

HARTE HANKS INC
Form 10-Q
August 01, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2011

or

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

For the transition period from _____ to _____

Commission File Number 001-7120

HARTE-HANKS, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

74-1677284
(I.R.S. Employer
Identification Number)

9601 McAllister Freeway, Suite 610, San Antonio, Texas 78216

(Address of principal executive offices) (Zip Code)

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

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 whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares outstanding of each of the registrant's classes of common stock as of July 15, 2011 was 62,790,280 shares of common stock, all of one class.

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HARTE-HANKS, INC. AND SUBSIDIARIES

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Item 1. Interim Condensed Consolidated Financial Statements
Harte-Hanks, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets (in thousands, except share amounts)

	June 30, 2011 (Unaudited)	December 31, 2010 (Audited)
Assets		
Current assets		
Cash and cash equivalents	\$ 47,860	\$ 85,996
Accounts receivable <i>(less allowance for doubtful accounts of \$2,421 at June 30, 2011 and \$3,103 at December 31, 2010)</i>	147,166	151,006
Inventory	7,578	7,324
Prepaid expenses	9,940	8,943
Prepaid income taxes	2,285	0
Current deferred income tax asset	6,495	8,911
Other current assets	6,181	6,283
Total current assets	227,505	268,463
Property, plant and equipment <i>(less accumulated depreciation of \$252,637 at June 30, 2011 and \$253,730 at December 31, 2010)</i>	73,381	72,659
Goodwill, net	565,651	565,651
Other intangible assets <i>(less accumulated amortization of \$15,362 at June 30, 2011 and \$14,942 at December 31, 2010)</i>	15,368	15,788
Other assets	3,998	4,319
Total assets	\$ 885,903	\$ 926,880
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	\$ 165,500	\$ 133,000
Accounts payable	45,979	56,085
Accrued payroll and related expenses	18,558	24,780
Customer advances and deferred revenue	38,444	36,834
Income taxes payable	1,239	2,247
Other current liabilities	21,462	28,017
Total current liabilities	291,182	280,963
Long-term debt	0	60,000
Other long-term liabilities <i>(including deferred income taxes of \$92,885 at June 30, 2011 and \$85,655 at December 31, 2010)</i>	153,028	148,094
Total liabilities	444,210	489,057
Stockholders' equity		
Common stock, \$1 par value per share, 250,000,000 shares authorized. 118,450,705 shares issued at June 30, 2011 and 118,296,334 shares issued at December 31, 2010	118,451	118,296
Additional paid-in capital	339,339	336,795
Retained earnings	1,259,527	1,252,438
Less treasury stock: 55,665,662 shares at cost at June 30, 2011 and 54,664,293 shares at cost at December 31, 2010	(1,244,336)	(1,236,024)

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Accumulated other comprehensive loss	(31,288)	(33,682)
Total stockholders' equity	441,693	437,823
Total liabilities and stockholders' equity	\$ 885,903	\$ 926,880

See Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**Harte-Hanks, Inc. and Subsidiaries****Consolidated Statements of Operations (in thousands, except per share amounts)****(Unaudited)**

	Three Months Ended June 30,	
	2011	2010
Operating revenues	\$ 213,047	\$ 207,609
Operating expenses		
Labor	91,274	84,893
Production and distribution	82,523	78,496
Advertising, selling, general and administrative	17,341	15,877
Depreciation and software amortization	5,153	5,545
Intangible asset amortization	210	225
Total operating expenses	196,501	185,036
Operating income	16,546	22,573
Other expenses (income)		
Interest expense	626	684
Interest income	(67)	(41)
Other, net	473	(18)
	1,032	625
Income before income taxes	15,514	21,948
Income tax expense	6,089	8,532
Net income	\$ 9,425	\$ 13,416
Basic earnings per common share	\$ 0.15	\$ 0.21
Weighted-average common shares outstanding	63,371	63,616
Diluted earnings per common share	\$ 0.15	\$ 0.21
Weighted-average common and common equivalent shares outstanding	63,703	64,183

See Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**Harte-Hanks, Inc. and Subsidiaries****Consolidated Statements of Operations (in thousands, except per share amounts)****(Unaudited)**

	Six Months Ended June 30,	
	2011	2010
Operating revenues	\$ 413,353	\$ 407,788
Operating expenses		
Labor	180,283	170,535
Production and distribution	158,792	151,500
Advertising, selling, general and administrative	32,681	33,087
Depreciation and software amortization	10,312	11,245
Intangible asset amortization	420	532
Total operating expenses	382,488	366,899
Operating income	30,865	40,889
Other expenses (income)		
Interest expense	1,262	1,397
Interest income	(136)	(67)
Other, net	1,115	(359)
	2,241	971
Income before income taxes	28,624	39,918
Income tax expense	11,282	15,733
Net income	\$ 17,342	\$ 24,185
Basic earnings per common share	\$ 0.27	\$ 0.38
Weighted-average common shares outstanding	63,538	63,607
Diluted earnings per common share	\$ 0.27	\$ 0.38
Weighted-average common and common equivalent shares outstanding	63,974	64,141

See Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**Harte-Hanks, Inc. and Subsidiaries****Consolidated Statements of Cash Flows (in thousands)****(Unaudited)**

	Six Months Ended June 30,	
	2011	2010
Cash Flows from Operating Activities		
Net income	\$ 17,342	\$ 24,185
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and software amortization	10,312	11,245
Intangible asset amortization	420	532
Stock-based compensation	2,812	1,906
Excess tax benefits from stock-based compensation	(213)	0
Net pension cost	710	1,866
Deferred income taxes	7,787	4,002
Other, net	86	42
Changes in operating assets and liabilities, net of acquisitions:		
Decrease in accounts receivable, net	3,840	6,593
Increase in inventory	(254)	(1,157)
Increase in prepaid expenses and other current assets	(895)	(1,358)
(Decrease) increase in accounts payable	(10,106)	1,369
Decrease in other accrued expenses and other current liabilities	(14,384)	(8,107)
Other, net	555	(3,382)
Net cash provided by operating activities	18,012	37,736
Cash Flows from Investing Activities		
Purchases of property, plant and equipment	(11,408)	(8,266)
Proceeds from sale of property, plant and equipment	104	129
Net cash used in investing activities	(11,304)	(8,137)
Cash Flows from Financing Activities		
Net repayment of borrowings	(27,500)	(22,125)
Issuance of common stock	686	63
Excess tax benefits from stock-based compensation	213	0
Purchase of treasury stock	(8,363)	0
Dividends paid	(10,253)	(9,570)
Net cash used in financing activities	(45,217)	(31,632)
Effect of exchange rate changes on cash and cash equivalents	373	(732)
Net decrease in cash and cash equivalents	(38,136)	(2,765)
Cash and cash equivalents at beginning of year	85,996	86,598
Cash and cash equivalents at end of period	\$ 47,860	\$ 83,833

See Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**Harte-Hanks, Inc. and Subsidiaries****Consolidated Statements of Stockholders Equity and Comprehensive Income (in thousands, except per share amounts)****(2011 Unaudited)**

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at December 31, 2009	\$ 118,243	\$ 333,612	\$ 1,217,975	\$ (1,236,217)	\$ (31,970)	\$ 401,643
Exercise of stock options and release of nonvested shares	53	22	0	(124)	0	(49)
Net tax effect of options exercised and release of nonvested shares	0	(588)	0	0	0	(588)
Stock-based compensation	0	3,907	0	0	0	3,907
Dividends paid (\$0.30 per share)	0	0	(19,141)	0	0	(19,141)
Treasury stock issued	0	(158)	0	317	0	159
Comprehensive income:						
Net income	0	0	53,604	0	0	53,604
Adjustment to pension liability (net of tax benefit of \$1,051)	0	0	0	0	(1,576)	(1,576)
Foreign currency translation adjustment	0	0	0	0	(136)	(136)
Total comprehensive income						51,892
Balance at December 31, 2010	118,296	336,795	1,252,438	(1,236,024)	(33,682)	437,823
Exercise of stock options and release of nonvested shares	155	531	0	(98)	0	588
Net tax effect of options exercised and release of nonvested shares	0	(732)	0	0	0	(732)
Stock-based compensation	0	2,812	0	0	0	2,812
Dividends paid (\$0.16 per share)	0	0	(10,253)	0	0	(10,253)
Treasury stock issued	0	(67)	0	149	0	82
Purchase of treasury stock	0	0	0	(8,363)	0	(8,363)
Comprehensive income:						
Net income	0	0	17,342	0	0	17,342
Adjustment to pension liability (net of tax expense of \$913)	0	0	0	0	1,370	1,370
Foreign currency translation adjustment	0	0	0	0	1,024	1,024
Total comprehensive income						19,736
Balance at June 30, 2011	\$ 118,451	\$ 339,339	\$ 1,259,527	\$ (1,244,336)	\$ (31,288)	\$ 441,693

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Harte-Hanks, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

Note A Basis of Presentation

Consolidation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of Harte-Hanks, Inc. and its subsidiaries (the Company). All intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified for comparative purposes.

In the Condensed Consolidated Balance Sheets, amounts related to postage deposits in our Direct Marketing business have been reclassified from the line item Prepaid expenses to the line item Other current assets, and amounts related to postage advances from our Direct Marketing customers have been reclassified from the line item Customer advances and deferred revenue to the line item Other current liabilities. We believe the new classification more accurately reflects each of these postage items as the cost of mailings in our Direct Marketing business is borne by our clients and is not directly reflected in our revenues or expenses.

In the Consolidated Statements of Cash Flows, contributions to our pension plans have been reclassified from the line item Other, net within the Changes in operating assets and liabilities, to the line item Net pension cost within the Adjustments to reconcile net income to net cash provided by operations. We believe the new classification more appropriately presents the net cash flow impact of activity related to our pension plans.

As used in this report, the terms Harte-Hanks, we, us or our may refer to Harte-Hanks, one or more of its consolidated subsidiaries, or all of them taken as a whole.

