

HARTE HANKS INC
Form 10-Q
May 02, 2012
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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 March 31, 2012

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 April 15, 2012 was 62,998,147 shares of common stock, all of one class.

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HARTE-HANKS, INC. AND SUBSIDIARIES

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March 31, 2012

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Table of Contents**Item 1. Interim Condensed Consolidated Financial Statements
Harte-Hanks, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets (in thousands, except share amounts)**

| | March 31, 2012 (Unaudited) | December 31, 2011 (Audited) |
|--|----------------------------------|--------------------------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 30,367 | \$ 86,778 |
| Accounts receivable (<i>less allowance for doubtful accounts of \$3,434 at March 31, 2012 and \$3,346 at December 31, 2011</i>) | 133,760 | 156,396 |
| Inventory | 6,108 | 7,110 |
| Prepaid expenses | 10,378 | 8,955 |
| Current deferred income tax asset | 7,594 | 9,590 |
| Other current assets | 7,507 | 6,688 |
| Total current assets | 195,714 | 275,517 |
| Property, plant and equipment (<i>less accumulated depreciation of \$236,099 at March 31, 2012 and \$231,221 at December 31, 2011</i>) | 68,954 | 71,583 |
| Goodwill | 565,651 | 565,651 |
| Other intangible assets (<i>less accumulated amortization of \$15,945 at March 31, 2012 and \$15,741 at December 31, 2011</i>) | 14,785 | 14,989 |
| Other assets | 5,595 | 4,774 |
| Total assets | \$ 850,699 | \$ 932,514 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Current maturities of long-term debt | \$ 10,719 | \$ 69,188 |
| Accounts payable | 39,251 | 46,373 |
| Accrued payroll and related expenses | 13,713 | 22,227 |
| Customer advances and deferred revenue | 35,837 | 36,731 |
| Income taxes payable | 1,844 | 4,594 |
| Other current liabilities | 20,295 | 25,956 |
| Total current liabilities | 121,659 | 205,069 |
| Long-term debt | 107,187 | 110,250 |
| Other long-term liabilities (<i>including deferred income taxes of \$94,909 at March 31, 2012 and \$92,448 at December 31, 2011</i>) | 171,912 | 170,840 |
| Total liabilities | 400,758 | 486,159 |
| Stockholders' equity | | |
| Common stock, \$1 par value per share, 250,000,000 shares authorized. 118,672,601 shares issued at March 31, 2012 and 118,487,455 shares issued at December 31, 2011 | 118,673 | 118,487 |
| Additional paid-in capital | 341,455 | 341,149 |
| Retained earnings | 1,277,654 | 1,276,266 |
| Less treasury stock: 55,681,846 shares at cost at March 31, 2012 and 55,668,137 shares at cost at December 31, 2011 | (1,244,305) | (1,244,224) |
| Accumulated other comprehensive loss | (43,536) | (45,323) |

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| | | |
|--|------------|------------|
| Total stockholders' equity | 449,941 | 446,355 |
| Total liabilities and stockholders' equity | \$ 850,699 | \$ 932,514 |

See Notes to Unaudited Condensed Consolidated Financial Statements.

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

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2012 | 2011 |
| Operating revenues | \$ 195,172 | \$ 200,306 |
| Operating expenses | | |
| Labor | 86,715 | 89,009 |
| Production and distribution | 74,173 | 76,269 |
| Advertising, selling, general and administrative | 15,812 | 15,340 |
| Depreciation and software amortization | 5,336 | 5,159 |
| Intangible asset amortization | 204 | 210 |
| Total operating expenses | 182,240 | 185,987 |
| Operating income | 12,932 | 14,319 |
| Other expenses (income) | | |
| Interest expense | 1,019 | 636 |
| Interest income | (29) | (69) |
| Other, net | 655 | 642 |
| | 1,645 | 1,209 |
| Income before income taxes | 11,287 | 13,110 |
| Income tax expense | 4,494 | 5,193 |
| Net income | \$ 6,793 | \$ 7,917 |
| Basic earnings per common share | \$ 0.11 | \$ 0.12 |
| Weighted-average common shares outstanding | 62,910 | 63,705 |
| Diluted earnings per common share | \$ 0.11 | \$ 0.12 |
| Weighted-average common and common equivalent shares outstanding | 63,273 | 64,244 |
| Other comprehensive income, net of tax | | |
| Adjustment to pension liability | \$ 901 | \$ 685 |
| Foreign currency translation adjustments | 886 | 784 |
| Total other comprehensive income, net of tax | 1,787 | 1,469 |
| Comprehensive income | \$ 8,580 | \$ 9,386 |

See Notes to Unaudited Condensed Consolidated Financial Statements.

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

| | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2012 | 2011 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 6,793 | \$ 7,917 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation and software amortization | 5,336 | 5,159 |
| Intangible asset amortization | 204 | 210 |
| Stock-based compensation | 993 | 1,089 |
| Excess tax benefits from stock-based compensation | (42) | (206) |
| Net pension cost | 506 | 1,530 |
| Deferred income taxes | 3,018 | 3,656 |
| Other, net | 3 | (26) |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Decrease in accounts receivable, net | 22,636 | 8,090 |
| Decrease (increase) in inventory | 1,002 | (1,269) |
| Increase in prepaid expenses and other current assets | (2,242) | (2,042) |
| Decrease in accounts payable | (7,122) | (8,879) |
| Decrease in other accrued expenses and other current liabilities | (17,956) | (15,189) |
| Other, net | (177) | (1,228) |
| Net cash provided by (used in) operating activities | 12,952 | (1,188) |
| Cash Flows from Investing Activities | | |
| Purchases of property, plant and equipment | (3,054) | (4,372) |
| Proceeds from sale of property, plant and equipment | 8 | 450 |
| Net cash used in investing activities | (3,046) | (3,922) |
| Cash Flows from Financing Activities | | |
| Repayment of borrowings | (61,532) | (13,750) |
| Issuance of common stock | 361 | 621 |
| Excess tax benefits from stock-based compensation | 42 | 206 |
| Dividends paid | (5,405) | (5,136) |
| Net cash used in financing activities | (66,534) | (18,059) |
| Effect of exchange rate changes on cash and cash equivalents | 217 | 285 |
| Net decrease in cash and cash equivalents | (56,411) | (22,884) |
| Cash and cash equivalents at beginning of year | 86,778 | 85,996 |
| Cash and cash equivalents at end of period | \$ 30,367 | \$ 63,112 |

See Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**Harte-Hanks, Inc. and Subsidiaries****Consolidated Statements of Changes in Equity (in thousands, except per share amounts)****(2012 Unaudited)**

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Stockholders Equity |
|---|-------------------------|---|------------------------------|---------------------------|--|--|
| 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 | 191 | 522 | 0 | (193) | 0 | 520 |
| Net tax effect of options exercised and release of nonvested shares | 0 | (959) | 0 | 0 | 0 | (959) |
| Stock-based compensation | 0 | 4,988 | 0 | 0 | 0 | 4,988 |
| Dividends paid (\$0.320 per share) | 0 | 0 | (20,370) | 0 | 0 | (20,370) |
| Treasury stock issued | 0 | (197) | 0 | 356 | 0 | 159 |
| Purchase of treasury stock | 0 | 0 | 0 | (8,363) | 0 | (8,363) |
| Net income | 0 | 0 | 44,198 | 0 | 0 | 44,198 |
| Other comprehensive income | | | | | (11,641) | (11,641) |
| Balance at December 31, 2011 | 118,487 | 341,149 | 1,276,266 | (1,244,224) | (45,323) | 446,355 |
| Exercise of stock options and release of nonvested shares | 186 | 175 | 0 | (179) | 0 | 182 |
| Net tax effect of options exercised and release of nonvested shares | 0 | (804) | 0 | 0 | 0 | (804) |
| Stock-based compensation | 0 | 993 | 0 | 0 | 0 | 993 |
| Dividends paid (\$0.085 per share) | 0 | 0 | (5,405) | 0 | 0 | (5,405) |
| Treasury stock issued | 0 | (58) | 0 | 98 | 0 | 40 |
| Net income | 0 | 0 | 6,793 | 0 | 0 | 6,793 |
| Other comprehensive income | 0 | 0 | 0 | 0 | 1,787 | 1,787 |
| Balance at March 31, 2012 | \$ 118,673 | \$ 341,455 | \$ 1,277,654 | \$ (1,244,305) | \$ (43,536) | \$ 449,941 |

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 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 section, to the line item Net pension cost within the Adjustments to reconcile net income to net cash provided by operations section. 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 ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. 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, 2011.

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 Statements of Operations

Labor in the Consolidated Statements of Comprehensive Income 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.

Other Current Liabilities

The Other Current Liabilities line in the Consolidated Balance Sheets includes customer postage deposits of \$12.4 million and \$15.8 million at March 31, 2012 and December 31, 2011, respectively.

Table of Contents**Note B Recent Accounting Pronouncements**

In the first quarter of 2012, we adopted Accounting Standards Updates (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 previously presented the components of comprehensive income in our Consolidated Statements of Stockholders' Equity and Comprehensive Income (now titled Consolidated Statements of Changes in Equity). In connection with this adoption we have presented the components of net income and comprehensive income in one combined financial statement, the Consolidated Statements of Comprehensive Income. The adoption of ASU 2011-05 did not affect our operating results, cash flows or financial position.

Note C Long-Term Debt

Our long-term debt obligations were as follows:

| In thousands | March 31, 2012 | December 31, 2011 |
|--|---------------------------|------------------------------|
| 2008 Term Loan Facility, various interest rates based on LIBOR, due March 7, 2012 | \$ 0 | \$ 60,000 |
| 2010 Revolving Credit Facility, various interest rates based on LIBOR, due August 12, 2013 (\$59.9 million capacity at March 31, 2012) | 0 | 0 |
| 2011 Term Loan Facility, various interest rates based on LIBOR (effective rate of 2.24% at March 31, 2012), due August 16, 2016 | 117,906 | 119,438 |
| Total debt | 117,906 | 179,438 |
| Less current maturities | 10,719 | 69,188 |
| Total long-term debt | \$ 107,187 | \$ 110,250 |

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

| In thousands | March 31, 2012 | | December 31, 2011 | |
|---------------------|---------------------------|-----------------------|------------------------------|-----------------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Total debt | \$ 117,906 | \$ 117,906 | \$ 179,438 | \$ 179,286 |

The estimated fair values were calculated using current rates provided to us by our bankers for debt of the same remaining maturity and characteristics. These current rates are considered level 2 inputs under the fair value hierarchy established by FASB ASC 820, Fair Value Measurements and Disclosures, (ASC 820).

As of March 31, 2012, we were in compliance with all of the covenants of our credit facilities.

Note D Income Taxes

Our first quarter 2012 income tax provision of \$4.5 million resulted in an effective income tax rate of 39.8%. Our effective income tax rate is derived by estimating pretax income and income tax expense for the year ending December 31, 2012. The effective income tax rate calculated for the first quarter of 2012 is higher than the federal statutory rate of 35.0%, primarily due to the addition of state income taxes.

