

HARTE HANKS INC
Form 10-Q
May 05, 2014
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U.S.

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, 2014

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)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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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, 2014 was 62,780,052 shares of common stock, all of one class.

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HARTE-HANKS, INC. AND SUBSIDIARIES

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Table of Contents**Item 1. Interim Condensed Consolidated Financial Statements**Harte-Hanks, Inc. and Subsidiaries Condensed Consolidated Balance Sheets

| | March 31, 2014 (Unaudited) | December 31, 2013 (Audited) |
|--|----------------------------------|-----------------------------------|
| <i>In thousands, except per share and share amounts</i> | | |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 84,539 | \$ 88,747 |
| Accounts receivable <i>(less allowance for doubtful accounts of \$1,169 at March 31, 2014 and \$1,729 at December 31, 2013)</i> | 110,178 | 120,122 |
| Inventory | 1,320 | 1,286 |
| Prepaid expenses | 10,321 | 8,528 |
| Current deferred income tax asset | 6,030 | 7,696 |
| Prepaid income tax | 4,520 | 4,755 |
| Other current assets | 7,309 | 8,171 |
| Total current assets | 224,217 | 239,305 |
| Property, plant and equipment <i>(less accumulated depreciation of \$172,963 at March 31, 2013 and \$169,854 at December 31, 2013)</i> | 39,429 | 40,711 |
| Goodwill | 398,164 | 398,164 |
| Other intangible assets <i>(less accumulated amortization of \$9,755 at March 31, 2014 and \$9,748 at December 31, 2013)</i> | 2,296 | 2,303 |
| Other assets | 4,786 | 5,053 |
| Total assets | \$ 668,892 | \$ 685,536 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Current maturities of long-term debt | \$ 16,844 | \$ 15,313 |
| Accounts payable | 36,877 | 36,756 |
| Accrued payroll and related expenses | 12,749 | 16,255 |
| Deferred revenue and customer advances | 35,928 | 36,257 |
| Income taxes payable | 886 | 3,407 |
| Customer postage and program deposits | 21,780 | 23,877 |
| Other current liabilities | 6,405 | 8,978 |
| Total current liabilities | 131,469 | 140,843 |
| Long-term debt | 78,094 | 82,687 |
| Other long-term liabilities <i>(including deferred income taxes of \$67,947 at March 31, 2014 and \$65,788 at December 31, 2013)</i> | 113,177 | 112,952 |
| Total liabilities | 322,740 | 336,482 |
| Stockholders' equity | | |
| Common stock, \$1 par value, 250,000,000 shares authorized | | |
| 119,478,549 shares issued at March 31, 2014 and 119,186,705 shares issued at December 31, 2013 | 119,479 | 119,187 |
| Additional paid-in capital | 345,445 | 345,095 |
| Retained earnings | 1,159,669 | 1,163,201 |
| Less treasury stock, 56,698,498 shares at cost at March 31, 2014 and 56,600,972 shares at cost at December 31, 2013 | (1,251,062) | (1,250,311) |
| Accumulated other comprehensive loss | (27,379) | (28,118) |
| Total stockholders' equity | 346,152 | 349,054 |
| Total liabilities and stockholders' equity | \$ 668,892 | \$ 685,536 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of ContentsHarte-Hanks, Inc. and Subsidiaries Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

| <i>In thousands, except per share amounts</i> | Three Months Ended March 31, | |
|--|------------------------------|------------|
| | 2014 | 2013 |
| Operating revenues | \$ 132,727 | \$ 132,352 |
| Operating expenses | | |
| Labor | 71,304 | 67,470 |
| Production and distribution | 40,276 | 38,985 |
| Advertising, selling, general and administrative | 12,730 | 12,428 |
| Depreciation, software and intangible asset amortization | 3,838 | 4,066 |
| Total operating expenses | 128,148 | 122,949 |
| Operating income | 4,579 | 9,403 |
| Other (income) expenses | | |
| Interest expense, net | 679 | 781 |
| Other, net | 734 | (1,218) |
| Total other (income) expenses | 1,413 | (437) |
| Income from continuing operations before income taxes | 3,166 | 9,840 |
| Income tax expense | 1,321 | 3,521 |
| Income from continuing operations | 1,845 | 6,319 |
| Income from discontinued operations, net of income taxes | 0 | 348 |
| Net income | \$ 1,845 | \$ 6,667 |
| Basic earnings per common share | | |
| Continuing operations | \$ 0.03 | \$ 0.10 |
| Discontinued operations | 0.00 | 0.01 |
| Basic earnings per common share | \$ 0.03 | \$ 0.11 |
| Weighted-average common shares outstanding | 62,686 | 62,471 |
| Diluted earnings per common share | | |
| Continuing operations | \$ 0.03 | \$ 0.10 |
| Discontinued operations | 0.00 | 0.01 |
| Diluted earnings per common share | \$ 0.03 | \$ 0.11 |
| Weighted-average common and common equivalent shares outstanding | 62,971 | 62,669 |
| Other comprehensive income (loss), net of tax | | |
| Adjustment to pension liability | \$ 553 | \$ 1,003 |
| Foreign currency translation adjustments | 186 | (1,130) |
| Total other comprehensive income (loss), net of tax | 739 | (127) |
| Comprehensive income | \$ 2,584 | \$ 6,540 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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Harte-Hanks, Inc. and Subsidiaries Condensed Consolidated Statements of Cash Flows

