HARTE HANKS INC
Form 10-K
March 18, 2019

U.S.
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2018

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-07120

HARTE HANKS, INC.
(Exact name of registrant as specified in its charter)

Delaware	74-1677284
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9601 McAllister Freeway, Suite 610, San Antonio, Texas 78216
(Address of principal executive offices, including zipcode)

(210) 829-9000
(Registrant’s telephone number including area code)

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

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

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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 ý No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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

Large accelerated filer	o	Accelerated filer	ý
Non-accelerated filer	o	Smaller reporting company	ý
		Emerging growth company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing price ($11.10) as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2018), was approximately $54,415,142.

The number of shares outstanding of each of the registrant's classes of common stock as of January 31, 2019 was 6,266,130 shares of common stock, all of one class.

Documents incorporated by reference:

Portions of the Proxy Statement to be filed for the company's 2018 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

THIS ANNUAL REPORT ON FORM 10-K IS BEING DISTRIBUTED TO STOCKHOLDERS IN LIEU OF A SEPARATE ANNUAL REPORT PURSUANT TO RULE 14a-3(b) OF THE ACT AND SECTION 203.01 OF THE NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL.

Harte Hanks, Inc. and Subsidiaries
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Form 10-K Report
December 31, 2018

PART I

ITEM 1. BUSINESS

INTRODUCTION

Harte Hanks, Inc. ("Harte Hanks," "we," "our," or "us") is a purveyor of data-driven, omni-channel marketing and customer relationship solutions and logistics. The Company has robust capabilities that offer clients the strategic guidance they need across the customer data landscape as well as the executional know-how in database build and management, data analytics, digital media, direct mail, customer contact, client fulfillment and marketing and product logistics. Harte Hanks solves marketing, commerce and logistical challenges for some of the world's leading brands in North America, Asia-Pacific and Europe.

We are the successor to a newspaper business started by Houston Harte and Bernard Hanks in Texas in the early 1920s. We were incorporated in Delaware on October 1, 1970. In 1972, Harte Hanks went public and was listed on the New York Stock Exchange ("NYSE"). We became a private company in a leveraged buyout in 1984, and in 1993 we again went public and listed our common stock on the NYSE.

We provide public access to all reports filed with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934, as amended (the "1934 Act"). These documents may be accessed free of charge on our website at www.hartehanks.com. There is not any information from this website incorporated by reference herein. These documents are provided as soon as practical after they are filed with the SEC and may also be found at the SEC’s website at www.sec.gov. Additionally, we have adopted and posted on our website a code of ethics that applies to our principal executive officer, principal financial officer, and principal accounting officer. Our website also includes our corporate governance guidelines and the charters for each of our audit, compensation, and nominating and corporate governance committees, and we will provide a printed copy of any of these documents to any requesting stockholder.

OUR BUSINESS

We offer a wide variety of integrated, omni-channel, data-driven solutions for top brands around the globe. We help our clients gain insight into their customers’ behaviors from their data and use that insight to create innovative multi-channel marketing programs that deliver greater return on marketing investment. We believe our clients’ success is determined not only by how good their tools are, but how well we help them use these tools to gain insight and analyze their consumers. This results in a strong and enduring relationship between our clients and their customers which is key to being leaders in customer interaction. We offer a full complement of capabilities and resources to provide a broad range of marketing services, in media from direct mail to email, including:

- Agency: We offer full-service, customer engagement solutions specializing in direct and digital communications for both consumer and business-to-business markets. With strategy, creative, and implementation services, we help marketers within targeted industries understand, identify, and engage prospects and customers in their channel of choice.

- Digital Solutions: Our digital solutions integrate online services within the marketing mix and include: search engine management, display, digital analytics, website development and design, digital strategy, social media, email, e-commerce, and interactive relationship management and a host of other services that support our core businesses.

- Database Marketing Solutions: We have successfully delivered marketing database solutions across various industries. Our solutions are built around centralized marketing databases with three core offerings: insight and analytics; customer data integration; and marketing communications tools. Our solutions enable organizations to build and manage customer communication strategies that drive customer acquisition and retention and maximize the value of existing customer relationships. Through insight and analytics, we help clients identify models of their most profitable customer relationships and then apply these models to increase the value of existing customers while also winning profitable new customers. Through customer data integration, data from multiple sources is brought together to provide a single customer view of client prospects and customers. We then help clients apply their data and insights to the entire customer life cycle, which helps clients sustain and grow their business, gain deeper customer insights, and continuously refine their customer resource management strategies and tactics.

- Direct Mail: As a full-service direct marketing provider and a substantial mailing partner of the U.S. Postal Service ("USPS"), our operational mandate is to ensure creativity and quality, provide an understanding of the options available in technologies and segmentation strategies and capitalize on economies of scale with our variety of execution options.

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- Mail and Product Fulfillment: We offer mail and product fulfillment solutions where we provide print on demand, manage product recalls, and distribute literature and other products. Harte Hanks has temperature-controlled, FDA-approved and geographically convenient warehouses to support print and product, all controlled by our proprietary nexTOUCH platform.

- Logistics: Harte Hanks is one of the leading providers of third-party logistics and freight optimization in the United States. We complete millions of shipments of time-sensitive materials annually and have access to a certified fleet of over 15,000 trucks and a proprietary logistical system called Allink®360 that is designed to get customers' products delivered on-time and on-budget.

- Contact Centers: We offer an intelligently responsive contact center approach, which uses real-time data and predictive insights to interact with each customer in the most effective way. Our on-shore and off-shore customer support representatives deftly handle incoming calls in multiple languages, email, chat, video and social media requests 24/7 to improve customer experiences. At the same time, our advanced analytics can alert customers to trending product or service issues. Our team skillfully configures Oracle CRM or Salesforce to create great customer interactions by seamlessly linking continually-improving content between agent or AI-driven interfaces and web-based self-help tools or community forums. Our lead specialists engage qualified buyers and influencers with just the right message at just the right moment. Additionally, when combined with our Fulfillment and Logistics offerings, we provide a full suite of services for customers' warranty, returns and recall issues.

Many of our client relationships start with an offering from the list above on an individual solution basis or a combination of our offerings from across our service offerings.

In 2018 and 2017, Harte Hanks had revenues of $284.6 million and $383.9 million, respectively.

Management Changes

Effective January 4, 2019, Bant Breen was appointed as our Chief Executive Officer. He joined Harte Hanks' Board in June 2018. Before joining Harte Hanks, Bant led numerous award-winning agencies within the WPP, IPG and Publicis groups and was inducted into the American Advertising Federation's Hall of Achievement in 2010. Most recently, Bant founded Qnary, the leading technology platform for executive reputation management. Qnary was recognized in 2018 by both Inc. and Entrepreneur magazines as one of the most innovative and fastest growing companies in America. In connection with Bant's appointment, the Office of the CEO that was formed upon the resignation of Karen A. Puckett was dissolved.

Effective January 4, 2019, Andrew Harrison was promoted to President and Chief Operating Officer. Andrew has been with Harte Hanks for more than 20 years and brings a wealth of company and industry knowledge to the leadership team.

On January 16, 2019, Mark Del Priore was appointed as Chief Financial Officer to succeed Jon Biro who chose to leave the Company. Mark has more than 15 years of media experience, most recently as CFO for the publicly traded advertising company, SITO Mobile. Mark began working with Harte Hanks as an advisor in October 2018.

On Feb 1, 2019, Martin Reidy took the helm of our marketing services division which covers our agency, digital solutions and database marketing solutions. Martin was a Harte Hanks board member and has significant experience in direct marketing, digital advertising, predictive marketing and data-driven results marketing. Most recently, Martin served as the President and CEO of Ansira Partners, a data and digital marketing agency. Prior to that he was CEO and President of Meredith Xcelerated Marketing (a marketing services division within Meredith Publishing Inc.), Publicis Modem and R/GA (leading digital advertising and relationship marketing services firms).

Restructuring Activities

On September 21, 2018, our Board of Directors approved a reduction in our workforce for certain employees performing sales and corporate marketing functions. in Q4 2018, we identified additional reduction opportunities which resulted in an additional reduction of our workforce in other functions. The workforce reductions resulted in a restructuring charge of approximately $0.9 million for employee severance and related costs and we anticipate that this action will result in annualized cost savings of approximately $7.5 million. In addition, beginning in 2019 we expect to reduce certain non-labor discretionary expenses, with the aim of reducing expenses by an additional approximately $2.0 million per year.

Customers

Our services are marketed to specific industries or markets with services and software products tailored to each industry or market. We tailor our services and software products depending on the industry or market we are targeting. We believe that we are generally able to provide services to new industries and markets by modifying our existing services and applications. We currently provide services primarily to the retail, B2B, financial services, consumer, and healthcare vertical markets, in addition to a range of other select markets. Our largest client (measured in revenue) comprised 8% of total revenues in 2018. Our largest 25 clients in terms of revenue comprised 64% of total revenues in 2018.

Sales and Marketing

We rely on our enterprise and solution sellers to primarily sell our products and services to new clients and task our employees supporting existing clients to expand our client relationship through additional solutions and products. Our marketing services sales force sells a variety of solutions and services to address client's targeted marketing needs. We maintain solution-specific sales forces and sales groups to sell our individual products and solutions.

Facilities

Our services are provided at the following facilities, all of which are leased:

Domestic Offices	
Austin, Texas	Lenexa, Kansas
Chelmsford, Massachusetts	Maitland, Florida
Deerfield Beach, Florida	New York, New York
Denver, Colorado	Raleigh, North Carolina
East Bridgewater, Massachusetts	San Antonio, Texas
Fullerton, California	Shawnee, Kansas
Grand Prairie, Texas	Trevose, Pennsylvania
Jacksonville, Florida	Texarkana, Texas
Langhorne, Pennsylvania	Wilkes-Barre, Pennsylvania

International Offices	
Hasselt, Belgium	Manila, Philippines
Iasi, Romania	Uxbridge, United Kingdom

Competition

Our competition comes from local, national, and international marketing and advertising companies, and internal client resources, against whom we compete for individual projects, entire client relationships, and marketing expenditures. Competitive factors in our industry include the quality and scope of services, technical and strategic expertise, the perceived value of the services provided, reputation, and brand recognition. We also compete against social, mobile, web-based, email, print, broadcast, and other forms of advertising for marketing and advertising dollars in general.

Seasonality

Our revenues tend to be higher in the fourth quarter than in other quarters during a given year. This increased revenue is a result of overall increased marketing activity prior to and during the holiday season, primarily related to our retail vertical.

GOVERNMENT REGULATION

As a company conducting varied business activities for clients across diverse industries around the world, we are subject to a variety of domestic and international legal and regulatory requirements that impact our business, including, for example, regulations governing consumer protection, and unfair business practices, contracts, e-commerce, intellectual property, labor, and employment (especially wage and hour laws), securities, tax, and other laws that are generally applicable to commercial activities.

We are also subject to, or affected by, numerous local, national, and international laws, regulations, and industry standards that regulate direct marketing activities, including those that address privacy, data security, and unsolicited marketing communications. Examples of some of these laws and regulations that may be applied to, or affect, our business or the businesses of our clients include the following:

- The Federal Trade Commission’s positions regarding the processing of personal information and protecting consumers as expressed through its Protecting Consumer Privacy in an Era of Rapid Change, Data Brokers, Big Data and Cross-Device Tracking reports (each of which seek to address consumer privacy, data protection, and technological advancements related to the collection or use of personal information for marketing purposes).
- Data protection laws in the European Union ("EU"), including the General Data Protection Regulation (EU Regulation 679/2016) which imposes a number of obligations with respect to the processing of personal data and prohibitions related to the transfer of personal information from the EU to other countries, including the U.S., that do not provide data subjects with an “adequate” level of privacy or security.
- The Financial Services Modernization Act of 1999, or Gramm-Leach-Bliley Act ("GLB"), which, among other things, regulates the use for marketing purposes of non-public personal financial information of consumers that is held by financial institutions. Although Harte Hanks is not considered a financial institution, many of our clients are subject to the GLB. The GLB also includes rules relating to the physical, administrative, and technological protection of non-public personal financial information.
- The Health Insurance Portability and Accountability Act of 1996 ("HIPAA"), which regulates the use of protected health information for marketing purposes and requires reasonable safeguards designed to prevent intentional or unintentional use or disclosure of protected health information.
- The Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"), which amended the FCRA and requires, among other things, consumer credit report notice requirements for creditors that use consumer credit report information in connection with risk-based credit pricing actions and also prohibits a business that receives consumer information from an affiliate from using that information for marketing purposes unless the consumer is first provided a notice and an opportunity to direct the business not to use the information for such marketing purposes, subject to certain exceptions.
- The Fair Credit Reporting Act ("FCRA"), which governs, among other things, the sharing of consumer report information, access to credit scores, and requirements for users of consumer report information.
- Federal and state laws governing the use of email for marketing purposes, including the U.S. Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 ("CAN-SPAM"), Canada’s Anti-Spam Legislation ("CASL") and similar e-Privacy laws in Europe (in support of Directive 2002/58/EC).
- Federal and state laws governing the use of telephones for unsolicited marketing purposes, including the Federal Trade Commission’s Telemarketing Sales Rule ("TSR"), the Federal Communications Commission’s Telephone Consumer Protection Act ("TCPA"), various U.S. state do-not-call laws, Canada’s National Do Not Call laws and rules (“Telecommunications Act”) and similar e-Privacy laws in Europe (in support of Directive 2002/58/EC).
- Federal and state laws governing the collection and use of personal data online and via mobile devices, including but not limited to the Federal Trade Commission Act and the Children's Online Privacy Protection Act, which seek to address consumer privacy and protection.
- Federal and state laws in the U.S., Canada, and Europe specific to data security and breach notification, which include required standards for data security and generally require timely notifications to affected persons in the event of data security breaches or other unauthorized access to certain types of protected personal data.

There are additional consumer protection, privacy, and data security regulations in locations where we or our clients do business. These laws regulate the collection, use, disclosure, and retention of personal data and may require consent from consumers and grant consumers other rights, such as the ability to access their personal data and to correct information in the possession of data controllers. For example, as discussed in the Company’s Risk Factors in Item 1A, the new European General Data Protection Regulation (GDPR) that took effect in May 2018 applies to all of our products and services in Europe. The GDPR includes operational requirements for companies that receive or process personal data of residents of the EU that are different than those currently in place in the EU. We and many of our clients also belong to trade associations that impose guidelines that regulate direct marketing activities, such as the

Direct Marketing Association’s Commitment to Consumer Choice.

As a result of increasing public awareness and interest in individual privacy rights, data protection, information security, and environmental and other concerns regarding marketing communications, federal, state, and foreign governmental and industry organizations continue to consider new legislative and regulatory proposals that would impose additional restrictions on direct marketing services and products. Examples include data encryption standards, data breach notification requirements, consumer choice and consent restrictions, and increased penalties against offending parties, among others.

In addition, our business may be affected by the impact of these restrictions on our clients and their marketing activities. These additional regulations could increase compliance requirements and restrict or prevent the collection, management, aggregation, transfer, use, or dissemination of information or data that is currently legally available. Additional regulations may also restrict or prevent current practices regarding unsolicited marketing communications. For example, many states have considered implementing "do-not-mail" legislation that could impact our business and the businesses of our clients and customers. In addition, continued public interest in individual privacy rights and data security may result in the adoption of further voluntary industry guidelines that could impact our direct marketing activities and business practices.

We cannot predict the scope of any new legislation, regulations, or industry guidelines or how courts may interpret existing and new laws. Additionally, enforcement priorities by governmental authorities may change and also impact our business either directly or through requiring our customers to alter their practices. Compliance with regulations is costly and time-consuming for us and our clients, and we may encounter difficulties, delays, or significant expenses in connection with our compliance. We may also be exposed to significant penalties, liabilities, reputational harm, and loss of business in the event that we fail to comply with applicable regulations. There could be a material adverse impact on our business due to the enactment or enforcement of legislation or industry regulations, the issuance of judicial or governmental interpretations, enforcement priorities of governmental agencies, or a change in customs arising from public concern over consumer privacy and data security issues.