Interim Financial Information

The financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2010.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results and outcomes could differ from those estimates and assumptions. On an ongoing basis management reviews its estimates based on currently available information. Changes in facts and circumstances could result in revised estimates and assumptions.

Operating Expense Presentation in Consolidated Statement of Operations

Labor in the Consolidated Statements of Operations includes all employee payroll and benefits, including stock-based compensation, along with temporary labor costs. Production and distribution and Advertising, selling, general and administrative do not include labor, depreciation or amortization.

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Note B Recent Accounting Pronouncements

In the first quarter of 2011, we adopted Accounting Standards Codification (ASC) Subtopic 605-25, *Revenue Recognition - Multiple-Element Arrangements* (ASC Subtopic 605-25). ASC Subtopic 605-25 provides principles for allocation of consideration among multiple-elements in an arrangement, allowing more flexibility in identifying and accounting for revenue from separate deliverables under an arrangement. ASC Subtopic 605-25 introduces an estimated selling price method for allocating revenue to the elements of a bundled arrangement if vendor-specific objective evidence or third-party evidence of selling price is not available, and significantly expands related disclosure requirements. This standard is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The adoption of ASC Subtopic 605-25 did not have a material effect on our consolidated financial statements.

In the first quarter of 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Updates (ASU) 2010-06, *Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 amends FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, and requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements, including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. ASU 2010-06 also clarifies existing fair-value measurement disclosure guidance about the level of disaggregation, inputs and valuation techniques. Except for the detailed Level 3 roll forward disclosures, we adopted the provisions of ASU 2010-06 in the first quarter of 2010. This adoption did not affect our consolidated financial statements. We adopted the provisions of ASU 2010-06 related to the new Level 3 roll forward disclosures in the first quarter of 2011. This adoption did not affect our consolidated financial statements.

In the first quarter of 2011, we adopted ASU 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations*. ASU 2010-29 requires public entities to disclose certain pro forma information about the revenue and earnings of the combined entity within the notes to the financial statements when a business combination occurs. The pro forma revenue and earnings of the combined entity must be presented as though the business combination had occurred as of the beginning of the comparable prior annual reporting period only. ASU 2010-29 also requires that this disclosure include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the pro forma revenue and earnings. This adoption did not affect our consolidated financial statements.

In the second quarter of 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. ASU 2011-05 eliminates the option to present other comprehensive income in the statement of changes in equity and provides the option to present the components of net income and comprehensive income in either one combined financial statement or two consecutive financial statements. We currently present the components of comprehensive income in our Consolidated Statements of Stockholders' Equity and Comprehensive Income. We will adopt ASU 2011-05 in the first quarter of 2012, at which point we plan to include one combined financial statement presenting the components of net income and comprehensive income. The adoption of ASU 2011-05 will not affect our operating results, cash flows or financial position.

Note C Income Taxes

Our second quarter 2011 income tax provision of \$6.1 million resulted in an effective income tax rate of 39.2%. Our first half 2011 income tax provision of \$11.3 million resulted in an effective income tax rate of 39.4%. Our effective income tax rate is derived by estimating pretax income and income tax expense for the year ending December 31, 2011. The effective income tax rate calculated for the second quarter and first half of 2011 is higher than the federal statutory rate of 35.0%, primarily due to the addition of state income taxes.

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Harte-Hanks or one of our subsidiaries files income tax returns at the federal level in the U.S., as well as in various U.S. state and foreign jurisdictions. For U.S. state and foreign returns, we are no longer subject to tax examinations for tax years prior to 2006. For U.S. federal returns, we are no longer subject to tax examinations for tax years prior to 2007.

The following is a reconciliation of the change in unrecognized tax benefits, excluding the effect of related penalties and interest and the federal effect of state unrecognized tax benefits (in thousands):

Balance at January 1, 2011	\$ 371
Additions for current year tax positions	0
Additions for prior year tax positions	41
Reductions for prior year tax positions	0
Lapse of statute	0
Settlements	(77)
 Balance at June 30, 2011	 \$ 335

Included in the balance of unrecognized tax benefits as of June 30, 2011 are \$0.3 million of federally effected tax benefits that, if recognized, would impact our effective tax rate. We anticipate that it is reasonably possible that we will have a reduction in our liability related to filing positions in the range of \$0.2 million to \$0.3 million within the next twelve months as a result of lapsing statutes.

We have elected to classify any interest expense and penalties related to income taxes within income tax expense in our Consolidated Statements of Operations. We had approximately \$0.1 million of interest and penalties accrued at June 30, 2011 and December 31, 2010.

Note D Stock-Based Compensation

We recognized \$1.7 million and \$1.0 million of stock-based compensation during the three months ended June 30, 2011 and 2010, respectively. We recognized \$2.8 million and \$1.9 million of stock-based compensation during the six months ended June 30, 2011 and 2010, respectively.

Our annual grant of stock-based awards occurred in the first quarter of 2011, which is consistent with the timing of previous annual grants.

\$0.5 million of stock-based compensation related to the retirement of the President of Harte-Hanks Shoppers was recorded in the second quarter of 2011. On the date of his retirement, August 31, 2011, all of his unvested stock-based awards will vest. We did not have any additional significant stock-based compensation activity in the second quarter of 2011.

