibilities, and obligations of PC Mall and us in connection with certain technology and software we license from PC Mall. We paid a one time license fee of $50,000 for one of the software license agreements. The licenses are non-exclusive, non-transferable, non-sublicensable, perpetual, royalty-free licenses for us to continue to use the technology and software in a manner substantially similar to our uses prior to the closing of our initial public offering as well as reproduce, prepare derivative works of, modify and use as reasonably necessary to operate our website. The technology and software is licensed to us on an “as is” basis, and we agree to indemnify PC Mall for any liability it incurs as a result of our use of such technology.

Sublease Agreement

In January 2003, we entered into a Sublease Agreement with PC Mall for approximately 7,800 square feet of office space located at PC Mall’ s corporate headquarters in Torrance, California. Prior to our initial public offering, we paid PC Mall monthly base rent of $6,472, adjusted periodically based on rent changes in the master lease and upon changes in the amount of space we may occupy from time to time. We were also responsible for additional rent, which included our proportionate share of all common area maintenance, including but not limited to amortization of leasehold improvements, real estate taxes, telecommunications systems and hardware and software systems expenses and other operating expenses. In 2004, we paid PC Mall approximately $1,717,000 for these expenses. The sublease terminates in September 2007.

Prior to the closing of our initial public offering, we amended and restated our Sublease Agreement with PC Mall to adjust for increases in square footage and base monthly rent over time as shown in the following table:

Dates	Square Feet	Base Rent
Through September 2004	9,900	$8,217
October 2004- December 2004	10,000	$8,300
January 2005- December 2005	11,000	$9,130
January 2006- September 2007	14,300	$11,869

Our use of certain items such as telecommunications systems and hardware and software systems, which were previously included in the additional rent figure under our existing Sublease Agreement, are provided under our Information Technology Systems Usage and Services Agreement with PC Mall.

Registration Rights Agreement with PC Mall

We entered into a registration rights agreement with PC Mall pursuant to which we granted PC Mall the right, in certain circumstances, to require registration of shares of our common stock held by PC Mall. The registration rights granted to PC Mall under the agreement terminated pursuant to its terms upon the consummation of the distribution.

Registration Rights Agreement with Frank F. Khulusi

Frank F. Khulusi is the principal stockholder, President and Chief Executive Officer of PC Mall. As a result of the distribution, Mr. Khulusi is the beneficial owner of 14.2% of our common stock. Mr. Khulusi has the right, in certain circumstances, to require registration of shares of our common stock that are held by Mr. Khulusi.

Demand Registration. Mr. Khulusi may request two demand registrations under the Securities Act of all or any portion of our shares covered by the registration rights agreement, and we are obligated to register such shares as requested by Mr. Khulusi. However, Mr. Khulusi may not make a request for registration until 180 days following the distribution. In addition, we have the right to postpone the filing or effectiveness of any demand registration in certain instances.

Piggy-Back Registration Rights. Mr. Khulusi has the right to include his shares of our common stock in certain of our offerings.

Registration Expenses. Mr. Khulusi is responsible for all of the costs and expenses associated with any demand registration, except that we are responsible for up to $200,000 of the first, and up to $100,000 of the second demand registration. We are responsible for all of the costs and expenses for any piggyback registration, excluding costs and expenses for underwriting discounts, selling commissions and transfer taxes applicable to the sale of the securities and any legal fees and expenses of counsel or other advisers of Mr. Khulusi, which will be the responsibility of Mr. Khulusi.

Termination. The rights under the agreement terminate upon the earliest to occur of:

- the fifth anniversary of the distribution;
- such time as the registrable shares have been sold;
- such time as the registrable shares have been registered under the Securities Act for a period of at least 90 days; or
- such time as we receive an opinion of counsel that the registrable shares may be sold by the holder without registration under the Securities Act and without restriction as to the quantity and manner of such sales.

Product Sales Agreement

In April 2005, we entered into a Product Sales Agreement, pursuant to which PC Mall continues to sell certain products to us for a transition period of up to 90 days after the distribution. Products are sold at a negotiated price, except in the case of certain refurbished products pursuant to which PC Mall has the right to require us to purchase any products for which we have issued a purchase order at PC Mall' s cost.

Historical Agreements with PC Mall

Since our inception, PC Mall has provided us various services, including administrative services (accounting, human resources, tax services, legal and treasury), inventory management and order fulfillment, information systems operation and administration, advertising services, and use of office space. PC Mall has historically allocated and charged us a portion of its overhead costs in consideration for these services based upon several factors including net sales, net cost of goods sold, square footage, systems utilization, headcount and other factors. In January 2003, we formalized our arrangements with PC Mall by entering into agreements that provided for substantially the same services that PC Mall provided us prior to that time. The agreements discussed above in this "Certain Relationships and Related Transactions" section replaced each of these historical agreements with PC Mall.

The following table sets forth the costs that we have been allocated and charged by PC Mall for the services described above for the past fiscal year identified by category as recorded in our statements of operations (in thousands):

	Year ended December 31, 2004
Cost of goods sold (including cost of products, shipping and fulfillment)	$ 151,873

Selling, general and administrative expenses	$ 2,421
Interest expense	$ 12

Prior to completion of our initial public offering, we declared a dividend of $2.5 million to PC Mall, which amount was paid by the non-cash settlement of the capital contribution due from PC Mall outstanding as of the date our initial public offering was completed.

Other Relationships and Transactions

Mark A. Timmerman, a principal of William Blair & Company, L.L.C., is a member of our board of directors. William Blair & Company, L.L.C. acted as one of the managing underwriters for our initial public offering. William Blair received fees and commissions of approximately $1.4 million in connection with our initial public offering. We agreed to indemnify William Blair and its agents for certain liabilities related to our initial public offering.

Adam W. Shaffer, our Chairman and Chief Executive Officer, purchased 15,000 shares of our common stock in our initial public offering at the public offering price of $5.80.

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We have entered into separate indemnification agreements with our directors and executive officers, in addition to the indemnification provided for in our charter documents.

In connection with our spin-off from PC Mall and pursuant to the Employee Benefit Matters Agreement described above, we granted options to purchase our common stock to the following officers, directors and principal stockholders as a result of their outstanding PC Mall options on the date of the distribution to preserve the intrinsic economic value of the outstanding PC Mall options:

Name	Number of Shares Underlying New eCOST.com Options	Exercise Price
Gary W. Guy	200	$ 0.80
	60	0.80
	604	0.95
	3,621	1.19
	3,259	3.58
	12,071	1.08
	2,414	0.81
Frank F. Khulusi	120,710	0.95
	120,710	1.13
	60,355	3.58
	241,420	0.75
	120,710	7.85
Thomas A. Maloof (1)	6,035	3.99
	24,142	2.50
	7,242	5.04
	6,035	1.13
	24,142	7.85

(1) Mr. Maloof resigned from our board of directors on April 11, 2005.

Item 14. Principal Accountant Fees and Services.

Audit Fees

The aggregate fees we incurred in fiscal year 2004 for professional services PricewaterhouseCoopers LLP rendered to us for the audit of our annual financial statements and review of the financial statements included in our quarterly reports on Form 10-Q, as well as for services that are normally provided by PricewaterhouseCoopers LLP in connection with statutory and regulatory filings or engagements was $298,000, of which $29,500 was billed within the year. Additionally, during fiscal year 2004, PricewaterhouseCoopers LLP performed audits and reviews of the annual and interim financial statements, respectively, as included in our Form S-1 registration statement which was initially filed with the SEC in May 2004. The aggregate fees for these additional services and the related SEC financial statement comment process was $654,000. We did not incur any audit fees in fiscal year 2003.

Audit-Related Fees

The aggregate fees PricewaterhouseCoopers LLP billed us in fiscal years 2003 and 2004 for assurance or related services associated with the performance of its audit or review of our financial statements, other than those reported above under the caption “Audit Fees,” was $0 and $268,000, respectively. For fiscal year 2004, the fees were related to work associated with our initial public offering and merger and acquisition consulting.

Tax Fees

PricewaterhouseCoopers LLP did not provide us, or bill us for, any professional services rendered for tax compliance, tax advice or tax planning in the last two fiscal years.

All Other Fees

PricewaterhouseCoopers LLP did not provide us, or bill us for, any products or services in the last two fiscal years, other than the services performed in connection with the fees reported under the caption “Audit Fees” and “Audit-Related Fees” above.

Audit Committee Pre-Approval Policy

The audit committee of our board of directors has adopted a policy requiring that all services provided to us by our independent auditors be pre-approved by the audit committee. The policy pre-approves specific types of services that the independent auditors may provide us if the types of services do not exceed specified cost limits. Any type of service that is not clearly described in the policy, as well as any type of described service that would exceed the pre-approved cost limit set forth in the policy, must be explicitly approved by our audit committee prior to any engagement with respect to that type of service. Our audit committee reviews the pre-approval policy and establishes fee limits annually, and may revise the list of pre-approved services from time to time.