INTELLECTUAL PROPERTY RIGHTS

Our intellectual property assets include trademarks and service marks that identify our company and our services, know-how, software, and other technology that we develop for our internal use and for license to clients and data and intellectual property licensed from third parties, such as commercial software and data providers. We generally seek to protect our intellectual property through a combination of license agreements and trademark, service mark, copyright, patent and trade secret laws as well as through domain name registrations and enforcement procedures. We also enter into confidentiality agreements with many of our employees, vendors, and clients and seek to limit access to and distribution of intellectual property and other proprietary information. We pursue the protection of our trademarks and other intellectual property in the U.S. and internationally. Although we from time to time evaluate inventions for patentability, we do not own any patents, and patents are not core to our intellectual property strategy (other than as may be incidental to commercially available technology or software we license).

EMPLOYEES

As of December 31, 2018, Harte Hanks employed 2,816 full-time employees and 167 part-time employees, of which approximately 1,308 are based outside of the U.S., primarily in the Philippines. A portion of our workforce is provided to us through staffing companies. None of our workforce is represented by labor unions. We consider our relations with our employees to be good.

AVAILABLE INFORMATION

Our website is http://www.hartehanks.com. We make available free of charge, on or through our website, our annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with, or furnishing them to, the SEC. The SEC's website, www.sec.gov, contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. These website addresses are intended to be for inactive textual references only. None of the information on, or accessible through, these websites are part of this Form 10-K or is incorporated by reference herein.

ITEM 1A. RISK FACTORS

Cautionary Note Regarding Forward-Looking Statements

This report, including the 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 (the "1933 Act") and Section 21E of the 1934 Act. 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 c meaning. Examples include statements regarding (1) our strategies and initiatives, (2) adjustments to our cost structure and other actions designed to respond to market conditions and improve our performance, and the anticipated effectiveness and expenses associated with these actions, (3) our financial outlook for revenues, earnings per share, operating income, expense related to equity-based compensation, capital resources and other financial items, (4) expectations for our businesses and for the industries in which we operate, including the impact of economic conditions of the markets we serve on the marketing expenditures and activities of our 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 SEC, including the factors discussed below in this Item 1A, "Risk Factors", and any updates thereto in our Forms 10-Q and 8-K. The forward-looking statements included in this report and those included in our other public filings, press releases, our website, and oral and written presentations by management are made only as of the respective dates thereof, and we undertake no obligation to update publicly any forward-looking statement in this report or in other documents, our website, or oral statements for any reason, even if new information becomes available or other events occur in the future, except as required by law.

In addition to the information set forth elsewhere in this report, including in the MD&A section, the factors described below should be considered carefully in making any investment decisions with respect to our securities.

Most of our client engagements are cancelable on short notice.

The marketing services we offer, and in particular for direct mail and contact center services, are generally terminable upon short notice by our clients, even if the term of the agreement (and the expected duration of services) is several or many years. Many of our customer agreements do not have minimum volume or revenue requirements, so clients may (and do) vary their actual orders from us over time based on their own business needs, their satisfaction with the quality and pricing of our services, and a variety of other competitive factors. In addition, the timing of particular jobs or types of jobs at particular times of year (such as mail programs supporting the holiday shopping season or contact center programs supporting a specific event) may cause significant fluctuations in the operating results of our operations in any given quarter. We depend to some extent on sales to certain industries, such as the consumer retail industries, technology, and financial services. To the extent these industries experience downturns, our clients may re-evalute their marketing spend, which could adversely affect the results of our operations.

A large portion of our revenue is generated from a limited number of clients, with concentration in the consumer retail industry. The loss of a client or significant work from one or more of our clients could adversely affect our business.

Our ten largest clients collectively represented 44% of our revenues for 2018. Furthermore, traditional consumer retail (which is an industry experiencing significant business model and financial challenges) represented 23% of our 2018 revenues. While we typically have multiple projects with our largest customers which would not all terminate at the same time, the loss of one or more of our larger clients or the projects or contracts with one of our largest clients could adversely affect our business, results of operations, and financial condition if the lost revenues were not replaced with profitable revenues from that client or other clients.

We rely on business partners for some services and technology, and we depend on one business partner in particular, which is also a significant equity holder, for a large number of critical services.

We have determined that for some services, and most technology, we are best served by partnering with other companies, engaging them as vendors either on a standing or as-needed basis. We believe this approach reduces the investment needed to access these services and technologies for our clients and provides greater flexibility in how we structure solutions for clients and adapt to market changes. However, because we do not own or control the service or technology partners, we are subject to the potential failure of those partners financially or commercially and must maintain good relations with them to ensure continued service. We may not be able to anticipate any such problems, and failure or weakness of one or more of our key business partners or our relationships with any such provider, could have a material effect on our ability to deliver services to our clients, and in turn harm our financial performance. Furthermore, our business partners may have different or conflicting interests, and although we seek to negotiate appropriate commercial terms, we may be unable to secure or enforce those terms in order to protect our client and employee relationships. Should our partners undermine our client or employee relations, our financial performance will be harmed.
Further, once we engage with a partner it may be difficult to switch to a different vendor even if we are not happy with their performance.

In particular, Wipro, LLC (“Wipro”) and its subsidiaries provide a wide array of services for us and for our clients, including database and software development, database support and analytics, IT infrastructure support and digital campaign management. Because of the nature of these services, it would be difficult and disruptive to our business to replace Wipro on short notice if doing so was necessary or desirable. Wipro also is our largest equity holder, having invested $9.9 million in us in 2018 through the purchase of our Series A Convertible Preferred Stock, which is convertible into 16.0% of our common stock. Subject to certain conditions, Wipro is entitled to appoint a non-voting board observer or a board member to our board of directors. As of December 31, 2018, Wipro has designated an observer to the Board of Directors.

Our indebtedness may adversely impact our ability to react to changes in our business or changes in general economic conditions.

On April 17, 2017, we entered into a credit agreement with Texas Capital Bank, N.A. The agreement consists of a two-year $20.0 million revolving credit facility, which we amended on January 9, 2018 to increase the availability under the revolving credit facility to $22.0 million and extended the term of the credit facility by one year to April 17, 2020. The agreement limits our ability to incur funded debt while any obligation or letter of credit issued thereunder is outstanding, subject to customary exceptions. See Note C, Long-Term Debt, in the Notes to Consolidated Financial Statements for further discussion.

We may incur additional indebtedness in the future and the terms of future arrangements may be less favorable to the company than our previous or current facilities. Our ability to incur indebtedness is also impacted by the terms of our Series A Convertible Preferred Stock, which limits our ability to incur indebtedness without the holders' consent to the greater of $40.0 million or four times our trailing 12-month EBITDA (measured at the time such indebtedness is incurred). Any failure or inability to obtain new financing arrangements when needed on favorable terms could have a material adverse impact on our liquidity position.

The amount of our indebtedness and the terms under which we borrow money under any future credit facilities or other agreements could have significant consequences for our business. Borrowings may include covenants requiring that we maintain certain financial measures and ratios. Covenant and ratio requirements may limit the manner in which we can conduct our business, and we may be unable to engage in favorable business activities or finance future operations and capital needs. A failure to comply with these restrictions or to maintain the financial measures and ratios contained in the debt agreements could lead to an event of default that could result in an acceleration of indebtedness. In addition, the amount and terms of any future indebtedness could:

- limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate, including limiting our ability to invest in our strategic initiatives, and consequently, place us at a competitive disadvantage;
- reduce the availability of our cash flows that would otherwise be available to fund working capital, capital expenditures, acquisitions, and other general corporate purposes; and
- result in higher interest expense in the event of increases in interest rates, as discussed below under the Risk Factor "Interest rate increases could affect our results of operations, cash flows, and financial position."

Risks related to our pension benefit plans may adversely impact our results of operations and cash flows.

Pension benefits represent significant financial obligations. Because of the uncertainties involved in estimating the timing and amount of future payments and asset returns, significant estimates are required to calculate pension expense and liabilities related to our plans. We utilize the services of independent actuaries, whose models are used to facilitate these calculations. Several key assumptions are used in the actuarial models to calculate pension expense and liability amounts recorded in the consolidated financial statements. In particular, significant changes in actual investment returns on pension assets, discount rates, or legislative or regulatory changes could impact future results of operations and required pension contributions. Differences between actual pension expenses and liability amounts from these estimated expense and liabilities may adversely impact our results of operations and cash flows.

We may need to obtain additional funding to continue as a going concern; if we are unable to meet our needs for additional funding in the future, we will be required to limit, scale back, or cease operations.

Our consolidated financial statements for the year ended December 31, 2018 have been prepared assuming we will continue to operate as a going concern. Because we continue to experience net operating losses, our ability to continue as a going concern is subject to our ability to obtain profitability or successfully raise sufficient additional capital as needed, through future financings or other strategic arrangements. Additional funds may not be available when needed, or if available, we may not be able to obtain such funds on terms acceptable to us. If adequate funds are unavailable when needed, we may not be able to continue as a going concern. We may be required to scale down or sell certain businesses or cease operations.

We face significant competition for individual projects, entire client relationships and advertising dollars in general.

Our business faces significant competition within each of our vertical markets and for all of our offerings. We offer our marketing services within a dynamic business environment characterized by rapid technological change, high turnover of client personnel who make buying decisions, client consolidations, changing client needs and preferences, continual development of competing products and services, and an evolving competitive landscape. This competition comes from numerous local, national, and international direct marketing and advertising companies, and client internal resources, against whom we compete for individual projects, entire client relationships, and marketing expenditures by clients and prospective clients. We also compete against internet (social, mobile, web-based, and email), print, broadcast, and other forms of advertising for marketing and advertising dollars in general. In addition, our ability to attract new clients and to retain existing clients may, in some cases, be limited by clients’ policies on or perceptions of conflicts of interest which may prevent us from performing similar services for competitors. Some of our clients have also sought to reduce the number of marketing vendors or use third-party procurement organizations, all of which increases pricing pressure, and may disadvantage us relative to our competitors. Our failure to improve our current processes or to develop new products and services could result in the loss of our clients to current or future competitors. In addition, failure to gain market acceptance of new products and services could adversely affect our growth and financial condition.

Current and future competitors may have significantly greater financial and other resources than we do, and they may sell competing services at lower prices or at lower profit margins, resulting in pressures on our prices and margins.

The sizes of our competitors vary widely across vertical markets and service lines. Therefore, some of our competitors may have significantly greater financial, technical, marketing, or other resources than we do in any one or more of our market segments, or overall. As a result, our competitors may be in a position to respond more quickly than we can to new or emerging technologies, methodologies, and changes in customer requirements, or may devote greater resources than we can to the development, promotion, sale, and support of products and services. Moreover, new competitors or alliances among our competitors may emerge and potentially reduce our market share, revenue, or margins. Some of our competitors also may choose to sell products or services that competes with ours at lower prices by accepting lower margins and profitability or may be able to sell products or services that competes with ours at lower prices given proprietary ownership of data, technical superiority, a broader or deeper product or experience set, or economies of scale. Price reductions or pricing pressure by our competitors could negatively impact our margins and results of operations and could also harm our ability to obtain new customers on favorable terms. Competitive pricing pressures tend to increase in difficult or uncertain economic environments, due to reduced marketing expenditures of many of our clients and prospects, and the resulting impact on the competitive business environment for marketing service providers such as our company.

We must maintain technological competitiveness, continually improve our processes, and develop and introduce new services in a timely and cost-effective manner.

We believe that our success depends on, among other things, maintaining technological competitiveness in our products, processing functionality, and software systems and services. Technology changes rapidly as makers of computer hardware, network systems, programming tools, computer and data architectures, operating systems, database technology, and mobile devices continually improve their offerings. Advances in information technology may result in changing client preferences for products and product delivery channels in our industry. The increasingly sophisticated requirements of our clients require us to continually improve our processes and provide new products and services in a timely and cost-effective manner (whether through development, license, or acquisition). Our direct mail operations are increasingly pressured by larger-scale competitors who have adopted technologies allowing them to more effectively and efficiently customize mailed marketing materials. We may be unable to successfully identify, develop, and bring new and enhanced services and products to market in a timely and cost-effective manner, such services and products may not be commercially successful, and services, products, and technologies developed by others may render our services and products noncompetitive or obsolete.

Our success depends on our ability to consistently and effectively deliver our services to our clients.

Our success depends on our ability to effectively and consistently staff and execute client engagements within the agreed upon time frame and budget. Depending on the needs of our clients, our engagements may require customization, integration, and coordination of a number of complex product and service offerings and execution across many facilities. Moreover, in some of our engagements, we rely on subcontractors and other third parties to provide some of the services to our clients, and we cannot guarantee that these third parties will effectively deliver their services, that we will be able to easily suspend work with contractors that are not performing adequately, or that we will have adequate recourse against these third parties in the event they fail to effectively deliver their services. Other contingencies and events outside of our control may also impact our ability to provide our products and services. Our failure to effectively and timely staff, coordinate, and execute our client engagements may adversely impact existing client relationships, the amount or timing of payments from our clients, our reputation in the marketplace and ability to secure additional business and our resulting financial performance. In addition, our contractual arrangements with our clients and other customers may not provide us with sufficient protections against claims for lost profits or other claims for damages.

We have recently experienced, and may experience in the future, reduced demand for our products and services due to the financial condition and marketing budgets of our clients and other factors that may impact the industry verticals that we serve.

Marketing budgets are largely discretionary in nature, and as a consequence are easier to reduce in the short-term than other expenses. Our customers have in the past, and may in the future, responded to their own financial constraints (whether caused by weak economic conditions, weak industry performance or client-specific issues) by reducing their marketing spending. Customers may also be slow to restore their marketing budgets to prior levels during a recovery and may respond similarly to adverse economic conditions in the future. Our revenues are dependent on national, regional, and international economies and business conditions. A lasting economic recession or anemic recovery in the markets in which we operate could have material adverse effects on our business, financial position, or operating results. Similarly, industry or company-specific factors may negatively impact our clients and prospective clients, and in turn result in reduced demand for our products and services, client insolvencies, collection difficulties or bankruptcy preference actions related to payments received from our clients. We may also experience reduced demand as a result of consolidation of clients and prospective clients in the industry verticals that we serve.

We must effectively manage our costs to be successful. If we do not achieve our cost management objectives, our financial results could be adversely affected.

Our business plan and expectations for the future require that we effectively manage our cost structure, including our operating expenses and capital expenditures across our operations. To the extent that we do not accurately anticipate and effectively manage our costs as our business evolves, our financial results may be adversely affected.

Our financial performance has harmed our commercial reputation and relationship with customers, vendors, and other commercial parties, and may impair our ability to attract, retain and motivate employees.

Our declining financial performance has caused customers and vendors to increase scrutiny on payment and performance terms in our agreements, which may impose additional costs (or result in reduced profitability) in our operations. Clients, vendors, and partners and recent performance, as well as prospective clients, vendors, and partners) may also decline to do business with us due to their concerns regarding our financial condition. Additionally, due to our liquidity constraints, we may be unable to aggressively price our services to win work in competitive bid situations. These impediments to working with clients, vendors and partners may reduce both our overall revenues and profitability, and consequently the value of our common stock.

Likewise, our declining financial performance has negatively affected employee morale and compensation. Due to financial constraints, we may have difficulty providing compensation that is sufficient to attract, retain and motivate employees, especially skilled professionals for whom sizable bonus payouts are a key element of market-driven cash compensation. Furthermore, the decline in the price of our common stock has eroded the value of our equity-based incentive programs. If we are unable to attract, retain and motivate employees despite our financial performance and within the resource constraints, it will impair our ability to effectively serve our clients, which in turn is likely to reduce both our overall revenues and profitability, and consequently the value of our common stock.

Our inability to comply with the listing requirements of the New York Stock Exchange could result in our common stock being delisted, which could affect our common stock’s market price and liquidity and reduce our ability to raise capital.