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

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We have elected to classify any interest expense and penalties related to income taxes within income tax expense in our Consolidated Statements of Comprehensive Income. We did not have a significant amount of interest or penalties accrued at March 31, 2012 or December 31, 2011.

Note E Stock-Based Compensation

We recognized \$1.0 million and \$1.1 million of stock-based compensation during the three months ended March 31, 2012 and 2011, respectively.

Our annual grant of stock-based awards occurred in the first quarter of 2012, consistent with the timing of previous annual grants. These grants consisted of:

| | Number of Shares | Weighted- Average Grant-Date Fair Value |
|-------------------------|---------------------|--|
| Stock options | 630,500 | \$ 3.05 |
| Non-vested shares | 332,113 | \$ 9.91 |
| Performance stock units | 136,000 | \$ 8.84 |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model.

All options granted in the first quarter of 2012 were granted under the 2005 Omnibus Incentive Plan (2005 Plan). These options become exercisable in 25% increments on the first, second, third and fourth anniversaries of their date of grant, and expire on the tenth anniversary of their date of grant. All stock options granted in the first quarter of 2012 have exercise prices equal to the market value of the common stock on the date of grant. Market value is defined by the 2005 Plan as the closing price on the previous trading day. The weighted-average exercise price of options granted in the first quarter of 2012 was \$9.91.

All non-vested shares have been granted under the 2005 Plan. 316,470 of the non-vested shares granted in the first quarter of 2012 vest in three equal increments on the first, second and third anniversaries of their date of grant. The remaining 15,643 non-vested shares granted in the first quarter of 2012 vest 100% on the first anniversary of their date of grant.

All performance stock units have been granted under the 2005 Plan. Performance stock units are a form of share-based awards similar to non-vested shares, except that the number of shares ultimately issued is based on our performance against specific performance goals over a three-year period. At the end of the performance period, the number of shares of stock issued will be determined by adjusting upward or downward from the maximum in a range between 0% and 100%.

Note F Fair Value of Financial Instruments

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 fair value of our outstanding debt is disclosed in Note C, *Long-Term Debt*.

Note G 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.

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

| In thousands, except per share amounts | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2012 | 2011 |
| BASIC EPS | | |
| Net Income | \$ 6,793 | \$ 7,917 |
| | | |
| Weighted-average common shares outstanding used in earnings per share computations | 62,910 | 63,705 |
| | | |
| Earnings per common share | \$ 0.11 | \$ 0.12 |
| DILUTED EPS | | |
| Net Income | \$ 6,793 | \$ 7,917 |
| | | |
| Shares used in diluted earnings per share computations | 63,273 | 64,244 |
| | | |
| Earnings per common share | \$ 0.11 | \$ 0.12 |
| Computation of shares used in earnings per share computations: | | |
| Weighted-average outstanding common shares | 62,910 | 63,705 |
| Weighted-average common equivalent shares - dilutive effect of stock options and awards | 363 | 539 |
| | | |
| Shares used in diluted earnings per share computations | 63,273 | 64,244 |

5.1 million and 5.6 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 March 31, 2012 and 2011, respectively. 0.2 million anti-dilutive non-vested shares have been excluded from the calculation of shares used in the diluted EPS calculation for the three months ended March 31, 2012. There were no anti-dilutive non-vested shares outstanding for the three months ended March 31, 2011.

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

Information about the operations of our two business segments follows:

| In thousands | Three Months Ended March 31, | |
|--------------------------------------|-------------------------------------|----------------|
| | 2012 | 2011 |
| Operating revenues | | |
| Direct Marketing | \$ 139,456 | \$ 141,081 |
| Shoppers | 55,716 | 59,225 |
| Total operating revenues | \$ 195,172 | \$ 200,306 |
| Operating income | | |
| Direct Marketing | \$ 15,653 | \$ 15,980 |
| Shoppers | 201 | 1,247 |
| Corporate Activities | (2,922) | (2,908) |
| Total operating income | \$ 12,932 | \$ 14,319 |
| Income before income taxes | | |
| Operating income | \$ 12,932 | \$ 14,319 |
| Interest expense | (1,019) | (636) |
| Interest income | 29 | 69 |
| Other, net | (655) | (642) |
| Total income before income taxes | \$ 11,287 | \$ 13,110 |

Note I Components of Net Periodic Pension Benefit Cost

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.

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.

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Net pension cost for both plans included the following components:

| In thousands | Three Months Ended March 31, | |
|------------------------------------|------------------------------|----------|
| | 2012 | 2011 |
| Service cost | \$ 117 | \$ 114 |
| Interest cost | 1,960 | 2,030 |
| Expected return on plan assets | (1,683) | (1,756) |
| Amortization of prior service cost | 1 | 12 |
| Recognized actuarial loss | 1,500 | 1,130 |
| Net periodic benefit cost | \$ 1,895 | \$ 1,530 |

We plan to make total contributions of approximately \$6.4 million to our funded, frozen pension plan in 2012 in order to obtain the Pension Protection Act of 2006 full funding limit exemption. We made contributions of \$1.1 million in the first quarter of 2012. We plan to make contributions of \$1.3 million in the second quarter, \$10.6 million to \$12.4 million in the third quarter and \$1.3 million in the fourth quarter of 2012, respectively.

We are not required to make and do not intend to make any contributions to our unfunded, supplemental pension plan in 2012 other than to the extent needed to cover benefit payments. We expect benefit payments under this supplemental pension plan to total \$1.2 million in 2012.