(Unaudited)

| <i>In thousands</i> | Three Months Ended March 31, | |
|--|------------------------------|-----------|
| | 2014 | 2013 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 1,845 | \$ 6,667 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Income from discontinued operations | 0 | (348) |
| Depreciation and software amortization | 3,832 | 4,011 |
| Intangible asset amortization | 6 | 55 |
| Stock-based compensation | 1,288 | 1,288 |
| Excess tax benefits from stock-based compensation | (425) | (5) |
| Net pension cost (payments) | 1,404 | 591 |
| Deferred income taxes | 3,825 | 3,121 |
| Other, net | (875) | (1,312) |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Decrease (increase) in accounts receivable, net | 9,944 | 15,485 |
| Decrease (increase) in inventory | (34) | (340) |
| Decrease (increase) in prepaid expenses and other current assets | (696) | (51) |
| (Decrease) increase in accounts payable | 121 | (2,109) |
| (Decrease) increase in other accrued expenses and liabilities | (13,810) | (14,565) |
| Other, net | 267 | (1,046) |
| Net cash provided by continuing operations | 6,692 | 11,442 |
| Net cash provided by (used in) discontinued operations | 0 | 656 |
| Net cash provided by operating activities | 6,692 | 12,098 |
| Cash Flows from Investing Activities | | |
| Purchases of property, plant and equipment | (2,550) | (4,581) |
| Proceeds from the sale of property, plant and equipment | 0 | 4,781 |
| Net cash flows from investing activities within discontinued operations | 0 | (50) |
| Net cash provided by (used in) investing activities | (2,550) | 150 |
| Cash Flows from Financing Activities | | |
| Borrowings | 0 | 0 |
| Repayment of borrowings | (3,062) | (3,062) |
| Debt financing costs | 0 | 0 |
| Issuance of common stock | (347) | 82 |
| Excess tax benefits from stock-based compensations | 425 | 5 |
| Purchase of treasury stock | (175) | (436) |
| Dividends paid | (5,377) | 0 |
| Net cash used in financing activities | (8,536) | (3,411) |
| Effect of exchange rate changes on cash and cash equivalents | 186 | 1,003 |
| Net increase (decrease) in cash and cash equivalents | (4,208) | 9,840 |
| Cash and cash equivalents at beginning of year | 88,747 | 49,384 |
| Cash and cash equivalents at end of year | \$ 84,539 | \$ 59,224 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of ContentsHarte-Hanks, Inc. and Subsidiaries Condensed Consolidated Statements of Changes in Equity

(2014 Unaudited)

| <i>In thousands, except per share amounts</i> | Common Stock | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated other comprehensive income (loss) | Total Stockholders Equity |
|--|--------------|----------------------------|-------------------|----------------|---|---------------------------|
| Balance at December 31, 2012 | \$ 118,737 | \$ 341,586 | \$ 1,165,952 | \$ (1,248,377) | \$ (49,734) | \$ 328,164 |
| Exercise of stock options and release of unvested shares | 450 | 469 | 0 | (407) | 0 | 512 |
| Net tax effect of stock options exercised and release of unvested shares | 0 | (2,606) | 0 | 0 | 0 | (2,606) |
| Stock-based compensation | 0 | 5,744 | 0 | 0 | 0 | 5,744 |
| Dividends paid (\$0.255 per share) | 0 | 0 | (16,121) | 0 | 0 | (16,121) |
| Treasury stock issued | 0 | (98) | 0 | 135 | 0 | 37 |
| Purchase of treasury stock | 0 | 0 | 0 | (1,662) | 0 | (1,662) |
| Net income | 0 | 0 | 13,370 | 0 | 0 | 13,370 |
| Other comprehensive loss | 0 | 0 | 0 | 0 | 21,616 | 21,616 |
| Balance at December 31, 2013 | \$ 119,187 | \$ 345,095 | \$ 1,163,201 | \$ (1,250,311) | \$ (28,118) | \$ 349,054 |
| Exercise of stock options and release of unvested shares | 292 | (63) | 0 | (576) | 0 | (347) |
| Net tax effect of stock options exercised and release of unvested shares | 0 | (875) | 0 | 0 | 0 | (875) |
| Stock-based compensation | 0 | 1,288 | 0 | 0 | 0 | 1,288 |
| Dividends paid (\$0.085 per share) | 0 | 0 | (5,377) | 0 | 0 | (5,377) |
| Purchase of treasury stock | 0 | 0 | 0 | (175) | 0 | (175) |
| Net income | 0 | 0 | 1,845 | 0 | 0 | 1,845 |
| Other comprehensive income | 0 | 0 | 0 | 0 | 739 | 739 |
| Balance at March 31, 2014 | \$ 119,479 | \$ 345,445 | \$ 1,159,669 | \$ (1,251,062) | \$ (27,379) | \$ 346,152 |

See Accompanying 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. (Harte Hanks) and its subsidiaries (the Company). All intercompany accounts and transactions have been eliminated in consolidation.