Note E Fair Value of Financial Instruments

FASB ASC 820, *Fair Value Measurements and Disclosures*, (ASC 820) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into three levels:

Level 1 Quoted prices in active markets for identical assets or liabilities.

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Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Because of their maturities and/or variable interest rates, certain financial instruments have fair values approximating their carrying values. These instruments include cash and cash equivalents, accounts receivable and trade payables.

The carrying values and estimated fair values of our outstanding debt were as follows:

In thousands	June 30, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Total debt	\$ 165,500	\$ 164,658	\$ 193,000	\$ 190,583

The estimated fair values were calculated using current rates proposed to us by our bankers for debt with similar characteristics.

Note F Earnings Per Share

Basic earnings per share is computed on the basis of the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed on the basis of the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and non-vested shares.

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A reconciliation of basic and diluted earnings per share (EPS) is as follows:

In thousands, except per share amounts	Three Months Ended June 30,	
	2011	2010
BASIC EPS		
Net Income	\$ 9,425	\$ 13,416
Weighted-average common shares outstanding used in earnings per share computations	63,371	63,616
Earnings per common share	\$ 0.15	\$ 0.21
DILUTED EPS		
Net Income	\$ 9,425	\$ 13,416
Shares used in diluted earnings per share computations	63,703	64,183
Earnings per common share	\$ 0.15	\$ 0.21
Computation of shares used in earnings per share computations:		
Weighted-average outstanding common shares	63,371	63,616
Weighted-average common equivalent shares - dilutive effect of stock options and awards	332	567
Shares used in diluted earnings per share computations	63,703	64,183

5.5 million and 6.2 million anti-dilutive market price options have been excluded from the calculation of shares used in the diluted EPS calculation for the three months ended June 30, 2011 and 2010, respectively.

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In thousands, except per share amounts	Six Months Ended June 30,	
	2011	2010
BASIC EPS		
Net Income	\$ 17,342	\$ 24,185
Weighted-average common shares outstanding used in earnings per share computations	63,538	63,607
Earnings per common share	\$ 0.27	\$ 0.38
DILUTED EPS		
Net Income	\$ 17,342	\$ 24,185
Shares used in diluted earnings per share computations	63,974	64,141
Earnings per common share	\$ 0.27	\$ 0.38
Computation of shares used in earnings per share computations:		
Weighted-average outstanding common shares	63,538	63,607
Weighted-average common equivalent shares - dilutive effect of stock options and awards	436	534
Shares used in diluted earnings per share computations	63,974	64,141

5.6 million and 6.0 million anti-dilutive market price options have been excluded from the calculation of shares used in the diluted EPS calculation for the six months ended June 30, 2011 and 2010, respectively.

Note G Business Segments

Harte-Hanks is a worldwide, direct and targeted marketing company with operations in two segments Direct Marketing and Shoppers.

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Information about the operations of our two business segments follows:

In thousands	Three Months Ended June 30,	
	2011	2010
Operating revenues		
Direct Marketing	\$ 152,721	\$ 140,926
Shoppers	60,326	66,683
Total operating revenues	\$ 213,047	\$ 207,609
Operating income		
Direct Marketing	\$ 20,356	\$ 20,000
Shoppers	(1,118)	5,275
Corporate Activities	(2,692)	(2,702)
Total operating income	\$ 16,546	\$ 22,573
Income before income taxes		
Operating income	\$ 16,546	\$ 22,573
Interest expense	(626)	(684)
Interest income	67	41
Other, net	(473)	18
Total income before income taxes	\$ 15,514	\$ 21,948
In thousands	Six Months Ended June 30,	
	2011	2010
Operating revenues		
Direct Marketing	\$ 293,802	\$ 275,421
Shoppers	119,551	132,367
Total operating revenues	\$ 413,353	\$ 407,788
Operating income		
Direct Marketing	\$ 36,336	\$ 36,852
Shoppers	129	9,443
Corporate Activities	(5,600)	(5,406)
Total operating income	\$ 30,865	\$ 40,889
Income before income taxes		
Operating income	\$ 30,865	\$ 40,889
Interest expense	(1,262)	(1,397)
Interest income	136	67
Other, net	(1,115)	359
Total income before income taxes	\$ 28,624	\$ 39,918

Note H Components of Net Periodic Pension Benefit Cost

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Prior to January 1, 1999, we maintained a defined benefit pension plan for which most of our employees were eligible. We elected to freeze benefits under this defined benefit pension plan as of December 31, 1998.

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In 1994, we adopted a non-qualified, unfunded, supplemental pension plan covering certain employees, which provides for incremental pension payments so that total pension payments equal those amounts that would have been payable from our principal pension plan if it were not for limitations imposed by income tax regulations. The benefits under this supplemental pension plan continue to accrue as if the principal pension plan had not been frozen.