Note J Comprehensive Income

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 March 31, | |
|---|------------------------------|----------|
| | 2012 | 2011 |
| Net income | \$ 6,793 | \$ 7,917 |
| Other comprehensive income: | | |
| Adjustment to pension liability | 1,501 | 1,142 |
| Tax expense | (600) | (457) |
| Adjustment to pension liability, net of tax | 901 | 685 |
| Foreign currency translation adjustment | 886 | 784 |
| Total other comprehensive income | 1,787 | 1,469 |
| Total comprehensive income | \$ 8,580 | \$ 9,386 |

Note K Goodwill

As of March 31, 2012 and December 31, 2011, 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.

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Due to the continued difficult economic climates in California and Florida and the continued decline in Shoppers' revenues, management concluded that this environment could impact the valuation of the Shoppers reporting segment during the three months ended March 31, 2012. Accordingly, during the first quarter, we performed a qualitative assessment of whether it is more likely than not that the Shoppers reporting segment's fair value is less than its carrying amount and determined we did not need to perform a quantitative goodwill impairment assessment at March 31, 2012.

Note L 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). During the fourth quarter of 2009 we accrued the full \$7.0 million associated with this agreement. 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 paid \$7.0 million to establish the class settlement fund in June of 2011. In return, each member of the class, including Gattuso and Sigala, 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. Based upon the claims received from the class members, we reduced the accrual by \$0.8 million in the first quarter of 2011 and \$0.5 million in the second quarter of 2011. Payments under the class settlement agreement from the class settlement fund concluded in August 2011, and at that time \$1.3 million of unclaimed funds reverted back to Shoppers.

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 and 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

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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, disposition of assets 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, 2011 (2011 Form 10-K) and in the **Cautionary Note Regarding Forward-Looking Statements** in our first quarter 2012 earnings release issued on April 26, 2012. 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.

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 2011 Form 10-K. Our 2011 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 clients 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 clients' 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 email, including:

agency and digital services;

database marketing solutions;

data quality software and services with Trillium Software;

direct mail and supply chain management;

fulfillment and contact centers; and

lead generation.

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Revenues from the Direct Marketing segment represented approximately 71% of our total revenue for the three months ended March 31, 2012.

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 segment also provides online advertising and other services through our websites, *PennySaverUSA.com*[®] and *TheFlyer.com*[®], as well as business websites and search engine marketing. Our websites 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 March 31, 2012, we were publishing approximately 6,700 PowerSites weekly.

At March 31, 2012, our Shoppers publications were zoned into approximately 950 separate editions with total circulation of approximately 11.3 million shopper packages in California and Florida each week. Our distribution products can be zoned even tighter, into approximately 2,400 subzones. Shoppers are delivered in five major markets covering the greater Los Angeles market, the greater San Diego market, Northern California, South Florida and the greater Tampa market.

Revenues from the Shoppers segment represented approximately 29% of our total revenue for the three months ended March 31, 2012.

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 and business conditions. Direct Marketing revenues are also affected by the 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. 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 first quarter of 2012, the poor 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 little, if any, improvement in the California and Florida economies and we expect to have further challenges before our performance improves. We continue to invest in our digital strategy where we are seeing revenue growth and are adding capabilities that add value for our readers and advertisers. We believe the steps we have taken in the last several years to improve overall efficiency, combined with our digital strategy, make our Shoppers business well positioned when the economies in California and Florida return to health.

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

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Operating results were as follows:

| In thousands, except per share amounts | Three months ended | | Change |
|---|--------------------|----------------|--------|
| | March 31, 2012 | March 31, 2011 | |
| Revenues | \$ 195,172 | \$ 200,306 | -2.6% |
| Operating expenses | 182,240 | 185,987 | -2.0% |
| Operating income | \$ 12,932 | \$ 14,319 | -9.7% |
| Net income | \$ 6,793 | \$ 7,917 | -14.2% |
| Diluted earnings per share | \$ 0.11 | \$ 0.12 | -8.3% |

1st Quarter 2012 vs. 1st Quarter 2011***Revenues***

Consolidated revenues decreased 2.6%, to \$195.2 million, and operating income decreased 9.7% to \$12.9 million in the first quarter of 2012 compared to the first quarter of 2011. Our overall results reflect decreased revenues of \$1.6 million, or 1.2%, from our Direct Marketing segment and decreased revenues of \$3.5 million, or 5.9%, from our Shoppers segment. Direct Marketing experienced decreased revenues from our financial and high-tech verticals, which were partially offset by increased revenues from our pharmaceutical and retail vertical markets. Our select vertical was flat compared to the prior year quarter. 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 decreased 2.0%, to \$182.2 million, in the first quarter of 2012 compared to the first quarter of 2011. The overall decrease in operating expenses was driven by decreased operating expenses in Shoppers of \$2.5 million, or 4.2%, and decreased operating expense of \$1.3 million, or 1.0%, in Direct Marketing. The decrease at Shoppers was due to decreased severance costs, lower variable payroll costs from lower ad sales and headcount reductions, and decreased lease expense. The overall decrease at Shoppers was partially offset by an increase in general and administrative costs, including bad debt expense, an increase in postage costs due to the April 2011 and January 2012 postage rate increases, and an increase in newsprint expense due to higher paper rates. The decrease at Direct Marketing was primarily due to decreased outsourced costs resulting from decreased outsourced volumes, and lower facility lease costs. The overall decrease at Direct Marketing was partially offset by an increase in labor due to increased headcount to support revenues and an increase in medical costs, and increases in travel, employee recruiting and bad debt expense.

Net Income/Earnings Per Share

Net income decreased 14.2%, to \$6.8 million, and diluted earnings per share decreased 8.3%, to \$0.11 per share, in the first quarter of 2012 when compared to the first quarter of 2011. The decrease in net income was a result of decreased operating income from both Direct Marketing and Shoppers and increased interest expense.