Additionally, our audit committee delegated to its chairman the authority to explicitly pre-approve engagements with our independent auditors, provided that any pre-approval decisions must be reported to our audit committee at its next scheduled meeting. If explicit pre-approval is required for any service, our chief financial officer and our independent auditor must submit a joint request to the audit committee, or its authorized delegate, describing in detail the specific services proposed and the anticipated costs of those services, as well as a statement as to whether and why, in their view, providing those services will be consistent with the SEC’ s rules regarding auditor independence.

During fiscal year 2004, approximately 1% of the services described above under the caption “Audit-Related Fees” were made pursuant to the de minimis exception provided under Section 10A(i)(1)(B) of the Exchange Act.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) The following documents are filed as part of this report:

(1) Financial Statements. See Financial Statements beginning on page F-1.

(2) Financial Statement Schedules. See Schedule II, Valuation and Qualifying Accounts which follow the Financial Statements.

All other schedules are omitted because the information is not applicable or is not material, or because the information is included in the financial statements or the notes thereto.

(3) Exhibits.

The following exhibits are filed or incorporated by reference as part of this report:

Exhibit Number	Description
2.1	Master Separation and Distribution Agreement, dated September 1, 2004 (included as Exhibit 10.1 hereto)
3.1	Amended and Restated Certificate of Incorporation (3)
3.2	Amended and Restated By-laws (3)
10.1	Master Separation and Distribution Agreement, dated September 1, 2004 (6)
10.2	Tax Allocation and Indemnification Agreement, dated September 1, 2004 (6)
10.3	Employee Benefit Matters Agreement, dated September 1, 2004 (6)
10.4(a)	Administrative Services Agreement, dated September 1, 2004 (6)
10.4(b)	Amendment to Administrative Services Agreement, dated March 17, 2005 (9)
10.5	Product Sales, Inventory Management and Order Fulfillment Agreement, dated September 1, 2004 (6)
10.6	Information Technology Systems Usage and Services Agreement, dated September 1, 2004 (6)
10.7	AF Services Software License Agreement, dated September 1, 2004 (6)
10.8	Amended and Restated Sublease Agreement, dated September 1, 2004 (6)
10.9	Registration Rights Agreement with PC Mall, dated September 1, 2004 (6)
10.10	Registration Rights Agreement with Frank Khulusi, dated September 1, 2004 (6)
10.11*	eCOST.com, Inc. 1999 Stock Incentive Plan (1)
10.12*	eCOST.com, Inc. 2004 Stock Incentive Plan and 2004 Non-Employee Director Option Program (2)
10.13	Loan and Security Agreement with Congress Financial Corporation (Western), dated August 3, 2004 (4)
10.14	Form of Indemnification Agreement with directors and executive officers (5)

* The referenced exhibit is a compensatory contract, plan or arrangement.

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10.15*	Form of Notice of Stock Option Award and Stock Option Award Agreement under 2004 Stock Incentive Plan (5)
10.16*	Form of Notice of Stock Option Award and Stock Option Award Agreement for Non-Employee Directors under 2004 Stock Incentive Plan (5)
10.17	PC Mall Software License Agreement (2)
10.18*	Employment Agreement with Adam W. Shaffer (1)
10.19*	Employment Agreement dated December 22, 2004, between us and Elizabeth S.C.S. Murray (7)
10.20	Lease dated January 14, 2005, by and between us and Teachers Insurance and Annuity Association of America for the benefit of its separate real estate account (8)
10.21*	Summary of Director Compensation (9)
21.1	Subsidiaries
23.1	Consent of PricewaterhouseCoopers LLP
31.1	Certification of the Chief Executive Officer of the Registrant pursuant to Exchange Act Rule 13a-14(a)
31.2	Certification of the Chief Financial Officer of the Registrant pursuant to Exchange Act Rule 13a-14(a)
32.1	Certification of the Chief Executive Officer of Registrant pursuant to 184 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer of Registrant pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to our Registration Statement on Form S-1 (File No. 333-115199), filed with the SEC on May 5, 2004.

(2) Incorporated by reference to Amendment No. 2 to our Registration Statement on Form S-1 (File No. 333-115199), filed with the SEC on July 2, 2004.

(3) Incorporated by reference to Amendment No. 3 to our Registration Statement on Form S-1 (File No. 333-115199), filed with the SEC on July 26, 2004.

(4) Incorporated by reference to Amendment No. 4 to our Registration Statement on Form S-1 (File No. 333-115199), filed with the SEC on August 3, 2004.

(5) Incorporated by reference to Form 10-Q for the quarter ended September 30, 2004, filed with the SEC on November 15, 2004.

(6) Incorporated by reference to our Form 10-Q/A for the quarter ended September 30, 2004, filed with the SEC on November 17, 2004.

(7) Incorporated by reference to our report on Form 8-K filed with the SEC on December 23, 2004.

(8) Incorporated by reference to our report on Form 8-K filed with the SEC on January 18, 2005.

(9) Incorporated by reference to our report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 31, 2005.

* The referenced exhibit is a compensatory contract, plan or arrangement.

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INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of eCOST.com, Inc.

In our opinion, the financial statements listed in the accompanying index on page F-1 present fairly, in all material respects, the financial position of eCOST.com, Inc. (the "Company"), a subsidiary of PC Mall, Inc., at December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index on page F-1 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related financial statements. These financial statements and financial statement schedule are the responsibility of the Company' s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Company has been historically consolidated as a subsidiary of PC Mall, Inc., and consequently, as indicated in Note 1, the financial statements of the Company have been derived from the consolidated financial statements and accounting records of PC Mall, Inc. and reflect significant assumptions and allocations. Accordingly, the financial statements do not necessarily reflect the Company' s financial position, results of operations and cash flows had it been a stand-alone company.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California
March 28, 2005

eCOST.com, Inc.
(A SUBSIDIARY OF PC MALL, INC.)

BALANCE SHEETS

(in thousands, except share data)

	December 31,	
	2003	**2004**
Assets		
Current assets:		
Cash and cash equivalents	$–	$8,790
Short-term investments	–	7,000
Accounts receivable, net of allowance for doubtful accounts of $50 and $199 at December 31, 2003 and 2004, respectively	2,044	2,039
Inventories	1,199	1,794
Prepaid expenses and other current assets	51	263
Due from Affiliate, net	–	813
Deferred income taxes	155	883
Receivable from the Parent (Note 3)	30,676	–
Total current assets	34,125	21,582
Property and equipment, net	125	342

Due from Affiliate, net	991	–
Deferred income taxes	4,206	4,467
Other assets	29	123
Total assets	$39,476	$26,514
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$1,678	$585
Accrued expenses and other current liabilities	1,738	2,635
Deferred revenue	1,345	2,014
Lines of credit (Note 3)	30,676	–
Total current liabilities	35,437	5,234
Total liabilities	35,437	5,234
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 10,000,000 authorized; none issued and outstanding	–	–

Common stock, $0.001 par value; 20,000,000 and 100,000,000 shares authorized, 14,000,000 and 17,465,000 shares issued and outstanding at December 31, 2003 and 2004, respectively	14	17
Additional paid-in capital	16,598	33,834
Deferred stock-based compensation	–	(1,333)
Capital contribution due from Affiliate	(2,543)	–
Accumulated deficit	(10,030)	(11,238)
Total stockholders' equity	4,039	21,280
Total stockholders' equity and liabilities	$39,476	$26,514

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

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eCOST.com, Inc.
(A SUBSIDIARY OF PC MALL, INC.)

STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Year ended December 31,		
	2002	2003	2004
Net sales	$89,009	$109,709	$178,464
Cost of goods sold (Note 7)	79,429	99,409	162,139
Gross profit	9,580	10,300	16,325
Selling, general and administrative expenses (Note 7)	8,945	9,885	18,384
Income (loss) from operations	635	415	(2,059)
Interest (income) expense, net	461	76	(67)
Interest expense−PC Mall commercial line of credit (Note 3)	1,097	1,476	1,329
Interest income−PC Mall commercial line of credit (Note 3)	(1,097)	(1,476)	(1,329)
Income (loss) before income taxes	174	339	(1,992)
Provision (benefit) for income taxes	27	(5,872)	(784)
Net income (loss)	$147	$6,211	$(1,208)

Earnings (loss) per share:			
Basic	$0.01	$0.44	$(0.08)
Diluted	$0.01	$0.43	$(0.08)
Weighted average number of shares:			
Basic	14,000	14,000	15,155
Diluted	14,422	14,279	15,155

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

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eCOST.com, Inc.
(A SUBSIDIARY OF PC MALL, INC.)

STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

(in thousands)

	Common Stock				Capital		
			Additional	Deferred	Contribution		
			Paid-in	Stock-Based	Due from	Accumulated	
	Shares	Amount	Capital	Compensation	Affiliate	Deficit	Total
Balance at December 31, 2001	14,000	$ 14	$111	$ –	$ –	$(16,388)	$(16,263)
Capital contribution–income taxes	–	–	15	–	–	–	15
Net income	–	–	–	–	–	147	147
Balance at December 31, 2002	14,000	14	126	–	–	(16,241)	(16,101)
Capital contribution from Affiliate	–	–	18,000	–	–	–	18,000
Capital contribution due from Affiliate	–	–	–	–	(2,543)	–	(2,543)
Affiliate utilization of deferred tax benefits, net	–	–	(1,528)	–	–	–	(1,528)
Net income	–	–	–	–	–	6,211	6,211
Balance at December 31, 2003	14,000	14	16,598	–	(2,543)	(10,030)	4,039
Issuance of common stock in connection with the initial public offering, net of offering costs	3,465	3	16,736	–	–	–	16,739

Compensatory stock option grant	–	–	2,000	(2,000)	–	–	–
Amortization of deferred stock-based compensation	–	–	–	667	–	–	667
Non-cash stock-based compensation	–	–	839	–	–	–	839
Dividend to Affiliate	–	–	(2,543)	–	2,543	–	–
Capital contribution – income taxes	–	–	204	–	–	–	204
Net loss	–	–	–	–	–	(1,208)	(1,208)
Balance at December 31, 2004	17,465	$ 17	$33,834	$ (1,333)	$ –	$ (11,238)	$21,280

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

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eCOST.com, Inc.
(A SUBSIDIARY OF PC MALL, INC.)

STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2002	2003	2004
Cash flows from operating activities:			
Net income (loss)	$147	$6,211	$(1,208)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	227	63	58
Bad debt expense	51	32	170
Deferred income taxes	−	(4,361)	(989)
Stock-based compensation expense	−	−	1,506
Affiliate utilization of deferred tax benefits, net	−	(1,528)	−
Capital contribution−income taxes	15	−	204
Changes in assets and liabilities:			
Accounts receivable	(882)	(584)	(165)
Inventories	292	(583)	(596)
Prepaid expenses and other assets	99	15	(212)

Other assets	(7)	(23)	(97)
Accounts payable	–	952	(367)
Accrued expenses and other current liabilities	208	779	888
Deferred revenue	(309)	653	669
Total adjustments	(306)	(4,585)	1,069
Net cash provided by (used in) operating activities	(159)	1,626	(139)
Cash flows from investing activities:			
Purchases of short-term investments	–	–	(14,000)
Sale of short-term investments	–	–	7,000
Purchases of property and equipment	(9)	(19)	(272)
Net cash used in investing activities	(9)	(19)	(7,272)
Cash flows from financing activities:			
Capital contribution from Affiliate	–	18,000	–
Net proceeds from initial public offering	–	–	18,690
Change in book overdraft	–	726	(726)
Payments for deferred offering costs	–	–	(1,941)

Net (repayments to)/advances from Affiliate	168	(17,790)	178
Capital contribution due from Affiliate	–	(2,543)	–
Net cash provided by (used in) financing activities	168	(1,607)	16,201
Net increase in cash and cash equivalents	–	–	8,790
Cash and cash equivalents:			
Beginning of period	–	–	–
End of period	$–	$–	$8,790

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

eCOST.com, Inc.
(A SUBSIDIARY OF PC MALL, INC.)

NOTES TO FINANCIAL STATEMENTS

(in thousands, except share and per share data)

1. Summary of Significant Accounting Policies

Description of Company

eCOST.com, Inc. (the “Company”) was formed on February 25, 1999 as a wholly-owned subsidiary of PC Mall, Inc. (formerly Creative Computers, Inc.) (the “Parent”). For purposes of these financial statements and related notes, the Parent and its wholly-owned subsidiaries excluding the Company will collectively be referred to as an “Affiliate.” The Company operates in a single business segment and sells its products principally to customers in the United States. The Company is a multi-category online discount retailer of new, “close-out” and refurbished brand-name merchandise. The Company offers products in twelve 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. The Company appeals to a broad range of consumer and small business customers through two shopping formats: every day low price and the Company’ s proprietary Bargain Countdown™. This combination of shopping formats helps attract value-conscious customers looking for high quality products at low prices to its eCOST.com website. The Company also provides rapid response customer service utilizing a strategically located distribution center operated by an Affiliate and third party fulfillment providers, as well as customer support from online and on-call sales representatives.

The Company has operated as a reporting segment of the Parent’ s business since April 1999. In September 2004, the Company completed an initial public offering (“IPO”) of 3,465,000 shares of the Company’ s common stock, leaving the Parent with ownership of approximately 80.2% of the outstanding shares of the Company’ s common stock. The Parent has advised the Company that the Parent plans to distribute its remaining ownership interest in the Company to its common stockholders. The Company refers to this as the “distribution” or the “spin-off.” The Parent has announced that the distribution will take the form of a spin-off by means of a special dividend to its common stockholders of all of the Company’ s common stock owned by the Parent on April 11, 2005. Completion of the distribution is contingent upon the satisfaction of certain conditions as set forth in the Master Separation and Distribution Agreement previously entered into between the Company and PC Mall. The distribution may not occur by the contemplated time or may not occur at all.

These financial statements have been derived from the consolidated financial statements and accounting records of the Parent, in which the Company has been reported as a separate segment, using the historical results of operations, and historical basis of assets and liabilities of its business. The statements of operations include expense allocations for certain corporate functions historically provided to the Company by an Affiliate, 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 the Parent’ s other businesses, of net sales, payroll, net cost of goods sold, square footage, headcount or other methods. The Company has not made a determination of whether these expenses are comparable to those it could have obtained from an unrelated third party. The Company’ s expenses as a separate, stand-alone company may be higher or lower than the amounts reflected in the statements of operations. All related activity between the Affiliate and the Company is reflected as related party payables and receivables on the Company’ s balance sheet.

On September 1, 2004, the Company completed the sale of 3,465,000 shares of its common stock for aggregate consideration of $20,097, less underwriting discounts and commissions of $1,407. The Company incurred approximately $1,951 of offering expenses in connection with the offering. No offering expenses were paid directly or indirectly to any directors or officers (or their associates) or persons owning ten percent (10%) or more of any class of equity securities or to any other affiliates. The Company’ s net proceeds from the offering after deducting offering expenses were $16,739. In connection with the IPO, the Company paid a dividend of $2,543 to the Parent through a settlement of the capital contribution due from the Parent outstanding at the completion of the IPO.

The Company believes the assumptions underlying the financial statements are reasonable. However, the financial statements may not necessarily reflect its results of operations, financial position and cash flows in the future or what the Company' s results of operations, financial position and cash flows would have been had the Company been a separate, stand-alone company during the periods presented. The historical financial information presented herein does not reflect the many significant changes that will occur in the Company' s funding and operations as a result of becoming a public company or its spin-off from PC Mall.

In July 2004, the Company' s board of directors declared a 1.4-for-1 stock split, which was effective upon completion of the Company' s IPO. The stock split has been given retroactive effect in the accompanying financial statements.

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Management believes that current working capital, together with cash flows from operations, and borrowing available under its credit facility, will be adequate to support the Company’ s current operating plans for at least the next twelve months.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the respective reporting periods. Actual results could differ from those estimates.

Cash Equivalents

As a subsidiary of the Parent, the Company participated in the Parent’ s cash management program, whereby trade cash receipts and disbursements were handled by the Affiliate. Accordingly, most trade cash receipts historically were received directly by the Affiliate and were credited to the Company on a daily basis through the Due from/Advances from Affiliate accounts. Further, any cash received directly by the Company historically was swept daily by the Affiliate from the Company’ s account and applied to the Due from/Advances from Affiliate account. As of December 31, 2004, the Company maintains its own cash accounts and received predominantly all trade receipts into such accounts The Company had a cash or cash equivalents balance of $8,790 at December 31, 2004.

Short-term Investments

The Company had a balance of $7,000 in short-term investments which the company classified as available-for-sale securities at December 31, 2004, with original maturities exceeding ninety days. Consistent with Statement of Financial Accounting Standards (“SFAS”) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, the Company has classified these securities as short-term because they all have readily determinable fair values, are highly liquid and the sale of such securities may be required prior to maturity to implement management’ s strategies. The Company had available-for-sale securities in Municipal Bonds of $5,000 and Government Securities of $2,000 with credit ratings of AAA at December 31, 2004, each with 28 day rollover intervals, maturing in 2024 and 2028, respectively. The Company’ s investments are reported at fair value, with unrealized gains and losses, net of taxes, recorded in accumulated other comprehensive income in the statements of stockholders’ equity (deficit). There was no unrealized gain or loss on these securities during the year ended December 31, 2004. Realized gains or losses and permanent declines in value, if any, on these securities are reported in other income and expense. The Company had no material realized gains or losses during the year ended December 31, 2004.