Net pension cost for both plans included the following components:

In thousands	Three Months Ended June 30,	
	2011	2010
Service cost	\$ 114	\$ 85
Interest cost	2,030	1,996
Expected return on plan assets	(1,756)	(1,541)
Amortization of prior service cost	12	14
Recognized actuarial loss	1,130	1,020
Net periodic benefit cost	\$ 1,530	\$ 1,574

In thousands	Six Months Ended June 30,	
	2011	2010
Service cost	\$ 229	\$ 170
Interest cost	4,059	3,992
Expected return on plan assets	(3,511)	(3,082)
Amortization of prior service cost	24	27
Recognized actuarial loss	2,259	2,041
Net periodic benefit cost	\$ 3,060	\$ 3,148

We plan to make total contributions of approximately \$5.2 million to our funded, frozen pension plan in 2011 in order to obtain the Pension Protection Act of 2006 full funding limit exemption. We made contributions of \$1.9 million in the first half of 2011. We plan to make contributions of \$2.3 million in the third quarter and \$1.1 million in the fourth quarter of 2011, respectively.

We are not required to make and do not intend to make any contributions to our unfunded, supplemental pension plan in 2011 other than to the extent needed to cover benefit payments. We expect benefit payments under this supplemental pension plan to total \$1.0 million in 2011.

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Comprehensive income for a period encompasses net income and all other changes in equity other than from transactions with our stockholders. Our comprehensive income was as follows:

In thousands	Three Months Ended June 30,	
	2011	2010
Net income	\$ 9,425	\$ 13,416
Other comprehensive income:		
Adjustment to pension liability (net of tax expense of \$457 in 2011 and \$414 in 2010)	685	620
Foreign currency translation adjustment	240	(1,238)
Total comprehensive income	\$ 10,350	\$ 12,798

In thousands	Six Months Ended June 30,	
	2011	2010
Net income	\$ 17,342	\$ 24,185
Other comprehensive income:		
Adjustment to pension liability (net of tax expense of \$913 in 2011 and \$827 in 2010)	1,370	1,240
Foreign currency translation adjustment	1,024	(3,039)
Total comprehensive income	\$ 19,736	\$ 22,386

Note J Goodwill

As of June 30, 2011 and December 31, 2010, we had goodwill of \$565.7 million. Under the provisions of FASB ASC 350, *Intangibles-Goodwill and Other*, goodwill is tested for impairment at least annually, or more frequently if events or circumstances indicate that it is more likely than not that goodwill might be impaired. Such events could include a significant change in business conditions, a significant negative regulatory outcome or other events that could negatively affect our business and financial performance. We perform our annual goodwill impairment assessment as of November 30th of each year.

Due to the continued difficult economic climates in California and Florida, the continued decline in Shoppers revenues and the significant charges incurred during the second quarter of 2011, management concluded that this environment could impact the valuation of the Shoppers reporting segment during the three months ended June 30, 2011. Accordingly, management performed a review for impairment focusing on current expectations of future cash flows and concluded that no impairment existed as the recent actions taken are expected to result in significant annualized savings going forward. Management will continue to monitor results and perform another interim test for impairment, if necessary.

Note K Litigation Contingencies

On January 25, 2010, Harte-Hanks Shoppers, Inc. (Shoppers), a California corporation and a subsidiary of Harte-Hanks, Inc. (Harte-Hanks), reached an agreement in principle with Shoppers employee Frank Gattuso and former employee Ernest Sigala, individually and on behalf of a certified class, to settle and resolve a previously disclosed class action lawsuit filed in 2001 (*Frank Gattuso et al. v. Harte-Hanks Inc. et al.*, as further described below).

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This agreement in principle was reduced to a class settlement agreement executed by the parties, and received final approval from the court on May 26, 2011. Pursuant to the settlement agreement, Shoppers has established a class settlement fund of \$7.0 million. In return, each member of the class, including Gattuso and Sigala, have released all claims against Shoppers and its affiliates that in any way arose from or related to the matters which were the subject of, or could have been the subject of, the claims alleged in the class action lawsuit. Notices to the class members were sent in the first and second quarters of 2011. Payments under the class settlement agreement from the class settlement fund began in late July 2011, and any unclaimed portion will revert back to Shoppers.