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Direct Marketing operating results were as follows:

| In thousands | Three months ended | | Change |
|--------------------|--------------------|----------------|--------|
| | March 31, 2012 | March 31, 2011 | |
| Revenues | \$ 139,456 | \$ 141,081 | -1.2% |
| Operating expenses | 123,803 | 125,101 | -1.0% |
| Operating income | \$ 15,653 | \$ 15,980 | -2.0% |

1st Quarter 2012 vs. 1st Quarter 2011**Revenues**

Direct Marketing revenues decreased \$1.6 million, or 1.2%, in the first quarter of 2012 compared to the first quarter of 2011. Direct Marketing results reflect the impact of a large, long standing retail customer which changed its marketing strategy from direct mail to broadcast. Revenues from our financial vertical decreased in the low teens (as a percentage) compared to the first quarter of 2011. Our pharmaceutical vertical experienced revenue growth in the mid single digits and our retail vertical grew in the low single digits. Our high-tech vertical declined in the low single digits and our select vertical was flat compared to the prior year quarter. Revenues from our vertical markets are impacted by, among other things, the economic fundamentals of each industry, various market factors, including the demand for services by our clients, and the financial condition of and budgets available to specific clients.

Future revenue performance will depend on, among other factors, the overall strength of the national and international economies and how successful we are at maintaining and growing business with existing clients, acquiring new clients and meeting client demands. We believe that in the long-term an increasing portion of overall marketing and advertising expenditures will be moved from other advertising media to the targeted media space, and that our business will benefit as a result. Targeted media advertising results can be more effectively tracked, enabling measurement of the return on marketing investment.

Operating Expenses

Operating expenses decreased \$1.3 million, or 1.0%, in the first quarter of 2012 compared to the first quarter of 2011. Labor costs increased \$0.7 million, or 1.0%, due to increased headcount to support revenues, and an increase in medical costs. Production and distribution costs decreased \$2.1 million, or 4.9%, due to decreased outsourced costs resulting from decreased outsourced volumes, and lower facility lease costs. General and administrative expense decreased \$0.1 million, or 0.5%, due primarily to a decrease in facility costs, partially offset by increases in travel, employee recruiting and bad debt expense. Depreciation and software amortization expense increased \$0.2 million, or 4.6%, due to increased capital expenditures in 2011. Intangible asset amortization was down slightly due to certain intangible assets becoming fully amortized.

Direct Marketing's largest cost components are labor, outsourced costs and mail supply chain costs. Each of these costs is somewhat variable and tends to fluctuate with revenues and the demand for our direct marketing services. Mail supply chain costs have increased significantly over the last few years due to demand and supply issues within the transportation industry. Future changes in mail supply chain costs will continue to impact Direct Marketing's total production costs and total operating expenses, and may have an impact on future demand for our supply chain management. Postage costs of mailings in our Direct Marketing business are borne by our clients and are not directly reflected in our revenues or expenses.

Table of Contents**Shoppers**

| In thousands | Three months ended | | Change |
|--------------------|--------------------|----------------|--------|
| | March 31, 2012 | March 31, 2011 | |
| Revenues | \$ 55,716 | \$ 59,225 | -5.9% |
| Operating expenses | 55,515 | 57,978 | -4.2% |
| Operating income | \$ 201 | \$ 1,247 | -83.9% |

1st Quarter 2012 vs. 1st Quarter 2011**Revenues**

Shoppers revenues decreased \$3.5 million, or 5.9%, in the first quarter of 2012 compared to the first quarter of 2011. These results reflect 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. At March 31, 2012, our Shoppers circulation reached approximately 11.3 million addresses each week. While we have not made any significant changes to our circulation in the last several years, we continue to evaluate all of our circulation performance and may make further circulation reductions in the future as part of our efforts to address the difficult economic conditions in California and Florida.

Future revenue performance will depend on, among other factors, the overall strength of the California and Florida economies, as well as how successful we are at maintaining and growing business with existing clients, and acquiring new clients.

Operating Expenses

Operating expenses decreased \$2.5 million, or 4.2%, in the first quarter of 2012 compared to the first quarter of 2011. Total labor costs decreased \$3.0 million, or 15.3%, due to decreased severance costs, and lower variable payroll costs from lower ad sales, headcount reductions and pay rate reductions. Total production costs were flat as decreased facility lease expenses and outsourced costs were offset by an increase in postage costs due to the April 2011 and January 2012 postage rate increases, and an increase in newsprint expense due to higher paper rates. Total general and administrative costs increased \$0.6 million, or 19.0%, due to a legal accrual reduction in the first quarter of 2011, and an increase in bad debt expense, partially offset by lower workers compensation costs. Depreciation and software amortization expense and intangible asset amortization were flat compared to the prior year quarter.

Shoppers largest cost components are labor, postage and paper. Shoppers labor costs are partially variable and tend to fluctuate with the number of zones, circulation, volumes and revenues. Standard postage rates have increased in recent years, and increased again in April 2011 and January 2012. Shoppers postage rates increased by less than 1.0% as a result of the April 2011 rate increase, and increased by approximately 2.1% as a result of the January 2012 rate increase. These postage rate increases, and any additional future changes in postage rates will affect Shoppers production costs. The U. S. Postal Service has also proposed various changes in its services to address its financial performance, such as delivery frequency and facility access. At this point we do not believe the proposed changes will have a material impact on our Shoppers business. Newsprint prices have been increasing since the second half of 2010 and continued to increase in the first quarter of 2012, causing the increase in Shoppers paper costs. Newsprint prices are expected to continue to increase slightly during the remainder of 2012. Any future changes in newsprint prices will affect Shoppers production costs.

General Corporate Expense

General corporate expense increased slightly in the first quarter of 2012 compared to the first quarter of 2011. This increase was attributable to increased pension expense resulting from an increase in the projected pension benefit obligation due to a lower discount rate.

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Interest Expense

Interest expense increased \$0.4 million, or 60.2%, in the first quarter of 2012 compared to the first quarter of 2011. This increase was due to a higher interest rate spread on our debt as a result of the 2011 Term Loan Facility, which replaced the 2006 Term Loan Facility in August 2011. See discussion of our credit facilities in the *Liquidity and Capital Resources* section below.

Interest Income

Interest income was down slightly in the first quarter of 2012 compared to the first quarter of 2011 due to lower returns on invested cash and cash equivalents in 2012.

Other Income and Expense

Other income, net, increased slightly in the first quarter of 2012 compared to the first quarter of 2011, as an increase in net foreign currency transaction losses was offset by decreases in several other expense items.

Income Taxes

Income tax expense decreased \$0.7 million in the first quarter of 2012 compared to the first quarter of 2011. Our effective tax rate was 39.8% for the first quarter of 2012, increasing from 39.6% for the first quarter of 2011. The increase in the effective tax rate is primarily due to a decrease in available tax credits.

Economic Climate and Impact on our Financial Statements

The current economic climate in California and Florida has had a negative impact on our Shoppers' operations and cash flows for the three months ended March 31, 2012, and our financial position at March 31, 2012. We cannot predict the strength or duration of the current difficult economic environment in California and Florida, or the timing or magnitude of any subsequent improvement. If the economic climate and markets we serve fail to improve, we may record charges related to restructuring costs and the impairment of goodwill, other intangibles and long-lived assets, and our operations, cash flows and financial position may be materially and adversely affected.

Liquidity and Capital Resources

Sources and Uses of Cash

As of March 31, 2012, cash and cash equivalents were \$30.4 million, decreasing \$56.4 million from cash and cash equivalents at December 31, 2011. This net decrease was a result of net cash provided by operating activities of \$13.0 million, net cash used in investing activities of \$3.0 million and net cash used in financing activities of \$66.5 million.

Operating Activities

Net cash provided by operating activities for the three months ended March 31, 2012 was \$13.0 million, compared to net cash used in operating activities of \$1.2 million for the three months ended March 31, 2011. The \$14.1 million year-over-year increase was primarily attributable to changes within working capital assets and liabilities.

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For the three months ended March 31, 2012, our principal working capital changes, which directly affected net cash provided by operating activities, were as follows:

A decrease in accounts receivable attributable to collection of the December 31, 2011 receivables as well as higher revenues in the fourth quarter of 2011 compared to the first quarter of 2012. Days sales outstanding of approximately 63 days at March 31, 2012 decreased from 64 days at December 31, 2011 and 65 days at March 31, 2011;

A decrease in inventory due to purchasing and holding higher levels of newsprint inventory in prior periods in advance of increases in newsprint prices;

An increase in prepaid expenses and other current assets due to timing of payments;

A decrease in accounts payable due to higher overall operating expenses in the fourth quarter of 2011 than in the first quarter of 2012;

A decrease in accrued payroll and related expenses due to the payment of 2011 incentive compensation;

A decrease in customer deposits, unearned revenue and other current liabilities due to timing of receipts; and

A decrease in income taxes payable due to the timing of payments.

Investing Activities

Net cash used in investing activities was \$3.0 million for the three months ended March 31, 2012, compared to \$3.9 million for the three months ended March 31, 2011. The \$0.9 million decrease is the result of lower capital spending in the first three months of 2012 compared to the first three months of 2011.

Financing Activities

Net cash used in financing activities was \$66.5 million for the three months ended March 31, 2012 compared to \$18.1 million for the three months ended March 31, 2011. The \$48.5 million increase is attributable primarily to a \$47.8 million increase in debt repayments in the first three months of 2012 compared to the first three months of 2011, as a result of retiring the 2008 Term Loan Facility in March 2012.

Credit Facilities

On March 7, 2008, we entered into a four-year \$100 million term loan facility (2008 Term Loan Facility) with Wells Fargo Bank, N.A., as Administrative Agent. The 2008 Term Loan Facility matured on March 7, 2012, at which time we paid the remaining outstanding principal of \$60.0 million using cash on hand.

On August 12, 2010, we entered into a new three-year \$70 million revolving credit facility, which includes a \$25 million accordion feature, a \$25 million letter of credit sub-facility and a \$5 million swing line loan sub-facility (2010 Revolving Credit Facility), with Bank of America, N.A., as Administrative Agent. The 2010 Revolving Credit Facility permits us to request up to a \$25 million increase in the total amount of the facility. The 2010 Revolving Credit Facility matures on August 12, 2013. For each borrowing under the 2010 Revolving Credit Facility, we can generally choose to have the interest rate for that borrowing calculated on either (i) the LIBOR rate (as defined in the 2010 Revolving Credit Facility) for the applicable interest period, plus a spread which is determined based on our total net debt-to-EBITDA ratio (as defined in the 2010 Revolving Credit Facility) then in effect, which ranges from 2.25% to 3.00% per annum; or (ii) the highest of (a) the Federal Funds Rate plus 0.50%, (b) the Agent's prime rate, and (c) the LIBOR rate plus 1.00%, plus a spread which is determined based on our total net

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debt-to-EBITDA ratio then in effect, which ranges from 1.25% to 2.00% per annum. There is a facility fee that we are also required to pay under the 2010 Revolving Credit Facility. The facility fee rate ranges from 0.40% to 0.45% per annum, depending on our total net debt-to-EBITDA ratio then in effect. In addition, there is a letter of credit fee with respect to outstanding letters of credit. That fee is calculated by applying a rate equal to the spread applicable to LIBOR based loans plus a fronting fee of 0.125% per annum to the average daily undrawn amount of the outstanding letters of credit. We may elect to prepay any amounts drawn on the 2010 Revolving Credit Facility at any time. At March 31, 2012, we did not have any outstanding amounts drawn against our 2010 Revolving Credit Facility. At March 31, 2012, we had letters of credit totaling \$10.1 million issued under the 2010 Revolving Credit Facility, decreasing the amount available for borrowing to \$59.9 million.