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, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. 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, 2013.

Discontinued Operations

As discussed in Note L, *Discontinued Operations*, we sold the assets of our California Shoppers operations on September 27, 2013. The operating results of our California Shoppers (Shoppers) are being reported as discontinued operations in the Condensed Consolidated Financial Statements. Unless otherwise stated, amounts related to the Shoppers operations are excluded from the Notes to Condensed Consolidated Financial Statements for all periods presented. Results of the remaining Harte Hanks business are reported as continuing operations.

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 Comprehensive Income

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.

Note B - Recent Accounting Pronouncements

In the first quarter of 2013, we adopted Accounting Standards Update (ASU) 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. ASU 2013-02 addresses the presentation of reclassification adjustments, which was deferred in the initial issuance of ASU 2011-05, *Presentation of Comprehensive Income*. ASU 2013-02 requires entities to disclose:

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- For items reclassified out of accumulated other comprehensive income and into net income in their entirety, the effect of the reclassification on each affected net income line item, and
- For accumulated other comprehensive income reclassification items that are not reclassified in their entirety into net income, a cross reference to other required U.S. GAAP disclosures.

In connection with this adoption we have added the required disclosures in Note J, *Comprehensive Income*. The adoption of ASU 2013-02 did not affect our operating results, cash flows or financial position.

Note C - 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.

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 E, *Long-Term Debt*.

Note D Goodwill

As of March 31, 2014 and December 31, 2013, we had goodwill of \$398.2 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.

The Company continues to monitor potential triggering events, including changes in the business climate in which it operates, attrition of key personnel, the current volatility in the capital markets, the Company's market capitalization compared to its book value, the Company's recent operating performance, and the Company's financial projections. The occurrence of one or more triggering events could require additional impairment testing, which could result in impairment charges in the future. There was no occurrence of a triggering event for fiscal year 2014 as of March 31, 2014.

Table of Contents**Note E Long-Term Debt**

Our long-term debt obligations were as follows:

| <i>In thousands</i> | March 31, 2014 | December 31, 2013 |
|--|-------------------|----------------------|
| 2010 Revolving Credit Facility, various interest rates based on LIBOR, due August 12, 2013 (\$60.5 million capacity at December 31, 2012) | N/A | \$ 0 |
| 2013 Revolving Credit Facility, various interest rates based on Eurodollar rate, due August 16, 2016 (\$72.5 million capacity and effective rate of 2.40% at March 31, 2014) | \$ 0 | N/A |
| 2011 Term Loan Facility, various interest rates based on LIBOR (effective rate of 2.15% at March 31, 2014), due August 16, 2016 | \$ 94,938 | \$ 98,000 |
| Total debt | \$ 94,938 | \$ 98,000 |
| Less current maturities | \$ 16,844 | \$ 15,313 |
| Total long-term debt | \$ 78,094 | \$ 82,687 |

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

| <i>In thousands</i> | March 31, 2014 | | December 31, 2013 | |
|---------------------|-------------------|------------|----------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Total Debt | \$ 94,938 | \$ 94,938 | \$ 98,000 | \$ 98,000 |

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 ASC 820.

Note F Stock-Based Compensation

We recognized \$1.0 million and \$1.1 million of stock-based compensation during the three months ended March 31, 2014 and 2013, respectively.

Our annual grant of stock-based awards occurred in the second quarter of 2014 (April 15, 2014). We did not have any significant stock-based compensation activity in the first quarter of 2014.

Note G 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 accrued after December 31, 1998 as if the principal pension plan had not been frozen.

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Net pension cost for both plans included the following components:

| <i>In thousands</i> | Three months ended March 31, | |
|------------------------------------|------------------------------|----------|
| | 2014 | 2013 |
| Service cost | \$ 100 | \$ 86 |
| Interest cost | 1,939 | 1,809 |
| Expected return on plan assets | (2,109) | (1,846) |
| Amortization of prior service cost | 0 | 0 |
| Recognized actuarial loss | 921 | 1,672 |
| Net periodic benefit cost | \$ 851 | \$ 1,721 |

We made contributions to our funded, frozen pension plan of \$1.1 million in the first quarter of 2014. We plan to make additional contributions of \$3.7 million to this pension plan during the remainder of 2014. These contributions to our funded, frozen pension plan are being made in order to satisfy the Pension Protection Act of 2006 minimum required contribution.