Concentration of Credit and Business Risk

The Company sells the majority of its products to customers that make payment via credit card. Accounts receivable potentially subject the Company to credit risk. The Company extends credit to business customers based upon an evaluation of the customer’ s financial condition and credit history and generally does not require collateral. The Company has historically incurred minimal credit losses that have been within management’ s expectations. At December 31, 2003 no individual customer represented more than 10% of trade accounts receivable. At December 31, 2004, one customer represented approximately 16% of trade accounts receivable. The Company uses third-party credit card payment processors for its credit card transactions. Balances owed by the processors for credit cards billed but unpaid to the Company, net of fees, at December 31, 2003 and 2004 were $1,119 and $1,371, respectively. No individual customer represented more than 10% of net sales for any of the three years in the period ended December 31, 2004.

The Company currently purchases a substantial majority of its products from the Affiliate. The Company expects to transition to its own distribution facility by early April 2005, and begin purchasing product directly. The Company does not have long-term contracts or arrangements with any of its vendors. Loss of any of these vendors could have a material adverse effect on the Company’ s financial position, results of operations and cash flows. In addition, the Company relies upon the Affiliate for various operational and administrative services (see Note 7).

Accounts Receivable

Accounts receivable consist of amounts primarily from customers with whom the Company has extended credit in 2003 and 2004. In 2003, accounts receivable also included credit cards billed but not yet received at period end due to the arrangement of credit card collections with the Parent at that time. The Company recorded an allowance for doubtful accounts of $50 and $199 at December 31, 2003 and 2004, respectively, against its trade accounts receivable. The allowance for doubtful accounts is determined based upon a review of receivable balances aged more than 90 days with specific provision made based upon management' s assessment of the collectability of each receivable balance including those deemed not collectible aged less than 90 days.

Inventories

The Company currently purchases its products from an Affiliate and other suppliers that ship directly to its customers. The majority of product shipments are fulfilled from an outsourced distribution center operated by the Affiliate. In January 2005, the Company signed a lease for its own distribution facility which the Company expects to be operational by early April 2005. This new facility will fulfill all product shipments currently being handled by the outsourced distribution center operated by the Affiliate. As discussed under Revenue Recognition below, the Company does not record revenue and related cost of goods sold until received by the customer. As such, inventories consist solely of goods in transit to customers at December 31, 2003 and 2004.

Advertising Costs

The Company produces and circulates catalogs at various dates throughout the year and receives market development funds and co-op advertising funds from vendors included in each catalog. Pursuant to Statement of Position ("SOP") 93-7, *Reporting on Advertising Costs*, the costs of developing, producing and circulating each catalog are deferred and charged to advertising expense ratably over the life of the catalog based on the revenue generated from each catalog, approximately eight weeks. In 2002, 2003 and 2004, advertising expenses, including those for catalog, internet and other methods, were $3,072, $3,609, and $5,945, respectively, and are included in selling, general and administrative expenses. Deferred advertising costs of $51 and $115 are included in prepaid expenses and other current assets at December 31, 2003 and 2004, respectively.

Market development and co-op advertising funds pursuant to Emerging Issues Task Force ("EITF") 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, are recognized as an offset to cost of goods sold. Market development and co-op advertising funds include an allocation credited from the Affiliate and also funds directly attributable to the Company. Market development and co-op advertising funds allocated to the Company in 2002, 2003 and 2004 were $2,821, $3,656 and $4,959, respectively. Direct market development and co-op funds in 2002, 2003 and 2004 were $0, $249, and $1,866, respectively.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets as noted below. The Company also capitalizes computer software costs that meet both the definition of internal-use software and defined criteria for capitalization in accordance with Statement of Position No. 98-1, *Accounting for the Cost of Computer Software Developed or Obtained for Internal Use*.

Computers, software and equipment	3 years
Furniture and fixtures	7 years
Leasehold improvements	Life of lease−not to exceed 15 years

Depreciation and amortization expense in 2002, 2003 and 2004 totaled $206, $42 and $55, respectively.

Disclosures about Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses and other current liabilities approximates fair value because of the short-term maturity of these instruments.

Net Advances from Affiliate/Due from Affiliate

Net Advances from affiliate or Due from affiliate primarily represent the application of customer receipts received by the Affiliate on the Company' s behalf, offset by the Company purchases of inventory as well as charges for services as described in Note 7 below. In addition, in March 2003, the Parent made a capital contribution of $18,000 to the Company, which was used to repay the cumulative advances from the affiliate owed by the Company at that time of $15,457. As a result of the contribution, the Company no longer had a liability balance to the Parent. At December 31, 2003 and 2004, the Company had a net receivable balance from affiliates.

Accounting for the Impairment of Long-Lived and Intangible Assets

In 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* ("SFAS 144"). In accordance with SFAS 144, the Company reviews long-lived assets and certain intangible assets for impairment when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Events and circumstances that may indicate that asset is impaired include: significant decreases in the market value of assets, significant underperformance relative to expected historical or projected future operating results, a change in the manner in which an asset is used, changes in technology, loss of key management or personnel, changes in our operating model or strategy and competitive forces.

If events and circumstances indicate that the carrying amount of an asset may not be recoverable and the expected undiscounted future cash flows attributable to the asset are less than the carrying amount of the asset, an impairment loss equal to the excess of the asset' s carrying value over its fair value is recorded. Fair value is determined based on the present value of estimated expected future cash flows using a discount rate commensurate with the risk involved, quoted market prices or appraised values, depending on the nature of the assets. To date, no impairment charges have been recorded.

Income Taxes

The Parent files a consolidated federal income tax return and a combined state income tax return that include the operating results of the Company. The income tax provision for the Company is computed as if a separate company tax return were being filed. The Company accounts for income taxes under the liability method. Under this method, deferred income taxes are recognized by applying enacted statutory tax rates applicable to future years to differences between the tax bases and financial reporting amounts of existing assets and liabilities. A valuation allowance is provided when it is more likely than not that all or some portion of deferred tax assets will not be realized.

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Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities comprise costs incurred but not paid primarily for payroll, advertising and certain other accrued expenses and current liabilities at the balance sheet date.

These liabilities consist of the following:

	December 31,	
	2003	2004
Accrued payroll and related expenses	$161	$291
Accrued advertising	228	1,140
Other accrued expenses	1,349	1,204
Accrued expenses and other current liabilities	$1,738	$2,635

Revenue Recognition

The Company applies the provisions of SEC Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition in Financial Statements*, which provides guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC. SAB No. 104 outlines the basic criteria that must be met to recognize revenue and provides guidance for disclosure related to revenue recognition policies. In general, the Company recognizes revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the sales price charged is fixed or determinable and (iv) collection is reasonably assured.

Net sales include product sales, gross outbound shipping charges, and related handling fees, and to a lesser extent, third-party extended warranties and other services. The Company recognizes revenue from product sales, net of estimated returns, promotional discounts, credit card fraud and chargebacks, and coupon redemptions, when both title and risk of loss to the products has transferred to the customer, which the Company has determined to occur upon receipt of products by the customer. The Company generally requires payment by credit card upon placing an order, and to a lesser extent, grants credit to business customers on normal credit terms.

The allowance for sales returns is determined based on historical experience using management' s best estimates. The Company periodically provides incentive offers to customers including percentage discounts off current purchases and offers for future discounts subject to a minimum current purchase. Such discounts are recorded as a reduction of the related purchase price at the time of sale based on actual and estimated redemption rates. Future redemption rates are estimated using the Company' s historical experience for similar sales inducement offers.

For product sales shipped directly from the Company' s vendors to end customers, the Company records revenue and related costs at the gross amounts charged to the customer and paid to the vendor based on an evaluation of the criteria outlined in EITF No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*. The Company' s evaluation is performed based on a number factors, including whether the Company is the primary obligor in the transaction, has latitude in establishing prices and selecting suppliers, takes title to the products sold upon shipment, bears credit risk, and bears inventory risk for returned products that are not successfully returned to third-party suppliers. The Company recognizes revenue on extended warranties and other services for which it is not the primary obligor on a net basis.

Accounting for Stock-Based Compensation

The Company accounts for employee stock-based compensation arrangements in accordance with the provisions of Accounting Principles Board ("APB") No. 25, *Accounting for Stock Issued to Employees,* and related interpretations and complies with the disclosure provisions of SFAS 123, *Accounting for Stock-Based Compensation*. Under APB 25, employee compensation expense is recognized based on the difference, if any, on the date of grant between the fair value of the Company' s common stock and the amount an employee must pay to acquire the stock. The expense associated with stock-based compensation is amortized over the periods the employee performs the related services, generally the vesting period.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF No. 96-18, *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. Under SFAS No. 123 and EITF 96-18, equity awards issued to non-employees are accounted for at fair value using the Black-Scholes option-pricing model. Management believes that the fair value of the stock options is more reliably measured than the fair value of the services received. The fair value of each non-employee stock award is re-measured each period until a commitment date is reached, which is generally the vesting date. For non-employee awards, deferred stock-based compensation is not reflected in stockholders' equity until a commitment date is reached.

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123*. This statement provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based compensation and amends the disclosure requirements of SFAS No. 123 to require prominent disclosure about the method of accounting for stock-based compensation and the effect of the method used on reported results. The transition provisions are effective for fiscal years ending after December 15, 2002. The Company has not adopted the fair value method of accounting for stock-based compensation of SFAS No. 123, and accordingly, SFAS No. 148 did not have a material impact on the Company' s financial position, results of operations or cash flows. See "Recent Accounting Pronouncements" below for information regarding the required adoption of SFAS No. 123 (revised 2004), *Share-Based Payment* in 2005.

If the Company had recorded stock-based compensation to employees using the fair value method as prescribed by SFAS No. 123, the Company' s net income (loss) would have been adjusted to the pro forma amounts below:

	Twelve months ended December 31,		
	2002	2003	2004
Net income (loss)−as reported	$147	$6,211	$(1,208)
Add: Non-cash stock-based compensation expense included in reported income, net of related taxes	−	−	913
Less: Stock-based compensation expense under SFAS 123, net of related taxes	(162)	(90)	(1,101)
Net income (loss)−pro forma	$(15)	$6,121	$(1,396)
Basic net income (loss) per share−as reported	$0.01	$0.44	$(0.08)
Basic net income (loss) per share−pro forma	$(0.00)	$0.44	$(0.09)
Diluted net income (loss) per share−as reported	$0.01	$0.43	$(0.08)
Diluted net income (loss) per share−pro forma	$(0.00)	$0.43	$(0.09)

The fair value of each stock option grant has been estimated pursuant to SFAS 123 on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Twelve months ended December 31,		
	2002	2003	2004
Risk free interest rates	3.90 %	3.68 %	3.64 %
Expected dividend yield	None	None	None

Expected lives	7yrs.	7yrs.	6yrs.
Expected volatility	129 %	119 %	100 %

Weighted average grant date fair values in 2002 and 2004 were $3.73 and $7.89. There were no stock option grants to employees in 2003.

Net Income (Loss) Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the reported periods. Diluted EPS reflects the potential dilution that could occur if stock options and other commitments to issue common stock were exercised using the treasury stock method.

The computation of Basic and Diluted EPS is as follows:

	Twelve months ended December 31,		
	2002	**2003**	**2004**
Net income (loss)	$147	$6,211	$(1,208)
Weighted average shares−Basic	14,000,000	14,000,000	15,155,000
Effect of dilutive stock options (a)	421,859	279,387	−
Weighted average shares−Diluted	14,421,859	14,279,387	15,155,000
Basic earnings (loss) per share	$0.01	$0.44	$(0.08)
Diluted earnings (loss) per share	$0.01	$0.43	$(0.08)

(a) Potential common shares of 1,349,900 for the year ended 2004 have been excluded from the loss per share computations because the effect of their inclusion would be anti-dilutive.

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Recent Accounting Pronouncements

Share-Based Payments

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (“FAS 123R”), that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise’ s equity instruments or that may be settled by the issuance of such equity instruments. The statement eliminates the ability to account for share-based compensation transactions using the intrinsic value method as prescribed by APB Opinion No. 25, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expenses in the Company’ s statements of operations. The statement requires companies to assess the most appropriate model to calculate the value of stock options and other share-based awards. The Company currently uses the Black-Scholes option pricing model to value options and is currently assessing which model the Company may use in the future under the new statement and may deem an alternative model to be the most appropriate. The use of a different model to value options may result in a different fair value than the use of the Black-Scholes option pricing model. In addition, there are a number of other requirements under the new standard that will result in different accounting treatment than currently required. These differences include, but are not limited to, the accounting for the tax benefit on employee stock options. In addition to the appropriate fair value model to be used for valuing share-based payments, the Company will also be required to determine the transition method to be used at the date of adoption. The allowed transition methods include prospective and retroactive adoption options. Under the retroactive options, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of FAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. The effective date of the new standard for the Company’ s financial statements is the Company’ s third fiscal quarter in 2005.

Upon adoption, this statement will have a significant impact on the Company’ s financial statements as the Company will be required to expense the fair value of the Company’ s stock option grants rather than disclose the impact on the Company’ s net income within its footnotes (see above), as is the Company’ s current practice. The amounts disclosed within the Company’ s footnotes are not necessarily indicative of the amounts that will be expensed upon adoption of FAS 123R. Compensation expense calculated under FAS 123R may differ from amounts currently disclosed within the Company’ s footnotes based on changes in the fair value of the Company’ s common stock, changes in the number of options granted or the terms of such options, the treatment of tax benefits and changes in interest rates or other factors. In addition, upon adoption of FAS 123R the Company may choose to use a different valuation model to value the compensation expense associated with employee stock options.

2. Property and Equipment

Property and equipment, net consist of the following:

	December 31,	
	2003	2004
Computers, software and equipment	$560	$435
Furniture and fixtures	42	94
Leasehold improvements	175	177
	777	706

Less: Accumulated depreciation and amortization	(652)	(364)
	$125	$342

3. Commercial Lines of Credit

The Company along with other subsidiaries of the Parent, was a co-borrower under the Parent’ s $75,000 asset-based commercial line of credit and a $3,500 term note. The Parent commercial line of credit is secured by substantially all of the assets of the Parent and its subsidiaries. Effective upon the completion of the Company’ s initial public offering, the Company was released from all obligations under the Parent’ s commercial line of credit and the Company’ s assets and outstanding common stock were released as collateral. There was $30,676 of gross working capital advances under the Commercial Line of Credit outstanding at December 31, 2003.

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Although the Company had not directly utilized proceeds from the Parent Commercial Line of Credit or the Term Note, because it was legally a borrower under the Parent Commercial Line of Credit and the Term Note, and had joint and several legal liability under their terms, the entire obligation included in the Parent' s consolidated financial statements is also reflected in the accompanying stand-alone financial statements for financial reporting purposes for all periods prior to the IPO. In addition, the Company accrued related interest expense on the obligation and unused commitment fees payable under the arrangement through the closing date of the IPO. However, on a stand-alone basis, prior to the IPO, the Company did not have the financial wherewithal, resources or collateral to enter into an asset-based credit facility of this size or nature, nor did the Company comply on a stand-alone basis with the financial covenants as provided for under the agreement. As such, the Company would not have been able to make the required principal and interest payments due on the obligation on a stand-alone basis without reliance upon the Parent to fund such principal and interest payments in an amount and at such times as they become due. Accordingly, for financial reporting purposes, in the Company' s stand-alone financial statements for periods presented prior to the IPO, the Company has recognized a corresponding receivable from the Parent equal to the amount of principal and interest and unused commitment fees payable under the obligation which is reflective of the operative borrowing arrangement with the bank within the Borrowing Group. As debt is repaid by the Parent, the receivable from the Parent and the debt outstanding in the Company' s financial statements are correspondingly reduced. As a result, the outstanding principal and interest due under the Parent Commercial Line of Credit and the Term Note, at any point in time is offset by a corresponding receivable from the Parent on the accompanying Balance Sheet, with equal amounts of interest expense recognized under the obligation and interest income recognized on the receivable from the Parent which are presented separately as interest income and expense in the accompanying Statements of Operations. The amounts recognized as interest expense and interest income were $1,097, $1,476 and $1,329 for 2002, 2003 and 2004, respectively. This financial presentation results in net interest expense of $0 under the Parent Commercial Line of Credit and the Term Note in each of the periods reported which is representative of the repayments of principal and interest being funded by a loan receivable from the Parent for which principal and interest payments match the timing and amount of principal and interest payments due on the Parent Commercial Line of Credit and the Term Note. In the accompanying Statements of Cash Flows, the receivable and the Commercial Line of Credit and the Term Note have been presented as supplemental information in that there was no cash flow activity between the Parent and the Company or between the Company and the Bank since the Parent has borrowed from and repaid the Bank directly (see Note 8).

In December, 2004, the Company entered into an asset-based line of credit of up to $15,000 with a financial institution, which is secured by substantially all of its assets. The credit facility functions as a working capital line of credit with the Company' s borrowings under the facility limited to a percentage of its inventory and accounts receivable. Outstanding amounts under the facility bear interest initially at the prime rate plus 0.25%. Beginning in 2006, outstanding amounts under the facility will bear interest at rates ranging from the prime rate to the prime rate plus 0.5%, depending on the Company' s financial results. At December 31, 2004, the prime rate was 5.25%. In connection with the line of credit, the Company entered into a cash management arrangement whereby the Company' s operating accounts are swept and used to repay outstanding amounts under the line of credit. The credit facility contains standard terms and conditions customarily found in similar facilities offered to similarly situated borrowers. The credit facility limits the Company' s ability to make acquisitions above pre-defined dollar thresholds, requires the Company to use the proceeds from any future stock issuances to repay outstanding amounts under the facility, and has as its sole financial covenant a minimum tangible net worth requirement. As of December 31, 2004, the Company is in compliance with its sole financial covenant. Borrowing availability is subject to satisfaction of certain standard conditions. Fees under the credit facility include an upfront cash fee, an annual unused line fee of 0.375% of the unused portion of the line and a termination fee ranging from 0.20% to 0.75% depending on the timing of any termination of the facility. The credit facility will mature in March 2007. As of December 31, 2004, the Company had no borrowings under its asset-based line of credit.

4. Income Taxes

The provision for income taxes consists of the following for the years ended December 31:

	2002	2003	2004
Current			

Federal	$ –	$6	$–
State	27	21	1
	27	27	1
Deferred			
Federal	–	(5,376)	(669)
State	–	(523)	(116)
	–	(5,899)	(785)
Net provision (benefit)	$27	$(5,872)	$(784)

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The provision for income taxes differed from the amount computed by applying the U.S. federal statutory rate to income (loss) before income taxes due to the effects of the following:

	2002	2003	2004
Expected taxes at federal statutory tax rate	34.0 %	34.0 %	34.0%
State income taxes, net of federal income tax benefit	6.6	4.6	5.8
Change in valuation allowance	(29.7)	(1,774.8)	–
Other	4.5	2.5	(0.4)
	15.4 %	(1,733.7)%	39.4%

The significant components of deferred tax assets and liabilities are as follows at December 31:

	2003	2004
Net operating loss carryforwards	$4,143	$4,468
Deferred stock-based compensation	–	600
Other temporary differences	218	282
	4,361	5,350
Valuation allowance	–	–
	$4,361	$5,350

At December 31, 2004, the Company has federal and state net operating loss carry forwards of $12,459 and $252, respectively, which begin to expire in 2019 and 2006, respectively.

The Company assesses the recoverability of deferred tax assets and the need for a valuation allowance on an ongoing basis. In making this assessment management is required to consider all available positive and negative evidence to determine whether, based on such evidence, it is more likely than not that some portion or all of the net deferred assets will be realized in future periods. This assessment requires significant judgment and estimates involving 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 realization of deferred tax assets. Primarily as a result of cumulative operating losses and the uncertainty surrounding the realization of the deferred tax assets in future years, the Company recorded a full valuation allowance at December 31, 2002 against its otherwise recognizable deferred tax assets.

During 2003, the valuation allowance of $6,012 was released as a result of the Company' s assessment of both positive and negative evidence with respect to the ability to realize deferred tax benefits. Specifically, management considered current forecasts and projections supporting the future utilization of deferred tax benefits, the Company' s recent earnings history, and the fact that net operating losses of $12,165 at the time were not limited with respect to their utilization and are available over a remaining carryover period of approximately 15-18 years to offset future taxable income. As a result of the above factors, management believes that it is more likely than not that the net deferred tax asset balance at December 31, 2004 will be realized.

The Company is a member of the Parent' s consolidated group for income tax purposes and files as part of a consolidated federal tax return. The allocation method the Company uses in calculating the tax provision is the separate return method. The differences between tax expense or benefit calculated on a separate return basis and cash paid or received under the legal tax sharing arrangement are treated as equity transactions. During 2003, the Company recorded a dividend of $1,538 to the Parent for the Parent' s utilization of the Company' s net operating losses. During 2003, the Company recorded a capital contribution from the Parent of $10 for state income taxes paid by the Parent on the Company' s behalf. During 2004, the Company recorded a capital contribution from the Parent of $204 to reflect additional net operating losses available to the Company based on the Parent' s actual utilization of net operating losses in its consolidated tax return.

As discussed in Note 1, the Parent intends to distribute to the Parent' s stockholders the Parent' s remaining equity interest in the Company. If the Company ceases to be a member of the Parent' s consolidated group, net operating loss carryforwards are first utilized on the Parent' s consolidated return and only the amount that is not absorbed by the group in that year is carried forward to the Company' s first separate return year. Accordingly, all or some portion of the Company' s net operating losses may continue to be utilized by the Parent and its subsidiaries, reducing the amount of deferred tax assets available to offset future taxable income with a corresponding reduction of additional paid-in capital.

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5. Commitments and Contingencies

Leases

The Company subleases office space from its Parent as more fully described in Note 7. Minimum annual rentals under such lease at December 31, 2004 were as follows:

	Operating Leases
2005	$ 110
2006	142
2007	107
2008	–
Thereafter	–
Total minimum lease payments	$ 359

Additional contractual arrangements entered into with Affiliates are described in Note 7.

Legal Proceedings

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. Management believes that the amount, and ultimate liability, if any, with respect to such claims and actions will not have any material adverse effect upon the Company' s financial position, results of operations or cash flows. There can be no assurance, however, that such actions will not be material or adversely affect the Company' s business, financial position, results of operations or cash flows.

Other Contingencies

On July 12, 2004, the Company received correspondence from MercExchange LLC alleging infringement of MercExchange' s U.S. patents relating to e-commerce and offering to license its patent portfolio to the Company. On July 15, 2004, the Company received a follow-up letter from MercExchange specifying which of the Company' s technologies MercExchange 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 the Company 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 makes the scope of the claims of those patents uncertain. In the July 15th letter, MercExchange also advised the Company 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. One such verdict was appealed to the United States Court of Appeals for the Federal Circuit and affirmed in part. Based on the Company' s investigation of this matter to date, management believes that the Company' s current operations do not infringe any valid claims of the patents identified by MercExchange in these letters. There can be no assurance, however, that such claims will not be material or adversely affect the Company' s business, financial position, results of operations or cash flows.

6. Employee Benefits

401(k) Savings Plan

The Company' s employees participate in the Parent' s 401(k) Savings Plan which covers substantially all full-time employees who meet the plan' s eligibility requirements. Participants may make tax-deferred contributions of up to 15% of annual compensation (subject to other limitations specified by the Internal Revenue Code). During 2002, 2003 and 2004, the Company incurred $2, $4 and $1 respectively, of expenses related to the 401(k) matching component of this plan. The matching component was eliminated effective April 1, 2004.

Stock Option Plans

1999 Plan

In 1999, the Company adopted the 1999 Stock Incentive Plan (the "1999 Plan"), which provides for the grant of various equity awards, including stock options, restricted stock and stock appreciation rights to employees, directors and consultants of the Company. To date, only stock option awards have been issued under the 1999 Plan. The 1999 Plan is administered by the Compensation and Stock Option Committee of the Board of Directors. Subject to the provisions of the 1999 Plan, the Committee has the authority to select the employees, directors and consultants to whom options are granted and determine the terms of each option, including (i) the number of shares of common stock covered by the award, (ii) when the award becomes exercisable, (iii) the award' s exercise price, which must be at least 100%, with respect to Incentive Stock Options, and at least 85%, with respect to Non-statutory Stock Options, of the fair market value of the common stock as of the date of grant, and (iv) the term of the award (which may not exceed ten years). At December 31, 2003 and 2004, 506,800 and 918,400 options were outstanding, respectively. The Company' s Board of Directors suspended the plan effective September 1, 2004, and accordingly no further shares are available for future grant under the 1999 Plan.

All non-employee awards have been granted to employees of the Parent. In accordance with the provisions of EITF No. 00-23, *Issues Related to the Accounting for Stock Compensation* under APB Opinion No. 25 and FASB Interpretation No. 44, stock option awards to employees of the Parent were measured at their fair value at the date of grant and recognized as a dividend to the Parent. The impact of applying EITF 00-23 to non-employee awards was not material. Of the total options outstanding at December 31, 2003 and 2004, 211,400 and 203,000 options were outstanding to employees of the Parent.

Options to purchase an aggregate of 358,400 shares of the Company' s common stock were outstanding under the 1999 Plan at a weighted average exercise price of $0.34 per share, which have terms that (i) restrict exerciseability based on the earlier of a corporate transaction involving the Company (e.g. a merger or consolidation or disposition of all or substantially all of the Company' s assets) as defined, the Company' s initial public offering or the lapse of a five or seven year period from date of grant, and (ii) for certain awards, provide repurchase rights to the Company at the original exercise price in the event of employee termination, which rights terminate in the event of a corporate transaction or IPO. No options were exercisable prior to the Company' s IPO which was completed on September 1, 2004, and the time-based vesting terms were not deemed substantive as the awards were effectively contingent upon a corporate transaction or the Company' s IPO. Due to such contingency, the Company had deemed the awards to be variable awards under APB 25 as the probability of these contingent events could not be reasonably determined. As a result of the closing of the Company' s IPO on September 1, 2004, at an offering price of $5.80 per share, the Company recognized a compensation charge of $839 based on the intrinsic value of these awards.

In March 2004, the Company granted an option under its 1999 Stock Incentive Plan (the "1999 Plan") to purchase 560,000 shares of common stock to its 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 of $2,000 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 the Company' s IPO. 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 Company' s IPO. The Company has recorded a non-cash stock-based compensation charge of $667 for the year ended December 31, 2004 to reflect compensation expense related to the accelerated vesting of shares under this option as a result of its IPO. The Company will amortize the additional non-cash stock-based compensation expense of $1,333 relating to the March 2004 option over the remainder of the three-year vesting period. The Company recognized total compensation expense of $1,506 in connection with all its outstanding options in the year ended December 31, 2004.

2004 Plan

In 2004, the Company adopted its 2004 Stock Incentive Plan. A total of 6,300,000 shares of the Company' s common stock are reserved for issuance under the Company' s 2004 Stock Incentive Plan, subject to adjustment for a stock split, or any future stock dividend or other similar change in the Company' s common stock or its capital structure. Commencing on the first business day of each calendar year beginning in 2005, the number of shares of stock reserved for issuance under the 2004 Stock Incentive Plan will be increased annually by a number equal to 3% of the total number of shares outstanding as of December 31 of the immediately preceding year or such lesser number of shares as may be determined by the plan administrator. Notwithstanding the foregoing, of the number of shares specified above, the maximum aggregate number of shares available for grant of incentive stock options shall be 6,300,000 shares, subject to adjustment for a stock split, or any future stock dividend or other similar change in the Company' s common stock or capital structure. As of December 31, 2004, under the 2004 stock incentive plan, 433,750 shares were granted, 2,250 shares were cancelled and 5,868,500 shares of common stock remained available for grant, subject to increase in the future as described above.

The following table summarizes stock option activity under the Company' s Stock Incentive Plans:

	1999 PLAN		2004 PLAN		TOTAL	
	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
Outstanding at December 31, 2002 and 2003	506,800	$ 0.29	–	$ –	506,800	$ 0.29

Granted	560,000	6.43	433,750	8.99	993,750	7.55
Canceled	(148,400)	0.14	(2,250)	8.93	(150,650)	0.27
Outstanding at December 31, 2004	918,400	$ 4.05	431,500	$ 8.99	1,349,900	$ 5.63

Of the options outstanding at December 31, 2004, a total of 232,400 options have an exercise price of $0.14 per share and a weighted average remaining contractual life of 4.2 years. A total of 126,000 options have an exercise price of $0.71 per share and a weighted average remaining contractual life of 5.4 years. A total of 650,000 options have an exercise price between $6.40 and $6.43 per share and a weighted average remaining contractual life of 9.3 years. A total of 341,500 options have an exercise price between $8.93 and $17.36 and a weighted average remaining contractual life of 9.8 years.

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PC Mall Plan

In addition to the Company' s 1999 and 2004 Plan, certain employees hold options to purchase shares of PC Mall common stock granted under the PC Mall Stock Option Plan. Under the PC Mall Stock Option Plan, options are generally granted at not less than the fair market value at date of grant, typically vest over a three-to five-year period and expire ten years after the date of grant.

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The following table summarizes stock option activity for the Company' s employees under the PC Mall Plan:

	Number	Weighted Average Exercise Price
Outstanding at December 31, 2001	56,772	$ 3.56
Granted	2,275	4.02
Canceled	(1,750)	4.11
Exercised	(130)	1.59
Outstanding at December 31, 2002	57,167	3.57
Granted	–	–
Canceled	(350)	4.96
Exercised	(26,850)	3.79
Outstanding at December 31, 2003	29,967	3.36
Canceled	(6,350)	2.55
Exercised	(4,408)	6.27
Transfers (a)	942	7.48
Outstanding at December 31, 2004	20,151	$ 3.17

(a) Represents shares held by employees who transferred to the Company from PC Mall during the period.

Of the PC Mall options outstanding at December 31, 2002, 2003 and 2004 held by the Company' s employees, options to purchase 29,642, 15,384 and 16,937 shares were exercisable at weighted average prices of $3.56, $3.32 and $3.12 per share, respectively. The following table summarizes information concerning currently outstanding and exercisable stock options:

	Options Outstanding at December 31, 2004			Options Exercisable at December 31, 2004	
Range of Exercise Prices	**Number Outstanding**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable**	**Weighted Average Exercise Price**
$1.00 - $1.89	3,209	3.56	$ 1.62	3,037	$ 1.65
$2.16 - $2.16	10,000	6.72	2.16	7,500	2.16
$2.39 - $4.10	3,292	3.34	2.51	3,125	2.42
$6.31 - $12.65	3,650	5.11	7.92	3,275	7.37
	20,151	5.37	$ 3.17	16,937	$ 3.12

Pro forma information regarding net income (loss) has been discussed in Note 1 to the financial statements, as required by SFAS 123 and SFAS 148.

7. Transactions with Affiliate

Since inception, the Affiliate has provided various services such as administration, warehousing and distribution, and use of its facilities to the Company. In consideration for those services, the Affiliate has historically allocated and charged a portion of its overhead costs related to such services to the Company. As such, the historical costs and expenses reflected in the Company' s financial statements include an allocation and charge for certain corporate functions historically provided by the Affiliate, including general corporate expenses, administrative costs, employee benefits and incentives, and interest expense. The allocations and charges are based upon several factors including net sales, net cost of goods sold, square footage, systems utilization, headcount, and other factors. These allocations and charges are based on what the Company and the Affiliate consider to be reasonable reflections of the historical utilization levels of these services required in support of the business. In addition, the Company purchased a majority of its products from the Affiliate.

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Direct and allocated costs charged from the Affiliate included in the accompanying statements of operations are as follows:

	Twelve months ended December 31,		
	2002	2003	2004
Cost of goods sold (including cost of products, shipping and fulfillment)	$67,040	$87,753	$151,873
Selling, general and administrative expenses	2,123	2,040	2,421
Interest expense	461	76	12

In January 2003, the Company formalized certain agreements with the Affiliate, which provide for substantially the same services and charges (computed on a comparable basis prior to January 2003) that were historically charged to the Company. A summary of the agreements is as follows:

Administrative Services Agreement and Information Technology Systems Usage and Services Agreement

The Administrative Services Agreement and Information Technology Systems Usage and Services Agreement entered into with the Affiliate provide the Company with certain general and administrative services, including but not limited to, the following:

- general accounting and finance services;
- tax services;
- telecommunications systems and hardware and software systems usage;
- information technology services and related support services, including maintaining management information and reporting systems and website hosting;
- human resources administration;
- record maintenance;
- credit card processing; and
- customer database management.

As consideration for the services provided, the Company paid approximately $1,430, $1,535 and $1,717 in 2002, 2003 and 2004, respectively. These charges, which are generally allocated and charged using a percentage of the Company’ s total sales in relation to the Affiliate’ s consolidated sales, reflect what the Company and the Affiliate consider to be a reasonable reflection of the historical utilization levels of these services required in support of the Company’ s business. These costs were included in Selling, General and Administrative expenses in the Statement of Operations. In addition to the above services, the Company was also allocated and charged a total of $283, $177 and $291 in 2002, 2003 and 2004, respectively, for other general and administrative services in the normal course of business, primarily consisting of employee benefit costs charged to the Affiliate for health, dental and other insurance plans provided to the Company as a subsidiary of the Parent.

Product Sales, Inventory Management and Order Fulfillment Agreement

The Product Sales, Inventory Management and Order Fulfillment Agreement with the Affiliate provides the Company with product sales, inventory management and order fulfillment services at the same levels as has historically been provided to the Company. Under the agreement, the Affiliate provides the following services to the Company:

purchasing services, including purchasing for the Affiliate’ s own account and inventory to meet the projected sales requirements;

inventory management, including maintaining sufficient facilities, equipment, employees, vendor relationships and technology to meet the Company’ s requirements; and

order fulfillment, including picking, packing, shipping, tracking and processing returns.

As consideration for these services, the Company paid approximately $3,633, $5,726 and $9,251 in 2002, 2003 and 2004, respectively. The charges include a fulfillment charge per shipment, shipping expenses at cost, restocking fees for returned products, inventory management fees and other costs. These costs were included in the Company’ s Cost of Goods Sold on the Statements of Operations.

The Company purchased the majority of its products sold in all periods presented from the Affiliate. Title and risk of loss pass to the Company at the time of shipment. In 2002, 2003 and 2004, the Affiliate charged the Company $63,407, $82,027 and $142,622 for products shipped by the Affiliate, net of discounts, market development funds and co-op advertising dollars allocated and credited to the Company for such purchases.

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Sublease Agreement

In January 2003, the Company entered into a Sublease Agreement with the Parent for approximately 7,800 square feet of office space located at the Parent' s corporate headquarters in Torrance, California. As a result of the Master Separation and Distribution Agreement between PC Mall and the Company, effective September 1, 2004, the Sublease Agreement was amended. The Company subleases approximately 10,000 square feet of office space at December 31, 2004. The Company currently pays monthly rent and is responsible for its proportionate share of all common area maintenance, including but not limited to amortization of leasehold improvements, real estate taxes, utilities and other operating expenses. In 2002, 2003 and 2004, the Company paid $410, $328 and $413 respectively, related to the use of office space. Such costs were included in the Company' s Selling, General and Administrative expenses on the Statements of Operations. The agreement provides for rent changes commensurate with the amount of space the Company may occupy from time to time, and terminates in September 2007.

Other Related Party Matters

In 2003, the Company' s Parent made a capital contribution of $18,000 to the Company, which was recorded as Additional Paid-in Capital. The capital contribution was used to repay the cumulative advances to the Company from the Parent at that time of $15,457, and the difference of $2,543 was returned back to the Parent, resulting in a Capital contribution due from Parent, a contra-equity account on the Company' s Balance Sheet. At December 31, 2003 and 2004, the Company had a balance due from Affiliates of $991 and $813, which represents amounts received by the Affiliate on the Company' s behalf, in excess of purchases made and overhead costs the Company incurred from the Affiliate.

Interest expense was charged to the Company by the Affiliate during periods when the Company owed balances due to the Affiliate. However, no interest income was recorded during periods when the Company had net balances due from the Affiliate. Interest expense was calculated using the prime rate in effect at that time multiplied by the cumulative balance due to the Affiliate, net of an amount equal to approximately one month' s inventory purchases (to approximate standard vendor terms).

In 2002, the Company did not maintain separate accounts payable, and all activities were performed and paid by the Affiliate. As such, balances the Company owed for trade payables are included in Advances from Affiliate. In 2003, the Company established a disbursement account and maintained separate accounts payable balances with third-party vendors.

8. Supplemental Disclosure of Non-Cash Financing Activities

	Twelve Months Ended December 31,		
	2002	2003	2004
Net borrowings (repayments) under line of credit	$10,947	$8,260	$(30,676)
Decrease (increase) in Receivable from the Parent	(10,947)	(8,260)	30,676

In connection with the Company' s initial public offering, the Company paid a dividend of $2,543 to the Affiliate through a settlement of the capital contribution due from the Affiliate outstanding at completion of the initial public offering.

9. Subsequent Events

On January 14, 2005, the Company entered into a lease with Teachers Insurance and Annuity Association of America for approximately 163,632 of rentable square feet in a facility located in Memphis, Tennessee, in order to provide the Company' s own inventory management and order fulfillment operations which are currently provided by PC Mall. The initial term of the lease is 70 months. Upon the expiration of the initial term, the Company has an option to renew the lease for a period of 5 years. The renewal option will be subject to all of the terms and conditions contained in the lease, except that the rent during the renewal term will be determined on the basis of the market rent, as such term is defined in the lease.

The equipment installation and office space configuration are currently under construction. The landlord has provided the Company with a construction allowance of $369.

Under the terms of the agreement, the Company' s initial monthly base rent is approximately $22 per month, which will increase periodically over the term of the lease to approximately $39. If the Company satisfies all of the initial terms and conditions of the lease, the Company is not required to pay the monthly base rent for the first two months of the lease. The total minimum rental amount under the lease is approximately $2,484 for the initial term. In addition to the monthly base rent, the Company is required to pay for all of the Company' s utilities and operating costs based on the Company' s proportionate share of all of the operating costs for the premises, but in no event will such costs increase by more than 7% per year in the aggregate over the lease term.

Upon execution of the lease in January 2005, the Company provided the landlord with a letter of credit in the amount of $200 to secure the payment obligations under the lease. The Company is required to keep the letter of credit in effect or replace it with a letter of credit with the same terms until 30 days after the expiration of the term of the lease. The amount of the letter of credit will be reduced periodically over the term of the lease.

In January 2005, the Company granted an option to purchase 250,000 shares of common stock to its Chief Financial Officer at fair value on the date of grant of $12.15.

On March 17, 2005, the Company and PC Mall amended the Administrative and Services Agreement to reduce the scope of services and corresponding monthly fees for such services from approximately $100 to $19, to be effective at the date of spin-off.

On March 18, 2005, the Parent announced its plan to distribute all of its 14,000 shares of common stock in the Company, equivalent to 80.2% of the Company' s outstanding common stock, by way of a special dividend to its stockholders. This is expected to be effective on April 11, 2005.

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SCHEDULE II

eCOST.com, Inc.
Valuation and Qualifying Accounts
For the years ended December 31, 2002, 2003 and 2004

	Balance at Beginning of Year	Additions Charged to Operations	Deductions from Reserves	Balance at End of Year
Allowance for doubtful accounts for the year ended:				
December 31, 2002	$ –	$ 51	$ (19)	$ 32
December 31, 2003	32	32	(14)	50
December 31, 2004	50	170	(21)	199
Deferred tax asset valuation allowance for the year ended:				
December 31, 2002	6,063	–	(51)	6,012
December 31, 2003 (a)	6,012	–	(6,012)	–
December 31, 2004	–	–	–	–
Sales returns reserve:				
December 31, 2002	213	2,961	(2,845)	329
December 31, 2003	329	3,464	(3,404)	389
December 31, 2004	389	5,265	(5,142)	512

(a) Reversal of valuation allowance for net deferred tax asset in 2003.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, registrant has duly caused this amendment to its annual report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Torrance, State of California, on May 2, 2005.

eCOST.com, Inc.

By: /s/ Adam W. Shaffer

Adam W. Shaffer

Chief Executive Officer

eCOST.com, Inc.

EXHIBIT INDEX

Exhibit Number	Description
23.1	Consent of PricewaterhouseCoopers LLP
31.1	Certification of the Chief Executive Officer of the Registrant pursuant to Exchange Act Rule 13a-14(a)
31.2	Certification of the Chief Financial Officer of the Registrant pursuant to Exchange Act Rule 13a-14(a)
32.1	Certification of the Chief Executive Officer of Registrant pursuant to 184 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer of Registrant pursuant to 18 U.S.C. 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002

EXHIBIT 23.1

Consent of Independent Registered Public Accounting Firm

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-118707) of eCOST.com, Inc. of our report dated March 28, 2005 relating to the financial statements and financial statement schedule, which appears in this Form 10-K/A.

/s/ PricewaterhouseCoopers LLP
Los Angeles, California
April 29, 2005

EXHIBIT 31.1

CERTIFICATION

I, Adam W. Shaffer, certify that:

1. I have reviewed this annual report on Form 10-K/A of eCOST.com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report; and

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

May 2, 2005

/S/ ADAM W. SHAFFER

Adam W. Shaffer
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Elizabeth S.C.S. Murray, certify that:

1. I have reviewed this annual report on Form 10-K/A of eCOST.com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report; and

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

May 2, 2005

/s/ ELIZABETH S.C.S. MURRAY

Elizabeth S.C.S. Murray
EVP & Chief Financial Officer

EXHIBIT 32.1

eCOST.com, Inc.

CERTIFICATION

In connection with the annual report of eCOST.com, Inc. (the “Company”) on Form 10-K/A for the fiscal year ended December 31, 2004 as filed with the Securities and Exchange Commission (the “Report”), I, Adam W. Shaffer, Chief Executive Officer of the Company, hereby certify as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, that to the best of my knowledge:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.

This Certification has not been, and shall not be deemed, “filed” with the Securities and Exchange Commission.

May 2, 2005

/S/ ADAM W. SHAFFER

Adam W. Shaffer

Chief Executive Officer

eCOST.com, Inc.

CERTIFICATION

In connection with the annual report of eCOST.com, Inc. (the "Company") on Form 10-K/A for the fiscal year ended December 31, 2004 as filed with the Securities and Exchange Commission (the "Report"), I, Elizabeth S.C.S. Murray, Chief Financial Officer of the Company, hereby certify as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, that to the best of my knowledge:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

May 2, 2005

/s/ ELIZABETH S.C.S. MURRAY

Elizabeth S.C.S. Murray

EVP & Chief Financial Officer