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On August 16, 2011, we entered into a five-year \$122.5 million term loan facility (2011 Term Loan Facility) with Bank of America, N.A., as Administrative Agent. The 2011 Term Loan Facility matures on August 16, 2016. For each borrowing under the 2011 Term Loan Facility, we can generally choose to have the interest rate for that borrowing calculated based on either (i) the LIBOR rate (as defined in the 2011 Term Loan Facility) for the applicable interest period, plus a spread (ranging from 2.00% to 2.75% per annum) based on our total net funded debt-to-EBITDA ratio (as defined in the 2011 Term Loan Facility) then in effect; or (ii) the highest of (a) the Agent's prime rate, (b) the BBA daily floating rate LIBOR, as determined by Agent for such date, plus 1.00%, and (c) the Federal Funds Rate plus 0.50%, plus a spread (ranging from 1.00% to 1.75% per annum) based on our total net funded debt-to-EBITDA ratio then in effect. We may elect to prepay the 2011 Term Loan Facility at any time without incurring any prepayment penalties. At March 31, 2012, we had \$117.9 million outstanding under the 2011 Term Loan Facility.

Under all of our credit facilities we are required to maintain an interest coverage ratio of not less than 2.75 to 1 and a total debt-to-EBITDA ratio of not more than 3.0 to 1. The credit facilities also contain customary covenants restricting our and our subsidiaries' ability to:

authorize distributions, dividends, stock redemptions and repurchases if a payment event of default has occurred and is continuing;

enter into certain merger or liquidation transactions;

grant liens;

enter into certain sale and leaseback transactions;

have foreign subsidiaries account for more than 20% of the consolidated revenue, assets or EBITDA of Harte-Hanks and its subsidiaries, in the aggregate;

enter into certain transactions with affiliates; and

allow the total indebtedness of Harte-Hanks' subsidiaries to exceed \$20.0 million.

The credit facilities each also include customary covenants regarding reporting obligations, delivery of notices regarding certain events, maintaining our corporate existence, payment of obligations, maintenance of our properties and insurance thereon at customary levels with financially sound and reputable insurance companies, maintaining books and records and compliance with applicable laws. The credit facilities each also provide for customary events of default including nonpayment of principal or interest, breach of representations and warranties, violations of covenants, failure to pay certain other indebtedness, bankruptcy and material judgments and liabilities, certain violations of environmental laws or ERISA or the occurrence of a change of control. Our material domestic subsidiaries have guaranteed the performance of Harte-Hanks under our credit facilities. As of March 31, 2012, we were in compliance with all of the covenants of our credit facilities.

Outlook

We consider such factors as total cash and cash equivalents, current assets, current liabilities, total debt, revenues, operating income, cash flows from operations, investing activities and financing activities when assessing our liquidity. Our primary sources of liquidity have been cash and cash equivalents on hand and cash generated from operating activities. Our management of cash is designed to optimize returns on cash balances and to ensure that it is readily available to meet our operating, investing and financing requirements as they arise. Capital resources are also available from and provided through our 2010 Revolving Credit Facility, subject to the terms and conditions of that facility.

The amount of cash on hand and borrowings available under our 2010 Revolving Credit Facility are influenced by a number of factors, including fluctuations in our operating results, revenue growth, accounts receivable collections, working capital changes, capital expenditures, tax payments, share repurchases, pension plan contributions, acquisitions and dividends.

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As of March 31, 2012, we had \$59.9 million of unused borrowing capacity under our 2010 Revolving Credit Facility and a cash balance of \$30.4 million. Based on our current operational plans, we believe that our cash on hand, cash provided by operating activities, and availability under the 2010 Revolving Credit Facility will be sufficient to fund operations, anticipated capital expenditures, payments of principal and interest on our borrowings, dividends on our common stock and pension contributions for the next 12 months. Nevertheless, we cannot predict the impact on our business performance of the economic climate in the U.S. and other economies in which we operate. A lasting economic recession in the United States and other economies could have a material adverse effect on our business, financial position or operating results.

Critical Accounting Policies

Our financial statements and accompanying notes are prepared in accordance with U.S generally accepted accounting principles. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are affected by management's application of accounting policies. We consider the following to be our critical accounting policies, as described in detail in our 2011 Form 10-K:

Revenue recognition;

Allowance for doubtful accounts;

Reserve for healthcare, workers' compensation, automobile and general liability insurance;

Goodwill; and

Stock-based compensation.

There have been no material changes to the critical accounting policies described in our 2011 Form 10-K.

As discussed in Note B, *Recent Accounting Pronouncements*, of the Notes to Unaudited Condensed Consolidated Financial Statements, certain new financial accounting pronouncements have been issued which either have already been reflected in the accompanying consolidated financial statements, or will become effective for our financial statements at various dates in the future. The adoptions of these new accounting pronouncements have not and are not expected to have a material effect on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk includes the risk of loss arising from adverse changes in market rates and prices. We face market risks related to interest rate variations and to foreign exchange rate variations. From time to time, we may utilize derivative financial instruments as described below to manage our exposure to such risks.

