

HARTE HANKS INC
Form 10-K
March 01, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

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 1-7120

HARTE-HANKS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

200 Concord Plaza Drive, San Antonio, Texas 78216

74-1677284
(I.R.S. Employer

Identification No.)

(Address of principal executive offices)(Zip Code)

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Registrant's telephone number, including area code 210-829-9000

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

Title of each class	Name of each exchange on which registered
Common Stock	New York Stock Exchange

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

None

(Title of class)

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

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

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 (229.405 of this chapter) 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 a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing price (\$25.64) as of the last business day of the registrant's most recently completed second fiscal quarter, (June 30, 2006, was approximately \$1,403,000,000.

The number of shares outstanding of each of the registrant's classes of common stock as of January 31, 2007 was 74,949,912 shares of common stock, all of one class.

Documents incorporated by reference:

Portions of the Proxy Statement for the Company's May 15, 2007 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

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Harte-Hanks, Inc. and Subsidiaries

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PART I

ITEM 1. BUSINESS
INTRODUCTION

Harte-Hanks is a worldwide direct and targeted marketing company that provides direct marketing services and shopper advertising opportunities to a wide range of local, regional, national and international consumer and business-to-business marketers. We manage our operations through two operating segments: Direct Marketing, which operates both nationally and internationally, and Shoppers, which operates in local and regional markets in California and Florida.

Marketing today is under intense focus in most organizations. Many corporations have a chief-level executive charged with marketing who is under pressure to utilize a combination of data, technology, channels and resources to demonstrate a return on marketing investment. This has led many to utilize direct and targeted marketing, as accountability and measurability are hallmarks of the discipline, allowing customer insight to be leveraged to create and accelerate value. Direct Marketing, which represented 60% of our total revenues in 2006, is a leader in the movement toward highly targeted marketing. Our Shoppers business applies geographic targeting principles. Our strategy is based on seven key elements:

Being a market leader in each of our businesses;

Increasing revenues through growing our base businesses;

Introducing new services, products and innovations;

Entering new markets and making acquisitions;

Using technology to create competitive advantages;

Employing people who understand our clients business and markets and who delight our clients; and

Creating shareholder value.

Harte-Hanks is the successor to a newspaper business begun in Texas in the early 1920s by Houston Harte and Bernard Hanks. In 1972, Harte-Hanks went public and was listed on the New York Stock Exchange. We became private in a leveraged buyout initiated by management in 1984. In 1993, we again went public and listed our common stock on the NYSE. In 1997, we sold all of our remaining traditional media operations (consisting of newspapers, television and radio companies) in order to focus all of our efforts on two business segments: Direct Marketing and Shoppers. See segment financial information in Note N Business Segments in the Notes to Consolidated Financial Statements.

Harte-Hanks provides public access to all reports filed with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, as amended (the 1934 Act). These documents may be accessed free of charge on our website at the following address: <http://www.harte-hanks.com>. Since November 15, 2002, these documents have been provided as soon as practical after they are filed with the SEC. The documents may also be found at the SEC's website at <http://www.sec.gov>. Additionally, we have adopted and posted on our website a code of ethics that applies to our principal executive officer, principal financial officer and principal accounting officer. Our website also includes our corporate governance guidelines and the charters for each of our audit, compensation, and corporate governance and nominating

committees. We will provide a printed copy of any of the aforementioned documents to any requesting shareholder.

DIRECT MARKETING

General

Direct marketing services are targeted to specific industries or markets with services and software products tailored to each industry or market. Our Direct Marketing clients include many of the largest retailers; financial

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companies including banks, financing companies, mutual funds and insurance companies; high-tech and telecommunications companies; and pharmaceutical companies and healthcare organizations. Direct Marketing clients are also from such selected markets as automotive, utilities, consumer packaged goods, hospitality, publishing, business services, energy and government/not-for-profit. We believe that we have the ability to provide services to new industries and markets by modifying our services and applications as opportunities are presented. In 2006, 2005 and 2004, Harte-Hanks Direct Marketing had revenues of \$709.7 million, \$694.6 million, and \$641.2 million, respectively, which accounted for approximately 60%, 61%, and 62% of our total revenues, respectively.

Depending on the needs of our clients, our Direct Marketing capabilities are provided in an integrated approach through more than 30 facilities worldwide, more than 10 of which are located outside of the United States. Each of these centers possesses some specialization and is linked with others to support the needs of our clients.

