

HARTE HANKS INC  
Form 10-Q  
July 31, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2009

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 1-7120

**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)

**200 Concord Plaza Drive, San Antonio, Texas**  
(Address of principal executive offices)

**78216**  
(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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§234.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The number of shares outstanding of each of the registrant's classes of common stock as of July 24, 2009 was 63,570,192 shares of common stock, all of one class.

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HARTE-HANKS, INC. AND SUBSIDIARIES

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Harte-Hanks, Inc. and Subsidiaries

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

|   | June 30,<br>2009<br>(Unaudited) | December 31,<br>2008<br>(Audited) |
|---|---------------------------------|-----------------------------------|
| <b>Assets</b>   |                                 |                                   |
| Current assets  |                                 |                                   |
| Cash and cash equivalents   | \$ 74,938                       | \$ 30,161                         |
| Accounts receivable ( <i>less allowance for doubtful accounts of \$3,057 at June 30, 2009 and \$4,191 at December 31, 2008</i> )                                    | 131,887                         | 169,418                           |
| Inventory   | 5,090                           | 7,481                             |
| Prepaid expenses  | 14,527                          | 14,169                            |
| Current deferred income tax asset   | 10,518                          | 13,000                            |
| Other current assets  | 2,495                           | 6,974                             |
| <b>Total current assets</b>   | <b>239,455</b>                  | <b>241,203</b>                    |
| Property, plant and equipment ( <i>less accumulated depreciation of \$239,969 at June 30, 2009 and \$231,197 at December 31, 2008</i> )                             |                                 |                                   |
| Goodwill, net   | 86,130                          | 97,433                            |
| Other intangible assets ( <i>less accumulated amortization of \$13,147 at June 30, 2009 and \$12,241 at December 31, 2008</i> )                                     | 552,886                         | 552,877                           |
| Other assets  | 17,083                          | 17,989                            |
|   | 3,954                           | 4,064                             |
| <b>Total assets</b>   | <b>\$ 899,508</b>               | <b>\$ 913,566</b>                 |
| <b>Liabilities and Stockholders' Equity</b>   |                                 |                                   |
| Current liabilities   |                                 |                                   |
| Current maturities of long-term debt  | \$ 38,813                       | \$ 30,938                         |
| Accounts payable  | 35,042                          | 48,182                            |
| Accrued payroll and related expenses  | 17,690                          | 22,177                            |
| Customer deposits and deferred revenue  | 55,495                          | 58,227                            |
| Income taxes payable  | 11,510                          | 9,128                             |
| Other current liabilities   | 11,024                          | 19,083                            |
| <b>Total current liabilities</b>  | <b>169,574</b>                  | <b>187,735</b>                    |
| Long-term debt  | 217,562                         | 239,687                           |
| Other long-term liabilities ( <i>including deferred income taxes of \$67,519 at June 30, 2009 and \$65,723 at December 31, 2008</i> )                               | 138,326                         | 129,772                           |
| <b>Total liabilities</b>  | <b>525,462</b>                  | <b>557,194</b>                    |
| <b>Stockholders' equity</b>   |                                 |                                   |
| Common stock, \$1 par value per share, 250,000,000 shares authorized. 118,241,270 shares issued at June 30, 2009 and 118,085,480 shares issued at December 31, 2008 | 118,241                         | 118,085                           |
| Additional paid-in capital  | 332,410                         | 331,227                           |

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|  |                |                |
|--|----------------|----------------|
| Retained earnings  | 1,199,992      | 1,189,376      |
| Less treasury stock: 54,674,955 shares at cost at June 30, 2009 and 54,672,070 shares at cost at December 31, 2008 | (1,236,373)    | (1,236,581)    |
| Accumulated other comprehensive loss   | (40,224)       | (45,735)       |
| <b>Total stockholders' equity</b>  | <b>374,046</b> | <b>356,372</b> |
| Total liabilities and stockholders' equity   | \$ 899,508     | \$ 913,566     |

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Harte-Hanks, Inc. and Subsidiaries

Consolidated Statements of Operations (in thousands, except per share amounts)

(Unaudited)

|  | <b>Three Months Ended June 30,</b> |             |
|--|------------------------------------|-------------|
|  | <b>2009</b>                        | <b>2008</b> |
| Operating revenues   | \$ 215,662                         | \$ 274,756  |
| Operating expenses   |                                    |             |
| Labor  | 90,004                             | 111,351     |
| Production and distribution                                      | 76,732                             | 98,441      |
| Advertising, selling, general and administrative                 | 16,672                             | 21,198      |
| Depreciation and software amortization                           | 6,869                              | 8,289       |
| Intangible asset amortization                                    | 453                                | 737         |
| Total operating expenses   | 190,730                            | 240,016     |
| Operating income   | 24,932                             | 34,740      |
| Other expenses (income)  |                                    |             |
| Interest expense   | 2,513                              | 3,575       |
| Interest income  | (65)                               | (115)       |
| Other, net   | 1,684                              | 970         |
|  | 4,132                              | 4,430       |
| Income before income taxes                                       | 20,800                             | 30,310      |
| Income tax expense   | 7,742                              | 12,096      |
| Net income   | \$ 13,058                          | \$ 18,214   |
| Basic earnings per common share                                  | \$ 0.21                            | \$ 0.29     |
| Weighted-average common shares outstanding                       | 63,566                             | 63,214      |
| Diluted earnings per common share                                | \$ 0.20                            | \$ 0.29     |
| Weighted-average common and common equivalent shares outstanding | 63,737                             | 63,303      |

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Harte-Hanks, Inc. and Subsidiaries

Consolidated Statements of Operations (in thousands, except per share amounts)

(Unaudited)

|  | <b>Six Months Ended June 30,</b> |             |
|--|----------------------------------|-------------|
|  | <b>2009</b>                      | <b>2008</b> |
| Operating revenues   | \$ 433,336                       | \$ 543,265  |
| Operating expenses   |                                  |             |
| Labor  | 189,246                          | 227,166     |
| Production and distribution                                      | 157,159                          | 194,881     |
| Advertising, selling, general and administrative                 | 32,029                           | 42,588      |
| Depreciation and software amortization                           | 15,306                           | 16,604      |
| Intangible asset amortization                                    | 906                              | 1,475       |
| Total operating expenses   | 394,646                          | 482,714     |
| Operating income   | 38,690                           | 60,551      |
| Other expenses (income)  |                                  |             |
| Interest expense   | 4,991                            | 7,338       |
| Interest income  | (90)                             | (226)       |
| Other, net   | 1,702                            | 1,638       |
|  | 6,603                            | 8,750       |
| Income before income taxes                                       | 32,087                           | 51,801      |
| Income tax expense   | 11,914                           | 20,001      |
| Net income   | \$ 20,173                        | \$ 31,800   |
| Basic earnings per common share                                  | \$ 0.32                          | \$ 0.49     |
| Weighted-average common shares outstanding                       | 63,541                           | 64,537      |
| Diluted earnings per common share                                | \$ 0.32                          | \$ 0.49     |
| Weighted-average common and common equivalent shares outstanding | 63,665                           | 64,720      |

See Notes to Unaudited Condensed Consolidated Financial Statements.

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Harte-Hanks, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (in thousands)

(Unaudited)

|   | <b>Six Months Ended June 30,</b> |                  |
|---|----------------------------------|------------------|
|   | <b>2009</b>                      | <b>2008</b>      |
| <b>Cash Flows from Operating Activities</b>                                       |                                  |                  |
| Net income  | \$ 20,173                        | \$ 31,800        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                  |                  |
| Depreciation and software amortization  | 15,306                           | 16,604           |
| Intangible asset amortization   | 906                              | 1,475            |
| Stock-based compensation  | 1,507                            | 2,891            |
| Excess tax benefits from stock-based compensation                                 | (13)                             | (120)            |
| Deferred income taxes   | 3,743                            | 3,692            |
| Other, net  | 38                               | 128              |
| Changes in operating assets and liabilities, net of acquisitions:                 |                                  |                  |
| Decrease in accounts receivable, net  | 37,531                           | 17,492           |
| Decrease (increase) in inventory  | 2,391                            | (846)            |
| Decrease (increase) in prepaid expenses and other current assets                  | 4,121                            | (3,536)          |
| Decrease in accounts payable  | (13,140)                         | (13,337)         |
| Decrease in other accrued expenses and other current liabilities                  | (7,525)                          | (4,743)          |
| Other, net  | 6,243                            | 1,914            |
| <b>Net cash provided by operating activities</b>                                  | <b>71,281</b>                    | <b>53,414</b>    |
| <b>Cash Flows from Investing Activities</b>                                       |                                  |                  |
| Acquisitions, net of cash acquired  |                                  | (8,609)          |
| Purchases of property, plant and equipment  | (3,918)                          | (12,041)         |
| Proceeds from sale of property, plant and equipment                               | 71                               | 113              |
| <b>Net cash used in investing activities</b>                                      | <b>(3,847)</b>                   | <b>(20,537)</b>  |
| <b>Cash Flows from Financing Activities</b>                                       |                                  |                  |
| Borrowings  |                                  | 177,000          |
| Repayment of borrowings   | (14,250)                         | (126,750)        |
| Issuance of common stock  | 538                              | 3,037            |
| Purchase of treasury stock  |                                  | (76,649)         |
| Excess tax benefits from stock-based compensation                                 | 13                               | 120              |
| Dividends paid  | (9,557)                          | (9,676)          |
| <b>Net cash used in financing activities</b>                                      | <b>(23,256)</b>                  | <b>(32,918)</b>  |
| Effect of exchange rate changes on cash and cash equivalents                      | 599                              | 176              |
| Net increase in cash and cash equivalents   | 44,777                           | 135              |
| Cash and cash equivalents at beginning of year                                    | 30,161                           | 22,847           |
| <b>Cash and cash equivalents at end of period</b>                                 | <b>\$ 74,938</b>                 | <b>\$ 22,982</b> |

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See Notes to Unaudited Condensed Consolidated Financial Statements.

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Harte-Hanks, Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity and Comprehensive Income (in thousands, except per share amounts)

(2009 Unaudited)

|   | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders<br>Equity |
|---|-----------------|----------------------------------|----------------------|-------------------|---|---------------------------------|
| Balance at December 31, 2007  | \$ 117,693      | \$ 323,182                       | \$ 1,145,736         | \$ (1,160,205)    | \$ (17,894)   | \$ 408,512                      |
| Common stock issued - employee stock purchase plan  | 298             | 2,639                            |                      |                   |   | 2,937                           |
| Exercise of stock options and release of nonvested shares   | 94              | 1,267                            |                      | (49)              |   | 1,312                           |
| Net tax effect of options exercised   |                 | (1,550)                          |                      |                   |   | (1,550)                         |
| Stock-based compensation  |                 | 5,827                            |                      |                   |   | 5,827                           |
| Dividends paid (\$0.30 per share)   |                 |                                  | (19,101)             |                   |   | (19,101)                        |
| Treasury stock repurchased  |                 |                                  |                      | (76,649)          |   | (76,649)                        |
| Treasury stock issued   |                 | (138)                            |                      | 322               |   | 184                             |
| Comprehensive income:   |                 |                                  |                      |                   |   |                                 |
| Net income  |                 |                                  | 62,741               |                   |   | 62,741                          |
| Adjustment to pension liability (net of tax benefit of \$15,259)  |                 |                                  |                      |                   | (22,886)  | (22,886)                        |
| Change in value of derivative instrument accounted for as a cash flow hedge (net of tax benefit of \$762)   |                 |                                  |                      |                   | (1,146)   | (1,146)                         |
| Foreign currency translation adjustment   |                 |                                  |                      |                   | (3,809)   | (3,809)                         |
| Total comprehensive income  |                 |                                  |                      |                   |   | 34,900                          |
| Balance at December 31, 2008  | 118,085         | 331,227                          | 1,189,376            | (1,236,581)       | (45,735)  | 356,372                         |
| Common stock issued - employee stock purchase plan  | 85              | 402                              |                      |                   |   | 487                             |
| Exercise of stock options and release of nonvested shares   | 71              | 29                               |                      | (129)             |   | (29)                            |
| Net tax effect of options exercised   |                 | (504)                            |                      |                   |   | (504)                           |
| Stock-based compensation  |                 | 1,507                            |                      |                   |   | 1,507                           |
| Dividends paid (\$0.15 per share)   |                 |                                  | (9,557)              |                   |   | (9,557)                         |
| Treasury stock issued   |                 | (251)                            |                      | 337               |   | 86                              |
| Comprehensive income:   |                 |                                  |                      |                   |   |                                 |
| Net income  |                 |                                  | 20,173               |                   |   | 20,173                          |
| Adjustment to pension liability (net of tax expense of \$1,162)   |                 |                                  |                      |                   | 1,742   | 1,742                           |
| Change in value of derivative instrument accounted for as a cash flow hedge (net of tax expense of \$1,143) |                 |                                  |                      |                   | 1,716   | 1,716                           |
| Foreign currency translation adjustment   |                 |                                  |                      |                   | 2,053   | 2,053                           |
| Total comprehensive income  |                 |                                  |                      |                   |   | 25,684                          |
| Balance at June 30, 2009  | \$ 118,241      | \$ 332,410                       | \$ 1,199,992         | \$ (1,236,373)    | \$ (40,224)   | \$ 374,046                      |

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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.

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 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. generally accepted accounting principles for complete financial statements. Operating results for the three months and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. 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, 2008.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

**Operating Expense Presentation in Consolidated Statement of Operations**

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

**Note B Recent Accounting Pronouncements**

We adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, (SFAS 157) relating to financial assets and liabilities on January 1, 2008. We adopted the provisions of SFAS 157 relating to non-financial assets and non-financial liabilities on January 1, 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The adoption of SFAS 157 did not have a significant impact on our consolidated financial statements.

On January 1, 2009 we adopted the provisions of SFAS No. 141, *Business Combinations*, as revised by the Financial Accounting Standards Board (FASB) in December 2007 (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquiring company:

Recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree;



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Recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and

Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

SFAS 141R requires an acquiring company to recognize the assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at fair value as of the acquisition date. Under SFAS 141, acquisition-related costs were included in the total costs of the acquisition that were allocated to the assets acquired and the liabilities assumed. Under SFAS 141R, these acquisition-related costs will be expensed in the period in which they occur. Under SFAS 141, contingent consideration usually was not recognized until the contingency was resolved, in which case an adjustment was made to goodwill. SFAS 141R requires an acquiring company to recognize contingent consideration at fair value as of the acquisition date. Our adoption of SFAS 141R will affect the way we account for future acquisitions, including acquisition-related costs, contingencies and contingent consideration. Our adoption of SFAS 141R may also impact the amount of information we disclose about future acquisitions.

We adopted the provisions of SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, (SFAS 161) on January 1, 2009. SFAS 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. This statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair values and amounts of and gains and losses on derivative instruments, and disclosures about contingent features related to credit risk in derivative agreements. New disclosures required by SFAS 161 are included in Note E, *Interest Rate Risk*. The adoption of SFAS 161 did not affect our consolidated financial statements.

In December 2008 the FASB again amended SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, (SFAS 132R-1) to provide additional guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The objectives of the disclosures required by SFAS 132R-1 are to provide users of financial statements with an understanding of:

How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies;

The major categories of plan assets;

The inputs and valuation techniques used to measure the fair value of plan assets;

The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period; and

Significant concentrations of risk within plan assets.

We will adopt SFAS 132R-1 on December 31, 2009 and the additional disclosures will be included in our annual report on Form 10-K for the year ended December 31, 2009. The adoption of SFAS 132R-1 will not affect our consolidated financial statements.

In April 2009, we adopted FASB Staff Position FAS 107-1 and Accounting Principles Board 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, (FSP 107-1). FSP 107-1 requires an entity to provide the disclosures previously required annually by SFAS 107, *Disclosures about Fair Value of Financial Instruments*, in its interim financial statements. New disclosures required by FSP 107-1 are included in Note F, *Fair Value of Financial Instruments*. The adoption of FSP 107-1 did not affect our consolidated financial statements.

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In June 2009, we adopted the provisions of SFAS No. 165, *Subsequent Events*, (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet but before financial statements are issued or are available to be issued. SFAS 165 sets forth:

The period after the balance sheet date during which management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements;

The circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and

The disclosures that an entity should make about events or transactions that occurred after the balance sheet date, as well as the date through which management has evaluated subsequent events and the basis for that date.

New disclosures required by SFAS 165 are included in Note M, *Subsequent Events*. The adoption of SFAS 165 did not affect our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. (SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification (the Codification) as the single source of authoritative nongovernmental U.S. GAAP. The Codification is effective for interim and annual periods ending after September 15, 2009. The adoption of this standard is not expected to have an impact on our financial statements.

**Note C Income Taxes**

Our second quarter 2009 income tax provision of \$7.7 million was calculated using an effective income tax rate of approximately 37.2%. Our first half 2009 income tax provision of \$11.9 million was calculated using an effective income tax rate of approximately 37.1%. Our effective income tax rate is derived by estimating pretax income and income tax expense for the year ending December 31, 2009. The effective income tax rate calculated is higher than the federal statutory rate of 35%, primarily due to the addition of state income taxes.

At January 1, 2009, unrecognized tax benefits for uncertain tax positions totaled \$7.1 million. If recognized, the entire unrecognized tax benefit amount, \$4.8 million net of tax, would impact the effective tax rate. In addition, interest and penalties accrued at January 1, 2009 totaled \$3.2 million, or \$2.5 million net of tax. There have been no significant changes to these amounts during the six months ended June 30, 2009.

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 years prior to 2004. For U.S. federal returns, we are no longer subject to tax examinations for the years prior to 2005. We believe that it is reasonably possible that a reduction in our unrecognized tax liabilities in the range of \$1.5 million to \$1.6 million, net of tax, and a reduction of interest and penalties in the range of \$0.8 million to \$0.9 million, net of tax, will occur in the next twelve months related to the statute expiring on various tax returns. If these reductions were to occur, they would decrease the tax expense and effective tax rate for the full year 2009.

**Note D Stock-Based Compensation**

We recognized \$1.2 million and \$1.7 million of stock-based compensation during the three months ended June 30, 2009 and 2008, respectively. We recognized \$1.5 million and \$2.9 million of stock-based compensation during the six months ended June 30, 2009 and 2008, respectively.

Our annual grant of stock-based awards occurred in the first quarter of 2009, which is consistent with the timing of previous annual grants. We did not have any significant stock-based compensation activity in the second quarter of 2009.

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In May 2009 our stockholders approved an amendment to the Harte-Hanks, Inc. 2005 Omnibus Incentive Plan to increase the maximum number of authorized shares that may be issued thereunder by 4,600,000 shares, from 4,570,000 shares to 9,170,000 shares.

**Note E Interest Rate Risk**

We use derivative instruments to manage the risk of changes in prevailing interest rates adversely affecting future cash flows associated with our credit facilities. We assess interest rate risk by regularly identifying and monitoring changes in interest rate exposure that may adversely impact expected future cash flows and by evaluating hedging opportunities. The derivative instrument used to manage such risk is the interest rate swap. We do not enter into derivative instruments for any purpose other than cash flow hedging. We do not speculate using derivative instruments.

As with any financial instrument, derivative instruments have inherent risks, primarily market and credit risk. Market risk associated with changes in interest rates is managed as part of our overall market risk monitoring process by establishing and monitoring limits as to the degree of risk that may be undertaken. Credit risk occurs when a counterparty to a derivative contract in which we have an unrealized gain fails to perform according to the terms of the agreement. We seek to minimize our credit risk by entering into transactions with counterparties that maintain high credit ratings.

We account for interest rate swaps in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. We have designated our interest rate swap as a cash flow hedge. For a derivative instrument designated as a cash flow hedge, the effective portion of changes in the fair value of the derivative instrument is recorded in other comprehensive loss and is recognized as a component of interest expense in the Statement of Operations when the hedged item affects results of operations. On a quarterly basis, we assess the ineffectiveness of the hedging relationship, and any gains or losses related to the ineffectiveness are recorded as interest expense in our Statement of Operations. There were no components of the derivative instrument that were excluded from the assessment of hedge effectiveness. We do not expect the ineffectiveness related to our current hedging activity to be material to our financial results in the future.

We discontinue hedge accounting prospectively if it is determined that (i) an interest rate swap is not highly effective in offsetting changes in the cash flows of a hedged item, (ii) the derivative expires or is sold, terminated or exercised, or (iii) the derivative is undesignated as a hedge instrument. If hedge accounting is discontinued, the derivative instrument will continue to be carried at fair value, with changes in the fair value of the derivative instrument recognized in the current period's results of operations. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the accumulated gains and losses included in accumulated other comprehensive income (loss) will be recognized immediately in results of operations. When hedge accounting is discontinued because the derivative instrument has not been or will not continue to be highly effective as a hedge, the remaining amount in accumulated other comprehensive income (loss) is amortized into earnings over the period that cash flows that were being hedged affect earnings.

In September 2007, we entered into a two-year interest rate swap agreement with a notional amount of \$150.0 million and a fixed rate of 4.655%. The two-year term began on September 28, 2007. This interest rate swap changes the variable-rate cash flow exposure on the \$150.0 million notional amount to fixed-rate cash flows by entering into receive-variable, pay-fixed interest rate swap transactions. Under this swap transaction, we receive London Interbank Offered Rate (LIBOR) based variable interest rate payments and make fixed-interest rate

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payments, thereby creating fixed-rate debt. We designated this hedging relationship as hedging the risk of changes in cash flows (a cash flow hedge) attributable to changes in the LIBOR rate applicable to our 2005 Revolving Credit Facility and 2006 Term Loan Facility. As such, we report the fair value of the swap as an asset or liability on our balance sheet, any ineffectiveness as interest expense, and effective changes to the fair value of the swap in other comprehensive income (loss). Fair value is determined using projected discounted future cash flows calculated using readily available market information (future LIBOR rates). At June 30, 2009, this swap is recorded at fair value as a \$1.6 million liability. We reclassified into earnings losses of \$1.6 million and \$0.8 million for the three months ended June 30, 2009 and 2008, respectively, that were related to the swap and previously reported in other comprehensive loss. We reclassified into earnings losses of \$3.2 million and \$1.1 million for the six months ended June 30, 2009 and 2008, respectively, that were related to the swap and previously reported in other comprehensive loss. We expect losses of \$1.6 million to be reclassified into earnings in the third quarter of 2009. These expected losses are currently reported in other comprehensive loss. The amount ultimately realized, however, could differ as interest rates change.

SFAS 157 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. SFAS 157 also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into three levels. Fair values determined by Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs are based on quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. The following table provides additional detail of the fair value of our swap liability at June 30, 2009 by level within the SFAS 157 fair value measurement hierarchy, as required by SFAS 157:

| In thousands                 | June 30, 2009 | Quoted Prices in<br>Active<br>Markets<br>for Identical<br>Assets (Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|------------------------------|---------------|---|---|--|
| Interest rate swap liability | \$ 1,643      | \$  | \$ 1,643  | \$   |
| Total                        | \$ 1,643      | \$  | \$ 1,643  | \$   |

The following table presents the location of our derivative instrument on the Consolidated Balance Sheets:

| In thousands                                  | Asset Derivatives         |               |                           |               | Liability Derivatives        |               |                              |               |
|---|---------------------------|---------------|---------------------------|---------------|------------------------------|---------------|------------------------------|---------------|
|   | June 30, 2009             |               | December 31, 2008         |               | June 30, 2009                |               | December 31, 2008            |               |
| Derivatives Designated as Hedging Instruments | Balance Sheet<br>Location | Fair<br>Value | Balance Sheet<br>Location | Fair<br>Value | Balance Sheet<br>Location    | Fair<br>Value | Balance Sheet<br>Location    | Fair<br>Value |
| Interest rate swap                            | Not applicable            | \$            | Not applicable            | \$            | Other current<br>liabilities | \$ 1,643      | Other current<br>liabilities | \$ 4,502      |
| <b>Total Derivatives</b>                      |                           | \$            |                           | \$            |                              | \$ 1,643      |                              | \$ 4,502      |

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The following table presents the impact of our derivative instrument on the Consolidated Statement of Operations for the three months ended June 30:

| In thousands  | Amount of (Loss) Gain Recognized in OCI on Derivative (Effective Portion) |                 | Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion) |                 |
|---|---|-----------------|--|--|-----------------|
|   | 2009  | 2008            |  | 2009   | 2008            |
| <b>Derivatives in Cash Flow Hedging Relationships</b> |   |                 |  |  |                 |
| Interest rate swap                                    | \$ (160)  | \$ 1,722        | Interest expense   | \$ (1,606)   | \$ (762)        |
| <b>Total</b>  | <b>\$ (160)</b>   | <b>\$ 1,722</b> |  | <b>\$ (1,606)</b>  | <b>\$ (762)</b> |

The following table presents the impact of our derivative instrument on the Consolidated Statement of Operations for the six months ended June 30:

| In thousands  | Amount of Loss Recognized in OCI on Derivative (Effective Portion) |                   | Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion) |                   |
|---|--|-------------------|--|--|-------------------|
|   | 2009   | 2008              |  | 2009   | 2008              |
| <b>Derivatives in Cash Flow Hedging Relationships</b> |  |                   |  |  |                   |
| Interest rate swap                                    | \$ (323)   | \$ (1,553)        | Interest expense   | \$ (3,182)   | \$ (1,102)        |
| <b>Total</b>  | <b>\$ (323)</b>  | <b>\$ (1,553)</b> |  | <b>\$ (3,182)</b>  | <b>\$ (1,102)</b> |

**Note F Fair Value of Financial Instruments**

Because of their maturities and/or variable interest rates, certain financial instruments have fair values approximating their carrying values. These instruments include cash and cash equivalents, accounts receivable and trade payables. The carrying value of the interest rate swap is adjusted to fair value at the end of each fiscal quarter and is disclosed in Note E, *Interest Rate Risk*.

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

| In thousands | June 30, 2009  |            | December 31, 2008 |            |
|--------------|----------------|------------|-------------------|------------|
|              | Carrying Value | Fair Value | Carrying Value    | Fair Value |
| Total debt   | \$ 256,375     | \$ 242,076 | \$ 270,625        | \$ 251,534 |

The fair value of our outstanding debt was estimated based on the current rates proposed to us by our bankers for debt of the same remaining maturity and characteristics.

**Table of Contents****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 nonvested shares.

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

| In thousands, except per share amounts  | Three Months Ended June 30, |           |
|---|-----------------------------|-----------|
|   | 2009                        | 2008      |
| <b>BASIC EPS</b>  |                             |           |
| Net Income  | \$ 13,058                   | \$ 18,214 |
| Weighted-average common shares outstanding used in earnings per share computations    | 63,566                      | 63,214    |
| Earnings per common share   | \$ 0.21                     | \$ 0.29   |
| <b>DILUTED EPS</b>  |                             |           |
| Net Income  | \$ 13,058                   | \$ 18,214 |
| Shares used in diluted earnings per share computations                                | 63,737                      | 63,303    |
| Earnings per common share   | \$ 0.20                     | \$ 0.29   |
| <b>Computation of shares used in earnings per share computations:</b>                 |                             |           |
| Weighted-average outstanding common shares  | 63,566                      | 63,214    |
| Weighted-average common equivalent shares dilutive effect of stock options and awards | 171                         | 89        |
| Shares used in diluted earnings per share computations                                | 63,737                      | 63,303    |

5.7 million and 7.4 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 June 30, 2009 and 2008, respectively.

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| In thousands, except per share amounts  | Six Months Ended June 30, |           |
|---|---------------------------|-----------|
|   | 2009                      | 2008      |
| <b>BASIC EPS</b>  |                           |           |
| Net Income  | \$ 20,173                 | \$ 31,800 |
| Weighted-average common shares outstanding used in earnings per share computations    | 63,541                    | 64,537    |
| Earnings per common share   | \$ 0.32                   | \$ 0.49   |
| <b>DILUTED EPS</b>  |                           |           |
| Net Income  | \$ 20,173                 | \$ 31,800 |
| Shares used in diluted earnings per share computations                                | 63,665                    | 64,720    |
| Earnings per common share   | \$ 0.32                   | \$ 0.49   |
| <b>Computation of shares used in earnings per share computations:</b>                 |                           |           |
| Weighted-average outstanding common shares  | 63,541                    | 64,537    |
| Weighted-average common equivalent shares dilutive effect of stock options and awards | 124                       | 183       |
| Shares used in diluted earnings per share computations                                | 63,665                    | 64,720    |

7.5 million and 7.0 million anti-dilutive market price options have been excluded from the calculation of shares used in the diluted EPS calculation for the six months ended June 30, 2009 and 2008, respectively.

**Note H Business Segments**

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

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Information about the operations of our two business segments follows:

| <b>In thousands</b>              | <b>Three Months Ended June 30,</b> |             |
|----------------------------------|------------------------------------|-------------|
|                                  | <b>2009</b>                        | <b>2008</b> |
| Operating revenues               |                                    |             |
| Direct Marketing                 | \$ 145,341                         | \$ 182,203  |
| Shoppers                         | 70,321                             | 92,553      |
| Total operating revenues         | \$ 215,662                         | \$ 274,756  |
| Operating income (loss)          |                                    |             |
| Direct Marketing                 | \$ 24,708                          | \$ 25,935   |
| Shoppers                         | 3,173                              | 11,727      |
| Corporate Activities             | (2,949)                            | (2,922)     |
| Total operating income           | \$ 24,932                          | \$ 34,740   |
| Income before income taxes       |                                    |             |
| Operating income                 | \$ 24,932                          | \$ 34,740   |
| Interest expense                 | (2,513)                            | (3,575)     |
| Interest income                  | 65                                 | 115         |
| Other, net                       | (1,684)                            | (970)       |
| Total income before income taxes | \$ 20,800                          | \$ 30,310   |
|                                  |                                    |             |
| <b>In thousands</b>              | <b>Six Months Ended June 30,</b>   |             |
|                                  | <b>2009</b>                        | <b>2008</b> |
| Operating revenues               |                                    |             |
| Direct Marketing                 | \$ 292,162                         | \$ 361,313  |
| Shoppers                         | 141,174                            | 181,952     |
| Total operating revenues         | \$ 433,336                         | \$ 543,265  |
| Operating income (loss)          |                                    |             |
| Direct Marketing                 | \$ 43,932                          | \$ 47,178   |
| Shoppers                         | 688                                | 19,432      |
| Corporate Activities             | (5,930)                            | (6,059)     |
| Total operating income           | \$ 38,690                          | \$ 60,551   |
| Income before income taxes       |                                    |             |
| Operating income                 | \$ 38,690                          | \$ 60,551   |
| Interest expense                 | (4,991)                            | (7,338)     |
| Interest income                  | 90                                 | 226         |
| Other, net                       | (1,702)                            | (1,638)     |
| Total income before income taxes | \$ 32,087                          | \$ 51,801   |

**Note I Components of Net Periodic Pension Benefit Cost**

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Prior to January 1, 1999, we maintained a defined benefit pension plan for which most of our employees were eligible. In conjunction with significant enhancements to our 401(k) plan, we elected to freeze benefits under this defined benefit pension plan as of December 31, 1998.

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In 1994, we adopted a non-qualified, 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 will continue to accrue as if the principal pension plan had not been frozen.

Net pension cost for both plans included the following components:

| <b>In thousands</b>                | <b>Three Months Ended June 30,</b> |               |
|------------------------------------|------------------------------------|---------------|
|                                    | <b>2009</b>                        | <b>2008</b>   |
| Service cost                       | \$ 137                             | \$ 168        |
| Interest cost                      | 2,038                              | 1,992         |
| Expected return on plan assets     | (1,401)                            | (2,244)       |
| Amortization of prior service cost | 14                                 | 15            |
| Transition obligation              | 3                                  | 24            |
| Recognized actuarial loss          | 1,436                              | 501           |
| <b>Net periodic benefit cost</b>   | <b>\$ 2,227</b>                    | <b>\$ 456</b> |

| <b>In thousands</b>                | <b>Six Months Ended June 30,</b> |               |
|------------------------------------|----------------------------------|---------------|
|                                    | <b>2009</b>                      | <b>2008</b>   |
| Service Cost                       | \$ 274                           | \$ 336        |
| Interest Cost                      | 4,077                            | 3,984         |
| Expected return on plan assets     | (2,802)                          | (4,488)       |
| Amortization of prior service cost | 27                               | 30            |
| Transition obligation              | 5                                | 48            |
| Recognized actuarial loss          | 2,872                            | 1,003         |
| <b>Net periodic benefit cost</b>   | <b>\$ 4,453</b>                  | <b>\$ 913</b> |

We are not required to make and do not intend to make any contributions to our frozen pension plan in 2009. We are not required to make and do not intend to make any contributions to our unfunded pension plan in 2009 other than to the extent needed to cover benefit payments.

**Table of Contents****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 June 30, |           |
|---|-----------------------------|-----------|
|   | 2009                        | 2008      |
| Net income  | \$ 13,058                   | \$ 18,214 |
| Other comprehensive income:   |                             |           |
| Adjustment to pension liability (net of tax expense of \$581 and \$216 in 2009 and 2008, respectively)  | 871                         | 325       |
| Change in value of derivative instrument accounted for as a cash flow hedge (net of tax expense of \$578 in 2009 and \$994 in 2008, respectively) | 868                         | 1,489     |
| Foreign currency translation adjustment   | 2,787                       | 211       |
| Total comprehensive income  | \$ 17,584                   | \$ 20,239 |

| In thousands  | Six Months Ended June 30, |           |
|---|---------------------------|-----------|
|   | 2009                      | 2008      |
| Net income  | \$ 20,173                 | \$ 31,800 |
| Other comprehensive income:   |                           |           |
| Adjustment to pension liability (net of tax expense of \$1,162 and \$432 in 2009 and 2008, respectively)  | 1,742                     | 650       |
| Change in value of derivative instrument accounted for as a cash flow hedge (net of tax expense of \$1,143 in 2009 and tax benefit \$179 in 2008, respectively) | 1,716                     | (272)     |
| Foreign currency translation adjustment   | 2,053                     | 1,032     |
| Total comprehensive income  | \$ 25,684                 | \$ 33,210 |

**Note K Goodwill**

As of June 30, 2009 and December 31, 2008, Harte-Hanks, Inc. had goodwill of approximately \$552.9 million. Under the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, 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 effect our business and financial performance. We perform our annual goodwill impairment assessment as of November 30th of each year.

Due to the continued uncertainty in the overall economic climate, we reviewed the significant assumptions in our goodwill analysis during the first and second quarters of 2009 in order to determine if it was more likely than not that our reporting units' fair values were less than their carrying values. The analyses focused on our current expectations of future cash flows, as well as current market conditions that impact various economic indicators

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that are utilized in assessing our reporting units' fair values. Based on these analyses, we determined that we did not have any triggering events requiring us to perform a goodwill assessment during the six months ended June 30, 2009.

**Note L Litigation Contingencies**

On March 23, 2001, inactive Harte-Hanks Shoppers employees Frank Gattuso and Ernest Sigala filed a putative class action against Harte-Hanks Shoppers, Inc., claiming that Harte-Hanks Shoppers failed to comply with a California statutory provision requiring an employer to indemnify employees for expenses incurred on behalf of the employer. The plaintiffs allege that Harte-Hanks Shoppers failed to reimburse them for expenses of using their automobiles as outside sales representatives and failed to accurately itemize these expenses on plaintiffs' wage statements. The suit was filed in Los Angeles County Superior Court. The putative class that plaintiffs seek to represent has been limited to all California Harte-Hanks outside sales representatives who were not separately reimbursed apart from their base salary and commissions for the expenses they incurred in using their own automobiles after early 1998. The plaintiffs seek indemnification and compensatory damages, statutory damages, exemplary damages, penalties, interest, costs of suit, and attorneys' fees. Harte-Hanks Shoppers filed a cross-complaint seeking a declaratory judgment that the plaintiffs have been indemnified for their automobile expenses by the higher salaries and commissions paid to them as outside sales representatives. The cross-complaint also alleges conversion, unjust enrichment, constructive trust and rescission and restitution based on mutual mistake. On January 30, 2002, the trial court ruled that California Labor Code Section 2802 requires employers to reimburse employees for mileage and other expenses incurred in the course of employment, but that an employer is permitted to pay increased wages or commissions instead of indemnifying actual expenses. On May 28, 2003, the trial court denied the plaintiffs' motion for class certification. On October 27, 2005, the California Court of Appeal issued a unanimous opinion affirming the trial court's rulings, including the interpretation of Labor Code Section 2802 and denial of class certification. On November 23, 2005, the Court of Appeal denied the plaintiffs' petition for rehearing. On November 5, 2007, the California Supreme Court affirmed the trial court's ruling that Labor Code Section 2802 permits lump sum reimbursement and that an employer may satisfy its obligations to indemnify employees for reasonable and necessary business expenses under Labor Code Section 2802 by paying enhanced taxable compensation. The Supreme Court remanded the matter back to the trial court for further proceedings related to the class certification issue and directed the trial court to consider whether the following issues could properly be resolved on a class-wide basis: (1) did Harte-Hanks Shoppers adopt a practice or policy of reimbursing outside sales representatives for automobile expenses by paying them higher commission rates and base salaries than it paid to inside sales representatives, (2) did Harte-Hanks Shoppers establish a method to apportion the enhanced compensation payments between compensation for labor performed and expense reimbursement and (3) was the amount paid for expense reimbursement sufficient to fully reimburse the employees for the automobile expenses they reasonably and necessarily incurred. On July 29, 2008, the trial court stated its intention to issue a split class action certification ruling, certifying a class action with respect to the first two questions listed immediately above (adoption of a policy or practice, and establishment of an apportionment method) and denying class certification on the third question listed immediately above (sufficiency of reimbursement). On May 19, 2009, the trial court issued its written partial class certification order, as described in the immediately preceding sentence. Based upon its belief that the conditions for a loss accrual described in SFAS No. 5, *Accounting for Contingencies*, have not been met, Harte-Hanks has made no accrual for this loss contingency. An estimate of the possible loss or range of loss from any adverse result on this case cannot reasonably be made. We believe that we have substantial meritorious defenses to these claims and we intend to vigorously defend the lawsuit. Nevertheless, we cannot predict the impact of future developments in this lawsuit, and any resolution of this lawsuit within a particular fiscal quarter may adversely impact our results of operations for that quarter.

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

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opinion of management, after consultation with counsel, any ultimate liability arising out of these pending claims and lawsuits is not currently expected to have 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 M Subsequent Events**

We have evaluated subsequent events from June 30, 2009 through the filing of this Form 10-Q on July 31, 2009, the date the financial statements were issued. No material subsequent events have occurred during this time which would require recognition in the financial statements or disclosure in the footnotes.

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

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

These forward-looking statements are based on current information, expectations and estimates and involve risks, uncertainties, assumptions and other factors that are difficult to predict and that could cause actual results to vary materially from what is expressed in or indicated by the forward-looking statements. In that event, our business, financial condition, results of operations or liquidity could be materially adversely affected and investors in our securities could lose part or all of their investments. Some of these risks, uncertainties, assumptions and other factors can be found in our filings with the Securities and Exchange Commission, including the factors discussed under Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008 (2008 Form 10-K) and any updates thereto in our Forms 10-Q and in the Cautionary Note Regarding Forward-Looking Statements in our second quarter 2009 earnings release issued on July 31, 2009. The forward-looking

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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 2008 Form 10-K. Our 2008 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 direct marketing services and shopper advertising opportunities to a wide range of local, regional, national and international consumer and business-to-business marketers. We manage our operations through two operating segments: Direct Marketing and Shoppers. We derive revenues from the sale of direct marketing services and shopper advertising services.

Direct Marketing services are targeted to specific industries or markets with services and software products tailored to each industry or market. Currently, our Direct Marketing business services various vertical markets including retail, high-tech/telecom, financial services, pharmaceutical/healthcare, and a wide range of selected markets. We believe that we are generally able to provide services to new industries and markets by modifying our services and applications as opportunities are presented. Depending on the needs of our clients, our Direct Marketing capabilities are provided in an integrated approach through more than 30 facilities worldwide, more than 10 of which are located outside of the United States. Each of these centers possesses some specialization and is linked with others to support the needs of our clients. We use various capabilities and technologies to enable our clients to capture, analyze and disseminate customer and prospect data across all points of customer contact. Specifically, we help companies:

gain insight into target markets;

build better information about customers and prospects;

turn customer information into marketing strategy;

design effective communications;

deliver communications and manage contacts; and

provide data analysis, profiling, quality and reporting software and services.

We offer a full complement of capabilities and resources, including:

agency and creative services;

database marketing solutions;

data quality software and services with Trillium Software;

digital marketing;

fulfillment and contact centers;

mail engineering and logistics; and

personalized and targeted mail.

Revenues from the Direct Marketing segment represented approximately 67% of our total revenue for the three months and six months ended June 30, 2009.

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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 standard mail to households and businesses in a particular geographic area. Shoppers offer advertisers a targeted, cost-effective local advertising system, with virtually 100% penetration in their area of distribution. Shoppers are particularly effective in large markets with high media fragmentation in which major metropolitan newspapers generally have low penetration. At June 30, 2009, our Shoppers were zoned into more than 950 separate editions with total circulation of approximately 11.5 million addresses in California and Florida each week. Our Shoppers segment also provides advertising and other services online through our websites, PennySaverUSA.com (California) and TheFlyer.com (Florida). These sites are online advertising portals, bringing buyers and sellers together through our online products, including local classifieds, business listings, coupons, special offers and Power Sites. Power Sites are templated web sites for our customers, optimized to help small / medium sized business owners establish a web presence and improve their lead generation.

Revenues from the Shoppers segment represented approximately 33% of our total revenue for the three months and six months ended June 30, 2009.

During the first half of 2009, our businesses continued to face challenging economic environments, which negatively impacted our financial performance. Marketing budgets are often more discretionary in nature and easier to reduce in the short-term than other expenses in response to weak economic conditions. Difficult economic conditions, in some cases including consolidation and bankruptcies of customers and prospective customers in the industry verticals that we serve, have resulted in pricing pressures and in reduced demand for our products and services.

Direct Marketing revenues are dependent on, among other things, national, regional and international economic and business conditions. During the first half of 2009, the ongoing economic recession in the United States and other economies continued to adversely impact the marketing expenditures and activities of our customers, resulting in pricing pressures, significant reductions and delays in spending by clients.

Revenues from our Shoppers business are largely dependent on local advertising expenditures in the California and Florida geographies in which we operate. Such expenditures are substantially affected by the strength of the local economies in those markets. During the first half of 2009, the negative trends and economic conditions that we have seen since the second half of 2007 in California and Florida continued.

Given the external environment, we face an uncertain revenue outlook for the remainder of 2009, and believe that our financial performance will continue to be negatively impacted. As a result, we have taken, and are continuing to take, actions designed to align our expense base and structure to the external economic environment facing our businesses. These actions include head count reductions, consolidating businesses and closing facilities, reductions of marginal Shoppers circulation, wage freezes and reductions, tightened management of capital spending, non-client travel restrictions and enhanced controls around accounts receivable and collections. Nevertheless, we cannot predict the impact of future economic conditions or the ultimate effectiveness and expenses associated with our efforts to address those economic conditions.

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

**Table of Contents****Results of Operations**

Operating results were as follows:

| In thousands, except<br>per share amounts | Three months ended |               |        | Six months ended |               |        |
|---|--------------------|---------------|--------|------------------|---------------|--------|
|   | June 30, 2009      | June 30, 2008 | Change | June 30, 2009    | June 30, 2008 | Change |
| Revenues                                  | \$ 215,662         | \$ 274,756    | -21.5% | \$ 433,336       | \$ 543,265    | -20.2% |
| Operating expenses                        | 190,730            | 240,016       | -20.5% | 394,646          | 482,714       | -18.2% |
| Operating income                          | \$ 24,932          | \$ 34,740     | -28.2% | \$ 38,690        | \$ 60,551     | -36.1% |
| Net income                                | \$ 13,058          | \$ 18,214     | -28.3% | \$ 20,173        | \$ 31,800     | -36.6% |
| Diluted earnings per share                | \$ 0.20            | \$ 0.29       | -31.0% | \$ 0.32          | \$ 0.49       | -34.7% |

**2<sup>nd</sup> Quarter 2009 vs. 2<sup>nd</sup> Quarter 2008***Revenues*

Consolidated revenues decreased 21.5%, to \$215.7 million, and operating income decreased 28.2% to \$24.9 million in the second quarter of 2009 compared to the second quarter of 2008. Our overall results reflect decreased revenues of \$36.9 million, or 20.2%, from our Direct Marketing segment and decreased revenues of \$22.2 million, or 24.0%, from our Shoppers segment. Direct Marketing experienced a year-over-year revenue decline in the low teens from our pharma/healthcare and high tech/telecom vertical and 20% declines from our retail and select verticals, while revenues from the financial services vertical declined more than 35%. These results reflect the effects of the ongoing economic recession on our Direct Marketing business. 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 Shoppers revenues was the result of decreased sales in established markets, including declines in virtually every revenue category, and curtailment of circulation of approximately 1.5 million addresses from July of 2008 to February of 2009. Excluding revenues from discontinued circulation, Shoppers revenues decreased approximately 20.0%.

*Operating Expenses*

Overall operating expenses decreased 20.5%, to \$190.7 million, in the second quarter of 2009 compared to the second quarter of 2008. The overall decrease in operating expenses was driven by decreased operating expenses in Direct Marketing of \$35.6 million, or 22.8%, decreased operating expenses in Shoppers of \$13.7 million, or 16.9%, partially offset by an increase in general corporate expense of 0.9%. The Direct Marketing decrease was primarily a result of headcount reductions, lower outsourced costs, lower logistics-related transportation costs resulting from lower volumes, and travel restrictions. The decrease at Shoppers was primarily due to postage related to circulation curtailments, declines in ad placements and distribution volumes, headcount reductions and decreased promotion-related expense. The overall decrease in operating expenses was partially offset by a \$1.7 million increase in pension expense due to 2008 declines in the market value of our pension plan assets.

*Net Income/Earnings Per Share*

Net income decreased 28.3%, to \$13.1 million, and diluted earnings per share decreased 31.0%, to \$0.20 per share, in the second quarter of 2009 when compared to the second quarter of 2008. The decrease in net income was a result of decreased operating income from both Shoppers and Direct Marketing, partially offset by lower interest expense and a lower effective tax rate.

**First Half 2009 vs. First Half 2008***Revenues*

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Consolidated revenues decreased 20.2%, to \$433.3 million, and operating income decreased 36.1% to \$38.7 million in the first half of 2009 compared to the first half of 2008. Our overall results reflect decreased revenues of \$69.2 million, or 19.1%, from our Direct Marketing segment and decreased revenues of \$40.8 million, or 19.1%, from our Shoppers segment. Direct Marketing experienced a year-over-year revenue decline from our pharma/healthcare vertical in the low teens, declines in the mid-teens from our retail, high tech/telecom and select verticals, while revenues from the financial services vertical declined more than 35%. These results reflect the effects of the ongoing economic recession on our Direct Marketing business. Shoppers revenue performance

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reflects the continued impact that the difficult economic environments in California and Florida are having on our Shoppers business. The decrease in Shoppers revenues was the result of decreased sales in established markets, including declines in virtually every revenue category, and curtailment of circulation of approximately 1.5 million addresses from July of 2008 to February of 2009. Excluding revenues from discontinued circulation, Shoppers revenues decreased approximately 18.6%.

*Operating Expenses*

Overall operating expenses decreased 18.2%, to \$394.6 million, in the first half of 2009 compared to the first half of 2008. The overall decrease in operating expenses was driven by decreased operating expenses in Direct Marketing of \$65.9 million, or 21.0%, decreased operating expenses in Shoppers of \$22.0 million, or 13.6%, and decreased general corporate expense of \$0.1 million, or 2.1%. The Direct Marketing decrease was primarily a result of headcount reductions, lower outsourced costs, lower logistics-related transportation costs resulting from lower volumes, and travel restrictions. The decrease at Shoppers was primarily due to postage related to circulation curtailments, declines in ad placements and distribution volumes, headcount reductions and decreased promotion-related expense. The overall decrease in operating expenses was partially offset by a \$3.4 million increase in pension expense due to 2008 declines in the market value of our pension plan assets.

*Net Income/Earnings Per Share*

Net income decreased 36.6%, to \$20.2 million, and diluted earnings per share decreased 34.7%, to \$0.32 per share, in the first half of 2009 when compared to the first half of 2008. The decrease in net income was a result of decreased operating income from both Shoppers and Direct Marketing, partially offset by lower interest expense, lower general corporate expense and a lower effective tax rate.

**Direct Marketing**

Direct Marketing operating results were as follows:

| In thousands       | Three months ended |               |        | Six months ended |               |        |
|--------------------|--------------------|---------------|--------|------------------|---------------|--------|
|                    | June 30, 2009      | June 30, 2008 | Change | June 30, 2009    | June 30, 2008 | Change |
| Revenues           | \$ 145,341         | \$ 182,203    | -20.2% | \$ 292,162       | \$ 361,313    | -19.1% |
| Operating expenses | 120,633            | 156,268       | -22.8% | 248,230          | 314,135       | -21.0% |
| Operating income   | \$ 24,708          | \$ 25,935     | -4.7%  | \$ 43,932        | \$ 47,178     | -6.9%  |

**2<sup>nd</sup> Quarter 2009 vs. 2<sup>nd</sup> Quarter 2008***Revenues*

Direct Marketing revenues decreased \$36.9 million, or 20.2%, in the second quarter of 2009 compared to the second quarter of 2008. Revenues from all of our vertical markets experienced double-digit declines in the second quarter compared to the second quarter of 2008. Our pharma/healthcare and high tech/telecom verticals experienced a revenue decline in the low teens, while our retail and select verticals declined 20%. The financial services vertical continued to be the most challenging, with revenues declining over 35% for the quarter. These results reflect the effects of the ongoing economic recession on our Direct Marketing business. 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. Revenues for Direct Marketing are affected by a number of factors, including general national and international economic trends.

Short-term revenue performance will depend on, among other factors, the impact and duration of the ongoing economic recession and 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

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moved from other advertising media to the targeted media space, the results of which can be more effectively tracked, enabling measurement of the return on marketing investment, and that our business will benefit as a result. Standard postage rates have increased in recent years, and increased again in May 2009. The average postage rate for our Direct Marketing customers increased by approximately 3.8% as a result of the May 2009 rate increase. Postage rates influence the demand for our Direct Marketing services even though the cost of mailings is borne by our clients and is not directly reflected in our revenues or expenses. There is no assurance that future postal increases will not have an adverse impact on us.

*Operating Expenses*

Operating expenses decreased \$35.6 million, or 22.8%, in the second quarter of 2009 compared to the second quarter of 2008. Labor costs decreased \$16.8 million, or 20.6%, due to headcount reductions, lower commissions as a result of revenue performance, a decrease in severance, and lower stock-based compensation. The decrease in labor costs was partially offset by an increase in pension expense. Production and distribution costs decreased \$14.9 million, or 27.4%, due to lower outsourced costs as a result of lower outsourced volumes, and lower logistics-related transportation costs resulting from reduced transportation volumes and decreased transportation costs. General and administrative expense decreased \$2.4 million, or 17.7%, due primarily to less travel. Depreciation and software amortization expense decreased \$1.3 million, or 19.8%, due to decreased capital expenditures in the last several quarters. Intangible asset amortization decreased \$0.3 million, or 57.1%, due to certain intangible assets becoming fully amortized

Direct Marketing's largest cost components are labor, outsourced costs and transportation costs. Each of these costs is somewhat variable and tends to fluctuate with revenues and the demand for our direct marketing services. Fuel costs have increased significantly in the last few years and were at historically high levels throughout much of 2008 before decreasing significantly in the fourth quarter of 2008 and holding at those levels in the first half of 2009. Future changes in fuel 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 transportation services.

As a result of the tough economic conditions, we have taken, and are continuing to take, actions to adjust our expense base to reduced revenue levels. These actions include headcount reductions, consolidating businesses and closing facilities, wage freezes and reductions, tightened management of capital spending, non-client travel restrictions and enhanced controls around accounts receivable and collections. We realized a positive impact on our first half 2009 Direct Marketing operating costs and we anticipate realizing a positive impact on the full year 2009 Direct Marketing operating costs as a result of these actions.

First Half 2009 vs. First Half 2008

*Revenues*

Direct Marketing revenues decreased \$69.2 million, or 19.1%, in the first half of 2009 compared to the first half of 2008. Revenues from all of our vertical markets experienced declines in the first half of 2009 compared to the first half of 2008. Our pharma/healthcare vertical experienced a revenue decline in the low teens while our retail, high tech/telecom and select verticals declined in the mid-teens. The financial services vertical continued to be the most challenging, with revenues declining over 35% in the first half of 2009 compared to the first half of 2008.

*Operating Expenses*

Operating expenses decreased \$65.9 million, or 21.0%, in the first half of 2009 compared to the first half of 2008. Labor costs decreased \$28.8 million, or 17.4%, due to headcount reductions, lower commissions as a result of revenue performance, and lower stock-based compensation. This decrease was partially offset by an increase in severance and pension expense. Production and distribution costs decreased \$28.1 million, or 25.9%, due to lower outsourced costs as a result of lower outsourced volumes, and lower logistics-related transportation costs resulting from reduced transportation volumes and decreased transportation costs. General and

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administrative expense decreased \$6.4 million, or 23.6%, due primarily to less travel. Depreciation and software amortization expense decreased \$2.1 million, or 16.6%, due to decreased capital expenditures in the last several quarters. Intangible asset amortization decreased \$0.5 million, or 57.1%, due to certain intangible assets becoming fully amortized

**Shoppers**

| In thousands       | Three months ended |               |        | Six months ended |               |        |
|--------------------|--------------------|---------------|--------|------------------|---------------|--------|
|                    | June 30, 2009      | June 30, 2008 | Change | June 30, 2009    | June 30, 2008 | Change |
| Revenues           | \$ 70,321          | \$ 92,553     | -24.0% | \$ 141,174       | \$ 181,952    | -22.4% |
| Operating expenses | 67,148             | 80,826        | -16.9% | 140,486          | 162,520       | -13.6% |
| Operating income   | \$ 3,173           | \$ 11,727     | -72.9% | \$ 688           | \$ 19,432     | -96.5% |

**2<sup>nd</sup> Quarter 2009 vs. 2<sup>nd</sup> Quarter 2008***Revenues*

Shoppers revenues decreased \$22.2 million, or 24.0%, in the second quarter of 2009 compared to the second quarter of 2008. 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 virtually every revenue category, and curtailment of circulation of approximately 250,000 in July of 2008, 500,000 in December of 2008 and 700,000 in February of 2009. The net impact of these circulation curtailments was a reduction in Shoppers revenues of \$4.6 million in the second quarter of 2009 compared to the second quarter of 2008. Excluding revenues from discontinued circulation, Shoppers revenues decreased approximately 20.0%. The net impact of these circulation curtailments on the full year 2009 compared to the full year 2008 will be a reduction in Shoppers revenues of \$15.5 million. At June 30, 2009 our Shoppers circulation reached approximately 11.5 million addresses each week. 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.

*Operating Expenses*

Operating expenses decreased \$13.7 million, or 16.9%, in the second quarter of 2009 compared to the second quarter of 2008. Total labor costs decreased \$5.0 million, or 17.9%, as a result of reductions in our Shoppers workforce due to consolidations and circulation curtailments. Total production costs decreased \$6.8 million, or 15.5%, due primarily to decreased postage costs resulting from circulation curtailments and distribution volumes, decreased offload printing costs due to decreased distribution volumes and decreased paper costs due to circulation reductions and a decline in ad placements. Total general and administrative costs decreased \$1.7 million, or 25.4%, due primarily to lower promotion-related expense due to revenue levels, lower insurance expense due to favorable workers compensation experience, and decreased bad debt expense due to timing and recoveries. Depreciation and software amortization expense decreased \$0.2 million, or 8.0%, due to decreased capital expenditures in the last several quarters.

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 May 2009. Shoppers postage rates increased by approximately 1.4% as a result of the May 2009 rate increase. Paper prices were down for much of 2008 before increasing in the second half of 2008 and continuing to increase in the first half of 2009. We expect average paper prices to continue to increase in the third quarter of 2009 and then stabilize in the fourth quarter of 2009. Average paper prices for the full year 2009 are expected to be approximately 7.0% higher than our average prices for the full year 2008. This increase and future changes in paper prices will affect Shoppers production costs. At the end of the first quarter of 2009, we completed the consolidation of our two Florida production facilities into one facility. We incurred approximately \$2.0 million in costs in the first quarter related to this action. The expected 2009 savings from this consolidation will be offset by the 2009 first quarter charges.

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The general economic conditions, initially created by weakness in the real estate and associated financing markets, in the California and Florida geographies in which we operate remain extremely challenging. We have taken, and are continuing to take, actions to reduce our cost base in Shoppers. These actions include headcount reductions, consolidating businesses and closing facilities, reductions of marginal Shoppers circulation, wage freezes and reductions, tightened management of capital spending and enhanced controls around accounts receivable and collections.

### **First Half 2009 vs. First Half 2008**

#### *Revenues*

Shoppers revenues decreased \$40.8 million, or 22.4%, in the first half of 2009 compared to the first half of 2008. 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 virtually every revenue category, and curtailment of circulation of approximately 250,000 in July of 2008, 500,000 in December of 2008 and 700,000 in February of 2009. The net impact of these circulation curtailments was a reduction in Shoppers revenues of \$8.5 million in the first half of 2009 compared to the first half of 2008. Excluding revenues from discontinued circulation, Shoppers revenues decreased approximately 18.6%.

#### *Operating Expenses*

Operating expenses decreased \$22.0 million, or 13.6%, in the first half of 2009 compared to the first half of 2008. Total labor costs decreased \$10.0 million, or 17.0%, as a result of reductions in our Shoppers workforce due to consolidations and circulation curtailments. Total production costs decreased \$9.6 million, or 11.1%, due primarily to decreased postage costs resulting from circulation curtailments and distribution volumes, decreased offload printing costs due to decreased distribution volumes and decreased paper costs due to circulation reductions and a decline in ad placements. This decrease was partially offset by \$1.6 million in lease write-offs in the first quarter of 2009 related to the consolidations and circulation curtailments. Total general and administrative costs decreased \$3.3 million, or 24.5%, due primarily to lower promotion-related expense due to revenue levels, and lower insurance expense due to favorable workers compensation experience. Depreciation and software amortization expense increased \$0.8 million, or 22.2%, due to the acceleration of depreciation of assets related to the circulation curtailments and plant consolidation.

### **General Corporate Expense**

General corporate expense increased 0.9% in the second quarter of 2009 compared to the second quarter of 2008 due to an increase in pension expense. Pension expense increased due to 2008 declines in the market value of our pension plan assets. This increase was partially offset by lower payroll, professional services and stock-based compensation. General corporate expense decreased \$0.1 million, or 2.1%, in the first half of 2009 compared to the first half of 2008. This decrease was primarily due to lower payroll, stock-based compensation and professional services, partially offset by an increase in pension expense.

### **Interest Expense**

Interest expense decreased \$1.1 million, or 29.7%, in the second quarter of 2009 and \$2.3 million, or 32.0%, in the first half of 2009 compared to the same periods in 2008. These decreases are due to lower outstanding debt levels and lower interest rates in the second quarter and first half of 2009 than in the same periods in 2008. The higher debt levels in 2008 were primarily the result of financing share repurchases.

### **Interest Income**

Interest income was down in the second quarter and first half of 2009 compared to the same period in 2008 due to lower interest rates on investments.

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### **Other Income and Expense**

Other net expense increased \$0.7 million, or 73.6%, in the second quarter of 2009 and \$0.1 million, or 3.9%, in the first half of 2009 compared to the same periods in of 2008, primarily due to an increase in net foreign currency transaction losses.

### **Income Taxes**

Income tax expense decreased \$4.4 million in the second quarter and \$8.1 million in the first half of 2009 compared to the same periods in 2008. The effective tax rate was 37.2% for the second quarter of 2009, down from 39.9% for the second quarter of 2008. The effective tax rate was 37.1% for the first half of 2009, down from 38.6% for the first half of 2008. The decrease in the effective tax rate is primarily due to a decrease in our state income tax, as operations in states with higher tax rates have been more negatively impacted by the economic downturn.

### **Economic Climate and Impact on our Financial Statements**

The current economic climate has had a negative impact on our operations and cash flows for the three months and six months ended 6/30/09 and our financial position at 6/30/09. We cannot predict the timing, strength or duration of the current economic recession or any subsequent economic recovery. If the economic climate and markets we serve deteriorate, 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 June 30, 2009, cash and cash equivalents were \$74.9 million, increasing \$44.8 million from December 31, 2008. This net increase was a result of net cash provided by operating activities of \$71.3 million, partially offset by cash used in investing activities of \$3.8 million and net cash used in financing activities of \$23.3 million.

#### *Operating Activities*

Net cash provided by operating activities for the six months ended June 30, 2009 was \$71.3 million, compared to \$53.4 million for the six months ended June 30, 2008. The \$17.9 million year-over-year increase was attributable to changes within working capital assets and liabilities, partially offset by lower net income.

For the six months ended June 30, 2009, our principal working capital changes, which directly affected net cash provided by operating activities, were as follows:

A decrease in accounts receivable attributable to lower revenues in the second quarter of 2009 than in the fourth quarter of 2008. Days sales outstanding of approximately 56 days at June 30, 2009 decreased from 58 days at December 31, 2008 and 61 days at June 30, 2008;

A decrease in inventory due to Shoppers circulation curtailment and lower Shoppers ad placements;

A decrease in prepaid expenses and other current assets due to timing of payments;

A decrease in accounts payable due to overall lower operating expenses in the second quarter of 2009 than in the fourth quarter of 2008;



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A decrease in accrued payroll and related expenses due to headcount reductions, timing of payroll payments and lower accrued commissions at June 30, 2009 than at December 31, 2008;

A decrease in customer deposits and unearned revenue due to timing of receipts and decrease in revenue levels; and

An increase in income taxes payable due to the timing of tax payments.

*Investing Activities*

Net cash used in investing activities was \$3.8 million for the six months ended June 30, 2009, compared to \$20.5 million for the six months ended June 30, 2008. The difference is primarily the result of the January 2008 acquisition of Mason Zimble and lower capital expenditures in the first half of 2009 than in the first half of 2008.

*Financing Activities*

Net cash outflows from financing activities were \$23.3 million for the six months ended June 30, 2009 compared to net cash outflows of \$32.9 million for the six months ended June 30, 2008. The difference is attributable primarily to \$76.6 million less spent on the repurchase of our common stock, partially offset by \$64.5 million less net borrowings in the first half of 2009 than in the first half of 2008.

*Credit Facilities*

Our five-year \$125 million Revolving Credit Facility has a maturity date of August 12, 2010. At June 30, 2009, we did not have any outstanding amounts drawn against our Revolving Credit Facility. The five-year \$200 million 2006 Term Loan Facility has a maturity date of September 6, 2011. At June 30, 2009, our debt balance related to the 2006 Term Loan Facility was \$160.9 million. The four-year \$100 million 2008 Term Loan Facility has a maturity date of March 7, 2012. At June 30, 2009, our debt balance related to the 2008 Term Loan Facility was \$95.5 million.

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 covenants restricting our ability to grant liens and enter into certain transactions and limit the total amount of indebtedness of our subsidiaries to \$20 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 prevent of default under existing agreements. As of June 30, 2009, we were in compliance with all of the covenants of our credit facilities.

In September 2007, we entered into a two-year interest rate swap with a notional amount of \$150 million and a fixed rate of 4.655% in order to limit a portion of our interest rate exposure by converting a portion of our variable-rate debt to fixed-rate debt. Please refer to Note E of the Notes to Unaudited Condensed Consolidated Financial Statements, *Interest Rate Risk*, and Item 3. to this Form 10-Q, *Quantitative and Qualitative Disclosures About Market Risk*, for a description of our interest rate risk.

*Outlook*

We consider such factors as 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

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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 Revolving Credit Facility, subject to the terms and conditions of that facility.

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

Recent developments in the financial markets have increased our exposure to the possible liquidity and credit risks of counterparties to our Revolving Credit Facility. As of June 30, 2009, we had \$125.0 million of unused borrowing capacity under our Revolving Credit Facility and we have not experienced any limitations to date on our ability to access this source of liquidity. At June 30, 2009 we had a cash balance of \$74.9 million. Based on our current operational plans, we believe that our Revolving Credit Facility, together with cash on hand and cash provided by operating activities, will be sufficient to fund operations, anticipated capital expenditures, payments of principal and interest on our borrowings, and dividends on our common stock for at least the next twelve months. Nevertheless, we cannot predict the impact on our business performance of the ongoing economic recession in the United States and other economies. 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.

Our Revolving Credit Facility matures in August 2010. If the ongoing disruptions in the credit markets continue for an extended period of time, we may be unable to obtain a replacement facility on acceptable terms or at all, or we may be unable to access funds under our Revolving Credit Facility because of counterparty risk or other factors. In that event, depending on our ability to generate sufficient cash flow from operations, our overall liquidity and ability to make payments on our indebtedness under our 2006 Term Loan Facility (which matures in September 2011) and our 2008 Term Loan Facility (which matures in March 2012) may be adversely impacted, and we may be required to seek one or more alternatives, such as refinancing or restructuring our indebtedness, selling material assets or operations, or seeking to raise debt or equity capital. We cannot assure you that any of these actions could be affected on a timely basis or on satisfactory terms, if at all. In addition, our existing debt agreements contain restrictive covenants which may prohibit us from adopting one or more of these alternatives.

**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 2008 Form 10-K:

Revenue recognition;

Allowance for doubtful accounts;

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

Goodwill; and

Stock-based compensation.

There have been no material changes to the critical accounting policies described in our 2008 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



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already been reflected in the accompanying consolidated financial statements, or will become effective for our financial statements at various dates in the future. Our adoption of SFAS 141R, *Business Combinations*, on January 1, 2009 will affect the way we account for future acquisitions, including acquisition-related costs, contingencies and contingent consideration. Our adoption of SFAS 141R may also impact the amount of information we disclose about future acquisitions.

The adoption of the remaining new accounting pronouncements discussed in Note B of the Notes to Unaudited Condensed Consolidated Financial Statements 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 Eurodollar rates (effective 30 day rate of 0.31% at June 30, 2009). The five-year \$125 million Revolving Credit Facility has a maturity date of August 12, 2010. At June 30, 2009, we did not have any debt outstanding under the Revolving Credit Facility. The five-year \$200 million 2006 Term Loan Facility has a maturity date of September 6, 2011. At June 30, 2009, our debt balance related to the 2006 Term Loan Facility was \$160.9 million. The four-year \$100 million 2008 Term Loan Facility has a maturity date of March 7, 2012. At June 30, 2009, our debt balance related to the 2008 Term Loan Facility was \$95.5 million. In September 2007, we entered into a two-year interest rate swap with a notional amount of \$150 million and a fixed rate of 4.655% in order to limit a portion of our interest rate exposure by converting a portion of our variable-rate debt to fixed-rate debt.

Assuming the actual level of borrowing throughout the second quarter and first half of 2009, and assuming a one percentage point change in the year's average interest rates, it is estimated that our second quarter and first half of 2009 net income would have changed by approximately \$0.2 million and \$0.4 million, respectively. Due to our interest rate swap, overall debt level at June 30, 2009, anticipated cash flows from operations, and the various financial alternatives available to management 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 Statement of Operations. Due to the current level of operations conducted in foreign currencies, we do not believe that the impact of fluctuations in foreign 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 results in an adjustment to income, which is recorded in Other, net in our Statement of Operations. Transactions such as these amounted to \$1.3 million and \$1.0 million in pre-tax currency transaction losses in the second quarter and first half of 2009, respectively. 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.

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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**

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 second quarter of 2009 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 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 2008 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in our 2008 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 2008 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.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During the second quarter of 2009, 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 June 30, 2009, we had repurchased a total of 63,924,509 shares at an average price of \$18.83 per share under this program. The maximum number of shares that may yet be purchased under this program was 10,475,491 at June 30, 2009.

**Item 4. Submission of Matters to a Vote of Security Holders**

We held our annual meeting of stockholders on May 12, 2009. At the meeting, our stockholders elected both of our nominees for Class I directors by the following votes:

|                      | For        | Withheld  |
|----------------------|------------|-----------|
| David L. Copeland    | 57,878,788 | 2,295,813 |
| Christopher M. Harte | 59,506,890 | 667,711   |

The following six directors terms continued after the annual meeting: William F. Farley, Larry D. Franklin, William K. Gayden, Houston H. Harte, Judy C. Odom and Karen A. Puckett. The terms of Messrs. Farley, Franklin and Gayden will expire at the 2010 annual meeting.

At the meeting, our stockholders ratified the appointment of KPMG LLP as our independent registered public accounting firm for fiscal year 2009 by the following votes:

|                      | For        | Against | Abstentions |
|----------------------|------------|---------|-------------|
| Ratification of KPMG | 59,969,298 | 197,045 | 8,258       |

At the meeting, our stockholders approved an amendment to the Harte-Hanks, Inc. 2005 Omnibus Incentive Plan to increase the maximum number of authorized shares that may be issued thereunder by 4,600,000 shares, from 4,570,000 shares to 9,170,000 shares by the following votes:

|   | For        | Against   | Abstentions | Non-Votes |
|---|------------|-----------|-------------|-----------|
| Increased authorized shares under 2005 Omnibus Incentive Plan | 50,307,382 | 4,889,171 | 30,445      | 4,947,603 |

At the meeting, our stockholders approved the material terms of the current performance goal set forth within the Harte-Hanks, Inc. 2005 Omnibus Incentive Plan by the following votes:

|  | For        | Against   | Abstentions | Non-Votes |
|--|------------|-----------|-------------|-----------|
| Approved performance goal within 2005 Omnibus Incentive Plan | 53,878,555 | 1,319,580 | 28,863      | 4,947,603 |

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**Item 6. Exhibits**

See Index to Exhibits on Page 36.

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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.

July 31, 2009

Date

HARTE-HANKS, INC.

/s/ Larry Franklin

Larry Franklin

President and Chief Executive Officer

July 31, 2009

Date

/s/ Douglas Shepard

Douglas Shepard

Executive Vice President and  
Chief Financial Officer

July 31, 2009

Date

/s/ Jessica Huff

Jessica Huff

Vice President, Finance and  
Chief Accounting Officer

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**INDEX TO EXHIBITS**

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   |
|--------------------|---|
| 10.1               | Amendment to Harte-Hanks, Inc. 2005 Omnibus Incentive Plan, dated as of May 12, 2009 (incorporated by reference to Exhibit 4.4 to Harte-Hanks Registration Statement on Form S-8, filed on May 12, 2009). |
| *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.   |

\* Filed or furnished herewith