We are not required to make and do not intend to make any contributions to our unfunded, supplemental pension plan in 2014 other than to the extent needed to cover benefit payments. We expect benefit payments under this supplemental pension plan to total \$1.6 million in 2014.

Effective April 1, 2014, we elected to freeze benefits under the unfunded, supplemental pension plan, which will be accounted for as a curtailment of the plan in the second quarter of 2014. The plan freeze results in a reduction of plan expense of \$0.4 million over the remainder of 2014 and a reduction in the projected benefit obligation of \$1.1 million. This curtailment gain will offset the unrecognized loss held by the plan. The remaining portion of the unrecognized loss will then be amortized over the average life expectancy of all participants.

Note H - Income Taxes

Our first quarter 2014 income tax expense of \$1.3 million resulted in an effective income tax rate of 41.7%. Our first quarter 2013 income tax provision of \$3.5 million resulted in an effective income tax rate of 35.8%. Our effective income tax rate is derived by estimating pretax income and income tax expense for the year ending December 31, 2014. The effective income tax rate calculated for the first quarter of 2014 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. state and foreign returns, we are no longer subject to tax examinations for tax years prior to 2009. For U.S. federal returns, we are no longer subject to tax examinations for tax years prior to 2010.

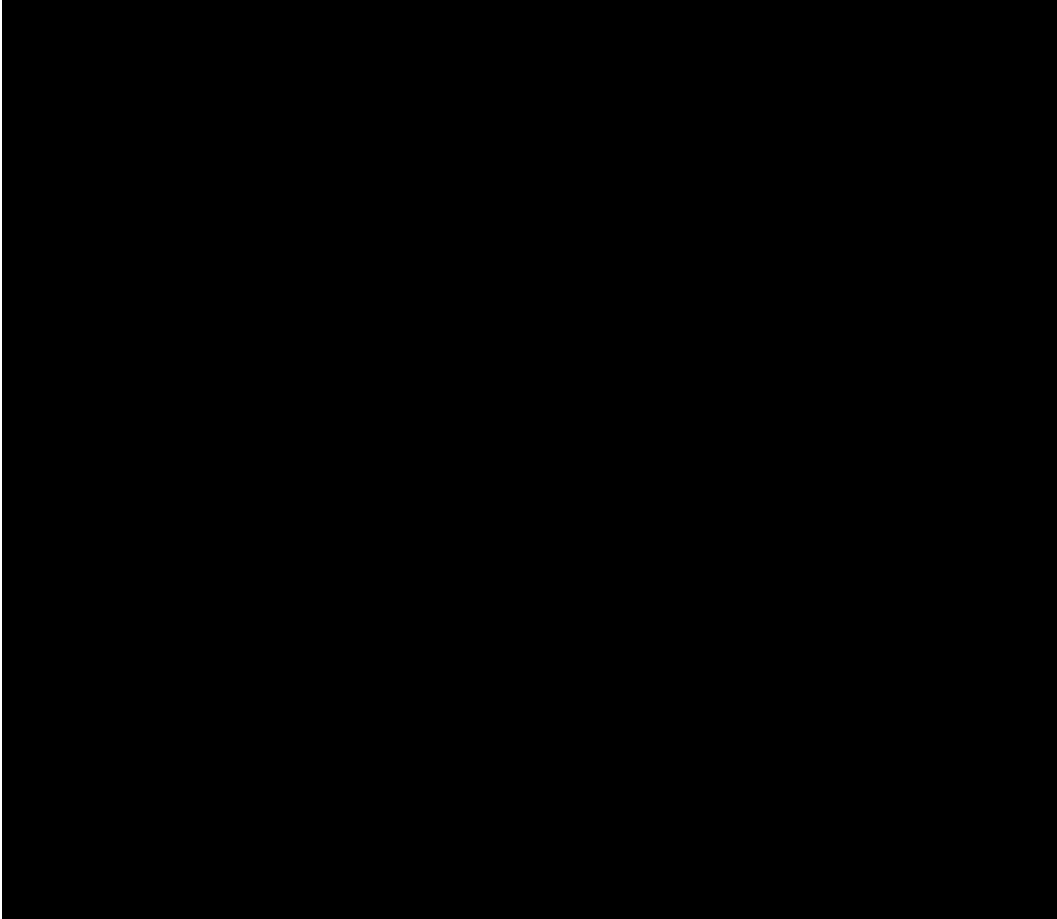
We have elected to classify any interest expense and penalties related to income taxes within income tax expense in our Consolidated Statements of Comprehensive Income. We did not have a significant amount of interest or penalties accrued at March 31, 2014 or December 31, 2013.

Note 1 - 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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Reconciliations of basic and diluted earnings per share (EPS) are as follows:



3.6 million and 4.4 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, 2014 and 2013, respectively. There were no anti-dilutive unvested shares excluded from the calculation of shares used in the diluted EPS calculation for the three months ended March 31, 2014. 0.4 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, 2013.