On March 23, 2001, Shoppers employee Frank Gattuso and former employee Ernest Sigala filed a class action against Shoppers in Los Angeles County Superior Court, claiming, among other related allegations, that Shoppers failed to comply with California Labor Code Section 2802 (CLC 2802), which requires an employer to indemnify employees for expenses incurred on behalf of the employer. The plaintiffs alleged that Shoppers failed to reimburse them for expenses of using their automobiles as outside sales representatives, and failed to accurately itemize these expenses on plaintiffs' wage statements. The class, as certified by the trial court, was limited to California Harte-Hanks outside sales representatives who were not separately reimbursed apart from their base salary and commissions for the expenses they incurred in using their own automobiles after early 1998. The plaintiffs sought indemnification and compensatory damages, statutory damages, exemplary damages, penalties, interest, costs of suit, and attorneys' fees. Shoppers filed a cross-complaint seeking a declaratory judgment that the plaintiffs were indemnified for their automobile expenses by the higher salaries and commissions paid to them as outside sales representatives. On January 30, 2002, the trial court ruled that CLC 2802 requires employers to reimburse employees for mileage and other expenses incurred in the course of employment, but that an employer is permitted to pay increased wages or commissions instead of indemnifying actual expenses. On May 28, 2003, the trial court denied the plaintiffs' motion for class certification. On October 27, 2005, the California Court of Appeal issued a unanimous opinion affirming the trial court's rulings, including the interpretation of CLC 2802 and denial of class certification. On November 23, 2005, the Court of Appeal denied the plaintiffs' petition for rehearing. On November 5, 2007, the California Supreme Court affirmed the trial court's ruling that CLC 2802 permits lump sum reimbursement and that an employer may satisfy its obligations to indemnify employees for reasonable and necessary business expenses under CLC 2802 by paying enhanced taxable compensation. The Supreme Court remanded the matter back to the trial court for further proceedings related to class certification and directed the trial court to consider whether the following issues could properly be resolved on a class-wide basis: (1) did Shoppers adopt a practice or policy of reimbursing outside sales representatives for automobile expenses by paying them higher commission rates and base salaries than it paid to inside sales representatives, (2) did Shoppers establish a method to apportion the enhanced compensation payments between compensation for labor performed and expense reimbursement and (3) was the amount paid for expense reimbursement sufficient to fully reimburse the employees for the automobile expenses they reasonably and necessarily incurred. On May 19, 2009, the trial court issued a partial class certification order certifying a class action with respect to the first two foregoing questions and denying class certification on the third foregoing question.

During the fourth quarter of 2009 we accrued the full \$7.0 million associated with this agreement. In June of 2011 we paid \$7.0 million to establish the class settlement fund. Based upon the claims received from the class members, we reduced the accrual by \$0.8 million and \$0.5 million in the first and second quarters of 2011, respectively, and have a \$1.3 million receivable on our Consolidated Balance Sheet at June 30, 2011. We cannot predict the impact of future developments relating to the settlement agreement and matters covered therein, and any further developments within a particular fiscal quarter may adversely impact our results of operations for that quarter.

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We are also currently subject to various other legal proceedings in the course of conducting our businesses and, from time to time, we may become involved in additional claims and lawsuits incidental to our businesses. In the opinion of management, after consultation with counsel, none of these matters is currently considered to be reasonably possible of resulting in a material adverse effect on our consolidated financial position or results of operations. Nevertheless, we cannot predict the impact of future developments affecting our pending or future claims and lawsuits and any resolution of a claim or lawsuit within a particular fiscal quarter may adversely impact our results of operations for that quarter. We expense legal costs as incurred, and all recorded legal liabilities are adjusted as required as better information becomes available to us. The factors we consider when recording an accrual for contingencies include, among others: (i) the opinions and views of our legal counsel; (ii) our previous experience; and (iii) the decision of our management as to how we intend to respond to the complaints.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Cautionary Note Regarding Forward-Looking Statements

This report, including this Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), contains forward-looking statements within the meaning of the federal securities laws. All such statements are qualified by this cautionary note, which is provided pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may also be included in our other public filings, press releases, our website and oral and written presentations by management. Statements other than historical facts are forward-looking and may be identified by words such as may, will, expects, believes, anticipates, plans, estimates, seeks, could, intends, or words of similar meaning. Examples include statements regarding (1) our strategies, initiatives, (2) adjustments to our cost structure and other actions designed to respond to market conditions and improve our performance, and the anticipated effectiveness and expenses associated with these actions, (3) our financial outlook for revenues, earnings per share, operating income, expense related to equity-based compensation, capital resources and other financial items, (4) expectations for our businesses and for the industries in which we operate, including with regard to the negative performance trends in our Shoppers business and the adverse impact of continuing economic uncertainty in the United States and other economies on the marketing expenditures and activities of our Direct Marketing clients and prospects, (5) competitive factors, (6) acquisition and development plans, (7) our stock repurchase program, (8) expectations regarding legal proceedings and other contingent liabilities, and (9) other statements regarding future events, conditions or outcomes.

These forward-looking statements are based on current information, expectations and estimates and involve risks, uncertainties, assumptions and other factors that are difficult to predict and that could cause actual results to vary materially from what is expressed in or indicated by the forward-looking statements. In that event, our business, financial condition, results of operations or liquidity could be materially adversely affected and investors in our securities could lose part or all of their investments. Some of these risks, uncertainties, assumptions and other factors can be found in our filings with the Securities and Exchange Commission, including the factors discussed under Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010 (2010 Form 10-K) and in the Cautionary Note Regarding Forward-Looking Statements in our second quarter 2011 earnings release issued on July 28, 2011. The forward-looking statements included in this report and those included in our other public filings, press releases, our website and oral and written presentations by management are made only as of the respective dates thereof, and we undertake no obligation to update publicly any forward-looking statement in this report or in other documents, our website or oral statements for any reason, even if new information becomes available or other events occur in the future.