During 2017, we received several notices from the NYSE indicating that the average closing price of our common stock had fallen below $1.00 per share over a period of 30 consecutive trading days, which is the minimum average share price for continued listing on the NYSE under Rule 802.01C of the NYSE Listed Company Manual. This compelled us to effect a 1-for-10 reverse stock split on January 31, 2018.

Although the NYSE has notified us that we have cured the average closing price requirement, additional NYSE continued listing requirements include that we maintain an average market capitalization of over $50 million (measured over a consecutive 30 trading-day periods) when our stockholders' equity is less than $50 million, as it recently has been (the “Market Capitalization Listing Requirement”).

On October 31, 2018, we disclosed that we received a notice from the NYSE that we were not in compliance with the “Market Capitalization Listing Requirement”.

The NYSE accepted our plan of definitive action to bring us into compliance with the Market Capitalization Listing Requirement in January 2019, thereby delaying any decision to delist us for up to 18 months. The NYSE will closely monitor our attempt to implement our plan over the next 18 months and our failure to achieve the initiatives and goals included in the plan will result in our being subject to a NYSE trading suspension at the time any initiative or goal is not met. In order to regain compliance with the Market Capitalization Listing Requirement, we will have to maintain the required $50 million global market capitalization. Our failure to do so will result in a suspension by the NYSE of trading in our common stock and the initiation of procedures to delist our common stock.

In addition, if our average global market capitalization over a consecutive 30 trading-day period is less than $15 million, the NYSE will promptly initiate suspension and delisting procedures and, under the NYSE’s continued listing standards, we will not have any opportunity to regain compliance and our common stock will be delisted.

Our common stock could be delisted if we are not in compliance with this (or any other such) requirement and are unable to regain compliance during any applicable cure or grace period. A delisting of our common stock could negatively impact us by, among other things, reducing the liquidity and market price of our common stock and reducing the number of investors willing to hold or acquire our common stock. A suspension or delisting could also adversely affect our relationships with our business partners and suppliers and customers’ and potential customers’ decisions to purchase our products and services, and would have a material, adverse impact on our business, operating results and financial condition. In addition, a suspension or delisting would impair our ability to raise additional capital through equity or debt financing and our ability to attract and retain employees by means of equity compensation.

In the event of a delisting, our common stock could be traded on the over-the-counter bulletin board, or in the so-called “pink sheets.” In the event of such trading, it is highly likely that there would be: significantly less liquidity in the trading of our common stock; decreases in institutional and other investor demand for our common stock, coverage by securities analysts, market making activity and information available concerning trading prices and volume; and fewer broker-dealers willing to execute trades in our common stock. The occurrence of any of these events could result in a further decline in the market price of our common stock. The occurrence of any of these events could impair our ability to retain and attract employees and members of management.

Privacy, information security and other regulatory requirements may prevent or impair our ability to offer our products and services.

We are subject to and affected by numerous laws, regulations, and industry standards that regulate direct marketing activities, including those that address privacy, data protection, information security, and marketing communications. Please refer to the section above entitled “Item 1. Business - Government Regulation” for additional information regarding some of these regulations.

As a result of increasing public awareness and interest in privacy rights, data protection and access, information security, environmental protection, and other concerns, national and local governments and industry organizations regularly consider and adopt new laws, rules, regulations, and guidelines that restrict or regulate marketing communications, services, and products. Examples include data encryption standards, data breach notification requirements, registration/licensing requirements (often with fees), consumer choice, notice, and consent restrictions and penalties for infractions, among others. In addition, the new European General Data Protection Regulation (GDPR) took effect in May 2018 and applied to all of our products and services that provide service in Europe. The GDPR includes operational requirements for companies that receive or process personal data of residents of the EU that are different than those currently in place in the EU. For example, we may be required to implement measures to change or limit (by age, use or geography) our service offerings. We may also be required to obtain consent and/or offer new controls to existing and new users in Europe before processing data for certain aspects of our services. In addition, the GDPR will include significant penalties for non-compliance. We anticipate that additional restrictions and regulations will continue to be proposed and adopted in the future. The Philippines has also adopted the Data Privacy Act of 2012 (Republic Act 10173) which mirrors most important aspects of the GDPR and is likely to have a similar effect on our operations in and involving the Philippines.

Our business may also be affected by the impact of these restrictions and regulations on our clients and their marketing activities. In addition, as we acquire new capabilities and deploy new technologies to execute our strategy, we may be exposed to additional types or layers of regulation. Current and future restrictions and regulations could increase compliance requirements and costs, and restrict or prevent the collection, management, aggregation, transfer, use or dissemination of information (especially with respect to personal information), or change the requirements therefore so as to require other changes to our business or that of our clients. Additional restrictions and regulations may limit or prohibit current practices regarding marketing communications and information quality solutions. For example, many states and countries have considered implementing "do not contact" legislation that could impact our business and the businesses of our clients and customers. In addition, continued public interest in privacy rights, data protection and access, and information security may result in the adoption of further industry guidelines that could impact our direct marketing activities and business practices.

We cannot predict the scope of any new laws, rules, regulations, or industry guidelines or how courts or agencies may interpret current ones. Additionally, enforcement priorities by governmental authorities will change over time, which may impact our business. Understanding the laws, rules, regulations, and guidelines applicable to specific client multichannel engagements and across many jurisdictions poses a significant challenge, as such laws, rules, regulations, and guidelines are often inconsistent or conflicting, and are sometimes at odds with client objectives. Our failure to properly comply with these regulatory requirements and client needs may materially and adversely affect our business. General compliance with privacy, data protection, and information security obligations is costly and time-consuming, and we may encounter difficulties, delays, or significant expenses in connection with our compliance, or because of our clients’ need to comply. We may be exposed to significant penalties, liabilities, reputational harm, and loss of business in the event that we fail to comply. We could suffer a material adverse impact on our business due to the enactment or enforcement of legislation or industry regulations affecting us and/or our clients, the issuance of judicial or governmental interpretations, changed enforcement priorities of governmental agencies, or a change in behavior arising from public concern over privacy, data protection, and information security issues.

Consumer perceptions regarding the privacy and security of their data may prevent or impair our ability to offer our products and services.

Various local, national, and international regulations, as well as industry standards, give consumers varying degrees of control as to how certain data regarding them is collected, used, and shared for marketing purposes. If, due to privacy, security, or other concerns, consumers exercise their ability to prevent or limit such data collection, use, or sharing, it may impair our ability to provide marketing to those consumers and limit our clients’ demand for our services. Additionally, privacy and security concerns may limit consumers’ willingness to voluntarily provide data to our customers or marketing companies. Some of our services depend on voluntarily provided data and therefore may be impaired without such data.

If we do not prevent security breaches and other interruptions to our infrastructure, we may be exposed to lawsuits, lose customers, suffer harm to our reputation, and incur additional costs.

The services we offer involve the transmission of large amounts of sensitive and proprietary information over public communications networks, as well as the processing and storage of confidential customer information. Unauthorized access, remnant data exposure, computer viruses, denial of service attacks, accidents, employee error or malfeasance, “social engineering” and “phishing” attacks, intentional misconduct by computer “hackers” and other disruptions can occur, and infrastructure gaps, hardware and software vulnerabilities, inadequate or missing security controls, and exposed or unprotected customer data can exist that (i) interfere with the delivery of services to our customers, (ii) impede our customers' ability to do business, or (iii) compromise the security of systems and data, which exposes information to unauthorized third parties. We are a target of cyber-attacks of varying degrees on a regular basis. Although we maintain insurance which may respond to cover some types of damages incurred by damage to, breaches of, or problems with, our information and telecommunications systems, such insurance is limited and expensive, and may not respond or be sufficient to offset the costs of such damages, and therefore such damages may materially harm our business.

Our reputation and business results may be adversely impacted if we, or subcontractors upon whom we rely, do not effectively protect sensitive personal information of our clients and our clients' customers.

Current privacy and data security laws and industry standards impact the manner in which we capture, handle, analyze, and disseminate customer and prospect data as part of our client engagements. In many instances, our client contracts also mandate privacy and security practices. If we fail to effectively protect and control information, especially sensitive personal information (such as personal health information, social security numbers, or credit card numbers) of our clients and their customers or prospects in accordance with these requirements, we may incur significant expense, suffer reputational harm, and loss of business, and, in certain cases, be subjected to regulatory or governmental sanctions or litigation. These risks may be increased due to our reliance on subcontractors and other third parties in providing a portion of our overall services in certain engagements. We cannot guarantee that these third parties will effectively protect and handle sensitive personal information or other confidential information, or that we will have adequate recourse against these third parties in that event.

If our facilities are damaged, or if we are unable to access and use our facilities, our business and results of operations will be adversely affected.

Our operations rely on the ability of our employees to work at specially-equipped facilities to perform services for our clients. Although we have some excess capacity and redundancy, we do not have sufficient excess capacity or redundancy (in equipment, facilities, or personnel) to maintain service and operational levels for extended periods if we are unable to use one of our major facilities. Should we lose access to a facility for any reason, our service levels are likely to decline or be suspended, clients would go without service or secure replacement services from a competitor. As consequence of such an event, we would suffer a reduction in revenues and harm to (and loss of) client relationships.

Significant system disruptions, loss of data center capacity or interruption of telecommunication links could adversely affect our business and results of operations.

Our business is heavily dependent upon data centers and telecommunications infrastructures, which are essential to both our call center services and our database services (which require that we efficiently and effectively create, access, manipulate, and maintain large and complex databases). In addition to the third-party data centers we use, we also operate several data centers to support both our own and our clients' needs in this regard, as well as those of some of our clients. Our ability to protect our operations against damage or interruption from fire, flood, tornadoes, power loss, telecommunications or equipment failure, or other disasters and events beyond our control is critical to our continued success. Likewise, as we increase our use of third-party data centers, it is critical that the vendors providing that service adequately protect their data centers from the same risks. Our services are very dependent on links to telecommunication providers. We believe we have taken reasonable precautions to protect our data centers and telecommunication links from events that could interrupt our operations. Any damage to the data centers we use or any failure of our telecommunications links could materially adversely affect our ability to continue services to our clients, which could result in loss of revenues, profitability and client confidence, and may adversely impact our ability to attract new clients and force us to expend significant company resources to repair the damage.

If our new leaders are unsuccessful, or if we continue to lose key management and are unable to attract and retain the talent required for our business, our operating results could suffer.

Over the past three years we have replaced many of our leaders (including our Chief Executive Officer, Chief Marketing Officer, and Chief Financial Officer) and we have eliminated or consolidated several leadership positions (including Chief Technology Officer, and Executive Vice President of Sales), resulting in a much smaller leadership team. If our new leaders fail in their new and additional roles and responsibilities (and more generally if we are unable to attract additional leaders with the necessary skills to manage our business) our business and its operating results may suffer. Further, our prospects depend in large part upon our ability to attract, train, and retain experienced technical, client services, sales, consulting, marketing, and management personnel. While the demand for personnel is dependent on employment levels, competitive factors, and general economic conditions, our recent business performance may diminish our attractiveness as an employer. The loss or prolonged absence of the services of these individuals could have a material adverse effect on our business, financial position, or operating results.

We could fail to adequately protect our intellectual property rights and may face claims for intellectual property infringement.

Our ability to compete effectively depends in part on the protection of our technology, products, services, and brands through intellectual property right protections, including copyrights, database rights, trade secrets, trademarks, as well as through domain name registrations, and enforcement procedures. The extent to which such rights can be protected and enforced varies by jurisdiction, and capabilities we procure through acquisitions may have less protection than would be desirable for the use or scale we intend or need. Litigation involving patents and other intellectual property rights has become far more common and expensive in recent years, and we face the risk of additional litigation relating to our use or future use of intellectual property rights of third parties.

Despite our efforts to protect our intellectual property, unauthorized parties may attempt to copy or otherwise obtain and use our proprietary information and technology. Monitoring unauthorized use of our intellectual property is difficult, and unauthorized use of our intellectual property may occur. We cannot be certain that trademark registrations will be issued, nor can we be certain that any issued trademark registrations will give us adequate protection from competing products. For example, others may develop competing technologies or databases on their own. Moreover, there is no assurance that our confidentiality agreements with our employees or third parties will be sufficient to protect our intellectual property and proprietary information.

Third-party infringement claims and any related litigation against us could subject us to liability for damages, significantly increase our costs, restrict us from using and providing our technologies, products or services or operating our business generally, or require changes to be made to our technologies, products, and services. We may also be subject to such infringement claims against us by third parties and may incur substantial costs and devote significant management resources in responding to such claims, as we have in the recent past. We have been, and continue to be, obligated under some agreements to indemnify our clients as a result of claims that we infringe on the proprietary rights of third parties. These costs and distractions could cause our business to suffer. In addition, if any party asserts an infringement claim, we may need to obtain licenses to the disputed intellectual property. We cannot assure you, however, that we will be able to obtain these licenses on commercially reasonable terms or that we will be able to obtain any licenses at all. The failure to obtain necessary licenses or other rights may have an adverse effect on our ability to provide our products and services.

Breaches of security, or the perception that e-commerce is not secure, could severely harm our business and reputation.

Business-to-business and business-to-consumer electronic commerce requires the secure transmission of confidential information over public networks. Some of our products and services are accessed through or are otherwise dependent on the internet. Security breaches in connection with the delivery of our products and services, or well-publicized security breaches that may affect us or our industry (such as database intrusion) could be severely detrimental to our business, operating results, and financial condition. We cannot be certain that advances in criminal capabilities, cryptography, or other fields will not compromise or breach the technology protecting the information systems that deliver our products, services, and proprietary database information.

Data suppliers could withdraw data that we rely on for our products and services.

We purchase or license much of the data we use for ourselves and for our clients. There could be a material adverse impact on our business if owners of the data we use were to curtail access to the data or materially restrict the authorized uses of their data. Data providers could withdraw their data if there is a competitive reason to do so, if there is pressure from the consumer community or if additional regulations are adopted restricting the use of the data. We also rely upon data from other external sources to maintain our proprietary and non-proprietary databases, including data received from customers and various government and public record sources. If a substantial number of data providers or other key data sources were to withdraw or restrict their data, if we were to lose access to data due to government regulation, or if the collection of data becomes uneconomical, our ability to provide products and services to our clients could be materially and adversely affected, which could result in decreased revenues, net income, and earnings per share.

We may be unable to make dispositions of assets on favorable terms, or at all.

In 2018, we sold our 3Q Digital business (which we purchased in 2015 for $30 million in cash plus an earn-out of up to $35 million) for $5 million in cash and assignment of the earn-out obligation. In the future, we may determine to divest certain assets or businesses consistent with our corporate strategy. The price we obtain for such assets or businesses will be driven by performance of those businesses and the current market demand for such assets, and we may not be able to realize a profit upon sale. If we are unable to make dispositions in a timely manner or at profitable price, our business, net income, and earnings per share could be materially and adversely affected.

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

Our services depend on the USPS and other commercial delivery services to deliver products. Standard postage rates have increased in recent years (most recently in January 2019) and may continue to do so at frequent and unpredictable intervals. Postage rates influence the demand for our services even though the cost of mailings is typically borne by our clients (and is not directly reflected in our revenues or expenses) because clients tend to reduce other elements of marketing spending to offset increased postage costs. Accordingly, future postal increases or disruptions in the operations of the USPS may have an adverse impact on us.

In addition, the USPS has had significant financial and operational challenges recently. In reaction, the USPS has proposed many changes in its services, such as delivery frequency and facility access. These changes, together with others that may be adopted, individually or in combination with other market factors, could materially and negatively affect our costs and ability to meet our clients' expectations.

We are vulnerable to increases in paper prices.

Price of print materials are subject to fluctuations. Increased paper costs could cause our customers to reduce spending on other marketing programs, or to shift to formats, sizes, or media which may be less profitable for us, in each case potentially materially affecting our revenues and profits.

We are unlikely to declare cash dividends or repurchase our shares.

Although our board of directors has in the past authorized the payment of quarterly cash dividends on our common stock, we announced in 2016 that we did not plan to declare any further dividends. In addition, although our board has authorized stock purchase programs (and we repurchased shares as recently as 2015), we are unlikely to make any repurchases in the near term. Decisions to pay dividends on our common stock or to repurchase our common stock will be based upon periodic determinations by our board that such dividends or repurchases are both in compliance with all applicable laws and agreements and in the best interest of our stockholders after considering our financial condition and results of operations, the price of our common stock, credit conditions, and such other factors as are deemed relevant by our board. The failure to pay a cash dividend or repurchase stock could adversely affect the market price of our common stock.

Interest rate increases could affect our results of operations, cash flows and financial position.

Interest rate fluctuations in Europe and the U.S. can affect the amount of interest we pay related to our debt and the amount we earn on cash equivalents. Borrowings under our Texas Capital Bank credit facility bear interest at variable rates based upon the prime rate or LIBOR. Our results of operations, cash flows, and financial position could be materially or adversely affected by significant increases in interest rates. We also have exposure to interest rate fluctuations in the U.S., specifically money market, commercial paper, and overnight time deposit rates, as these affect our earnings on excess cash. Even with the offsetting increase in earnings on excess cash in the event of an interest rate increase, we cannot be assured that future interest rate increases will not have a material adverse impact on our business, financial position, or operating results.

We are subject to risks associated with operations outside the U.S.

Harte Hanks conducts business outside of the U.S. During 2018, approximately 14.5% of our revenues were derived from operations outside the U.S., primarily Europe and Asia. We may expand our international operations in the future as part of our growth strategy. Accordingly, our future operating results could be negatively affected by a variety of factors, some of which are beyond our control, including:

- changes in local, national, and international legal requirements or policies resulting in burdensome government controls, tariffs, restrictions, embargoes, or export license requirements;
- higher rates of inflation;
- the potential for nationalization of enterprises;
- less favorable labor laws that may increase employment costs and decrease workforce flexibility;
- potentially adverse tax treatment;
- less favorable foreign intellectual property laws that would make it more difficult to protect our intellectual property from misappropriation;
- more onerous or differing data privacy and security requirements or other marketing regulations;

- longer payment cycles;
- social, economic, and political instability;
- the differing costs and difficulties of managing international operations;
- modifications to international trade policy, including changes to or repeal of the North American Free Trade Agreement or the imposition of increased or new tariffs, quotas or trade barriers on key commodities; and
- geopolitical risk and adverse market conditions caused by changes in national or regional economic or political conditions (which may impact relative interest rates and the availability, cost, and terms of mortgage funds), including with regard to Brexit.

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

We have identified material weaknesses in our internal control over financial reporting that could, if not remediated, result in material misstatements in our financial statements. In addition, current and potential stockholders could lose confidence in our financial reporting, which could cause our stock price to decline.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company’s annual or interim consolidated financial statements will not be prevented or detected on a timely basis. We identified control deficiencies in our financial reporting process that constitute material weaknesses; as of December 31, 2018, two of those material weaknesses were not yet remediated.

As discussed in Part II, Item 9A, material weaknesses in the following areas existed as of December 31, 2018; (i) two of five components of internal control as defined by COSO (control activities and information and communication), and (ii) the effectiveness of internal controls over the completeness and accuracy of data used to recognize and record revenue and related accounts such as accounts receivable, accrued revenue and deferred revenue, and the precision of management’s review of controls over revenue. As a result of these material weaknesses management has determined that both our disclosure controls and procedures and internal control over financial reporting were not effective as of December 31, 2018.

In light of the material weaknesses identified, we performed additional analysis and procedures to ensure that our consolidated financial statements were prepared in accordance with GAAP and fairly reflected our financial position and results of operations as of and for the year ended December 31, 2018. Prior to our December 31, 2016 fiscal year end, we began taking a number of actions in order to remediate the material weaknesses described above, including developing a plan to redesign processes and controls, and in 2017 we engaged specialists to assist in the comprehensive review, design, and implementation of new internal controls. Improvements in the design and operating effectiveness of internal controls over financial reporting that we have affected to date have led to the successful remediation of several previously disclosed material weaknesses including contingent consideration, recoverability of deferred tax assets, financial close and reporting, and three of the five components of internal control as defined by COSO (control environment, risk assessment and monitoring). Our remediation efforts will continue into the fiscal year ending December 31, 2019. We expect to incur additional costs remediating these material weaknesses.

Although we believe we are taking appropriate actions to remediate the control deficiencies identified and to strengthen our internal control over financial reporting, we may need to take additional measures to fully mitigate the material weaknesses discussed above. Measures to improve our internal controls may not be sufficient to ensure that our internal controls are effective or that the identified material weaknesses will not result in a material misstatement of our annual or interim consolidated financial statements. In addition, other material weaknesses or deficiencies may be identified in the future. If we are unable to correct material weaknesses in internal controls in a timely manner, our ability to record, process, summarize, and report financial information accurately and within the time periods specified in the rules and forms of the SEC will be adversely affected. This failure could negatively affect the market price and trading liquidity of our common stock, cause investors to lose confidence in our reported financial information, subject us to civil and criminal investigations and penalties, and adversely impact our business and financial condition.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Over time, controls may become inadequate because changes in conditions or deterioration in the degree of compliance with policies or procedures may occur. Implementation of new technology related to the control system may result in misstatements due to errors that are not detected and corrected during testing. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

Fluctuation in our revenue and operating results and other factors may impact the volatility of our stock price.

The price at which our common stock has traded in recent years has fluctuated greatly and has declined significantly. Our common stock price may continue to be volatile due to a number of factors including the following (some of which are beyond our control):

- variations in our operating results from period to period and variations between our actual operating results and the expectations of securities analysts, investors, and the financial community;
- unanticipated developments with client engagements or client demand, such as variations in the size, budget, or progress toward the completion of engagements, variability in the market demand for our services, client consolidations, and the unanticipated termination of several major client engagements;
- announcements of developments affecting our businesses;
- competition and the operating results of our competitors;
- the overall strength of the economies of the markets we serve and general market volatility; and
- other factors discussed elsewhere in this Item 1A, “Risk Factors.”

Because of these and other factors, investors in our common stock may not be able to resell their shares at or above their original purchase price.

Our certificate of incorporation and bylaws contain anti-takeover protections that may discourage or prevent strategic transactions, including a takeover of our company, even if such a transaction would be beneficial to our stockholders

Provisions contained in our certificate of incorporation and bylaws, in conjunction with provisions of the Delaware General Corporation Law, could delay or prevent a third party from entering into a strategic transaction with us, even if such a transaction would benefit our stockholders. For example, our certificate of incorporation and bylaws provide for a staggered board of directors, do not allow written consents by stockholders, and have strict advance notice and disclosure requirements for nominees and stockholder proposals.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our business is conducted in facilities worldwide containing aggregate space of approximately 1.3 million square feet. All facilities are held under leases, which expire at dates through 2025. See “Item 1 - Business - Facilities”.

ITEM 3. LEGAL PROCEEDINGS

Information regarding legal proceedings is set forth in Note I, Commitments and Contingencies, of the “Notes to Consolidated Financial Statements” and is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock

Our common stock is listed on the NYSE under the symbol HHS. As of January 31, 2019, there are approximately 1617 common stockholders of record. The last reported share price of our common stock on March 15, 2019 was $3.95.

Issuer Purchases of Equity Securities

The following table contains information about our purchases of equity securities during the fourth quarter of 2018:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan (2)	Maximum Dollar Amount that May Yet Be Spent Under the Plan
October 1 - 31, 2018	—	$ ——		$ 11,437,544
November 1 - 30, 2018	—	$ ——		$ 11,437,544
December 1 - 31, 2018	—	$ ——		$ 11,437,544
Total	—	$ ——		

(1) Total number of shares purchased includes shares, if any, (i) purchased as part of our publicly announced stock repurchase program, and (ii) pursuant to our 2013 Omnibus Incentive Plan and applicable inducement award agreements with certain executives, withheld to pay withholding taxes upon the vesting of shares.

(2) During the fourth quarter of 2018, we did not purchase any shares of our common stock through our stock repurchase program that was publicly announced in August 2014. Under this program, from which shares can be purchased in the open market, our Board has authorized us to spend up to $20.0 million to repurchase shares of our outstanding common stock. As of December 31, 2018, we have repurchased 150,667 shares and spent $8.6 million under this authorization. Through December 31, 2018, we had repurchased a total of 6,788,798 shares at an average price of $181.02 per share under this program and previously announced programs.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected historical financial information for the periods ended and as of the dates indicated. You should read the following historical financial information along with "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in this Form 10-K.

In thousands, except per share amounts	2018	2017
Statement of Comprehensive Income (loss) data		
Revenues	$284,628	$383,906
Operating income (loss) from continuing operations	(26,034)	(40,865)
Income (loss) from continuing operations	$17,550	$(41,860)
Earnings (loss) from continuing operations per common share—diluted	$2.38	$(6.76)
Weighted-average common and common equivalent shares outstanding—diluted	6,270	6,192
Cash dividends per share	$—	$—
Balance sheet data (at end of period)		
Cash and cash equivalents	$20,882	$8,397
Total assets	125,175	130,812
Total debt	14,200	—
Total stockholders' equity (deficit)	(19,184)	(34,635)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Note About 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 the cautionary note included under Item 1A above, which is provided pursuant to the safe harbor provisions of Section 27A of the 1933 Act and Section 21E of the 1934 Act. Actual results may vary materially from what is expressed in or indicated by the forward-looking statements.

Overview

The following MD&A section is intended to help the reader understand the results of operations and financial condition of Harte Hanks. This section is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes to the consolidated financial statements.

Harte Hanks partners with clients to deliver relevant, connected, and quality customer interactions. Our approach starts with discovery and learning, which leads to customer journey mapping, creative and content development, analytics, and data management, and ends with execution and support in a variety of digital and traditional channels. We do something powerful: we produce engaging and memorable customer interactions to drive business results for our clients, which is why Harte Hanks is known for developing better customer relationships and experiences and defining interaction-led marketing.

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

- agency and digital services;
- database marketing solutions and business-to-business lead generation;
- direct mail, logistics, and fulfillment; and

• contact centers.

We are affected by the general, national, and international economic and business conditions in the markets where we and our customers operate. Marketing budgets are largely discretionary in nature, and as a consequence are easier for our clients to reduce in the short-term than other expenses. Further, our contracts with our clients generally don’t require them to purchase a specified amount of services from us and could be cancelled on relatively short notice. Our revenues are also affected by the economic fundamentals of each industry that we serve, various market factors, including the demand for services by our clients, and the financial condition of and budgets available to specific clients, among other factors. We remain committed to making the investments necessary to execute our multichannel strategy while also continuing to adjust our cost structure to reduce costs in the parts of the business that are not growing as fast.

We continued to face a challenging competitive environment in 2018. The sale of 3Q Digital in 2018, and our recent preferred stock financing from Wipro, together with our restructuring efforts that are meant to decrease recurring expenses, are all parts of our efforts to prioritize our investments and focus on our core business of optimizing our clients' customer journey across an omni-channel delivery platform. We expect these actions will enhance our liquidity and financial flexibility. For additional information see Liquidity and Capital Resources. We have taken actions to return the business to profitability and improve our cash, liquidity, and financial position. This includes workforce restructuring, making investments targeted at improving product offerings, and implementing expense reductions.

Results of Operations

Operating results from operations were as follows:

	Year Ended December 31,		
In thousands, except per share amounts	2018	% Change	2017
Revenues	$284,628	-25.9 %	$383,906
Operating expenses	310,662	-26.9 %	424,771
Operating loss	$(26,034)	36.3 %	$(40,865)
Operating margin	(9.1)%	-14.2 %	(10.6)%
Other (income) and expenses	(25,472)	-333.9 %	10,889
Income tax benefit	(18,112)	83.1 %	(9,894)
Net Income (loss)	$17,550	141.9 %	$(41,860)
Diluted EPS from operations	$2.38	135.2 %	$(6.76)

Year ended December 31, 2018 vs. Year ended December 31, 2017

Revenues

Revenues were $284.6 million in the year ended December 31, 2018, compared to $383.9 million in the year ended December 31, 2017. These results reflected the impact of declines in all of our industry verticals. Our consumer brand, retail, B2B, transportation, financial services and healthcare verticals declined by $29.9 million, or 33.8%, $28.9 million, or 30.3%, $19.2 million, or 23.1%,
$11.8 million, or 35.0%, $6.3 million, or 10.4% and $3.2 million, or 13.8%, respectively. These declines were partially due to the sale of 3Q Digital at the end of February 2018, which led to $29.2 million of the revenue reduction from 2017 to 2018 and primarily impacted our B2B and Consumer verticals. Other causes of the decrease included lost clients and lower volumes from existing clients.

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

Operating Expenses

Operating expenses were $310.7 million in the year ended December 31, 2018, compared to $424.8 million in 2017. This $114.1 million year-over-year decline was partially caused by the sale of 3Q Digital ($26.8 million of total operating expense reduction). Labor costs decreased by $66.4 million, or 28.8%, primarily due to lower payroll expense as a result of our expense reduction efforts and the sale of 3Q Digital ($21.3 million). Production and distribution expenses declined $8.8 million, or 8.1%, primarily due to the lower transportation expenses and the sale of 3Q Digital ($2.1 million expense reduction compared to 2017). Advertising, Selling and General expenses declined $6.2 million primarily due to a reduction in employee-related expenses and the sale of 3Q Digital ($3.2 million expense reduction compared to 2017). Impairment of assets was $4.9 million in 2018 compared to $34.5 million goodwill impairment recorded in 2017. Depreciation, software and intangible asset amortization expense declined $3.1 million from 2017 primarily due to lower capital expenditure and the elimination of the intangible assets upon the sale of 3Q Digital.

Our largest cost components are labor, outsourced costs, and mail transportation expenses. Each of these costs is somewhat variable and tends to fluctuate with revenues and the demand for our services. Mail transportation rates have increased over the last few years due to demand and supply fluctuations within the transportation industry. Future changes in mail transportation expenses will continue to impact our total production costs and total operating expenses and may have an impact on future demand for our supply chain management services.

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

Operating Loss

Operating loss from operations was $26.0 million in the year ended December 31, 2018, compared to $40.9 million in the year ended December 31, 2017. The $14.8 million decrease in operating loss reflected the impact of a decrease in revenue of $99.3 million, offset by a larger $114.1 million decrease in operating expenses.

Other (Income) Expense

Year ended December 31, 2018 vs. Year ended December 31, 2017

Total other income was $25.5 million in the year ended December 31, 2018, compared to other expense of $10.9 million in 2017. This $36.4 million increase in other income was primarily attributable to the sale of 3Q Digital resulting in a gain of $31 million.

Income Taxes

Year ended December 31, 2018 vs. Year ended December 31, 2017

Our 2018 income tax benefit is $18.1 million. Favorably impacting our benefit was deductible basis on the sale of 3Q Digital ($11.9 million), loss from deemed liquidation of foreign subsidiary ($4.2 million), rate benefit from carryback of capital loss to 35% tax rate year ($6.5 million) and return to provision differences ($1.8 million). Unfavorably impacting our benefit was change in valuation allowance due to realization of deferred tax assets for current year operations and dividend inclusions from foreign subsidiaries related to current period Global Intangible Low Tax Income (GILTI) expense, the impact of which were $3.4 million and $2.8 million, respectively.

This compares to our 2017 income tax benefit of $9.9 million. Unfavorably impacting our benefit was nondeductible goodwill associated with our impairment loss and the change in valuation allowance due to realization of deferred tax assets for current year operations, the impact of which were $6.0 million and $2.3 million, respectively. Favorably impacting our benefit was the enactment of the U.S. Tax Cuts and Jobs Act (the "Tax Reform Act”), the impact of which was a $3.4 million credit. This was the result of remeasurement of our deferred tax balances for the reduction in the corporate tax rate from 35% to 21%, and remeasurement of the valuation allowance for application of provisions in the Tax Reform Act.

Net Income (loss)

Year ended December 31, 2018 vs. Year ended December 31, 2017

We recorded income of $17.6 million and net loss from operations of $41.9 million in 2018 and 2017, respectively. The increase in income from operations is the result of the $31.0 million pre-tax gain recognized for the sale of 3Q Digital in February 2018, and the income tax benefit related to the items noted above, which was partially offset by the loss from operations.

Liquidity and Capital Resources

Sources and Uses of Cash

Our cash and cash equivalent balances were $20.9 million and $8.4 million as of December 31, 2018 and 2017. Our principal sources of liquidity are cash on hand, cash provided by operating activities, and borrowings. Our cash is primarily used for general corporate purposes, working capital requirements and capital expenditures.

At this time, we believe that we will be able to continue to meet our liquidity requirements and fund our fixed obligations (such as debt services, operating leases and unfunded pension plan benefit payments) and other cash needs for our operations for at least the next twelve months through a combination of cash on hand, cash flow from operations, a significant tax refund receivable and borrowings under the Texas Capital Credit Facility. Although the Company believes that it will be able to meet its cash needs for the foreseeable future, if unforeseen circumstances arise the company may need to seek alternative sources of liquidity.

Operating Activities

Net cash used in operating activities was $9.2 million for the year ended December 31, 2018. This compared to cash used in operating activities of $30.8 million for the year ending December 31, 2017. The $21.6 million year-over-year decrease was primarily the result of change from net loss in 2017 to net income in 2018, a change in accrued liabilities, which included the impact of 2017 federal income tax payment due to the sale of our Trillium Software business in 2016, the impact of an increase in accounts payable during 2018, as compared to a decrease in 2017.

Investing Activities

Net cash used in investing activities was $0.1 million for the year ended December 31, 2018. This compared to cash used in investing activities of $5.7 million for the year ending December 31, 2017. The $5.6 million decrease was due to the sale of 3Q Digital in late February 2018 and reduced capital expenditure in 2018.

Financing Activities

Net cash provided by financing activities was $22.7 million for the year ended December 31, 2018 and net cash used in financing activities was $1.5 million for the year ended December 31, 2017. The $24.2 million increase in cash inflows in 2018 compared to 2017 was driven by the $14.2 million borrowing under our revolver line and the issuance of $9.7 million Series A Preferred Stock in 2018.

Foreign Holdings of Cash

Consolidated foreign holdings of cash as of December 31, 2018 and 2017 were $2.6 million and $2.6 million.

Credit Facilities

On April 17, 2017, we entered into a secured credit facility with Texas Capital Bank, N.A., that provides that we may borrow up to $20 million from time to time (the "Texas Capital Credit Facility"). The Texas Capital Credit Facility is being used for general corporate purposes and to provide collateral for up to $5.0 million of letters of credit issued by Texas Capital Bank. The Texas Capital Credit Facility is secured by substantially all of the company's assets and is guaranteed by HHS Guaranty, LLC, an entity formed to provide credit support for Harte Hanks by certain members of the Shelton family (descendants of one of our founders) that is otherwise not related to our company.

On January 9, 2018, we entered an amendment (the "First Amendment") to the Texas Capital Credit Facility. The First Amendment (i) increased the availability under the revolving credit facility from $20 million to $22 million and (ii) extended the term of the Texas

Capital Credit Facility one year to April 17, 2020. The Credit Facility remains secured by substantially all of our assets. At December 31, 2018, we had $14.2 million outstanding borrowing under the Texas Capital facility. As of December 31, 2018, we had the ability to borrow up to an additional $5 million under the facility.

Our fee for the collateral provided by HHS Guaranty, LLC was also changed from an annual fee of $0.5 million to 2.0% of collateral actually pledged. For the year ended December 31, 2018, this fee amounted to $0.5 million. See Note C, Long-Term Debt, in the Notes to Consolidated Financial Statements for further discussion.

At December 31, 2018 and 2017, we had letters of credit in the amount of $2.8 million outstanding. No amounts were drawn against these letters of credit at December 31, 2018 and 2017. These letters of credit exist to support insurance programs relating to workers' compensation, automobile, and general liability. We had no other off-balance sheet arrangements at December 31, 2018 and 2017.

Contractual Obligations

Contractual obligations at December 31, 2018 are as follows:

In thousands	Total	2019	2020	2021	2022	2023	Thereafter
Debt	$14,200	$—	$14,200	$—	$—	$—	$ —
Interest on debt [(1)]	825	634	191	—	—	—	—
Operating lease obligations	35,018	9,645	8,815	7,425	5,456	2,349	1,328
Capital lease obligations	1,423	748	307	131	133	104	—
Purchase obligations and others	9,104	3,167	3,087	2,632	218	—	—
Unfunded pension plan benefit payments	17,680	1,684	1,714	1,742	1,786	1,836	8,918
Total contractual cash obligations	$78,250	$15,878	$28,314	$11,930	$7,593	$4,289	$ 10,246

(1) Assumes $14.2 million and $4.3 million of average debt outstanding for the years ended December 31, 2019 and December 31, 2020.

Dividends

We did not pay any dividends in 2018 and 2017. We currently intend to retain any future earnings and do not expect to pay dividends on our common stock. Any future dividend declaration can be made only upon, and subject to, approval of our Board, based on its business judgment.

Share Repurchase

During 2018 and 2017, we did not repurchase any shares of our common stock under our current stock repurchase program that was publicly announced in August 2014. Under our current program we are authorized to spend up to $20.0 million to repurchase shares of our outstanding common stock. At December 31, 2018, we had authorization of $11.4 million under this program. From 1997 through December 31, 2018, we repurchased 6.8 million shares for an aggregate of $1.2 billion.

Outlook

We consider such factors as total cash and cash equivalents, current assets, current liabilities, total debt, revenues, operating income, cash flows from operations, investing activities, and financing activities when assessing our liquidity. Our 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.

We believe that there are not any conditions or events, considered in the aggregate, that raise substantial doubt about our ability to continue as a going concern for the 12 months following the issuance of the financial statements.

Critical Accounting Policies

Critical accounting policies are defined as those that, in our judgment, are most important to the portrayal of our company’s financial condition and results of operations and which require complex or subjective judgments or estimates. The areas that we believe involve the most significant management estimates and assumptions are detailed below. Actual results could differ materially from those estimates under different assumptions and conditions.

Our Significant Accounting policies are described in Note A, Significant Accounting Policies, in the Notes to Consolidated Financial Statement.

Revenue Recognition

Application of various accounting principles in U.S. GAAP related to measurement and recognition of revenue requires us to make significant judgments and estimates. Specifically, complex arrangements with non-standard terms and conditions may require significant contract interpretation to determine appropriate accounting.

We recognize revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to be entitled to receive in exchange for those products or services. We apply the following five-step revenue recognition model:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when (or as) we satisfy the performance obligation

Certain client programs provide for adjustments to billings based upon whether we achieve certain performance criteria. In these circumstances, revenue is recognized when the foregoing conditions are met. We record revenue net of any taxes collected from customers and subsequently remitted to governmental authorities. Any payments received in advance of the performance of services or delivery of the product are recorded as deferred revenue until such time as the services are performed or the product is delivered. Costs incurred for search engine marketing solutions and postage costs of mailings are billed to our clients and are not directly reflected in our revenue.

Income Taxes

We are subject to income taxes in the United States and numerous other jurisdictions. Significant judgment is required in determining our provision for income taxes and income tax assets and liabilities, including evaluating uncertainties in the application of accounting principles and complex tax laws.

We record a provision for income taxes for the anticipated tax consequences of the reported results of operations using the asset and liability method. Under this method, we recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities, as well as for operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the tax rates that are expected to apply to taxable income for the years in which those tax assets and liabilities are expected to be realized or settled. We record a valuation allowance to reduce our deferred tax assets to the net amount that we believe is more likely than not to be realized. For additional information on the valuation allowance see Note D, Income Taxes, in the Notes to Consolidated Financial Statements.

We recognize tax benefits from uncertain tax positions only if we believe that it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. Although we believe that we have adequately reserved for our uncertain tax positions, we can provide no assurance that the final tax outcome of these matters will not be materially different. We adjust these reserves when facts and circumstances change, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made and could have a material impact on our financial condition and operating results. The provision for income taxes includes the effects of any reserves that we believe are appropriate, as well as the related net interest and penalties.

Recent Accounting Pronouncements

See Note A, Significant Accounting Policies, in the Notes to Consolidated Financial Statements for a discussion of certain accounting standards that we have recently adopted and certain accounting standards that we have not yet been required to adopt and may be applicable to our future financial condition and results of operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The interest rate on the Texas Capital Credit Facility is variable based upon the prime rate or LIBOR and, therefore, is affected by changes in market interest rates. We estimate that a 100-basis point increase in market interest rates on the actual borrowings in 2018 would have an immaterial impact on our interest expense. At December 31, 2018, the company had $14.2M of debt outstanding under the Texas Capital Credit Facility. The nature and amount of our borrowings can be expected to fluctuate as a result of business requirements, market conditions, and other factors. Due to our overall debt level and cash balance at December 31, 2018, anticipated cash flows from operations, and the various financial alternatives available to us, we do not believe that we currently have significant exposure to market risks associated with an adverse change in interest rates. At this time, we have not entered into any interest rate swap or other derivative instruments to hedge the effects of adverse fluctuations in interest rates.

Our earnings are also affected by fluctuations in foreign currency exchange rates as a result of our operations in foreign countries. Our primary exchange rate exposure is to the Euro, British Pound Sterling, and Philippine Peso. We monitor these risks throughout the normal course of business. The majority of the transactions of our U.S. and foreign operations are denominated in the respective local currencies. Changes in exchange rates related to these types of transactions are reflected in the applicable line items making up operating income in our Consolidated Statements of Comprehensive Income (Loss). Due to the current level of operations conducted in foreign currencies, we do not believe that the impact of fluctuations in foreign currency exchange rates on these types of transactions is significant to our overall annual earnings. A smaller portion of our transactions are denominated in currencies other than the respective local currencies. For example, intercompany transactions that are expected to be settled in the near-term are denominated in U.S. Dollars. Since the accounting records of our foreign operations are kept in the respective local currency, any transactions denominated in other currencies are accounted for in the respective local currency at the time of the transaction. Any foreign currency gain or loss from these transactions, whether realized or unrealized, results in an adjustment to income, which is recorded in “Other, net” in our Consolidated Statements of Comprehensive Income (Loss). Transactions such as these amounted to $0.5 million pre-tax currency transaction gain in 2018 and $0.4 million in pre-tax currency transaction loss in 2017. At this time, we are not party to any foreign currency forward exchange contracts or other derivative instruments to hedge the effects of adverse fluctuations in foreign currency exchange rates.

We do not enter into derivative instruments for any purpose. We do not speculate using derivative instruments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Financial Statements required to be presented under Item 8 are presented in the Consolidated Financial Statements and the notes thereto beginning at page 38 of this Form 10-K (Financial Statements).

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act”) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to management, including our CEO, CFO, and Corporate Controller as appropriate to allow timely decisions regarding required disclosure.

Our management, including our CEO, CFO, and Corporate Controller evaluated the effectiveness of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of December 31, 2018, the end of the period covered by this Annual Report on form 10-K. Based upon such evaluation, our CEO, CFO, and Corporate Controller concluded that our disclosure controls and procedures were not effective solely due to the material weaknesses in our internal controls over financial reporting that are described below.

Notwithstanding the material weaknesses described below, based on the additional analysis and other post-closing procedures performed, we believe the consolidated financial statements included in this Annual Report on Form 10-K are fairly presented in all material respects, in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Our internal control over financial reporting is a process designed by, or under the supervision of our CEO and CFO to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with U.S. GAAP.

Management evaluated, under the supervision of our CEO, CFO, and Corporate Controller, the design and effectiveness of the Company's internal control over financial reporting based on the framework in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organization of the Treadway Commission ("COSO"). Based on this assessment, management concluded that internal control over financial reporting was not effective because material weaknesses existed at December 31, 2018 as described below.

A material weakness, as defined in the Exchange Act Rule 12b-2, is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. We identified material weaknesses in each of the following areas.

Control Activities and Information and Communication

We identified deficiencies in aggregate that constitute material weaknesses in two of the five components of internal control as defined by COSO (control environment, risk assessment, control activities, information and communication and monitoring). In particular, controls related to the following were not effectively designed and implemented:

Information and Communication

- We did not design and maintain effective controls to obtain, generate and communicate relevant and accurate information to support the function of internal control over financial reporting.
- We did not use an adequate level of precision in our review of information used in certain controls.

These deficiencies create a reasonable possibility that a material misstatement of the annual or interim financial statements would not have been prevented or detected on a timely basis. Further, the above material weakness contributed to the following additional material weakness at the control-activity level:

Revenue Recognition

Management did not design and maintain effective controls over the completeness and accuracy of data used to recognize and record revenue and related accounts such as accounts receivable, accrued revenue, contract assets, deferred revenue and related disclosures. We did not use an adequate level of precision in performance of controls over revenue.

Deloitte & Touche LLP, our independent registered public accounting firm, has issued an audit report on the effectiveness of the company’s internal control over financial reporting as of December 31, 2018.

Changes in Internal Control over Financial Reporting

Improvements in the design and operating effectiveness of internal controls over financial reporting that we have affected to date have led to the successful remediation of several previously disclosed material weaknesses including monitoring, control environment and risk assessment. Other than the material weaknesses discussed above, and the successful remediation of previously disclosed material weaknesses related to monitoring, control environment and risk assessment, there have been no changes in our internal controls over financial reporting during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Remediation Plan for Material Weaknesses in Internal Control over Financial Reporting

Management has been actively engaged in remediation efforts to address the material weaknesses throughout fiscal year 2018 and these efforts will continue into fiscal year 2019. We have made progress towards addressing the weakness in information and communication by preparing a comprehensive listing of applications and assessing each to determine its impact on financial reporting. We have identified and documented all the systems utilized as we redesigned processes and controls. We have documented which reports are used in the execution of controls.

Significant progress has been made towards addressing the weakness in revenue recognition. Walkthroughs have been performed for all significant revenue streams and flow charts have been completed to document these processes. Current key controls have been assessed and mapped to risks within the process. Additional key controls have been identified and designed. We have begun implementing new controls and enhancing the reviews and documentation of currently implemented controls.

We continue to work with the third-party specialists we engaged to review, document, and (as needed) supplement our controls, with the goal of designing and implementing controls that not only better address both the accuracy and precision of management's review, but also enhance our ability to manage our business as it has evolved. In 2018, significant progress was made in relation to the design and implementation of controls, however, there is still additional work to be done to completely remediate the material weakness. While we have made improvements to many of our control activities, management may determine that additional steps may be necessary to remediate the material weaknesses.

While we intend to resolve all the material control deficiencies discussed above, we cannot provide any assurance that these remediation efforts will be successful, will be completed quickly, or that our internal control over financial reporting will be effective as a result of these efforts by any particular date.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the stockholders and Board of Directors of Harte Hanks, Inc.

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Harte Hanks, Inc. and subsidiaries (the "Company") as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, because of the effect of the material weaknesses identified below on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2018, of the Company and our report dated March 18, 2019 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding the Company's adoption of a new accounting standard.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Material Weaknesses

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. Management identified material weaknesses, which affected the information and communication and control activities components of internal control as defined by COSO. Management also identified material weaknesses over the accounting for revenue as management did not design and maintain effective controls over the completeness and accuracy of data used to recognize and record revenue and related accounts such as accounts receivable, accrued revenue, contract assets, deferred revenue, and controls related to revenue disclosures and the precision of management’s revenue review controls.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements as of and for the year ended December 31, 2018, of the Company, and this report does not affect our report on such financial statements.

/s/ DELOITTE & TOUCHE LLP
San Antonio, TX
March 18, 2019

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Section 16(a) Beneficial Ownership Reporting Compliance

The information to appear in our 2019 Proxy Statement under the caption "General Information - Section 16(a) Beneficial Ownership Reporting Compliance" is incorporate herein by reference.

Directors and Executive Officers

The information required by this item regarding our directors and executive officers will be set forth in our 2019 Proxy Statement under the caption “Directors and Executive Officers” which information is incorporated herein by reference.

Code of Ethics and Other Governance Information

The information required by this item regarding the Supplemental Code of Ethics for our Senior Financial Officers (Code of Ethics), audit committee financial experts, audit committee members and procedures for stockholder recommendations of nominees to our Board of Directors will be set forth in our 2019 Proxy Statement under the caption “Corporate Governance” which information is incorporated herein by reference.

Our Code of Ethics may be found on our website at www.hartehanks.com “Corporate Governance” section of the “Investors” tab, and a printed copy of our Code of Ethics will be furnished without charge, upon written request to Harte Hanks, Inc., Attn: Corporate Secretary, 9601 McAllister Freeway, Suite 610, San Antonio, Texas 78216. In accordance with the rules of the NYSE and the SEC, we currently intend to disclose any future amendments to our Code of Ethics, or waivers from our Code of Ethics for our Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer, by posting such information on our website (www.HarteHanks.com) within the time period required by applicable SEC and NYSE rules.

Management Certifications

In accordance with the Sarbanes-Oxley Act of 2002 and SEC rules thereunder, our CEO and CFO have signed certifications under Sarbanes-Oxley Section 302, which are filed as exhibits to this Form 10-K. In addition, our CEO most recently submitted an annual certification to the NYSE under Section 303A.12(a) of the NYSE listing standards on September 17, 2018.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item regarding the compensation of our “named executive officers” and directors and other required information will be set forth in our 2019 Proxy Statement under the captions “Executive Compensation,” and “Director Compensation,” which information is incorporated herein by reference. In accordance with the rules of the SEC, information to be contained in the 2019 Proxy Statement under the caption “Compensation Committee Report” is not deemed to be “filed” with the SEC or subject to the liabilities of the 1934 Act.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Equity Compensation Plan Information at Year-End 2018

The information required by this item regarding securities authorized for issuance under equity compensation plans will be set forth in our 2019 Proxy Statement under the caption “Executive Compensation - Equity Compensation Plan Information at Year-End 2018,” which information is incorporated herein by reference.

Beneficial Ownership

The information required by this item regarding security ownership of certain beneficial owners, management and directors will be set forth in our 2019 Proxy Statement under the caption “Security Ownership of Management and Principal Stockholders,” which information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Independence of Directors

The information required by this item regarding director independence will be set forth in our 2019 Proxy Statement under the caption “Corporate Governance—Independence of Directors,” which information is incorporated herein by reference.

Certain Relationships and Related Transactions

The information required by this item regarding transactions with related persons, including our policies and procedures for the review, approval or ratification of related person transactions that are required to be disclosed under the SEC’s rules and regulations, will be set forth in our 2019 Proxy Statement under the caption “Corporate Governance—Certain Relationships and Related Transactions,” which information is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item regarding the audit committee’s pre-approval policies and procedures and the disclosures of fees billed by our principal independent auditor will be set forth in our 2019 Proxy Statement under the caption “Audit Committee and Independent Registered Public Accounting Firm,” which information is incorporated herein by reference.

PART IV

ITEM 15.	EXHIBITS AND FINANCIAL STATEMENT SCHEDULES
15(a)(1)	Financial Statements

The financial statements filed as part of this report and referenced in Item 8 are presented in the Consolidated Financial Statements and the notes thereto beginning at page 38 of this Form 10-K (Financial Statements).

15(a)(2) Financial Statement Schedules

All schedules for which provision is made in the applicable rules and regulations of the SEC have been omitted as the schedules are not required under the related instructions, are not applicable, or the information required thereby is set forth in the Consolidated Financial Statements or notes thereto.

15(a)(3) Exhibits

The Exhibit Index following the Notes to Consolidated Financial Statements in this Form 10-K lists the exhibits that are filed or furnished, as applicable, as part of this Form 10-K.

Harte Hanks, Inc. and Subsidiaries

Index to Consolidated Financial Statements

All schedules for which provision is made in the applicable rules and regulations of the SEC have been omitted as the schedules are not required under the related instructions, are not applicable, or the information required thereby is set forth in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the stockholders and the Board of Directors of Harte Hanks, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Harte Hanks, Inc. and subsidiaries (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of comprehensive income (loss), changes in equity, and cash flows for the years then ended, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on the criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 18, 2019 expressed an adverse opinion on the Company's internal control over financial reporting because of material weaknesses.

Change in Accounting Principle

As discussed in Note B to the financial statements, the Company changed its method of accounting for revenue from contracts with customers in 2018 due to adoption of the new revenue standard. The Company adopted the new revenue standard using a modified retrospective approach.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP
San Antonio, Texas
March 18, 2019
We have served as the Company’s auditor since 2016.

Harte Hanks, Inc. and Subsidiaries Consolidated Balance Sheets

	December 31,	
In thousands, except per share and share amounts	2018	2017
ASSETS		
Current assets		
Cash and cash equivalents	$20,882	$ 8,397
Accounts receivable (less allowance for doubtful accounts of $430 at December 31, 2018 and $697 at December 31, 2017)	54,240	81,397
Contract assets	2,362	—
Inventory	448	587
Prepaid expenses	4,088	5,039
Prepaid income tax and income tax receivable	20,436	3,886
Other current assets	2,536	3,900
Total current assets	104,992	103,206
Property, plant and equipment		
Buildings and improvements	15,737	16,821
Software	50,531	52,967
Equipment and furniture	80,230	84,747
Software development and equipment installations in progress	653	4,005
Gross property, plant and equipment	147,151	158,540
Less accumulated depreciation and amortization	(133,559)	(136,753)
Net property, plant and equipment	13,592	21,787
Other intangible assets (less accumulated amortization of $2,184 at December 31, 2017)	—	2,589
Other assets	6,591	3,230
Total assets	$125,175	$ 130,812
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	31,052	36,130
Accrued payroll and related expenses	6,783	10,601
Deferred revenue and customer advances	6,034	5,342
Customer postage and program deposits	6,729	11,443
Other current liabilities	3,564	3,732
Total current liabilities	54,162	67,248

Long-term debt	Cost of maintenance, services, and hosting fees	80,948	37.8%	51,944	33.5%	
Research and development	33,642		15.7%	34,213	22.1%	10
Selling and marketing	24,098		11.3%	20,448	13.2%	7
General and administrative	24,559		11.5%	24,533	15.8%	7
Depreciation and amortization	15,249		7.1%	9,742	6.3%	3
Total expenses	184,384		86.2%	146,754	94.6%	54

Operating income (loss)		29,555	13.8%		8,308	5.4%		3
Other expense:								
Interest income		159	0.1%		222	0.1%		
Interest expense		(7,453)	-3.5%		(2,620)	-1.7%		(1
Other, net		(3,152)	-1.5%		(1,430)	-0.9%		(
Total other expense		(10,446)	-4.9%		(3,828)	-2.5%		(1
Income (loss) before income taxes		19,109	8.9%		4,480	2.9%		1
Income tax expense (benefit)		5,347	2.5%		(1,175)	-0.8%		
Net income (loss)	$	13,762	6.4%	$	5,655	3.6%	$	1

Three-Month Period Ended September 30, 2013 Compared to Three-Month Period September 30, 2012

Revenues

Total revenues for the three months ended September 30, 2013 increased $58.9 million, or 38.0%, as compared to the same period in 2012 of which $36.6 million, or 23.6%, was due to the addition of ORCC. Total revenues increased as a result of a $16.7 million, or 42.2%, increase in software license fee revenue, a $12.5 million, or 26.2%, increase in maintenance revenue, and a $35.2 million, or 110.9%, increase in software hosting fees revenue partially offset by a $5.5 million, or 15.6%, decrease in services revenues.

The increase in total revenues was driven by increases in the Americas, EMEA and Asia/Pacific reportable segments of $49.0 million, $8.9 million and $1.0 million, respectively. Revenue from the addition of ORCC is included in the Americas reportable segment.

Software License Fees Revenue

Customers purchase the right to license ACI software for the term of their agreement which is generally 60 months. Within these agreements are specified capacity limits typically based on customer transaction volumes. ACI employs measurement tools that monitor the number of transactions processed by customers and if contractually specified limits are exceeded, additional fees are charged for the overage. Capacity overages may occur at varying times throughout the term of the agreement depending on the product, the size of the customer, and the significance of customer transaction volume growth. Depending on specific circumstances, multiple overages or no overages may occur during the term of the agreement.

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Certain of our initial license fees are required to be recognized ratably over an extended period. Initial license and capacity fees that are recognized as revenue ratably over an extended period are included in our monthly license fee revenues.

Initial License Fees (ILF) Revenue

ILF revenue includes license and capacity revenues that do not recur on a monthly or quarterly basis. Included in ILF revenues are license and capacity fees that are recognizable at the inception of the agreement and license and capacity fees that are recognizable at interim points during the term of the agreement, including those that are recognizable annually due to negotiated customer payment terms. ILF revenues during the three months ended September 30, 2013 compared to the same period in 2012, increased by $19.3 million, or 129.7%. The increase in ILF revenues is primarily due to an increase in revenue recognized from capacity and customer go-live events as compared to the year ago quarter. ILF revenue increased in the Americas, EMEA and Asia/Pacific reportable segments by $10.2 million, $6.3 million and $2.8 million, respectively. Capacity-related revenues increased $18.0 million for the three months ended September 30, 2013 as compared to the same period in 2012 primarily in the Americas and EMEA reportable segments.

Monthly License Fees (MLF) Revenue

MLF revenues are license and capacity revenues that are paid monthly or quarterly due to negotiated customer payment terms as well as initial license and capacity fees that are recognized as revenue ratably over an extended period as MLF revenue. MLF revenues decreased $2.6 million, or 10.5%, during the three months ended September 30, 2013, as compared to the same period in 2012. The Americas and EMEA reportable segments decreased by $2.5 million and $0.9 million respectively, partially offset by an increase in the Asia/Pacific reportable segment by $0.7 million when compared to the same period in 2012. The reduction in MLF revenue is primarily due to a reduction in the amount and timing of initial license and capacity fees that are recognized as revenue ratably over an extended period as MLF revenue.

Maintenance Fees Revenue

Maintenance fees revenue includes standard and enhanced maintenance or any post-contract support fees received from customers for the provision of product support services. Maintenance fees revenues increased $12.5 million, or 26.2%, during the three months ended September 30, 2013, as compared to the same period in 2012 of which $0.4 million is due to the addition of ORCC. Maintenance fees revenue increased in the Americas, EMEA and Asia/Pacific reportable segments by $4.9 million, $5.8 million and $1.8 million, respectively.

Services Revenue

Services revenue includes fees earned through implementation services, professional services and facilities management services. Implementation services include product installations, product configurations, and retrofit custom software modifications (CSM s). Professional services include business consultancy, technical consultancy, on-site support services, CSM s, product education, and testing services. These services include new customer implementations as well as existing customer migrations to new products or new releases of existing products. During the period in which non-essential services revenue is being deferred, direct and incremental costs related to the performance of these services are also being deferred. During the period in which essential services revenue is being deferred, direct and indirect costs related to the performance of these services are also being deferred.

Services revenue decreased $5.5 million, or 15.6%, for the three months ended September 30, 2013, as compared to the same period in 2012, such decrease was partially offset by $0.1 million due to the addition of ORCC. Services revenue decreased in the EMEA and Asia/Pacific reportable segments by $2.3 million and $4.3 million, respectively, offset by an increase of $1.1 million in the Americas reportable segment. Services revenue decreased primarily due to sizable implementation projects completed and recognized in the EMEA and Asia/Pacific reportable segments during the three months ended September 30, 2012.

Software Hosting Fees Revenue

Software hosting fees revenue includes fees earned through hosting and on-demand arrangements. All revenues from hosting and on-demand arrangements, which may include set-up fees, implementation or customization services, and product support services, are included in software hosting fees revenue.

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Software hosting fees revenue increased $35.2 million, or 110.9%, for the three months ended September 30, 2013 as compared to same period in 2012 primarily due to the acquisition of ORCC which is included in the Americas reportable segment.

Expenses

Total operating expenses for the three months ended September 30, 2013 increased $37.6 million, or 25.6%, as compared to the same period of 2012. Included in operating expenses for the three months ended September 30, 2013 were approximately $34.4 million of operating expenses from the addition of ORCC. There were approximately $8.7 million and $4.5 million of significant transaction related expenses incurred in the three months ended September 30, 2013 and September 30, 2012, respectively. Significant transaction related expenses for the three months ended September 30, 2013 included $5.2 million of personnel related charges, $1.0 million for facility closures and $2.5 million of professional and other expenses related to the acquisition of ORCC. Excluding these expenses, total operating expenses were flat in the three months ended September 30, 2013 compared to the same period in 2012.

Cost of Software License Fees

The cost of software licenses for our products sold includes third-party software royalties as well as the amortization of purchased and developed software for resale. In general, the cost of software licenses for our products is minimal because we internally develop most of the software components, the cost of which is reflected in research and development expense as it is incurred as technological feasibility coincides with general availability of the software components.

Cost of software license fees was flat for the three months ended September 30, 2013 compared to the same period in 2012.

Cost of Maintenance, Services, and Hosting fees

Cost of maintenance, services and hosting fees includes costs to provide hosting services and both the costs of maintaining our software products as well as the service costs required to deliver, install and support software at customer sites. Maintenance costs include the efforts associated with providing the customer with upgrades, 24-hour help desk, post go-live (remote) support and production-type support for software that was previously installed at a customer location. Service costs include human resource costs and other incidental costs such as travel and training required for both pre go-live and post go-live support. Such efforts include project management, delivery, product customization and implementation, installation support, consulting, configuration, and on-site support.

Cost of maintenance, services, and hosting fees increased $29.0 million, or 55.8%, in the three months ended September 30, 2013 compared to the same period in 2012. There were $25.0 million of ORCC expenses added in the quarter ended September 30, 2013. Excluding these expenses, the cost of maintenance, services and hosting fees increased $4.0 million in the three months ended September 30, 2013 compared to the same period in 2012 primarily due to an increase in personnel related expenses.

Research and Development

Research and development (R&D) expenses are primarily human resource costs related to the creation of new products, improvements made to existing products as well as compatibility with new operating system releases and generations of hardware.

Research and development expense decreased $0.6 million, or 1.7%, in the three months ended September 30, 2012 compared to the same period in 2012. There were $2.0 million of ORCC expenses added in the quarter ended September 30, 2013. Excluding these expenses, total research and development expenses decreased $2.6 million in the three months ended September 30, 2013 compared to the same period in 2012 primarily due to a decrease in personnel related expenses.

Selling and Marketing

Selling and marketing includes both the costs related to selling our products to current and prospective customers as well as the costs related to promoting the Company, its products and the research efforts required to measure customers future needs and satisfaction levels. Selling costs are primarily the human resource and travel costs related to the effort expended to license our products and services to current and potential customers within defined territories and/or industries as well as the management of the overall relationship with customer accounts. Selling costs also include the costs associated with assisting distributors in their efforts to sell our products and services in their respective local markets. Marketing costs include costs needed to promote the Company and its products as well as perform or acquire market research to help us better understand what products our customers are looking for in the future. Marketing costs also include the costs associated with measuring customers opinions toward the Company, our products and personnel.

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Selling and marketing expense increased $3.7 million, or 17.9%, in the three months ended September 30, 2013 compared to the same period in 2012. There were $1.6 million of ORCC expenses added in the quarter ended September 30, 2013. Excluding these expenses, total operating expenses increased $2.1 million in the three months ended September 30, 2013 compared to the same period in 2012 primarily due to an increase in personnel related expenses and an increase in professional promotion and advertising fees.

General and Administrative

General and administrative expenses are primarily human resource costs including executive salaries and benefits, personnel administration costs, and the costs of corporate support functions such as legal, administrative, human resources and finance and accounting.

General and administrative expenses were flat for the three months ended September 30, 2013 compared to the same period in 2012. Included in general and administrative expenses were approximately $8.7 million and $4.5 million of significant transaction related expenses incurred in the three months ended September 30, 2013 and September 30, 2012, respectively. Significant transaction related expenses for the three months ended September 30, 2013 included $5.2 million of personnel related charged, $1.0 million for facility closures and $2.5 million of professional and other expenses related to the acquisition of ORCC. Excluding these expenses, total general and administrative expenses decreased $4.2 million in the three months ended September 30, 2013 compared to the same period in the prior year, partially due to a $1.5 million release of bad debt allowances. The remaining difference is due to a decrease in personnel related expenses.

Depreciation and Amortization

Depreciation and amortization expense includes charges for depreciation of property and equipment and amortization of acquired intangibles excluding amortization of purchased or developed technology for resale. Amortization of acquired intangibles include customer relationships, trade names, non-competes and other intangible assets.

Depreciation and amortization expense increased $5.5 million, or 56.5%, in the three months ended September 30, 2013 compared to the same period in 2012 primarily due to acquisition related intangibles.

Other Income and Expense

Other income and expense includes interest income and expense, foreign currency gains and losses, and other non-operating items. Fluctuating currency rates impacted the three months ended September 30, 2013 by $2.9 million in net foreign currency losses as compared with $1.4 million in net losses during the same period in 2012. Interest expense increased $4.8 million during the three months ended September 30, 2013 compared to the same period in 2012 due primarily to the increased debt used to partially fund the ORCC acquisition in March 2013 and the addition of the Notes in August of 2013.

Income Taxes

The effective tax rate for the three months ended September 30, 2013 was 28.0%. The earnings of our foreign entities for the three months ended September 30, 2013 were $7.4 million. The tax rates in the foreign jurisdictions in which we operate are less than the domestic tax rate. The effective tax rate for the three months ended September 30, 2013 was positively impacted by foreign profits taxed at lower rates.

We reported a tax benefit for the three months ended September 30, 2012 while reporting a pretax profit for the same period. The resulting effective tax rate is negative. The earnings of our foreign entities for the three months ended September 30, 2012 were $14.5 million. The tax rates in the foreign jurisdictions in which we operate are less than the domestic tax rate. The effective tax rate for the three months ended September 30, 2012 was positively impacted by foreign profits taxed at lower rates and a domestic loss taxed at a higher rate. The effective tax rate for the three months ended September 30, 2012 was positively impacted by a $1.6 million release of an accrued tax liability and a favorable adjustment of $1.0 million in our uncertain tax positions as the statute of limitations expired for the tax returns to which they are associated during the three months ended September 30, 2012.

Our effective tax rate could fluctuate significantly on a quarterly basis and could be negatively affected to the extent earnings are lower in the countries in which we operate that have a lower statutory rate or higher in the countries in which we operate that have a higher statutory rate or to the extent we have losses sustained in countries where the future utilization of those losses is uncertain. Our effective tax rate could also fluctuate due to changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are occasionally subject to examination of our income tax returns by tax authorities in the jurisdictions we operate. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

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Nine-Month Period Ended September 30, 2013 Compared to Nine-Month Period September 30, 2012

Revenues

Total revenues for the nine months ended September 30, 2013 increased $139.3 million, or 31.5%, as compared to the same period in 2012 of which $83.8 million, or 18.9%, was due to the addition of ORCC. Total revenues increased as a result of a $24.2 million, or 19.0%, increase in software license fee revenue, a $35.9 million, or 25.5%, increase in maintenance fee revenue, and a $90.6 million, or 110.8%, increase in software hosting fees revenue partially offset by a $11.4 million, or 12.3%, decrease in services revenues.

The increase in total revenues was driven by increases in the Americas, EMEA and Asia/Pacific reportable segments of $125.8 million, $8.8 million and $4.7 million, respectively. Revenue from the addition of ORCC is included in the Americas reportable segment.

Initial License Fees (ILF) Revenue

ILF revenue includes license and capacity revenues that do not recur on a monthly or quarterly basis. Included in ILF revenues are license and capacity fees that are recognizable at the inception of the agreement and license and capacity fees that are recognizable at interim points during the term of the agreement, including those that are recognizable annually due to negotiated customer payment terms. ILF revenues during the nine months ended September 30, 2013 compared to the same period in 2012, increased by $31.0 million, or 59.2%. The increase in ILF revenues is primarily due to an increase in revenue recognized from capacity and customer go-live events as compared to the year ago quarter. ILF revenue increased in the Americas, EMEA and Asia/Pacific reportable segments by $27.7 million, $1.0 million and $2.3 million, respectively. Capacity-related revenues increased $20.0 million for the nine months ended September 30, 2013 as compared to the same period in 2012 primarily in the Americas reportable segment.

Monthly License Fees (MLF) Revenue

MLF revenues are license and capacity revenues that are paid monthly or quarterly due to negotiated customer payment terms as well as initial license and capacity fees that are recognized as revenue ratably over an extended period as MLF revenue. MLF revenues decreased $6.8 million, or 9.1%, during the nine months ended September 30, 2013, as compared to the same period in 2012. The Americas and EMEA reportable segments decreased by $5.0 million and $2.5 million, respectively, partially offset by a $0.7 million increase in the Asia/Pacific reportable operating segment when compared to the same period in 2012. The reduction in MLF revenue is primarily due to a reduction in the amount and timing of initial license and capacity fees that are recognized as revenue ratably over an extended period as MLF revenue.

Maintenance Fees Revenue

Maintenance fees revenue includes standard and enhanced maintenance or any post-contract support fees received from customers for the provision of product support services. Maintenance fees revenues increased $35.9 million, or 25.5%, during the nine months ended September 30, 2013, as compared to the same period in 2012 of which $0.9 million is due to the addition of ORCC. Maintenance fees revenue increased in the Americas, EMEA and Asia/Pacific reportable segments by $14.8 million, $14.0 million and $7.1 million, respectively. Maintenance fees revenue increased partly due to the inclusion of S1 operations for the full nine months ended September 30, 2013.

Services Revenue

Services revenue decreased $11.4 million, or 12.3%, for the nine months ended September 30, 2013, as compared to the same period in 2012, the decrease was partially offset by a $0.5 million increase due to the addition of ORCC. Services revenue decreased in the Americas, EMEA and Asia/Pacific reportable segments by $0.3 million, $5.7 million and $5.4 million, respectively. Services revenue decreased primarily due to sizable implementation projects completed and recognized in the EMEA and Asia/Pacific reportable segments during the nine months ended September 30, 2012.

Software Hosting Fees Revenue

Software hosting fees revenue increased $90.6 million, or 110.8%, for the nine months ended September 30, 2013 as compared to same period in 2012 of which $82.4 million is due to the addition of ORCC which is included in the Americas reportable segment. Software hosting fees revenue increased in the Americas and EMEA segments by $88.6 million and $2.0 million, respectively, and can be attributed to new customers adopting our on-demand or hosted offerings and existing customers adding new functionality or services. Software hosting fees revenue increased partly due to the inclusion of S1 operations for the full nine months ended September 30, 2013.

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Expenses

Total operating expenses for the nine months ended September 30, 2013 increased $101.1 million, or 22.8%, as compared to the same period of 2012. Included in operating expenses for the nine months ended September 30, 2013 were approximately $76.6 million of operating expenses from the addition of ORCC. There were approximately $19.2 million and $27.1 million of acquisition related significant transaction related expenses incurred in the nine months ended September 30, 2013, and September 30, 2012, respectively. Significant transaction related expenses for the nine months ended September 30, 2013 included $9.4 million of personnel related charges, $1.0 million for facility closures and $8.8 million of professional and other expenses related to the acquisition of ORCC. Excluding these expenses, total operating expenses increased $32.3 million in the nine months ended September 30, 2013 compared to the same period in 2012 primarily due the inclusion of S1 operations for a full nine months.

Cost of Software License Fees

Cost of software license fees increased $1.4 million, or 8.1% in the nine months ended September 30, 2013 compared to the same period in 2012 primarily due to an increase in third party product royalty fees.

Cost of Maintenance, Services, and Hosting fees

Cost of maintenance, services, and hosting fees increased $76.8 million, or 51.7%, in the nine months ended September 30, 2013 compared to the same period in 2012. There were $56.2 million of ORCC expenses added in the nine months ended September 30, 2013. Excluding these expenses, the cost of maintenance, services and hosting fees increased $20.6 million in the nine months ended September 30, 2013 compared to the same period in 2012 primarily due the inclusion of S1 operations for a full nine months.

Research and Development

Research and development expense increased $9.0 million, or 9.0%, in the nine months ended September 30, 2013 compared to the same period in 2012. There were $4.8 million of ORCC expenses added in the nine months ended September 30, 2013. Excluding these expenses, the cost of research and development increased $4.2 million in the nine months ended September 30, 2013 compared to the same period in 2012 primarily due the inclusion of S1 operations for a full nine months.

Selling and Marketing

Selling and marketing expense increased $12.4 million, or 19.3%, in the nine months ended September 30, 2013 compared to the same period in 2012. There were $5.0 million of ORCC expenses added in the nine months ended September 30, 2013. Excluding these expenses, the cost of selling and marketing increased $7.4 million in the nine months ended September 30, 2013 compared to the same period in 2012 primarily due the inclusion of S1 operations for a full nine months.

General and Administrative

General and administrative expense decreased $11.4 million, or 13.1%, in the nine months ended September 30, 2013. There were approximately $19.2 million and $27.1 million of significant transaction related expenses incurred in the nine months ended September 30, 2013, and September 30, 2012, respectively. Significant transaction related expenses for the nine months ended September 30, 2013 included $9.4 million of personnel related charges, $1.0 million for facility closures and $8.8 million of professional and other expenses related to the acquisition of ORCC.

Excluding these expenses, total general and administrative expenses decreased $3.5 million in the nine months ended September 30, 2013.

Depreciation and Amortization

Depreciation and amortization expense increased $12.9 million, or 47.9%, in the nine months ended September 30, 2013 compared to the same period in 2012 primarily due to acquisition related intangibles.

Other Income and Expense

Other income and expense includes interest income and expense, foreign currency gains and losses, and other non-operating items. Fluctuating currency rates impacted the nine months ended September 30, 2013 by $0.8 million in net foreign currency losses, as compared with $2.4 million in net losses during the same period in 2012. Interest expense increased $10.0 million during the nine months ended September 30, 2013 compared to the same period in 2012 due primarily to the increased debt used to partially fund the S1 acquisition in February 2012 and the ORCC acquisition in March 2013 and the addition of the Notes in August 2013.

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Income Taxes

The effective tax rate for the nine months ended September 30, 2013 was 27.8%. The earnings of our foreign entities for the nine months ended September 30, 2013 were $18.9 million. The tax rates in the foreign jurisdictions in which we operate are less than the domestic tax rate. The effective tax rate for the nine months ended September 30, 2013 was positively impacted by foreign profits taxed at lower rates and a domestic loss taxed at a higher rate as well as recognition of $1.4 million tax benefit as a result of implementing the 2012 American Taxpayer Relief Act. The effective tax rate for the nine months ended September 30, 2013 was negatively impacted by acquisition related expenses that are not deductible for tax purposes as well as an increase in the valuation allowance against foreign tax credits as a result of the acquisition of ORCC.

The effective tax rate for the nine months ended September 30, 2012 was 90.6%. The earnings of our foreign entities for the nine months ended September 30, 2012 were $37.0 million. The tax rates in the foreign jurisdictions in which we operate are less than the domestic tax rate. The effective tax rate for the nine months ended September 30, 2012 was positively impacted by foreign profits taxed at lower rates and a domestic loss taxed at a higher rate. The effective tax rate for the nine months ended September 30, 2012 was positively impacted by a $1.4 million release of a valuation allowance. The valuation allowance was released based upon evidence that one of our foreign entities will be able to fully utilize its remaining tax losses. The effective tax rate for the nine months ended September 30, 2012 was positively impacted by a $1.6 million release of an accrued tax liability and a favorable adjustment of $1.0 million to our uncertain tax positions as the statute of limitations expired for the tax returns to which they are associated during the nine months ended September 30, 2012.

Our effective tax rate could fluctuate significantly on a quarterly basis and could be negatively affected to the extent earnings are lower in the countries in which we operate that have a lower statutory rate or higher in the countries in which we operate that have a higher statutory rate or to the extent we have losses sustained in countries where the future utilization of those losses is uncertain. Our effective tax rate could also fluctuate due to changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are occasionally subject to examination of our income tax returns by tax authorities in the jurisdictions we operate. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Segment Results

The following table presents revenues and income (loss) before income taxes for the periods indicated by geographic region (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Revenues:				
Americas	$ 136,812	$ 87,766	$ 369,504	$ 243,674
EMEA	51,692	42,844	145,982	137,252
Asia/Pacific	25,435	24,452	66,280	61,558
	$ 213,939	$ 155,062	$ 581,766	$ 442,484

Income (loss) before income taxes:				
Americas	$ 36,320	$ 19,714	$ 79,612	$ 55,250
EMEA	14,968	13,493	43,176	37,365
Asia/Pacific	10,641	7,406	19,828	15,384
Corporate	(42,820)	(36,133)	(123,956)	(116,742)
	$ 19,109	$ 4,480	$ 18,660	$ (8,743)

Reportable segment results are impacted by both direct expenses and allocated shared function costs such as global product development, global customer operations and global product management. Shared function costs are allocated to the geographic reportable segments as a percentage of revenue or as a percentage of headcount. All administrative costs that are not directly attributable or able to be allocated to a geographic segment are included in the corporate line item.

The increase in expenses for the Americas segment is primarily due to the addition of ORCC in March 2013. The Company incurred integration expenses of approximately $8.7 million and $4.5 million during the three months ended September 30, 2013 and 2012, respectively. Amortization of intangible assets allocated to the Corporate business segment was approximately $9.2 million and $6.7 million during the three months ended September 30, 2013 and 2012, respectively. Interest expense on long term debt allocated to the Corporate segment was approximately $7.4 million and $2.5 million during the three months ended September 30, 2013 and 2012, respectively.

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The Company incurred significant transaction related expenses of approximately $19.2 million and $27.1 million during the nine months ended September 30, 2013 and 2012, respectively. Amortization of intangible assets allocated to the Corporate business segment was approximately $25.2 million and $18.0 million during the nine months ended September 30, 2013 and 2012, respectively. Interest expense on long term debt allocated to the Corporate segment was approximately $17.2 million and $7.3 million during the nine months ended September 30, 2013 and 2012, respectively. The Company expects corporate costs to decrease moving forward as the synergy savings from the acquisitions are realized.

Liquidity and Capital Resources

General

Our primary liquidity needs are: (i) to fund normal operating expenses; (ii) to meet the interest and principal requirements of our outstanding indebtedness; and (iii) to fund acquisitions, capital expenditures and lease payments. We believe these needs will be satisfied using cash flow generated by our operations, our cash and cash equivalents and available borrowings under our revolving credit facility.

As of September 30, 2013, we had $166.5 million in cash and cash equivalents. Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less.

As of September 30, 2013, $93.4 million of the $166.5 million of cash and cash equivalents was held by our foreign subsidiaries. If these funds were needed for our operations in the U.S. we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

The following table sets forth summary cash flow data for the periods indicated.

	Nine Months Ended September 30,	
	2013	2012
	(amounts in thousands)	
Net cash provided by (used by):		
Operating activities	$ 86,560	$ (12,742)
Investing activities	(282,562)	(339,868)
Financing activities	287,731	243,705

Net cash flows provided by (used by) operating activities for the nine months ended September 30, 2013 amounted to $86.6 million as compared to a $(12.7) million during the same period in 2012. The comparative period increase was primarily due to an additional $33.3 million in cash receipts from customers, a $21.3 million reduction in employee compensation payments, a $14.3 million increase in net income, and a $9.9 million decrease in tax payments during the first nine months of 2013 when compared to the same period in 2012. Our current policy is to use our operating cash flow primarily for funding capital expenditures, lease payments, stock repurchases and acquisitions.

During the first nine months of 2013, we paid $250.2 million, net of $9.9 million in cash acquired, to acquire ORCC. In addition, we paid $14.0 million, net of $0.2 million in cash acquired, to acquire PTESA. We also used cash of $18.4 million to purchase software, property and equipment.

In the first nine months of 2013, we received proceeds of $300.0 million from our Term Credit Facility to fund our purchase of ORCC. In addition, we received proceeds of $300.0 million from our Notes during the first nine months of 2013. We used a portion of the proceeds to pay the $188.0 million balance of the Revolver and repurchase $80.6 million of common stock. We repaid $22.0 million of the Term Credit Facility during the nine months ended September 30, 2013 as well as $7.5 million of debt acquired with ORCC. In addition, during the first nine months of 2013, we received proceeds of $14.0 million, including corresponding excess tax benefits, from the exercises of stock options and the issuance of common stock under our 1999 Employee Stock Purchase Plan, as amended, and used $5.9 million for the repurchase of restricted stock and performance shares for tax withholdings. We paid $16.4 million and $1.1 million in debt issuance costs during the nine months ended September 30, 2013 and 2012, respectively. We also made payments to third-party institutions, primarily related to debt and capital leases, totaling $5.8 million.

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We may decide to use cash to acquire new products and services or enhance existing products and services through acquisitions of other companies, product lines, technologies and personnel, or through investments in other companies.

We believe that our existing sources of liquidity, including cash on hand and cash provided by operating activities, will satisfy our projected liquidity requirements, which primarily consists of working capital requirements, for the next twelve months and foreseeable future.

Debt

As of September 30, 2013, we had $464.3 million outstanding under our Term Credit Facilities, with up to $250.0 million of unused borrowings under the Revolving Credit Facility portion of the Credit Agreement, as amended. The amount of unused borrowings actually available varies in accordance with the terms of the agreement. The Credit Agreement contains certain affirmative and negative covenants, including limitations on the incurrence of indebtedness, asset dispositions, acquisitions, investments, dividends and other restricted payments, liens and transactions with affiliates. The Credit Agreement also contains financial covenants relating to maximum permitted leverage ratio and the minimum fixed charge coverage ratio. The facility does not contain any subjective acceleration features and does not have any required payment or principal reduction schedule and is included as a long-term liability in our consolidated balance sheet. At September 30, 2013 (and at all times during these periods) we were in compliance with our debt covenants. The interest rate in effect at September 30, 2013 was 2.43%.

On August 20, 2013, the Company completed a $300.0 million offering of 6.375% Senior Notes due in 2020 (the Notes) at an issue price of 100% of the principal amount in a private placement for resale to qualified institutional buyers. The Notes bear an interest rate of 6.375% per annum, payable semi-annually in arrears on August 15 and February 15 of each year, commencing on February 15, 2014. Interest will accrue from August 20, 2013. The Notes will mature on August 15, 2020.

Stock Repurchase Program

As of December 31, 2011, our Board of Directors had approved a stock repurchase program authorizing us, from time to time as market and business conditions warrant, to acquire up to $210 million of our common stock. In February 2012, our Board of Directors approved an increase of $52.1 million to our current stock repurchase authorization, bringing the total authorization to $262.1 million.

On September 13, 2012, our Board of Directors approved the repurchase of up to 2,500,000 shares of our common stock, or up to $113.0 million in place of the remaining repurchase amounts previously authorized.

In July 2013, our Board of Directors approved an additional $100 million for the stock repurchase program.

We repurchased 1,651,708 shares for $80.6 million under the program during the nine months ended September 30, 2013. Under the program to date, we have purchased 11,171,580 shares for approximately $325.6 million. The maximum remaining authorized for purchase under the stock repurchase program was approximately $108.3 million as of September 30, 2013.

There is no guarantee as to the exact number of shares that will be repurchased by us. Repurchased shares are returned to the status of authorized but unissued shares of common stock. In March 2005, our Board of Directors approved a plan under Rule 10b5-1 of the Securities Exchange Act of 1934 to facilitate the repurchase of shares of common stock under the existing stock repurchase program. Under our Rule 10b5-1 plan, we have delegated authority over the timing and amount of repurchases to an independent broker who does not have access to inside information about the Company. Rule 10b5-1 allows us, through the independent broker, to purchase shares at times when we ordinarily would not be in the market because of self-imposed trading blackout periods, such as the time immediately preceding the end of the fiscal quarter through a period three business days following our quarterly earnings release.

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Contractual Obligations and Commercial Commitments

For the nine months ended September 30, 2013, other than as discussed below, there have been no material changes to the contractual obligations and commercial commitments disclosed in Item 7 of our Form 10-K for the fiscal year ended December 31, 2012.

	Payments due by Period (amounts in thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual Obligations					
Acquired operating lease obligations (1)	$ 9,915	$ 1,238	$ 6,368	$ 2,309	$
New operating lease obligations (2)	3,153	163	1,286	1,233	471
Term Credit Facility (3)	464,253	41,398	133,066	289,789	
Term Credit Facility interest (4)	38,605	10,874	17,587	10,144	
Senior Notes (5)	300,000				300,000
Senior Notes interest (5)	133,875	19,125	38,250	38,250	38,250
Total	$ 949,801	$ 72,798	$ 196,557	$ 341,725	$ 338,721

(1) Operating leases acquired as a result of the acquisitions.
(2) New operating lease obligations entered into during the nine months ended September 30, 2013.
(3) Increase in the Term Credit Facility represents debt used to partially fund acquisitions during the nine months ended September 30, 2013.
(4) Based upon the debt outstanding and interest rate in effect at September 30, 2013 of 2.43%.
(5) Represents Notes issued during the nine months ended September 30, 2013.
(6) Based upon Notes issued of $300 million at per annum rate of 6.375%.

We are unable to reasonably estimate the ultimate amount or timing of settlement of our reserves for income taxes under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740, *Income Tax*. The liability for unrecognized tax benefits at September 30, 2013 is $15.5 million. The amount of unrecognized tax benefits for uncertain tax positions increased by $1.9 million during the nine months ended September 30, 2013 for the uncertain tax positions of ORCC which were included in the preliminary purchase price allocation.

Critical Accounting Estimates

The preparation of the condensed consolidated financial statements requires that we make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and other assumptions that we believe to be proper and reasonable under the circumstances. We continually evaluate the appropriateness of estimates and assumptions used in the preparation of our condensed consolidated financial statements. Actual results could differ from those estimates.

The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

Allowance for Doubtful Accounts

Business Combinations

Intangible Assets and Goodwill

Stock-Based Compensation

Accounting for Income Taxes

During the nine months ended September 30, 2013, there were no significant changes to our critical accounting policies and estimates other than as disclosed in Note 1, *Condensed Consolidated Financial Statements*. Please refer to Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended December 31, 2012, filed on March 1, 2013, for a more complete discussion of our critical accounting policies and estimates.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to our market risk for the nine months ended September 30, 2013. We conduct business in all parts of the world and are thereby exposed to market risks related to fluctuations in foreign currency exchange rates. The U.S. dollar is the single largest currency in which our revenue contracts are denominated. Thus, any decline in the value of local foreign currencies against the U.S. dollar results in our products and services being more expensive to a potential foreign customer, and in those instances where our goods and services have already been sold, may result in the receivables being more difficult to collect. Additionally, any decline in the value of the U.S. dollar in jurisdictions where the revenue contracts are denominated in U.S. dollars and operating expenses are incurred in local currency will have an unfavorable impact to operating margins. We at times enter into revenue contracts that are denominated in the country s local currency, principally in South Africa, Australia, Canada, the United Kingdom and other European countries. This practice serves as a natural hedge to finance the local currency expenses incurred in those locations. We have not entered into any foreign currency hedging transactions. We do not purchase or hold any derivative financial instruments for the purpose of speculation or arbitrage.

The primary objective of our cash investment policy is to preserve principal without significantly increasing risk. Based on our cash investments and interest rates on these investments at September 30, 2013, and if we maintained this level of similar cash investments for a period of one year, a hypothetical 10 percent increase or decrease in effective interest rates would increase or decrease interest income by less than $0.1 million annually.

Item 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report, September 30, 2013. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that the Company s disclosure controls and procedures are effective as of September 30, 2013.

Changes in Internal Control over Financial Reporting

On March 11, 2013, the Company completed its acquisition of ORCC and all its subsidiaries. The Company considers the transaction material to its results of operations, cash flows and financial position from the date of the acquisition through September 30, 2013 and believes the internal controls and procedures of ORCC will have a material effect on the Company s internal control over financial reporting. See Note 2, *Business Combination,* to the Condensed Consolidated Financial Statements included in Item 1 for discussion of the acquisition and related financial data.

The Company is currently in the process of integrating ORCC operations. The Company anticipates a successful integration of operations and internal controls over financial reporting. Management will continue to evaluate its internal control over financial reporting as it executes integration activities.

Our management, under the supervision of and with the participation of the Chief Executive Officer and Chief Financial Officer evaluated any change in the Company s internal control over financial reporting (as defined in Rules 13a-15(f) under the Exchange Act) during the Company s quarter ended September 30, 2013, and determined that except for the changes discussed above, there were no other changes in the Company s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect the Company s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

From time to time, we are involved in various litigation matters arising in the ordinary course of our business. We are not currently a party to any legal proceedings, the adverse outcome of which, individually or in the aggregate, we believe would be likely to have a material effect on our financial condition or results of operations.

Item 1A. RISK FACTORS

Other than as disclosed below, there have been no material changes to the risk factors disclosed in Item 1A of our Form 10-K for the fiscal year ended December 31, 2012. Additional risks and uncertainties, including risks and uncertainties not presently known to us, or that we currently deem immaterial, could also have an adverse effect on our business, financial condition and/or results of operations.

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Certain payment funding methods expose us to the credit and/or operating risk of our clients.

When we process an automated clearing house or automated teller machine network payment transaction for certain clients, we occasionally transfer funds from our settlement account to the intended destination account before we receive funds from a client s source account. The vast majority of these occurrences are resolved quickly through normal processes. However, if they are not resolved and we are then unable to reverse the transaction that sent funds to the intended destination, a shortfall in our settlement account will be created. Although we have legal recourse against our clients for the amount of the shortfall, timing of recovery may be delayed by litigation or the amount of any recovery may be less than the shortfall. In either case, we would have to fund the shortfall in our settlement account from our corporate funds.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

The following table provides information regarding the Company s repurchases of its common stock during the three months ended September 30, 2013:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
July 1, 2013 through July 31, 2013	35,600	$ 46.47	35,600	171,304,584
August 1, 2013 through August 31, 2013	740,256	49.81	740,256	134,432,432
September 1, 2013 through September 30, 2013	524,138(1)	50.43	517,908	108,314,332
Total	1,299,994	$ 49.97	1,293,764	

(1) Pursuant to our 2005 Incentive Plan, we granted restricted share awards (RSAs). These awards have requisite service periods of either three or four years and vest in increments of either 33% or 25% on the anniversary dates of the grants. Under each arrangement, stock is issued without direct cost to the employee. During the three months ended September 30, 2013, 17,630 shares of the RSAs vested. We withheld 6,230 of those shares to pay the employees portion of applicable payroll taxes.

In fiscal 2005, we announced that our Board of Directors approved a stock repurchase program authorizing us, from time to time as market and business conditions warrant, to acquire up to $80 million of our common stock, and that we intend to use existing cash and cash equivalents to fund these repurchases. In May 2006, our Board of Directors approved an increase of $30 million to the stock repurchase program, bringing the total of the approved program to $110 million. In March 2007, our Board of Directors approved an increase of $100 million to its current repurchase authorization, bringing the total authorization to $210 million. In February 2012, our Board of Directors approved an increase of $52.1 million to its current stock repurchase authorization, bringing the total authorization to $262.1 million. On September 13, 2012, our Board of Directors approved the repurchase of up to 2,500,000 shares of the Company s common stock, or up to $113.0 million, in place of the remaining repurchase amounts previously authorized. In July, 2013, our Board of Directors approved an additional $100 million for stock repurchases. Approximately $108.3 million remains available at September 30, 2013. There is no guarantee as to the exact number of shares that will be repurchased by us. Repurchased shares are returned to the status of authorized but unissued shares of common stock. In March 2005, our Board of Directors approved a plan under Rule 10b5-1 of the Securities Exchange Act of 1934 to facilitate the repurchase of shares of common stock under the existing stock repurchase program. Under our Rule 10b5-1 plan, we have delegated authority over the timing and amount of repurchases to an independent broker who does not have access to inside information about the Company. Rule 10b5-1 allows us, through the independent broker, to purchase shares at times when we ordinarily would not be in the market because of self-imposed trading blackout periods, such as the time immediately preceding the end of the fiscal quarter through a period three business days following our quarterly earnings release.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

Not applicable.

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Item 6. EXHIBITS

The following lists exhibits filed as part of this quarterly report on Form 10-Q:

Exhibit No.		Description
2.03 (1)		Agreement and Plan of Merger, dated September 23, 2013, by and among ACI Worldwide, Inc., Olympic Acquisition Corp. and Official Payments Holdings, Inc.
3.01 (2)		2013 Amended and Restated Certificate of Incorporation of the Company
3.02 (3)		Amended and Restated Bylaws of the Company
4.01 (4)		Form of Common Stock Certificate
4.02 (5)		Indenture, dated as of August 20, 2013, among the ACI Worldwide, Inc., the guarantors listed therein, and Wilmington Trust, National Association, as trustee
4.03		Form of 6.375% Senior Notes due 2020 (included as Exhibit A to Exhibit 4.02).
10.25(6)		Fourth Amendment to Credit Agreement, dated August 20, 2013, by and among ACI Worldwide, Inc., the subsidiary guarantors thereto, Wells Fargo Bank, National Association, as administrative agent, and the lenders that are party thereto
31.01		Certification of Principal Executive Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02		Certification of Principal Financial Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	*	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.02	*	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS		XBRL Instance Document
101.SCH		XBRL Taxonomy Extension Schema
101.CAL		XBRL Taxonomy Extension Calculation Linkbase
101.LAB		XBRL Taxonomy Extension Label Linkbase
101.PRE		XBRL Taxonomy Extension Presentation Linkbase
101.DEF		XBRL Taxonomy Extension Definition Linkbase

* This certification is not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates it by reference.

(1) Incorporated herein by reference to Exhibit 2.1 to the registrant s current report on Form 8-K filed September 23, 2013.
(2) Incorporated herein by reference to Exhibit 3.1 to the registrant s current report on Form 8-K filed June 13, 2013.
(3) Incorporated herein by reference to Exhibit 3.2 to the registrant s current report on Form 8-K filed December 18, 2008.
(4) Incorporated herein by reference to Exhibit 4.01 to the registrant s Registration Statement No. 33-88292 on Form S-1.
(5) Incorporated herein by reference to Exhibit 4.1 to the registrant s current report on Form 8-K filed August 20, 2013.
(6) Incorporated herein by reference to Exhibit 10.1 to the registrant s current report on Form 8-K filed August 20, 2013.

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SIGNATURE

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 thereunto duly authorized.

ACI WORLDWIDE, INC.

(Registrant)

Date: November 7, 2013

By: /s/ SCOTT W. BEHRENS
Scott W. Behrens
Executive Vice President, Chief Financial Officer and Chief Accounting Officer
(Principal Financial Officer)

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EXHIBIT INDEX

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* This certification is not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates it by reference.

(1) Incorporated herein by reference to Exhibit 2.1 to the registrant s current report on Form 8-K filed September 23, 2013.

(2) Incorporated herein by reference to Exhibit 3.1 to the registrant s current report on Form 8-K filed June 13, 2013.
(3) Incorporated herein by reference to Exhibit 3.2 to the registrant s current report on Form 8-K filed December 18, 2008.
(4) Incorporated herein by reference to Exhibit 4.01 to the registrant s Registration Statement No. 33-88292 on Form S-1.
(5) Incorporated herein by reference to Exhibit 4.1 to the registrant s current report on Form 8-K filed August 20, 2013.
(6) Incorporated herein by reference to Exhibit 10.1 to the registrant s current report on Form 8-K filed August 20, 2013.