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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:

| <i>In thousands</i> | Three Months Ended March 31, | |
|---|------------------------------|----------|
| | 2014 | 2013 |
| Net income | \$ 1,845 | \$ 6,667 |
| Other comprehensive income (loss): | | |
| Adjustment to pension liability | 921 | 1,672 |
| Tax expense | (368) | (669) |
| Adjustment to pension liability, net of tax | 553 | 1,003 |
| Foreign currency translation adjustment | 186 | (1,130) |
| Total other comprehensive income (loss) | 739 | (127) |
| Total comprehensive income | \$ 2,584 | \$ 6,540 |

Changes in accumulated other comprehensive income by component are as follows:

| <i>In thousands</i> | Defined Benefit Pension | Foreign Currency | Total |
|---|----------------------------|---------------------|-------------|
| | Items | Items | |
| Balance at December 31, 2013 | \$ (32,279) | \$ 4,161 | \$ (28,118) |
| Other comprehensive (loss), net of tax, before reclassifications | 0 | 186 | 186 |
| Amounts reclassified from accumulated other comprehensive income, net of tax | 553 | 0 | 553 |
| Net current period other comprehensive income (loss), net of tax | 553 | 186 | 739 |
| Balance at March 31, 2014 | \$ (31,726) | \$ 4,347 | \$ (27,379) |

| <i>In thousands</i> | Defined Benefit Pension | Foreign Currency | Total |
|---|----------------------------|---------------------|-------------|
| | Items | Items | |
| Balance at December 31, 2012 | \$ (54,431) | \$ 4,697 | \$ (49,734) |
| Other comprehensive income (loss), net of tax, before reclassifications | 0 | (1,130) | (1,130) |
| Amounts reclassified from accumulated other comprehensive income, net of tax | 1,003 | 0 | 1,003 |

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| | | | |
|--|-------------|----------|-------------|
| Net current period other comprehensive income (loss), net of tax | 1,003 | (1,130) | (127) |
| Balance at March 31, 2013 | \$ (53,428) | \$ 3,567 | \$ (49,861) |

Reclassification amounts related to the defined pension plans are included in the computation of net period pension benefit cost (see Note G, *Components of Net Periodic Pension Benefit Cost*).

Note K Litigation Contingencies

In the normal course of our business, we are obligated under some agreements to indemnify our clients as a result of claims that we infringe on the proprietary rights of third parties. The terms and duration of these commitments vary and, in some cases, may be indefinite, and certain of these commitments do not limit the maximum amount of future payments we could become obligated to make there under; accordingly, our actual aggregate maximum exposure related to these types of commitments cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for obligations of this nature, and no liabilities have been recorded for these obligations in our financial statements.

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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.

Note L. Discontinued Operations

We sold the assets of our California Shoppers operations to affiliates of OpenGate Capital Management, LLC (OpenGate) on September 27, 2013. Because Shoppers represented a distinct business unit with operations and cash flows that can clearly be distinguished, both operationally and for financial purposes, from the rest of Harte Hanks, the results of the Shoppers operations are reported as discontinued operations for all periods presented.

Results of the remaining Harte Hanks marketing services business are reported as continuing operations.

Summarized operating results for the Shoppers discontinued operations are as follows:

| <i>In thousands</i> | Three Months Ended March 31, | |
|--|------------------------------|-----------|
| | 2014 | 2013 |
| Revenues | \$ 0 | \$ 45,980 |
| Income from discontinued operations before impairment charges and income taxes | 0 | 783 |
| Income tax expense | 0 | 435 |
| Income from discontinued operations | \$ 0 | \$ 348 |

The major components of cash flows for the Shoppers discontinued operations are as follows:

| <i>In thousands</i> | Three Months Ended March 31, | |
|--|------------------------------|--------|
| | 2014 | 2013 |
| Income (Loss) from discontinued operations | \$ - | \$ 348 |
| Loss on sale | - | - |
| Depreciation and software amortization | - | 871 |
| Other, net | - | (563) |
| Net cash provided by (used in) discontinued operations | \$ - | \$ 656 |

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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, 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 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 U.S. 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, 2013 (2013 Form 10-K) and in the Cautionary Note Regarding Forward-Looking Statements in our first quarter 2014 earnings release issued on May 1, 2014. 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 2013 Form 10-K. Our 2013 Form 10-K contains a discussion of other matters not included herein, such as disclosures regarding critical accounting policies and estimates, and contractual obligations.

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Harte Hanks is one of the world's leading, insight-driven multi-channel marketing organizations, delivering impactful business results for some of the world's best-known brands. Through strategic agencies and our core marketing services, we develop integrated solutions that connect brands with prospects and customers, moving them beyond awareness to transactions and brand loyalty.

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We offer a wide variety of integrated, multi-channel, 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 multi-channel 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 and business-to-business lead generation;
- data quality software and services with Trillium Software;
- direct mail; and
- contact centers.

Previously, Harte Hanks also provided shopper advertising opportunities through our Shoppers segment, which operated in certain California markets. On September 27, 2013 we sold the assets of our California Shoppers operations, The Pennysaver, for gross proceeds of \$22.5 million. This transaction resulted in an after-tax loss of \$12.4 million. Because Shoppers represented a distinct business unit with operations and cash flows that can clearly be distinguished, both operationally and for financial purposes, from the rest of Harte Hanks, the results of the Shoppers operations are reported as discontinued operations for all periods presented. Results of the remaining Harte Hanks business are reported as continuing operations. After this sale, Harte Hanks no longer has any Shoppers operations or circulation.

With business operations in several countries, we are affected by the general local, national and international economic and business conditions in the markets where we and our customers operate. Marketing budgets are often discretionary in nature, and are easier to reduce in the short-term than other expenses in response to weak economic conditions. Our 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 continuing to adjust 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 principal operating expense items are labor, postage and mail supply chain management.

Results of Continuing Operations

As discussed in Note L, *Discontinued Operations*, we sold the assets of our California Shoppers operations on September 27, 2013. Therefore, the operating results of our California Shoppers are being reported as discontinued operations in the Condensed Consolidated Financial Statements, and are excluded from management's discussion and analysis of financial condition and results of operations below.

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Operating results from our continuing operations were as follows:

| | March 31, | | March 31, | | |
|---|------------|----|-----------|--|----------|
| <i>In thousands, except per share amounts</i> | 2014 | | 2013 | | % Change |
| Revenues | \$ 132,727 | \$ | 132,352 | | 0.3% |
| Operating expenses | 128,148 | | 122,949 | | 4.2% |
| Operating income | \$ 4,579 | \$ | 9,403 | | -51.3% |
| Income from continuing operations | \$ 1,845 | \$ | 6,319 | | -70.8% |
| Diluted EPS from continuing operations | \$ 0.03 | \$ | 0.10 | | -70.9% |

1st Quarter 2014 vs. 1st Quarter 2013*Revenues*

Revenues increased 0.3%, to \$132.7 million, in the first quarter of 2014 compared to the first quarter of 2013. These results reflect the impact of our select markets vertical increasing \$3.1 million, or 30%, compared to the first quarter of 2013, primarily due to non-recurring streaming enrollment services from a large contract with an existing contact center customer. In addition, our automobile and consumer brands vertical increased \$2.9 million, or 14%, over the prior year quarter, due to additional work with an existing contact center customer and a large Trillium contract, and our pharmaceuticals vertical increased \$2.4 million, or 24%, due to new mail business with an existing customer. Our retail, high tech, and financial services verticals decreased 8%, 9%, and 10%, respectively. 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

Overall operating expenses were \$128.1 million in the first quarter of 2014, compared to \$122.9 million in the first quarter of 2013.

Labor costs increased \$3.8 million, or 5.7%, compared to the first quarter of 2013, primarily due to an increase in salaries and wages related to an investment in key personnel to generate additional revenues, as well as headcount reductions which resulted in approximately \$1.0 million of severance, the benefits of which will impact our performance from April onwards. Production and distribution costs increased \$1.3 million, or 3.3%, due to increased outsourced services to support additional revenues and software service contracts repairs and maintenance costs. General and administrative expense, increased \$0.3 million, or 2.4%, compared to prior year, reflecting increased promotion expense related to rebranding and various increased business services expenses. Depreciation and intangible asset and software amortization expense decreased \$0.2 million, or 5.6%, compared to the prior year, primarily related to decreased software depreciation.

Our 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 services. Mail supply chain rates have increased over the last few years due to demand and supply issues within the transportation industry. Future changes in mail supply chain rates will continue to impact our total production costs and total operating expenses, and may have an impact on future demand for our supply chain management.

Postage costs of mailings are borne by our clients and are not directly reflected in our revenues or expenses.

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Interest Expense

1st Quarter 2014 vs. 1st Quarter 2013

Interest expense is comparable to the first quarter of 2013 and decreased \$0.1 million, or 13.1%, in the first quarter of 2014. This was due to a lower average debt balance in the first quarter of 2014. The lower average debt balance in the first quarter of 2014 is a result of scheduled quarterly principal payments on the 2011 Term Loan Facility. See discussion of our credit facilities in the *Liquidity and Capital Resources* section below.

Other Income and Expense

1st Quarter 2014 vs. 1st Quarter 2013

Other expense, net, was \$0.7 million in the first quarter of 2014 compared to other income, net of \$1.2 million in the first quarter of 2013. This \$1.9 million variance from the prior year quarter is due to a \$1.0 million change in net foreign currency transaction gains and losses and a \$0.9 million gain on the sale of our facility in Belgium in the first quarter of 2013.

Income Taxes

1st Quarter 2014 vs. 1st Quarter 2013

Income tax expense decreased \$2.2 million in the first quarter of 2014 compared to the first quarter of 2013. Our effective tax rate was 41.7% for the first quarter of 2014, increasing from 35.8% for the first quarter of 2013. The increase in the effective tax rate is primarily due to an increase in state deferred tax accruals resulting from the state enacted tax legislation. Excluding the impact of our first quarter discrete items, including the state enacted legislation, which was offset by other discrete items, our effective tax rate for the first quarter of 2014 would have been 37.2%.

Income/Earnings Per Share from Continuing Operations

1st Quarter 2014 vs. 1st Quarter 2013

We recorded income from continuing operations of \$1.8 million and diluted earnings per share from continuing operations of \$0.03. These results compare to income from continuing operations of \$6.3 million and diluted earnings per share from continuing operations of \$0.10 per share in the first quarter of 2013. The decrease in income from continuing operations is primarily a result of no change in revenues and increased expenses that resulted in decreased operating income, the change in other income and expense discussed above, and the increase in the effective tax rate discussed above.

Economic Climate and Impact on our Financial Statements

As discussed above, we sold the assets of the California Shoppers operations on September 27, 2013. The business and economic climate in California had a negative impact on our Shoppers operations and cash flows, which is reflected in the discontinued operations results throughout our financial statements. In addition, local, national and international economic and business conditions affect the marketing expenditures of our clients, as they adjust expenditures in reaction to market conditions. These conditions are presently uneven among the markets we serve, with most showing modest but uncertain economic growth. These conditions also affect our costs and ability to attract and retain qualified employees.

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Liquidity and Capital Resources

Sources and Uses of Cash

As of March 31, 2014, cash and cash equivalents were \$84.5 million, decreasing \$4.2 million from cash and cash equivalents of \$88.7 million at December 31, 2013. This net decrease was a result of net cash provided by operating activities of \$6.7 million, net cash used in investing activities of \$2.6 million, net cash used in financing activities of \$8.5 million and the effect of exchange rate changes of \$0.0 million.

Operating Activities

Net cash provided by operating activities for the three months ended March 31, 2014 was \$6.7 million, compared to \$12.1 million for the three months ended March 31, 2013. The \$5.4 million year-over-year decrease was primarily attributable a decrease in net income, as well as changes within working capital assets and liabilities.

For the three months ended March 31, 2014, 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, 2013 receivables as well as higher revenues in the fourth quarter of 2013 compared to the first quarter of 2014. Days sales outstanding were approximately 72 days at March 31, 2014, which increased from 71 days at December 31, 2013;
- An increase in prepaid expenses due to timing of payments related to prepaid insurance, rent and annual licenses/agreements.;
- A decrease in accrued payroll and related expenses due to the timing of the first payroll in January of 2014 and accrual of severance at year-end 2013;
- A decrease in deferred revenue and customer advances due to timing of receipts; and
- A decrease in customer postage deposits due to timing of receipts and lower mail volumes.

Investing Activities

Net cash used in investing activities was \$2.6 million for the three months ended March 31, 2014, compared to net cash provided by investing activities of \$0.1 million for the three months ended March 31, 2013. The \$2.7 million variance is the result of the sale of our Belgium facility in the first quarter of 2013 for net proceeds of \$4.6 million, partially offset by decreased capital spending in the first three months of 2014 compared to the first three months of 2013.

Financing Activities

Net cash used in financing activities was \$8.5 million for the three months ended March 31, 2014 compared to \$3.4 million for the three months ended March 31, 2013. The \$5.1 million increase is primarily due the \$5.4 million in dividends paid in the first quarter

of 2014. We accelerated the payment of our regular first quarter 2013 dividend into December of 2012.

Credit Facilities

On August 12, 2010, we entered into a three-year \$70 million revolving credit facility (2010 Revolving Credit Facility) with Bank of America, N.A., as Administrative Agent. The 2010 Revolving Credit Facility matured on August 12, 2013.

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

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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, 2014, we had \$94.9 million outstanding under the 2011 Term Loan Facility.

On August 8, 2013, we entered into a three-year \$80 million revolving credit facility, a \$25 million letter of credit sub-facility and a \$5 million swing line loan sub-facility (2013 Revolving Credit Facility) by amending and restating the 2010 Revolving Credit Facility agreements. The 2013 Revolving Credit Facility permits us to request up to a \$15 million increase in the total amount of the facility, and matures on August 16, 2016. The 2013 Revolving Credit Facility replaces the 2010 Revolving Credit Facility, under which Harte Hanks had no borrowings as of August 8, 2013, except for letters of credit totaling approximately \$9.5 million. For each borrowing under the 2013 Revolving Credit Facility, we can generally choose to have the interest rate for that borrowing calculated on either (i) the Eurodollar rate for the applicable interest period plus a spread which is determined based on our total net debt-to-EBITDA ratio then in effect, which ranges from 2.25% to 3.00% per annum; or (ii) the highest of (a) the Agent's prime rate, (b) the Federal Funds Rate plus 0.50% per annum, (c) Eurodollar rate plus 1.00% per annum, plus a spread which is determined based on our total debt-to-EBITDA ratio then in effect, which spread ranges from 1.25% to 2% per annum. We are also required to pay a quarterly commitment fee under the 2013 Revolving Credit Facility. The rate of which is applied to the amount equal to the difference of the total commitment amount under the 2013 Revolving Credit Facility less the aggregate amount of outstanding obligations under such facility. The commitment fee rate ranges from 0.50% to 0.55% per annum, depending on our total net debt-to-EBITDA ratio then in effect. In addition, we pay 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 Eurodollar 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 the 2013 Revolving Credit Facility at any time without incurring any prepayment penalties.

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 2.25 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 25% of the consolidated revenue, or 20% of the assets 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

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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, 2014, 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 2013 Revolving Credit Facility, subject to the terms and conditions of that facility. The amount of cash on hand and borrowings available under our 2013 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.

As of March 31, 2014, we had \$72.5 million of unused borrowing capacity under our 2013 Revolving Credit Facility (which matures on August 16, 2016) and a cash balance of \$84.5 million. Based on our current operational plans, we believe that our cash on hand, cash provided by operating activities, and availability under the 2013 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 U.S. 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. GAAP. Preparing financial statements requires that management 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 2013 Form 10-K:

- Revenue recognition;
- Allowance for doubtful accounts;
- Reserve for healthcare, workers' compensation, automobile and general liability insurance;
- Goodwill and other intangible assets; and
- Stock-based compensation.

There have been no material changes to the critical accounting policies described in our 2013 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.

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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 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 0.15% at March 31, 2014). The five-year 2011 Term Loan Facility has a maturity date of August 16, 2016. At March 31, 2014, our debt balance related to the 2011 Term Loan Facility was \$94.9 million. The three-year \$80 million 2013 Revolving Credit Facility has a maturity date of August 16, 2016. At March 31, 2014, we did not have any debt outstanding under the 2013 Revolving Credit Facility.

Assuming the actual level of borrowings throughout the first quarter of 2014, and assuming a one percentage point change in the average interest rates, we estimate that our net income for the first quarter of 2014 would have changed by approximately \$0.1 million. Due to our overall debt level and cash balance at March 31, 2014, 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. At this time we are not entered into any interest rate swap or other derivative instruments to hedge the effects of adverse fluctuations in 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 and Philippine peso. 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 (Loss). 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, intercompany 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 2014. At this time we are 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.

We do not enter into derivative instruments for any purpose other than cash flow hedging. We do not speculate using derivative instruments.

Item 4. Controls and Procedures

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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

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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 2014 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding legal proceedings is set forth in Note K 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.

Table of Contents**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 2013 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in our 2013 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 2013 Form 10-K. Refer to Part I, Item 2 of this Quarterly Report on Form 10-Q, for a discussion of the economic climate and impact on our financial statements.

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 2014:

| 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 Dollar Amount that May Yet Be Spent Under the Plan |
|-----------------------|---|------------------------------|--|--|
| January 1 - 31, 2014 | 22,414 | \$ 7.82 | 22,414 | \$ 3,760,826 |
| February 1 - 28, 2014 | 73,589 | \$ 7.01 | 0 | \$ 3,760,826 |
| March 1 - 31, 2014 | 7,085 | \$ 8.33 | 0 | \$ 3,760,826 |
| Total | 103,088 | \$ 7.13 | 22,414 | |

(1) During the first quarter of 2014, we purchased 22,414 shares of our common stock through our stock repurchase program that was publicly announced in August 2012. Under this program, from which shares can be purchased in the open market, our Board of Directors has authorized us to spend up to \$10.0 million to repurchase shares of our outstanding common stock. As of March 31, 2014, we have repurchased 919,781 shares and spent \$6.2 million under this authorization. Through March 31, 2014, we had repurchased a total of 65,844,290 shares at an average price of \$18.48 per share under this program and previously announced programs.

(2) Total number of shares purchased includes shares, if any, (i) purchased as part of our publicly announced stock repurchase program, and pursuant to our 2005 Omnibus Incentive Plan and 2013 Omnibus Incentive Plan, (ii) withheld to pay withholding taxes and the exercise price in certain cashless exercises of stock options, and (iii) withheld to offset withholding taxes upon the vesting of invested shares.

Item 6. Exhibits

| Exhibit No. | Description of Exhibit |
|-------------|---|
| *31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

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- *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.

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*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

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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 5, 2014
Date

/s/ Robert A. Philpott
Robert A. Philpott
President and Chief Executive Officer

May 5, 2014
Date

/s/ Douglas C. Shepard
Douglas C. Shepard
Executive Vice President and
Chief Financial Officer

May 5, 2014
Date

/s/ Carlos M. Alvarado
Carlos M. Alvarado
Vice President, Finance and
Corporate Controller