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Overview

The following MD&A section is intended to help the reader understand the results of operations and financial condition of Harte-Hanks, Inc. (Harte-Hanks). This section is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying notes to the financial statements contained elsewhere in this report and our MD&A section, financial statements and accompanying notes to financial statements in our 2010 Form 10-K. Our 2010 Form 10-K contains a discussion of other matters not included herein, such as disclosures regarding critical accounting policies and estimates, and contractual obligations.

Harte-Hanks® is a worldwide direct and targeted marketing company that provides multichannel direct and digital 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 and Shoppers.

Our Direct Marketing services offer a wide variety of integrated, multichannel, data-driven solutions for top brands around the globe. We help our customers gain insight into their customers' behaviors from their data and use that insight to create innovative multichannel marketing programs to deliver a return on marketing investment. We believe our customers' success is determined not only by how good their tools are, but how well we help them use the tools to gain insight and analyze their consumers. This results in a strong and enduring relationship between our clients and their customers. We offer a full complement of capabilities and resources to provide a broad range of marketing services and data management software, in media from direct mail to e-mail, including:

agency and creative services;

database marketing solutions;

data quality software and services with Trillium Software;

digital marketing and social networking services;

direct mail and supply chain management;

fulfillment and contact centers; and

lead generation.

Revenues from the Direct Marketing segment represented approximately 72% and 71% of our total revenue for the three months and six months ended June 30, 2011, respectively.

Harte-Hanks Shoppers is North America's largest owner, operator and distributor of shopper publications, based on weekly circulation and revenues. Shoppers are weekly advertising publications delivered free by mail to households and businesses in a particular geographic area. Through print and digital offerings, Shoppers is a trusted local source for saving customers money and helping businesses grow. Shoppers offer advertisers a geographically 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. Our Shoppers business also provides advertising and other services online through our websites, *PennySaverUSA.com* and *TheFlyer.com*. These sites are online advertising portals, bringing buyers and sellers together through our online offerings, such as local classifieds, business listings, coupons, special offers and PowerSites®. PowerSites are templated websites for our customers, optimized to help small and medium sized business owners establish a web presence and improve their lead generation. At June 30, 2011, we are publishing approximately 6,500 PowerSites weekly. At June 30, 2011, our Shoppers publications were zoned into approximately 950 separate editions with total circulation of approximately 11.2 million shopper packages in California and Florida each week.

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Revenues from the Shoppers segment represented approximately 28% and 29% of our total revenue for the three months and six months ended June 30, 2011, respectively.

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We derive revenues from the sale of direct marketing services and shopper advertising services.

As a worldwide business, Direct Marketing is affected by general national and international economic trends. Direct Marketing revenues are also affected by economic fundamentals of each industry that we serve, various market factors, including the demand for services by our clients, and the financial condition of and budgets available to specific clients, among other factors. The second quarter of 2011 was the fourth consecutive quarter that Direct Marketing has shown good year-over-year growth. We remain committed to making the investments necessary to execute our multichannel strategy while also adjusting our cost structure to reduce costs in the parts of the business that are not growing as fast. We believe these actions will improve our profitability in future periods.

Our Shoppers operate in regional markets in California and Florida and are greatly affected by the strength of the state and local economies. Revenues from our Shoppers business are largely dependent on local advertising expenditures in the areas of California and Florida in which we operate. During the second quarter of 2011, the negative trends and economic conditions that we have experienced since the second half of 2007 in California and Florida continued. These conditions were initially created by weakness in the real estate and associated financing markets and have spread and persist across virtually all categories. We see no noticeable improvement in the California and Florida economies and we expect to have further challenges before performance improves. In response, during the second quarter, we incurred \$3.3 million of charges through our efforts to reduce expenses in the Shoppers business, primarily through organizational restructuring and headcount reductions. Of these charges, \$3.1 million were related to the recently announced retirement of our Shoppers President, Pete Gorman and severance due to the headcount reductions. The remaining charges were related to facilities and other miscellaneous items. We continue to invest in our digital strategy where we are seeing good revenue growth and are adding capabilities that add value for our readers and advertisers. We believe the steps we are taking to improve overall efficiency, combined with our digital strategy, will make our Shoppers business well positioned when the economies in California and Florida improve.

Our principal operating expense items are labor, postage and transportation.

Results of Operations

Operating results were as follows:

In thousands, except per share amounts	Three months ended			Six months ended		
	June 30, 2011	June 30, 2010	Change	June 30, 2011	June 30, 2010	Change
Revenues	\$ 213,047	\$ 207,609	2.6%	\$ 413,353	\$ 407,788	1.4%
Operating expenses	196,501	185,036	6.2%	382,488	366,899	4.2%
Operating income	\$ 16,546	\$ 22,573	-26.7%	\$ 30,865	\$ 40,889	-24.5%
Net income	\$ 9,425	\$ 13,416	-29.7%	\$ 17,342	\$ 24,185	-28.3%
Diluted earnings per share	\$ 0.15	\$ 0.21	-28.6%	\$ 0.27	\$ 0.38	-28.9%

2nd Quarter 2011 vs. 2nd Quarter 2010**Revenues**

Consolidated revenues increased 2.6%, to \$213.0 million, and operating income decreased 26.7% to \$16.5 million in the second quarter of 2011 compared to the second quarter of 2010. Our overall results reflect increased revenues of \$11.8 million, or 8.4%, from our Direct Marketing segment and decreased revenues of \$6.4 million,

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or 9.5%, from our Shoppers segment. Direct Marketing experienced increased revenues from our select, retail, financial and healthcare verticals, which were partially offset by decreased revenues from our high-tech vertical market. The August 31, 2010 acquisition of Information Arts also contributed to Direct Marketing's second quarter revenue growth. Shoppers revenue performance reflects the continued impact that the difficult economic environments in California and Florida are having on our Shoppers business. The decrease in revenues was the result of decreased sales in established markets, including declines in most revenue categories.