We are exposed to market risk for changes in interest rates related to our credit facilities. Our earnings are affected by changes in short-term interest rates as a result of our credit facilities, which bear interest at variable rates based on LIBOR rates (effective 30 day LIBOR rate of 0.24% at March 31, 2012). The five-year 2011 Term Loan Facility has a maturity date of August 16, 2016. At March 31, 2012, our debt balance related to the 2011 Term Loan Facility was \$117.9 million. The three-year \$70 million 2010 Revolving Credit Facility has a maturity date of August 12, 2013. At March 31, 2012, we did not have any debt outstanding under the 2010 Revolving Credit Facility.

Assuming the actual level of borrowings throughout the first quarter of 2012, and assuming a one percentage point change in the average interest rates, we estimate that our net income for the first quarter of 2012 would have

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changed by approximately \$0.2 million. Due to our overall debt level and cash balance at March 31, 2012, anticipated cash flows from operations, and the various financial alternatives available to us should there be an adverse change in interest rates, we do not believe that we currently have significant exposure to market risks associated with changing interest rates.

Our earnings are also affected by fluctuations in foreign currency exchange rates as a result of our operations in foreign countries. Our primary exchange rate exposure is to the Euro, British pound sterling, Australian dollar, Philippine peso and Brazilian real. We monitor these risks throughout the normal course of business. The majority of the transactions of our U.S. and foreign operations are denominated in the respective local currencies. Changes in exchange rates related to these types of transactions are reflected in the applicable line items making up operating income in our Consolidated Statements of Comprehensive Income. Due to the current level of operations conducted in foreign currencies, we do not believe that the impact of fluctuations in foreign currency exchange rates on these types of transactions is significant to our overall annual earnings. A smaller portion of our transactions are denominated in currencies other than the respective local currencies. For example, inter-company transactions that are expected to be settled in the near-term are denominated in U.S. dollars. Since the accounting records of our foreign operations are kept in the respective local currency, any transactions denominated in other currencies are accounted for in the respective local currency at the time of the transaction. Any foreign currency gain or loss from these transactions, whether realized or unrealized, results in an adjustment to income, which is recorded in Other, net in our Consolidated Statements of Comprehensive Income. Transactions such as these amounted to \$0.4 million in pre-tax currency transaction losses in the first quarter of 2012. At this time 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.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act). It should be noted that, because of inherent limitations, our disclosure controls and procedures, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the disclosure controls and procedures are met. Based upon that evaluation, the Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer concluded that the design and operation of these disclosure controls and procedures were effective, at the reasonable assurance level, to ensure information required to be disclosed by us in the reports that we file or submit under the Exchange Act is properly recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms.

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, of our internal control over financial reporting to determine whether any changes occurred during the first quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, there were no changes in our internal control over financial reporting or in other factors that have materially affected or are reasonably likely to materially affect our internal control over financial reporting. We may make changes in our internal control processes from time to time in the future. It should also be noted that, because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements, and controls may become inadequate because of changes in conditions or in the degree of compliance with the policies or procedures.

Table of Contents**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

Information regarding legal proceedings is set forth in Note L to the Notes to Unaudited Condensed Consolidated Financial Statements, *Litigation Contingencies*, in Item 1 of Part I of this Quarterly Report on Form 10-Q, which information is incorporated herein by reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2011 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in our 2011 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and operating results. In our judgment, there were no material changes in the risk factors as previously disclosed in Part I, Item 1A. Risk Factors of our 2011 Form 10-K. Refer to Part I, Item 2 of this Quarterly Report on Form 10-Q, for a discussion of the ongoing economic downturn in the United States and other economies and its adverse impact on our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table contains information about our purchases of equity securities during the first quarter of 2012:

| Period | Total Number of Shares Purchased(2) | 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 |
|---------------------|--|---|---|--|
| January 1 31, 2012 | 18,082 | \$ 9.91 | 0 | 9,475,491 |
| February 1 29, 2012 | 0 | \$ 0 | 0 | 9,475,491 |
| March 1 31, 2012 | 0 | \$ 0 | 0 | 9,475,491 |
| Total | 18,082 | \$ 9.91 | 0 | |

- (1) During the first quarter of 2012, we did not purchase any shares of our stock through our stock repurchase program that was publicly announced in January 1997. Under this program, from which shares can be purchased in the open market or through privately negotiated transactions, our Board of Directors has authorized the repurchase of up to 74,400,000 shares of our outstanding common stock. As of March 31, 2012, we had repurchased a total of 64,924,509 shares at an average price of \$18.67 per share under this program.
- (2) Total number of shares purchased includes shares, if any, purchased as part of our publicly announced stock repurchase program, plus shares withheld to pay applicable withholding taxes and the exercise price related to stock options, and shares withheld to pay applicable withholding taxes related to the vesting of nonvested shares, pursuant to the Harte-Hanks, Inc. 2005 Omnibus Incentive Plan.

Item 6. Exhibits

See Index to Exhibits on Page 26.

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Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

| | |
|-------------|---|
| | HARTE-HANKS, INC. |
| May 2, 2012 | /s/ LARRY FRANKLIN |
| Date | Larry Franklin President and Chief Executive Officer |
| May 2, 2012 | /s/ DOUGLAS SHEPARD |
| Date | Douglas Shepard Executive Vice President and Chief Financial Officer |
| May 2, 2012 | /s/ JESSICA HUFF |
| Date | Jessica Huff Vice President, Finance and Chief Accounting Officer |

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INDEX TO EXHIBITS

Exhibit

| No. | Description of Exhibit |
|------------|---|
| *31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| *31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| *32.1 | Furnished Certification of Chief Executive Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *32.2 | Furnished Certification of Chief Financial Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| *101 | XBRL Instance Document |

* Filed or furnished herewith