We utilize various capabilities and technologies to enable our clients to identify, reach, influence and nurture their customers. Harte-Hanks Direct Marketing improves the return on its clients' marketing investment by increasing their prospect and customer value—a process of customer optimization—organized around five strategic considerations:

Information (data collection/management);

Opportunity (data access/utilization);

Insight (data analysis/interpretation);

Engagement (knowledge application); and

Interaction (program execution).

Harte-Hanks Direct Marketing uses various capabilities and technologies as enablers to capture, analyze and disseminate customer and prospect data across all points of customer contact. Using both proprietary software and open software solutions, we build contact databases for our clients using the information gained from the clients' marketing and communication activities across different media such as mail, websites, e-mail, inbound and outbound teleservices, trade shows, point-of-sale and other sources. We believe that these databases enable clients to measure the return on their marketing communications investments and make more informed decisions about future marketing efforts. We help clients manage the inquiries they receive from a myriad of sources related to their marketing efforts. These inquiries, or leads, are qualified, tracked and distributed both to appropriate sales channels and to client management for analysis, decision-making and/or additional interaction in order for clients to manage their customer and prospect relationships more effectively. These leads are also developed for business-to-business clients through our CI Technology Database and through research efforts of our Aberdeen operation.

Our customer optimization activities often start with the development of a roadmap, followed by building customized marketing databases for specific clients and providing them with easy-to-use tools to perform analysis and to target their best customers and prospects. Using our proprietary name and address matching software, the Trillium Software System®, we investigate and standardize large numbers of customer records from multiple sources, integrate them into a single database for each client and, if needed, append demographic and lifestyle information.

Our Allink® databases are built for clients and tailored to specific market segments. These databases are moved to the clients' site or maintained at Harte-Hanks with online access from client locations. In addition to building a clients' database and providing solutions for analytics and campaign management, we perform regular database updates.

These solutions are seamlessly linked to our service bureau preparing list selections, maximizing deliverability and reducing clients' mailing costs through our Advanced Data Quality services, including Trillium Software and Global Address capabilities in addition to sophisticated postal coding, hygiene and address updates through a non-exclusive National Change of Address license with the U.S. Postal Service.

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As a further extension of the client's marketing arm, we provide customer insight by using marketing research and analytics services. Specific capabilities include tracking and reporting, media analysis, modeling, database profiling, primary data collection, marketing applications, consulting and program development.

We engage with our client's customers by offering direct marketing agency services that combine information-based strategy and brand-building creative efforts that are channel independent, using both traditional direct and interactive media.

In addition, Harte-Hanks provides a variety of services to help clients develop and execute targeted marketing communication programs. These include services such as telephone, email using our proprietary Postfuture® offering, website development and search marketing, personalization of communication pieces using laser and inkjet printing, targeted mail and fulfillment, transportation logistics, and print-on-demand as well as traditional printing.

Our mail tracking capability and long-standing relationship with the U.S. Postal Service help ensure that customer mailings reach their destinations on time. By controlling the final stage of the print distribution process through its logistics operations, we facilitate the delivery of our clients' materials while holding costs to a minimum.

Customers

Direct marketing services are marketed to specific industries or markets with services and software products tailored to each industry or market. We are able to provide services to new industries and markets by modifying our existing services and applications. We currently provide direct marketing services to all of our primary vertical markets including retail, high-tech/telecom, financial services and pharmaceutical/healthcare, in addition to a range of selected markets. Our Direct Marketing business is not overly dependent on any one client or any group of clients. The largest client, measured in revenue, comprised 8% of total Direct Marketing revenues and 5% of our total revenues in 2006, respectively. The largest 25 clients, measured in revenue, comprised 40% of total Direct Marketing revenues and 24% of our total revenues in 2006, respectively.

Backlogs

We do not experience backlogs in our Direct Marketing business.

Sales and Marketing

The national direct marketing sales force of Harte-Hanks is headquartered in Cincinnati, Ohio, with additional offices maintained throughout the United States. There are also product specific sales forces and sales groups in Europe, Australia, South America and Asia. The sales forces, with industry-specific knowledge and experience, emphasize the cross-selling of a full range of direct marketing services and are supported by employees in each sector. The overall sales focus is to position Harte-Hanks as a marketing partner offering various services and solutions (including end-to-end) as required to meet our client's targeted marketing needs.

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Direct Marketing Facilities

Direct marketing services are provided at the following facilities:

National Offices

Austin, Texas
Baltimore, Maryland
Billerica, Massachusetts
Bloomfield, Connecticut
Boston, Massachusetts
Cincinnati, Ohio
Clearwater, Florida
Deerfield Beach, Florida
East Bridgewater, Massachusetts
Fort Worth, Texas
Fullerton, California
Glen Burnie, Maryland
Grand Prairie, Texas
Jacksonville, Florida
Lake Mary, Florida
Langhorne, Pennsylvania
Monroe Township, New Jersey
New York, New York
Ontario, California
Pennsauken, New Jersey
Richardson, Texas
River Edge, New Jersey

For more information please refer to Item 2 - Properties.

San Diego, California
Shawnee, Kansas
Troy, Michigan
Wilkes-Barre, Pennsylvania

National Markets Headquarters

Cincinnati, Ohio

International Offices

Aldermaston, United Kingdom
Böblingen, Germany
Bristol, United Kingdom
Dublin, Ireland
Frenchs Forest (Sydney), Australia
Hasselt, Belgium
Madrid, Spain
Manila, Philippines
Melbourne, Australia
São Paulo, Brazil
Sèvres, France
Stuttgart, Germany
Uxbridge, United Kingdom

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Competition

Direct marketing is a rapidly evolving business, subject to periodic technological advancements, high turnover of client personnel who make buying decisions, client consolidations and changing client needs and preferences. In addition, our Direct Marketing business faces competition in all of its offerings and within each of its vertical markets. This competition comes from numerous local, national and international direct marketing companies which we compete against for individual projects and entire client relationships. There are various competitive factors in our industry, including, the quality of service, technical and strategic expertise, the value of the services provided as compared to the price of the services, reputation and brand recognition. We also compete against print and electronic media and other forms of advertising for marketing and advertising dollars in general. Failure to continually improve our current processes, advance and upgrade our technology applications and to develop new products and services could result in the loss of our clients to current or future competitors. In addition, failure to gain market acceptance of new products and services could adversely affect our growth. We believe that our capabilities and breadth of services, combined with our national and worldwide production capability, industry focus and ability to offer a full range of integrated services, enable us to compete effectively.

Seasonality

Our Direct Marketing business is somewhat seasonal as revenues in the fourth quarter tend to be at least 10% higher than revenues in other quarters during a given year. This increased revenue is a result of overall increased marketing activity prior to and during the holiday season.

SHOPPERS

General

Harte-Hanks Shoppers is North America's largest owner, operator and distributor of shopper publications, based on weekly circulation and revenues, and is the only U.S. targeted media company that focuses on shoppers as a core business. Shoppers are weekly advertising publications delivered free by Standard Mail to households and businesses in a particular geographic area. Shoppers offer advertisers a targeted, cost-effective local advertising system, with virtually 100% penetration in their area of distribution. Shoppers are particularly effective in large markets with high media fragmentation in which major metropolitan newspapers generally have low penetration.

As of December 31, 2006, Shoppers delivered more than 13 million shopper packages in five major markets each week covering the greater Los Angeles market (Los Angeles County, Orange County, Riverside County, San Bernardino County, Ventura County and Kern County), the greater San Diego market, Northern California (San Jose, Sacramento, Stockton and Modesto), South Florida (Dade County and Broward County) and the greater Tampa market. Two editions of the shopper publication are delivered to approximately 241,000 households and businesses in South Orange County where both an early and late edition *PennySaver* are published each week. Our California publications account for approximately 80% of Shoppers' weekly circulation.

Harte-Hanks publishes 1,121 individual shopper editions each week distributed to zones with circulation of approximately 12,000 each. This allows single-location, local advertisers to saturate a single geographic zone, while enabling multiple-location advertisers to saturate multiple zones. This unique delivery system gives large and small advertisers alike a cost-effective way to reach their target markets. We believe that our zoning capabilities and production technologies have enabled us to saturate and target areas in a number of ways including geographic, demographic, lifestyle, behavioral and language allowing our advertisers to effectively target their customers. Our strategy is to increase our share of local advertising in our existing circulation areas, and, over time, to increase circulation through internal expansion into contiguous areas. In 2006, 2005, and 2004, Harte-Hanks Shoppers had revenues of \$475.0 million, \$440.4 million, and \$389.2 million, respectively, accounting for approximately 40%, 39% and 38% of our total revenues, respectively.

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Total Shoppers circulation increased by 870,000 during 2006 as follows:

Market	Publication Name	Circulation Increase
Greater Los Angeles	PennySaver	335,000
Greater San Diego	PennySaver	22,000
Northern California	PennySaver	198,000
South Florida	The Flyer	17,000
Greater Tampa	The Flyer	298,000
Total		870,000

At December 31, 2006, Shoppers circulation reached over 13.4 million in California and Florida each week (including 241,000 in South Orange County, California where Shoppers publishes two editions each week). We believe that future expansions provide increased revenue opportunities, although we do plan to moderate the pace of expansion in 2007. Newer areas initially tend to contribute less from a revenue-per-thousand perspective than existing areas, and in fact are typically expected to be less profitable or even unprofitable until the publications in those areas mature.

Publications

The following table sets forth certain information with respect to Shoppers publications:

Market	Publication Name	December 31, 2006	
		Circulation	Number of Zones
Greater Los Angeles	PennySaver	5,956,000	527
Greater San Diego	PennySaver	1,872,000	157
Northern California	PennySaver	2,799,500	228
South Florida	The Flyer	1,461,000	116
Greater Tampa	The Flyer	1,345,500	93
Total		13,434,000	1,121

Our shopper publications contain classified and display advertising and are delivered by Standard Mail saturation. The typical shopper publication contains approximately 45 pages and is 7 by 9-1/2 inches in size. Each edition, or zone, is targeted around a natural neighborhood marketing pattern. Shoppers also serve as a distribution vehicle for multiple ads from national and regional advertisers; "print and deliver" single-sheet inserts designed and printed by us; coupon books; preprinted inserts; and four-color glossy flyers printed by third party printers. In addition, our shoppers offer advertising using our internet sites www.pennysaverusa.com for our California publications and www.theflyer.com for our South Florida and Tampa, Florida publications.

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We have acquired, developed and applied innovative technology and customized equipment in the publication of our shoppers, contributing to efficiency and growth. A proprietary pagination system has made it possible for over a thousand weekly zoned editions to be designed, built and output to plate-ready negatives in a paperless, digital environment. Automating the production process saves on labor, newsprint, and overweight postage. This software also allows for better ad tracking, immediate checks on individual zone and ad status, and more on-time press starts with less manpower.

Customers

Shoppers serves both business and individual advertisers in a wide range of industries, including real estate, employment, automotive, retail, high-tech/telecom, financial services, and a number of other industries. Shoppers is not overly dependent on any one client or any group of clients. The largest client, measured in revenue, comprised 3% of total Shoppers revenue and 1% of our total revenue in 2006, respectively. The top 25 clients in terms of revenue comprised 14% of Shoppers revenues and 6% of our total revenue in 2006, respectively.

Backlogs

We do not experience backlogs in our Shoppers business.

Sales and Marketing

We maintain local Shoppers sales offices throughout our geographic markets and employ more than 800 commissioned sales representatives who develop both targeted and saturation advertising programs for clients. The sales organization provides service to both national, regional and local advertisers through its telemarketing departments and field sales representatives. Shoppers clients vary from individuals with a single item for sale to local neighborhood advertisers to large multi-location advertisers. The core clients continue to be local service businesses and small retailers. We also focus our marketing efforts on larger national accounts by emphasizing our ability to deliver saturation advertising in defined zones, or even partial zones for inserts, in combination with advertising in the shopper publication.

Additional focus is placed on particular industries/categories through the use of sales specialists. These sales specialists are primarily used to target automotive, real estate and employment advertisers.

We utilize proprietary sales and marketing systems to enter client orders directly from the field, instantly checking space availability, ad costs and other pertinent information. These systems efficiently facilitate the placement of advertising into multiple-zoned editions and include built-in error-reducing safeguards that aid in minimizing costly sales adjustments. In addition to allowing advertising information to be entered for immediate publication, these systems feed a relational client database enabling sales personnel to access client history by designated variables to facilitate the identification of similar potential clients and to assist with timely follow-up on existing clients.

Shoppers Facilities

Our shoppers are produced at owned or leased facilities in the markets they serve. We have six production facilities — three in Southern California, one in Northern California, one in Southern Florida and one in Tampa, Florida — and more than 30 sales offices.

For more information please refer to Item 2 Properties.

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Competition

Our Shoppers business competes for advertising, as well as for readers, with other print and electronic media. Competition comes from local and regional newspapers, magazines, radio, broadcast and cable television, other shoppers, the internet, other communications media and other advertising printers that operate in our markets. The extent and nature of such competition are, in large part, determined by the location and demographics of the markets targeted by a particular advertiser, and the number of media alternatives in those markets. Failure to continually improve our current processes, advance and upgrade our technology applications and to develop new products and services could result in the loss of our clients to current or future competitors. In addition, failure to gain market acceptance of new products and services and geographic areas could adversely affect our growth. We believe that our production systems and technology, which enable us to publish separate editions in narrowly targeted zones, and our local ad content, allow us to compete effectively, particularly in large markets with high media fragmentation.

Seasonality

Our Shoppers business is somewhat seasonal in that revenues from the last two publication dates in December and first two to three publication dates in January each year are affected by a slowdown in advertising by businesses and individuals after the holidays. In general the second and third quarters are Shoppers highest revenue quarters.

US AND FOREIGN GOVERNMENT REGULATIONS

Our business is subject to various laws that regulate various aspects of direct marketing, the internet and emerging technologies, including on-line content, email, intellectual property, privacy, and taxation. In addition, federal, state, local and foreign governmental organizations also are considering, and may consider in the future, other legislative and regulatory proposals that would regulate various direct marketing services and products. There is privacy legislation pending in Congress and in most of the 50 states, and we anticipate that additional legislation will continue to be introduced in the future. In addition, the European Union and European Commission have adopted directives to address the regulation of various areas related to marketing, including privacy, e-commerce, security, and consumer protection.

It is not known how courts will interpret both existing and new laws. Therefore, we are uncertain as to how new laws or the application of existing laws will affect our business. This pending legislation could result in restrictions placed upon the collection, management, aggregation, transfer and use of information that is legally available. It is also possible that we could be prohibited from disseminating certain types of data. In addition, our business may be indirectly affected by the effect that this legislation may have on our clients. There could be a material adverse impact on our business due to the enactment of legislation or industry regulations, the issuance of judicial interpretations, or simply a change in customs, arising from public concern over consumer privacy and security issues.

INTELLECTUAL PROPERTY RIGHTS

We seek to protect our intellectual property through a combination of license agreements and trademark, service mark, copyright, patent and trade secret laws. We enter into confidentiality agreements with our employees, vendors and clients and use our best efforts to limit access to and distribution of proprietary information licensed from third parties. We pursue the protection of our trademarks in the United States and internationally. Our efforts to protect our intellectual property rights could be inadequate to deter misappropriation of our proprietary information. Furthermore, we may not be able to detect all instances of unauthorized use of our intellectual property.

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EMPLOYEES

As of December 31, 2006, Harte-Hanks employed 6,338 full-time employees and 505 part-time employees, as follows: Direct Marketing 3,881 full-time and 148 part-time employees; Shoppers 2,438 full-time and 356 part-time employees; and corporate office 19 full-time employees and 1 part-time employee. None of the work force is represented by labor unions. We consider our relations with our employees to be good.

ITEM 1A. RISK FACTORS

From time to time, in written reports, filings and oral statements by senior management, we may express our expectations regarding future performance. These forward-looking statements are inherently uncertain, and events could turn out to be other than what we expected. Statements containing the words believes, anticipates, estimates, expects, intends, plans, seeks, will, may, should, would, continues and similar expressions or the negative of these terms constitute forward-looking statements that involve risks and uncertainties. Those statements are based on current expectations and are subject to risks, uncertainties and changes in condition, significance, value and effect, including those discussed in this section entitled Risk Factors. Those risks, uncertainties and changes in condition, significance, value and effect could cause actual results to differ materially from those anticipated.

Set forth below are some key factors and important risks, uncertainties and contingencies that could cause our actual results, performances or achievements, to be materially different from our forward-looking statements, including our revenues, net income and earnings per share; however, the risks described below are not the only ones we face. Additional risks and uncertainties that are not presently known, or that we currently consider immaterial, could also impair our business operations.

Risks Related to our Business

We face intense competition.

Direct marketing is a rapidly evolving business, subject to periodic technological advancements, high turnover of client personnel who make buying decisions, mergers and acquisitions of client companies, and changing client needs and preferences. Consequently, our Direct Marketing business faces competition in all of its offerings and within each of its vertical markets. This competition comes from numerous local, national and international direct marketing companies which we compete against for individual projects and entire client relationships. We also compete against print and electronic media and other forms of advertising for advertising dollars in general. In addition, our ability to attract new clients and to retain existing clients may, in some cases, be limited by clients' policies on or perceptions of conflicts of interest. These policies can prevent us from performing similar services for competing products or companies. Our Shoppers business competes for advertising, as well as for readers, with other print and electronic media. Competition comes from local and regional newspapers, magazines, radio, broadcast and cable television, other shoppers, the internet, other communications media and other advertising printers that operate in our markets. The extent and nature of such competition are, in large part, determined by the location and demographics of the markets targeted by a particular advertiser and the number of media alternatives in those markets. Our failure to improve our current processes or to develop new products and services could result in the loss of our clients to current or future competitors. In addition, failure to gain market acceptance of new products and services could adversely affect our growth.

We must be able to attract, maintain and retain qualified personnel.

We believe that our future prospects will depend in large part upon our ability to attract, train and retain highly skilled technical, client services and administrative personnel. While the demand for personnel is dependent on employment levels and general economic conditions, qualified personnel historically have been in great demand

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and from time to time and in the foreseeable future will likely remain a limited resource. There can be no assurance that we will be able to retain our existing personnel or attract and retain qualified employees. We are dependent on the efforts, abilities, experience and expertise of our current officers. The loss or prolonged absence of the services of these individuals could have a material adverse effect on our business, financial position or operating results.

We must maintain technological competitiveness.

We believe that our future success will be dependent on, among other things, maintaining technological competitiveness in our direct marketing and shopper products, processing functionality, and software systems and services. Advances in information technology may result in changing client preferences for products and product delivery formats in our industry. We must continually improve our current processes and develop and introduce new products and services in order to match our competitors' technological developments and the increasingly sophisticated requirements of our clients. We cannot be assured that we will be able to successfully identify, develop and bring new and enhanced services and products to market in a timely manner, that such services or products will be commercially successful or that services, products or technologies developed by others will not render our services and products noncompetitive or obsolete.

We may not be able to protect our computer systems and databases.

Our ability to protect our data centers against damage from a security breach, fire, power loss, telecommunications failure or other disaster is critical to our future. We believe we have taken reasonable precautions to protect our data centers from events that could interrupt our operations. Any damage to our data centers that causes interruptions in our operations could affect our ability to meet our clients' requirements, which could have a material adverse effect on our business, financial position or operating results.

Data suppliers could withdraw data.

We purchase or license much of the data we use. There could be a material adverse impact on our Direct Marketing business if owners of the data we use were to withdraw or cease to allow access to the data. Data providers could withdraw their data if there is a competitive reason to do so or if additional legislation is passed restricting the use of the data. If a substantial number of data providers were to withdraw their data, our ability to provide products and services to our clients would be materially adversely affected.

We must successfully integrate acquisitions.

We continue to pursue acquisition opportunities. Acquisition activities, even if not consummated, require substantial amounts of management time and can distract from normal operations. In addition, there can be no assurance that the synergies and other objectives sought in acquisitions would be achieved. We believe that we will be able to successfully integrate recently acquired businesses into existing operations but there is no certainty that future acquisitions will be consummated on acceptable terms or that any acquired assets, data or businesses will be successfully integrated into our operations. The failure to identify appropriate candidates, to negotiate favorable terms, or to successfully integrate future acquisitions into existing operations could result in not achieving planned revenue growth or could negatively impact our net income and earnings per share.

We are vulnerable to increases in paper prices.

In recent years, newsprint prices have fluctuated widely. We maintain, on average, less than 30 days of paper inventory and do not purchase our paper pursuant to long-term paper contracts. Because we have a limited ability to protect ourselves from fluctuations in the price of paper or to pass increased costs along to our clients, these fluctuations could materially affect the results of our operations.

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We are vulnerable to increases in postal rates and disruptions in postal services.

Our Shoppers and Direct Marketing services depend on the United States Postal Service to deliver products. Our shoppers are delivered by Standard Mail, and postage is the second largest expense, behind payroll, in our Shoppers business. Standard postage rates increased in January of 2006 and are expected to increase again in the spring or summer of 2007. The discount structure is also expected to change at the time of the anticipated 2007 increase. Overall Shoppers postage costs are expected to grow as a result of anticipated increases in postage rates, circulation and insert volumes. Postage rates also influence the demand for our Direct Marketing services even though the cost of mailings is borne by our clients and is not directly reflected in our revenues or expenses. While there is no assurance that future postal increases will not have an adverse impact on us, newly enacted postal reform legislation should minimize the impact.

Our international operations subject us to risks associated with operations outside the U.S.

Harte Hanks Direct Marketing conducts business outside of the United States. During 2006, approximately 8.9% of Harte Hanks Direct Marketing's revenues were derived from businesses outside the United States. Accordingly, our future operating results could be negatively affected by a variety of factors, some of which are beyond our control, including:

social, economic and political instability;

changes in U.S. and foreign governmental legal requirements or policies resulting in burdensome government controls, tariffs, restrictions, embargoes or export license requirements;

inflation;

the potential for nationalization of enterprises;

potentially adverse tax treatment;

less favorable foreign intellectual property laws that would make it more difficult to protect our intellectual properties from appropriation by competitors;

longer payment cycles for sales in foreign countries; and

the costs and difficulties of managing international operations.

In addition, exchange rate movements may have an impact on our future costs or on future cash flows from foreign investments. We have not entered into any foreign currency forward exchange contracts or other derivative instruments to hedge the effects of adverse fluctuations in foreign currency exchange rates. The various risks that are inherent in doing business in the United States are also generally applicable to doing business outside of the United States, and may be exaggerated by the difficulty of doing business in numerous sovereign jurisdictions due to differences in culture, laws and regulations.

We must maintain effective internal controls.

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In designing and evaluating our internal controls over financial reporting, we recognize that any internal control or procedure, no matter how well designed and operated, can provide only reasonable assurance of achieving desired control objectives. We believe that our internal controls over financial reporting currently provide reasonable assurance of achieving their control objectives; however, no system of internal controls can be designed to provide absolute assurance of effectiveness. If we fail to maintain a system of effective internal controls, it could have a material adverse effect on our business, financial position or operating results. Additionally, adverse publicity related to a failure in our internal controls over financial reporting could have a negative impact on our reputation and business.

Fluctuation in our revenue and operating results may impact our stock price.

Fluctuations in our quarterly revenues and operating results in any future period that fall below the expectations of securities analysts and investors could cause a decline in our stock price. These fluctuations could be

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caused by unanticipated variations in the size, budget, or progress toward the completion of our engagements; variability in the market demand for our services, client consolidations or the unanticipated termination of several major client engagements.

The granting of stock-based awards to our employees affects our expenses and our stock price.

New stock-based compensation accounting rules adopted January 1, 2006 increased our reported expenses. These increased expenses could affect the price of our common shares. Effective January 1, 2006, we became subject to new stock-based compensation accounting rules that require that compensation costs related to stock-based payment transactions, including stock options, restricted stock and performance stock units, be recognized in our financial statements. Previously, we accounted for stock-based compensation of employees using the intrinsic value method, which resulted in no compensation expense charged against income for stock options grants to employees where the exercise price was equal to the market price of the underlying stock at the date of grant. Beginning January 1, 2006, grants of options, stock or other forms of equity have been recognized as compensation expense in our income statement, increasing our reported expenses for the same activities and negatively impacting our earnings per share.

General economic conditions could result in reduced demand for our products and services.

Economic downturns often severely affect the marketing services industry. In the past, our customers have responded, and may respond in the future, to weak economic conditions by reducing their marketing budgets, which are generally discretionary in nature and easier to reduce in the short-term than other expenses. In addition, revenues from our Shoppers business are dependent to a large extent on local advertising expenditures in the markets in which they operate. Such expenditures are substantially affected by the strength of the local economies in those markets. Direct Marketing revenues are dependent on national and international economies. A lasting economic recession or downturn in the United States economy and the economies we operate in abroad, could have material adverse effects on our business, financial position or operating results.

Our Shoppers business is geographically concentrated and is subject to the California and Florida economies.

Our Shoppers business is concentrated geographically in California and Florida. A large disaster, such as a flood, hurricane, earthquake or other disaster or condition that disables our facilities, immobilizes the United States Postal Service or causes a significant negative change in the economies of these regions could have a material adverse effect on our business, financial position or operating results.

Changes in legislation, judicial interpretations, or the consumer environment could affect us.

Our business is subject to various laws that regulate various aspects of direct marketing, the internet and emerging technologies, including on-line content, email, intellectual property, privacy, and taxation. In addition, federal, state, local and foreign governmental organizations also are considering, and may consider in the future, other legislative and regulatory proposals that would regulate various direct marketing services and products. There is privacy legislation pending in Congress and in most of the 50 states, and we anticipate that additional legislation will continue to be introduced in the future. In addition, the European Union and European Commission have adopted directives to address the regulation of various areas related to marketing, including privacy, e-commerce, security, and consumer protection.

It is not known how courts will interpret both existing and new laws. Therefore, we are uncertain as to how new laws or the application of existing laws will affect our business. This pending legislation could result in restrictions placed upon the collection, management, aggregation, transfer and use of information that is legally available. It is also possible that we could be prohibited from disseminating certain types of data. In addition, our business may be indirectly affected by our clients who may be subject to such legislation. There could be a

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material adverse impact on our business due to the enactment of legislation or industry regulations, the issuance of judicial interpretations, or simply a change in customs, arising from public concern over consumer privacy and security issues.

Interest rate increases could affect our expenses and financial position.

Interest rate movements in Europe and the United States can affect the amount of interest we pay related to our debt and the amount we earn on cash equivalents. Our primary interest rate exposure is to interest rate fluctuations in Europe, specifically Eurodollar rates due to their impact on interest related to our \$125 million revolving credit facility and our \$195 million term loan. We also have exposure to interest rate fluctuations in the United States, specifically money market, commercial paper and overnight time deposit rates, as these affect our earnings on excess cash. Even with the offsetting increase in earnings on excess cash in the event of an interest rate increase, we cannot be assured that future interest rate increases will not have a material adverse impact on our business, financial position or operating results.

War or terrorism could affect our business.

War and/or terrorism or the threat of war and/or terrorism involving the United States could have a significant impact on our business, financial position or operating results. War or the threat of war could substantially affect the levels of advertising expenditures by clients in each of our businesses. In addition, each of our businesses could be affected by operation disruptions and a shortage of supplies and labor related to such a war or threat of war.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located in San Antonio, Texas and we occupy approximately 17,000 square feet of leased premises at that location. Our business is conducted in facilities worldwide containing aggregate space of approximately 3.2 million square feet. Approximately 3.1 million square feet are held under leases, which expire at dates through 2023. The balance of the properties, used in our Southern California shopper operations and Hasselt, Belgium direct marketing operations, are owned.

ITEM 3. LEGAL PROCEEDINGS

From time to time we become involved in various claims and lawsuits incidental to our businesses. In the opinion of management, after consultation with counsel, any ultimate liability arising out of currently pending claims and lawsuits is not expected to have a material effect on our financial condition or operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

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Our common stock is listed on the New York Stock Exchange (symbol: HHS). The reported high and low quarterly sales price ranges for 2006 and 2005 were as follows:

	2006		2005	
	High	Low	High	Low
First Quarter	31.00	25.60	27.62	25.24
Second Quarter	28.21	24.33	30.98	26.11
Third Quarter	27.17	22.35	30.18	25.62
Fourth Quarter	27.84	25.03	26.82	25.39

In 2006, quarterly dividends were paid at the rate of 6.0 cents per share. In 2005, quarterly dividends were paid at the rate of 5.0 cents per share.

In January 2007, we announced an increase in the regular quarterly dividend from 6.0 cents per share to 7.0 cents per share, payable March 15, 2007 to holders of record on March 1, 2007.

As of February 1, 2007, there are approximately 2,700 holders of record.

Issuer Purchases of Equity Securities

The following table contains information about our purchases of our equity securities during the fourth quarter of 2006:

Period	Total Number of Shares	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan(1)	Maximum Number of Shares that May Yet Be Purchased Under the Plan
October 1 - 31, 2006	176,700	\$ 25.86	176,700	7,126,828
November 1 - 30, 2006(2)	1,370,300	\$ 25.99	1,370,300	5,756,528
December 1 - 31, 2006	585,318	\$ 26.66	489,911	