Operating Expenses

Overall operating expenses increased 6.2%, to \$196.5 million, in the second quarter of 2011 compared to the second quarter of 2010. The overall increase in operating expenses was driven by increased operating expenses in Direct Marketing of \$11.4 million, or 9.5%. The increase at Direct Marketing was primarily due to increased headcount to support revenues, increased outsourced costs resulting from increased outsourced volumes, and higher mail supply chain costs on higher transportation volumes. The acquisition of Information Arts also contributed to the second quarter increase in Direct Marketing operating expenses. Shoppers operating expenses were up slightly, 0.1%, due to \$3.3 million of charges recognized in the second quarter of 2011 related to our efforts to reduce expenses in the Shoppers business. Of these charges, \$3.1 million were related to the recently announced retirement of our Shoppers President and severance due to headcount reductions. These charges were partially offset by lower variable payroll costs, decreased postage, decreased outsourced costs and a \$0.5 million reduction of a legal accrual. Excluding the retirement, severance and other charges, and the legal accrual reduction, Shoppers operating expenses decreased \$2.8 million, or 4.5%, and consolidated operating expenses increased \$8.7 million, or 4.7%.

Net Income/Earnings Per Share

Net income decreased 29.7%, to \$9.4 million, and diluted earnings per share decreased 28.6%, to \$0.15 per share, in the second quarter of 2011 when compared to the second quarter of 2010. The decrease in net income was a result of decreased operating income from Shoppers, changes in net foreign currency transaction gains and losses and a higher effective tax rate.

First Half 2011 vs. First Half 2010***Revenues***

Consolidated revenues increased 1.4%, to \$413.4 million, while operating income decreased 24.5% to \$30.9 million in the first half of 2011 compared to the first half of 2010. Our overall results reflect increased revenues of \$18.4 million, or 6.7%, from our Direct Marketing segment and decreased revenues of \$12.8 million, or 9.7%, from our Shoppers segment. Direct Marketing experienced increased revenues from our select, retail and financial verticals, which were partially offset by decreased revenues from our high-tech and healthcare vertical markets. The acquisition of Information Arts also contributed to Direct Marketing's first half revenue growth. Shoppers revenue performance reflects the continued impact that the difficult economic environments in California and Florida are having on our Shoppers business. The decrease in revenues was the result of decreased sales in established markets, including declines in most revenue categories.

Operating Expenses

Overall operating expenses increased 4.2%, to \$382.5 million, in the first half of 2011 compared to the first half of 2010. The overall increase in operating expenses was driven by increased operating expenses in Direct Marketing of \$18.9 million, or 7.9%, and increased general corporate expense of \$0.2 million, or 0.4%, partially offset by decreased operating expenses in Shoppers of \$3.5 million, or 2.8%. The Direct Marketing increase was primarily due to increased headcount to support revenues, increased outsourced costs resulting from increased outsourced volumes, higher mail supply chain costs on higher transportation volumes, increased travel and increased employee recruiting. The acquisition of Information Arts also contributed to the first half increase in Direct Marketing operating expenses. The decrease at Shoppers was primarily due to lower variable payroll costs, decreased postage due to lower distribution volumes and the elimination of the second day edition, decreased outsourced costs on lower volumes, and a \$1.3 million reduction of a legal accrual. The decrease at Shoppers was

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partially offset by \$4.1 million of charges recognized in the first half of 2011 related to our efforts to reduce expenses in the Shoppers business. Of these charges, \$3.9 million were related to the recently announced retirement of our Shoppers President and severance due to headcount reductions. The decrease at Shoppers was also partially offset by increased newsprint expense and outside printing costs, both a result of higher paper rates. The increase in general corporate expense was driven by higher stock-based compensation, partially offset by lower incentive-based compensation and acquisition-related expenses. Excluding the retirement, severance and other charges, and the legal accrual reduction, Shoppers operating expenses decreased \$6.3 million, or 5.1%, and consolidated operating expenses increased \$12.8 million, or 3.5%.

Net Income/Earnings Per Share

Net income decreased 28.3%, to \$17.3 million, and diluted earnings per share decreased 28.9%, to \$0.27 per share, in the first half of 2011 when compared to the first half of 2010. The decrease in net income was a result of decreased operating income from Shoppers and Direct Marketing, increased general corporate expense and changes in net foreign currency transaction gains and losses.

Direct Marketing

Direct Marketing operating results were as follows: