HARTE HANKS INC
Form 10-K
June 16, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

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 001-7120
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) (Zip Code)

Registrant’s telephone number, including area code — 210-829-9000

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 o No ý

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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, or a smaller reporting 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 (Do not check if a smaller reporting company)	Smaller reporting company o
	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 ($1.59) as of the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2016), was approximately $76,374,241.

The number of shares outstanding of each of the registrant's classes of common stock as of January 31, 2017 was 61,645,099 shares of common stock, all of one class.

Documents incorporated by reference:

None.

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PART I

ITEM 1. BUSINESS

INTRODUCTION

Harte Hanks, Inc. ("Harte Hanks," "we, "our," or "us") 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 continues with execution and support in a variety of digital and traditional channels. We produce engaging and memorable customer interactions to drive business results for our clients, develop better customer relationships, experiences, and defining interaction-led marketing.

Virtually all organizations rely on marketing to generate revenues and publicity. Many businesses have a chief-level executive responsible for marketing who is charged with combining data, technology, channels, and resources to demonstrate a return on marketing investment. This has led many businesses to use direct and targeted marketing, which offer accountability and measurability of marketing programs, allowing customer insight to be leveraged to create and accelerate value. Harte Hanks is a leader in highly targeted, multichannel marketing.

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 private 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. We will provide a printed copy of any of the aforementioned documents to any requesting stockholder.

OUR BUSINESS

We offer a wide variety of integrated, multi-channel, data-driven solutions for top brands around the globe. We help our clients gain insight into their customers' behaviors from their data and use that insight to create innovative multi-channel marketing programs to deliver a return on marketing investment. We believe our clients' success is determined not only by how good their tools are, but how well we help them use the tools to gain insight and analyze their consumers. This results in a strong and enduring relationship between our clients and their customers 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 & Digital Services. Our agency services are full-service, customer engagement agencies 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. 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 and Business-to-Business Lead Generation. 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 new customer acquisition and retention and maximize the value of existing customer relationships. Through insight, 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 comes together to provide a single customer view of client prospects and customers. Then we help clients apply their data and insights to the entire customer life cycle, to help clients sustain and grow their business, gain deeper customer insights, and continuously refine their customer resource management strategies and tactics.

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- Direct Mail. As a full-service direct marketing provider and one of the largest mailing partners 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. Our services include: digital printing, print on demand, advanced mail optimization, logistics and transportation optimization, tracking (including our proprietary prEtrak solution), commingling, shrink wrapping, and specialized mailings. We also maintain fulfillment centers where we provide custom kitting services, print on demand, product recalls, and freight optimization allowing our customers to distribute literature and other marketing materials.

- Contact Centers. We operate teleservice workstations around the globe providing advanced contact center solutions such as: speech, voice and video chat, integrated voice response, analytics, social cloud monitoring, and web self-service. We provide both inbound and outbound contact center services and support many languages with our strategically placed global locations for both consumer and business-to-business markets.

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 portfolio of businesses.

In 2016, 2015, and 2014, Harte Hanks had revenues from continuing operations of $404.4 million, $444.2 million, and $499.4 million, respectively.

Recent Developments

On April 17, 2017, we entered into a credit agreement with Texas Capital Bank, N.A. as Lender. The agreement consists of a two-year $20 million credit facility guaranteed by HHS Guaranty, LLC, and entity formed by certain members of the Shelton family, descendants of one of the company's founders. See Note C, Long-Term Debt, in the Notes to Consolidated Financial Statements for further discussion.

On April 18, 2017, we announced our intention to sell our wholly-owned subsidiary 3Q Digital, Inc. ("3Q Digital"). We believe this initiative will further focus the company on its core business and will give us the opportunity to invest in strategies that will strengthen that core. If a sale of the 3Q Digital business is completed, we intend to leverage a partnership model to continue providing comprehensive solutions to our customers.

On May 1, 2017, we entered into an agreement with 3Q Digital (the "3Q Agreement") which deferred our obligation to pay the contingent consideration to the former owners until April 1, 2019 or the sale of the 3Q Digital business, whichever is earlier.

Customers

Our services are marketed to specific industries or markets with services and software products tailored to each industry or market. 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, technology, financial services, automotive and consumer brands, and pharmaceutical/healthcare vertical markets, in addition to a range of select markets. Our largest client (measured in revenue) comprised 8% of total revenues in 2016. Our largest 25 clients in terms of revenue comprised 60% of total revenues in 2016.

Sales and Marketing

Our enterprise 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. Our direct sales forces, with industry-specific knowledge and experience, emphasize the cross-selling of a full range of direct marketing services and are supported by employees in each sector assigned to specific clients with industry specific expertise. 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.

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Facilities

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

Domestic Offices

Austin, Texas	Maitland, Florida
Baltimore, Maryland	New York, New York
Burlington, Massachusetts	Oakland, California
Burlington, Vermont	San Antonio, Texas
Chicago, Illinois	San Diego, California
Deerfield Beach, Florida	San Francisco, California
Denver, Colorado	San Mateo, California
East Bridgewater, Massachusetts	Shawnee, Kansas
Fullerton, California	Trevose, Pennsylvania
Grand Prairie, Texas	Texarkana, Texas
Jacksonville, Florida	Wilkes-Barre, Pennsylvania
Langhorne, Pennsylvania	

International Offices

Bristol, United Kingdom	Manila, Philippines
Hasselt, Belgium	Uxbridge, United Kingdom

Competition

Our business faces significant competition in all of its offerings and within each of its vertical markets. Direct marketing is a dynamic business, subject to 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. Our 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. 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 internet (social, mobile, web-based, and email), print, broadcast, and other forms of advertising for marketing and advertising dollars in general. Failure to continually improve our current processes, advance and upgrade our technology applications, and to develop new products and services in a timely and cost-effective manner, could result in the loss of our clients or prospective clients to current or future competitors. In addition, failure to gain market acceptance of new products and services could adversely affect our growth. Although we believe that our capabilities and breadth of services, combined with our U.S. and international production capability, industry focus, and ability to offer a broad range of integrated services, enable us to compete effectively, our business results may be adversely impacted by competition. Please refer to Item 1A, “Risk Factors”, for additional information regarding risks related to competition.

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.

Discontinued Operations

Previously, Harte Hanks also provided data quality solutions through Trillium Software, Inc. (“Trillium US”). On December 23, 2016, (i) Harte Hanks completed the sale of Trillium US to Syncsort Incorporated (“US Buyer”), (ii) Harte-Hanks UK Limited (“UK Seller”) completed the sale of Harte-Hanks Trillium UK Limited (“Trillium UK”) to Syncsort Limited (“UK Buyer”), and (iii) Harte-Hanks GmbH (“German Seller” and together with Harte Hanks and UK Seller, the “Sellers”) completed the sale of Harte-Hanks Trillium Software Germany GmbH (“Trillium Germany” and together with Trillium US and Trillium UK, “Trillium”) to Syncsort GmbH (“German Buyer” and together with US Buyer and UK Buyer, the “Syncsort Buyers”), in each case pursuant to a Stock Purchase Agreement (the “Purchase Agreement”) entered into on November 29, 2016 by and among the Sellers, the Syncsort Buyers, Trillium, and Harte Hanks, in its capacity as representative of the Sellers (such transaction, the “Trillium Sale”). The aggregate consideration received by the Sellers in respect of Trillium from the Syncsort Buyers was approximately $112.0 million in cash, less estimated purchase price adjustments, pursuant to the terms of the Purchase Agreement. A portion of the cash consideration has been deposited into escrow to support post-closing purchase price adjustments and the Sellers’ indemnification obligations.

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The decision to sell Trillium largely derived from the desire to prioritize investment in support of our other services that more directly serve chief marketing officers by optimizing our clients' customer journey across an omni-channel delivery platform. Because the Trillium business required continuing investment and development, and because the competitive and other market dynamics of software businesses were so distinct from our other services, we thought a sale of the business would be best for both the rest of our business as well as Trillium itself. The proceeds from the sale were used to repay in full, and allow the termination of, our 2016 Secured Credit Facility with Wells Fargo Bank, N.A. See Liquidity and Capital Resources in the Management's Discussion and Analysis for further discussion.

This transaction resulted in an after-tax loss of $39.9 million. Because Trillium represented a distinct business unit with operations and cash flows that can clearly be distinguished, both operationally and for financial purposes, from the rest of Harte Hanks, the results of operations, financial position, and cash flows for Trillium are reported separately as discontinued operations for all periods presented. Results of the remaining Harte Hanks business are reported as continuing operations.

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:

- Federal and state laws governing the use of the internet and regulating telemarketing, including the U.S. Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 ("CAN-SPAM"), which regulates commercial email and requires that commercial emails give recipients an opt-out method. Canada’s Anti-Spam Legislation ("CASL") applies in a comparable manner for our activities in Canada. Telemarketing activities are regulated by, among other requirements, the Federal Trade Commission’s Telemarketing Sales Rule ("TSR"), the Federal Communications Commission’s Telephone Consumer Protection Act ("TCPA"), and various state do-not-call laws.
- 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.
- The U.S. Department of Commerce’s proposed Privacy Shield Framework, the Federal Trade Commission’s Protecting Consumer Privacy in an Era of Rapid Change policy, and the European Commission’s European General Data Protection Regulation ("GDPR"), each of which seeks to address consumer privacy, data protection, and technological advancements in relation to the collection or use of personal information.
- A significant number of states in the U.S. have passed versions of data security or breach notification laws, 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. With the increased attention security breaches have received, federal legislation may also be adopted and impose additional obligations.
- 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.
- 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

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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 European Union ("EU") data protection laws, including the comprehensive EU Directive on Data Protection (1995) ("EU Directive"), and the GDPR (which will replace the EU Directive once implemented), which imposes a number of obligations with respect to use of personal data, and includes a prohibition on the transfer of personal information from the EU to other countries that do not provide consumers with an “adequate” level of privacy or security. The EU standard for adequacy is generally stricter and more comprehensive than that of the U.S. and most other countries.

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. 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 2012 and 2013, several members of the U.S. Congress (in coordination with the Federal Trade Commission and consumer advocacy groups) initiated several inquiries regarding data brokerage, one of which was directed to us (among others). We anticipate that further inquiries and legislative proposals will be made which may affect the services we offer our clients.

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, and 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, 2016, Harte Hanks employed 5,588 full-time employees and 64 part-time employees, of which approximately 2,669 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.

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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. 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. Additional risks and uncertainties that are not presently anticipated or that we may currently believe are immaterial could also impair our business operations and financial performance.

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, 2016 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 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. Information on our going concern and management's plan to continue to support its operations and meet its obligations is included in Note A, Significant Accounting Policies, of the Notes to Consolidated Financial Statements included in Part IV, "Financial Statement Schedules" of this Form 10-K.

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 and Chief Financial Officer, and we have significantly reorganized our operational structures. If our new leaders fail in their new roles and responsibilities (and more generally if we are unable to attract new 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, administrative, 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.

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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, the results of our operations may be adversely affected.

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

Our ten largest clients collectively represented 42.9% of our revenues for 2016. Furthermore, traditional consumer retail (which is experiencing significant economic changes) represented 26.9% of our 2016 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 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 face significant competition for individual projects, entire client relationships and advertising dollars in general.

Our business faces significant competition in all of its offerings and within each of its vertical markets. We offer our marketing services in 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.

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 market and service segments. 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 competitive to ours at lower prices by accepting lower margins and profitability, or may be able to sell products or services competitive to 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.

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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 are adopting technologies allowing them to more effectively 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 of our 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 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.

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.

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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.

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.

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 "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. We anticipate that additional restrictions and regulations will continue to be proposed and adopted in the future.

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, 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.

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 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.

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 and 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.

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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 rely on business partners as an essential element of our go-to-market strategy.

We have determined that for some services, and most technology, we are best served by partnering with other companies, such as our recently announced relationship with a global information technology, consulting and outsourcing company. 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. We may not be able to anticipate any such problems, and failure or weakness of one or more of our key business partners could have a material affect 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.

We must successfully identify and evaluate acquisition targets and integrate acquisitions.

We frequently evaluate acquisition opportunities to expand our product and service offerings. Acquisition activities, even if not consummated, require substantial amounts of management time, and can distract from normal operations. In addition, we have in the past and may in the future be unable to achieve the profitability goals, synergies, and other objectives initially sought in acquisitions, and any acquired assets, data, or businesses may not be successfully integrated into our operations. Acquisitions may result in the impairment of relationships with employees and customers. Moreover, although we review and analyze assets or companies we acquire, such reviews are subject to uncertainties and may not reveal all potential risks, and we may incur unanticipated liabilities and expenses as a result of our acquisition activities. The failure to identify appropriate candidates, to negotiate favorable terms, or to successfully integrate future acquisitions into existing operations could result in not achieving planned revenue growth and could negatively impact our net income and earnings per share.

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

In 2016 we sold our Trillium business resulting in a pre-tax loss of $44.5 million. In 2015 we sold our B2B research business resulting in a pre-tax loss of $9.5 million. 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 2017) 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.

Prices 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.

Our financial results could be negatively impacted by impairments of goodwill.

In the third quarter of 2015, as a result of a sustained decline in our market capitalization below our book value of equity and recent operating performance, we performed an interim impairment test of our Customer Interaction and Trillium goodwill reporting units. As a result, we recorded a non-cash impairment charge of $209.9 million in our Customer Interaction segment.
Our annual impairment test in 2016 indicated a $38.7 million impairment of goodwill that is recorded in the Consolidated Statements of Comprehensive Income (Loss) at December 31, 2016. As of December 31, 2016, the net book value of our goodwill and other intangibles represented approximately $37.8 million out of our total assets of $213.4 million. We test goodwill and other intangible assets with indefinite useful lives for impairment as of November 30 of each year and on an interim basis should factors or indicators become apparent that would require an interim test. A downward revision in the fair value of our reporting unit or any of the other intangible assets could result in additional impairments and non-cash charges. Any such impairment charges could have a significant negative effect on our reported net income.

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. as Lender. The agreement consists of a two-year $20 million credit facility guaranteed by HHS Guaranty, LLC, an entity formed by certain members of the Shelton family, descendants of one of the company's founders. See Note C, Long-Term Debt, in the Notes to Consolidated Financial Statements for further discussion.

During 2016, we failed to comply with certain covenants under our 2016 Secured Credit Facility with Wells Fargo Bank, N.A. (the "2016 Secured Credit Facility"). The lenders waived our noncompliance subject to certain conditions. The proceeds of the sale of Trillium were used to pay off the remaining obligation related to the 2016 Secured Credit Facility. 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. Any failure to obtain new financing arrangements on favorable terms could have a material and adverse effect on our liquidity position.

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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."

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

Although our Board of Directors (the "Board") 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. Our primary interest rate exposure during 2016 was to interest rate fluctuations in Europe, specifically Eurodollar rates, due to their impact on interest related to our prior credit facilities. On December 31, 2016, we did not have any debt outstanding under the prior credit facilities. On April 17, 2017 we entered into the Texas Capital Credit Facility, which consists of a two-year $20 million revolving credit facility. 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 2016, approximately 19.7% 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:

- social, economic, and political instability;
- 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; and
- the differing costs and difficulties of managing international operations.

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 have identified control deficiencies in our financial reporting process that constitute material weaknesses and for which remediation is still in process as of December 31, 2016.

As discussed in Part II, Item 9A, we identified material weaknesses in the following areas (i) the effectiveness of the control environment, risk assessment, information and communication, monitoring, and design and implementation of control activities, (ii) the effectiveness of internal controls over revenue recognition, (iii) the effectiveness of the accounting for the contingent consideration, (iv) the effectiveness of evaluation of goodwill for impairment, (v) the effectiveness of controls around evaluation of deferred tax assets, and (vi) the effectiveness of controls over the financial closing and reporting process. As a result of these material weaknesses management has determined that our disclosure controls and procedures and internal control over financial reporting were not effective as of December 31, 2016.

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 accurately reflected our financial position and results of operations as of and for the year ended December 31, 2016. 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. We are assessing tools and potential enhancements to document, support, and review controls to better address both the accuracy and precision of management's review. Our remediation efforts will continue into the fiscal year ending December 31, 2017. 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.

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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):

- the overall strength of the economies of the markets we serve and general market volatility;
- 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; and
- other factors discussed elsewhere in this Item 1A, “Risk Factors.”

As a result 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 financial performance and failure to timely file periodic reports with the SEC 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 and failure to timely file periodic reports with the SEC 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 prospective clients, vendors and partner) 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 and failure to timely file periodic reports with the SEC 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 sizeable 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 failure to timely file any periodic reports with the SEC may prevent us from complying with the NYSE rules and may make it more difficult for us to access the public markets to raise debt or equity capital.

Despite extensive efforts, we were unable to file our Annual Report on Form 10-K for the year ended December 31,2016 within the time frame required by the SEC (including the extension permitted by Rule 12b-25 under the Exchange Act). We also have not filed our Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 within the time allowed by the SEC, and may be unable to file future Quarterly Reports on Form 10-Q within the time prescribed by the SEC. As a result, we are not in full compliance with the NYSE Listed Company Manual, Section 802.01E. We are required to comply with the NYSE Listed Company Manual as a condition for our common stock to continue to be listed on the NYSE. If we are unable to comply with such conditions, then our shares of common stock are subject to delisting from the NYSE. A delisting of our common stock from the NYSE could have a significant negative effect on the value and liquidity of our securities, may preclude us from using exemptions from certain state and federal securities regulations, and could adversely affect our ability to raise capital on terms acceptable to us or at all.

In addition, because we were unable to timely file our Annual Report, we will not be eligible to use a registration statement on Form S-3 to conduct public offerings of our securities until we have timely made our periodic filings with the SEC for a full year. Our inability to use Form S-3 during this time period may have a negative impact on our ability to access the public capital markets in a timely fashion because we would be required to file a long-form registration statement on Form S-1 and have it reviewed and declared effective by the SEC. This may limit our ability to access the public markets to raise debt or equity

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capital. Our limited ability to access the public markets could prevent us from pursuing transactions or implementing business strategies that we believe would be beneficial to our business.

If the Company cannot meet the New York Stock Exchange continued listing requirements, the NYSE may delist our common stock.

The Company's common stock is currently listed on the NYSE. In the future, if the company is unable to meet the continued listing requirements of the NYSE-which require, among other things, that the average closing price of the common stock remain at or above $1.00 over 30 consecutive trading days-the common stock could be delisted if the company is unable to regain compliance. A delisting of our common stock could negatively impact the company by, among other things, reducing the liquidity and market price of the common stock and reducing the number of investors willing to hold or acquire the common stock.

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 1.7 million square feet. All facilities are held under leases, which expire at dates through 2025.

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 (symbol: HHS). The reported high and low quarterly sales price ranges for 2016 and 2015 were as follows:

	2016		2015	
	High	Low	High	Low
First Quarter	$3.72	$2.53	$8.10	$7.27
Second Quarter	2.74	0.85	7.79	5.96
Third Quarter	1.93	1.42	6.00	3.40
Fourth Quarter	1.83	1.28	4.31	3.23

We paid a dividend of 8.5 cents per share in the first quarter of 2016 and a quarterly dividend of 8.5 cents per share in each quarter of 2015. 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 of directors, based on its business judgment.

As of May 31, 2017, there are approximately 1,900 holders of record.

Issuer Purchases of Equity Securities

The following table contains information about our purchases of equity securities during the fourth quarter of 2016:

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, 2016	2,504	$ 1.45	—	$ 11,437,538
November 1 - 30, 2016	—	$ —	—	$ 11,437,538
December 1 - 31, 2016	758	$ 1.52	—	$ 11,437,538
Total	3,262	$ 1.47	—	

(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 2016, 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 of directors has authorized us to spend up to $20.0 million to repurchase shares of our outstanding common stock. As of December 31, 2016, we have repurchased 1,506,679 shares and spent $8.6 million under this authorization. Through December 31, 2016, we had repurchased a total of 67,887,989 shares at an average price of $18.13 per share under this program and previously announced programs.

Comparison of Stockholder Returns

The following graph compares the cumulative total return of our common stock during the period December 31, 2011 to December 31, 2016 with the Standard & Poor’s 500 Stock Index ("S&P 500 Index") and with our peer group.

Our current peer group includes: Acxiom Corporation, Cenveo, Inc., Convergys Corp., Conversant, Inc. (through acquisition by Alliance Data Systems Corp. in December 2014), Dex Media, Inc. (through delisting in July 2016), Digital River, Inc. (through acquisition by Siris Capital Group LLC in February 2015), Dun & Bradstreet Corporation, Forrester Research, Inc., Gartner, Inc., Informatica Corp. (through acquisition by Permira Advisers LLC in August 2015), MDC Partners, Inc., Meredith Corp., Reach Local, Inc. (through acquisition by Gannett Company, Inc. in August 2016), Sykes Enterprises, Inc., and TeleTech Holdings, Inc.

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The S&P Index includes 500 U.S. companies in the industrial, transportation, utilities, and financial sectors and is weighted by market capitalization. The peer groups are also weighted by market capitalization.

The graph depicts the results of investing $100 in our common stock, the S&P 500 Index and the peer groups at closing prices on December 31, 2011 and assumes the reinvestment of dividends.

	ANNUAL RETURN PERCENTAGE				
	Years Ending				
Company Name / Index	Dec 2012	Dec 2013	Dec 2014	Dec 2015	Dec 2016
Harte Hanks, Inc.	(30.94)	36.62	3.88	(55.17)	(52.11)
S&P 500 Index	16.00	32.39	13.69	1.38	11.96
Peer Group	9.55	51.30	1.36	5.12	11.58

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our summary 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. The fiscal year financial information included in the table below for the years ended December 31, 2016, 2015, and 2014 is derived from audited financial statements contained in this Form 10-K. Information for the years ended December 31, 2013 and 2012 was derived from previously filed audited financial statements not contained in this Form 10-K. All financial information presented below excludes amounts related to our discontinued Trillium operations.

In thousands, except per share amounts	2016	2015	2014	2013	2012
Statement of Comprehensive Income Data					
Revenues	$404,412	$444,166	$499,444	$503,760	$528,042
Operating income (loss) from continuing operations	(55,780)	(203,269)	25,285	24,772	47,035
Income (loss) from continuing operations	$(89,778)	$(181,066)	$13,754	$11,637	$25,904
Earnings (loss) from continuing operations per common share—diluted	$(1.46)	$(2.94)	$0.22	$0.19	$0.41
Weighted-average common and common equivalent shares outstanding—diluted	61,487	61,643	62,658	62,812	63,148
Cash dividends per share	$0.09	$0.34	$0.34	$0.26	$0.43
Balance sheet data (at end of period) (1)					
Total assets	213,437	414,413	643,613	684,613	706,212
Total debt	—	77,105	82,123	97,079	109,572
Total stockholders' equity	2,656	140,316	326,676	349,054	328,164

(1) Includes reclassification of debt issuance costs as a reduction of the debt balance related to ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. Prior to the adoption of this ASU, unamortized debt issuance costs were included in other assets. Please refer to Note A, Significant Accounting Policies, and Note C, Long-Term Debt, of the Notes to Consolidated Financial Statements.

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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, Inc. ("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 famous 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 email, including:

- agency and digital services;
- database marketing solutions and business-to-business lead generation;
- direct mail; and
- contact centers.

Previously, Harte Hanks also provided data quality solutions through Trillium Software, Inc. and its subsidiaries (collectively "Trillium"). On December 23, 2016, we sold the equity interests of our Trillium operations for gross proceeds of $112.0 million. This transaction resulted in an after-tax loss of $39.9 million. Because Trillium represented a distinct business unit with operations and cash flows that can clearly be distinguished, both operationally and for financial purposes, from the rest of Harte Hanks, the results of the Trillium operations are reported as discontinued operations for all periods presented. Results of the remaining Harte Hanks business are reported as continuing operations.

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. Our revenues are also affected by the economic fundamentals of each industry that we serve, various market factors, including the demand for services by our clients, and the financial condition of and budgets available to specific clients, among other factors. We remain committed to making the investments necessary to execute our multichannel strategy while also continuing to adjust our cost structure to reduce costs in the parts of the business that are not growing as fast. We believe these actions will improve our profitability in future periods.

Our principal operating expense items are labor, outsourced costs, and mail supply chain management.

We continued to face a challenging competitive environment in 2016. The sale of Trillium in 2016, the new credit facility we entered into in 2017, and our announced intention to sell 3Q Digital 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.

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Results of Continuing Operations

As discussed in Note N, Discontinued Operations, of the Notes to Consolidated Financial Statements we sold the equity interests of our Trillium operations on December 23, 2016. Therefore, the operating results of Trillium, including the loss on the sale, is reported as discontinued operations in the Consolidated Financial Statements, and are excluded from Management's Discussion and Analysis of Financial Condition and Results of Operations below.

Operating results from our continuing operations were as follows:

	Year Ended December 31,				
In thousands, except per share amounts	2016	% Change	2015	% Change	2014
Revenues	$404,412	-9.0 %	$444,166	-11.1 %	$499,444
Operating expenses	460,192	-28.9 %	647,435	36.5 %	474,159
Operating income (loss)	$(55,780)	72.6 %	$(203,269)	-903.9 %	$25,285
Operating Margin	(13.8)%		N/M		5.1 %
Income (loss) from continuing operations	$(89,778)	50.4 %	$(181,066)	N/M	$13,754
Diluted EPS from continuing operations	$(1.46)	50.3 %	$(2.94)	N/M	$0.22

(N/M = Not Meaningful)

Year ended December 31, 2016 vs. Year ended December 31, 2015

Revenues

Revenues from continuing operations were $404.4 million in the year ended December 31, 2016, compared to $444.2 million in the year ended December 31, 2015. These results reflect the impact of decreased revenue from our healthcare and pharmaceutical and retail verticals of $16.1 million, or 36.4%, and $12.5 million, or 10.3%, respectively, as the result of lost clients and clients reducing their marketing spend (in particular, reducing mail volumes). Our select markets vertical decreased $4.1 million, or 9.8%, compared to the prior year, primarily from the reduction of call center work supporting streaming enrollment services for an entertainment client. The decline of $4.0 million, or 4.0%, in our technology vertical was primarily driven by the loss of an electronics company client. Our financial services vertical decreased $3.8 million, or 5.9%, compared to the year ended December 31, 2015, due to reduced mail volumes. These decreases are slightly offset by an increase in our automobile and consumer brands vertical of $0.8 million, or 1.1%, compared to the year ended December 31, 2015.

Our revenue performance will depend on, among other factors, 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 client demands. We believe that, in the long-term, an increasing portion of overall marketing and advertising expenditures will be moved from other advertising media to the targeted media space, and that our business will benefit as a result. Targeted media advertising results can be more effectively tracked, enabling measurement of the return on marketing investment.

Operating Expenses

Operating expenses from continuing operations were $460.2 million in the year ended December 31, 2016, compared to $647.4 million in 2015. This $187.2 million year-over-year decrease is primarily a result of an impairment loss of $209.9 million recorded in 2015 versus an impairment loss of $38.7 million in 2016. In addition, we experienced a decrease in production and distribution costs of $24.8 million, or 17.5%, primarily driven by lower fuel and freight costs, as well as decreased outsourced costs resulting from lower mail volumes. The decrease was partially offset by increased labor costs of $8.6 million, or 3.6%, primarily due to increased severance costs and non-recurring database development labor expense.

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

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

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Year ended December 31, 2015 vs. Year ended December 31, 2014

Revenues

Revenues from continuing operations were $444.2 million in the year ended December 31, 2015, compared to $499.4 million in the year ended December 31, 2014. These results reflect the impact of decreased revenue from all of our verticals. Revenue from our retail and select markets verticals decreased $15.3 million, or 11.2%, and $6.7 million, or 14.1%, respectively, as the result of clients reducing mail volumes and database losses. Our auto and consumer brands vertical decreased $14.5 million, or 17.0%, compared to the prior year, primarily from the loss of agency work with a luxury auto manufacturer. Revenue from our technology vertical declined $15.5 million, or 13.1%, primarily driven by the sale of our B2B research business. Our healthcare and pharmaceutical vertical decreased $2.0 million, or 4.3%, and our financial services vertical decreased $1.2 million, or 1.9%, compared to the year ended December 31, 2014.

Operating Expenses

Operating expenses from continuing operations were $647.4 million in the year ended December 31, 2015, compared to $474.2 million in 2014. This $173.3 million year over year increase is primarily a result of a goodwill impairment loss of $209.9 million in the third quarter of 2015. In addition, general and administrative expense increased $1.8 million, or 4.3%, compared to the prior year, due to an increase in sales and marketing expense related to employment of additional sales force personnel. The increase was partially offset by a decrease in labor costs of $14.6 million, or 5.8%, primarily due to reductions in headcount and severance costs recorded in 2014. In addition, production and distribution costs decreased $23.4 million, or 14.1%, primarily driven by decreased lease expense, lower fuel costs, and decreased outsourced costs resulting from lower volumes.

Other Expense

Year ended December 31, 2016 vs. Year ended December 31, 2015

Total other expense was $13.4 million in the year ended December 31, 2016, compared to $15.2 million in 2015. This $1.8 million decrease is primarily the result of a $9.5 million loss on sale of our B2B research business in 2015, partially offset by a $7.0 million adjustment to the fair value of the contingent consideration. Interest expense decreased $1.6 million, or 31.1%, in 2016 compared to 2015 primarily due to the reclassification of interest expense for the 2016 Secured Credit Facility to discontinued operations in accordance with ASC 205-20-45-6. These decreases were offset by foreign currency losses of $1.3 million in the year ended December 31, 2016.

Year ended December 31, 2015 vs. Year ended December 31, 2014

Total other expense was $15.2 million in the year ended December 31, 2015, compared to $3.9 million in 2014. This $11.3 million increase is primarily the result of a $9.5 million loss on sale of our B2B research business in 2015. Interest expense increased $2.2 million, or 78.8%, in 2015 compared to 2014 primarily due to the interest accretion for the contingent consideration liability related to the purchase of 3Q Digital. See Note M, Acquisition and Disposition. These increases were offset slightly by foreign currency gains of $0.5 million in the year ended December 31, 2015.

Income Taxes

Year ended December 31, 2016 vs. Year ended December 31, 2015

Our 2016 income tax expense of $20.6 million resulted in a negative effective income tax rate of 29.9%. Unfavorably impacting our expense is nondeductible goodwill associated with our impairment loss and the deferred tax valuation allowance, the impact of which were $6.3 million and $34.5 million, respectively. This compares to our 2015 income tax benefit of $37.4 million that resulted in an effective income tax rate of 17.1%. Benefiting our 2015 rate was having a greater proportion of our income in jurisdictions outside the United States having tax rates below 35%.

Year ended December 31, 2015 vs. Year ended December 31, 2014

Our 2015 income tax benefit of $37.4 million resulted in an effective income tax rate of 17.1%. Unfavorably impacting our benefit is nondeductible goodwill associated with our impairment loss, nondeductible basis on the sale of operations, and foreign tax credit limitations on the dividends paid from foreign subsidiaries, the impact of which was $36.7 million, $0.7 million, and $0.6 million, respectively. Lastly, the unfavorable impact of state income taxes was principally offset by our ability to use tax credits. This compares to our 2014 income tax expense of $7.6 million that resulted in an effective income tax rate of 35.7%.

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Benefiting our 2014 rate was a valuation allowance reversal associated with a recovery of previously remitted foreign tax, and having a greater proportion of our income in jurisdictions outside the United States having tax rates below 35%.

Income/Earnings Per Share from Continuing Operations

Year ended December 31, 2016 vs. Year ended December 31, 2015

We recorded a loss from continuing operations of $89.8 million and diluted loss per share from continuing operations of $1.46. These results compare to a loss from continuing operations of $181.1 million and diluted loss per share from continuing operations of $2.94 in 2015. The decrease in loss from continuing operations is primarily the result of a $209.9 million impairment loss related to goodwill recorded in 2015.

Year ended December 31, 2015 vs. Year ended December 31, 2014

We recorded a loss from continuing operations of $181.1 million and diluted loss per share from continuing operations of $2.94. These results compare to income from continuing operations of $13.8 million and diluted earnings per share from continuing operations of $0.22 in 2014. The decrease in income from continuing operations is primarily the result of an impairment loss of $209.9 million related to goodwill recorded in 2015.

Liquidity and Capital Resources

Sources and Uses of Cash

Our cash and cash equivalent balances were $46.0 million, $16.6 million, and $53.3 million as of December 31, 2016, 2015, and 2014, respectively. 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.

Operating Activities

Net cash provided by operating activities was $14.6 million, $33.3 million, and $26.0 million for the years ending December 31, 2016, 2015, and 2014, respectively. The $18.7 million decrease of net cash provided by operating activities in 2016 was the result a decrease of $51.3 million in cash provided by discontinued operations. The $7.3 million increase of net cash provided by operating activities in 2015 is attributable to favorable changes within our working capital accounts.

Investing Activities

Net cash provided by investing activities was $99.7 million for the year ending December 31, 2016 compared to cash used in investing activities of $36.1 million and $11.2 million for the years ending December 31, 2015, and 2014, respectively. The primary source of the increase in 2016 is the result the sale of Trillium for gross proceeds of $112.0 million reflected in the cash provided by investing activities within discontinued operations. The increase is also the result of the favorable impact of lower acquisition expenditures, as we purchased Aleutian Consulting for $3.5 million in 2016 but spent $29.9 million to purchase 3Q Digital in 2015. The $25.0 million increase in cash used by investing activities in 2015 compared to 2014 is driven by the acquisition of 3Q Digital. This was offset slightly by cash provided by the disposition of our B2B research business of $5.0 million and a decrease in capital expenditures.

Financing Activities

Net cash used in financing activities was $85.3 million, $31.9 million, and $44.6 million for the years ending December 31, 2016, 2015, and 2014, respectively. The $53.4 million increase in cash outflows in 2016 compared to 2015 is driven by costs incurred in connection with the commencement of the 2016 Secured Credit Facility and the subsequent repayment of the 2016 Secured Credit Facility, 2013 Revolving Credit Facility, and 2011 Term Loan Facility. This is offset slightly by the favorable impact of the suspension of dividend payments in 2016. Net cash used in financing activities decreased $12.7 million in 2015 compared to 2014. This is due to borrowings made in 2015 and a decline in cash used to purchase treasury shares.

Credit Facilities

On August 16, 2011, we entered into a five-year $122.5 million term loan facility ("2011 Term Loan Facility") with Bank of America, N.A., as Administrative Agent. The 2011 Term Loan Facility was repaid on March 11, 2016 using the proceeds of the 2016 Secured Credit Facility.

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On August 8, 2013, we entered into a three-year $80 million revolving credit facility, which included a $25 million letter of credit sub-facility and a $5 million swing line loan sub-facility ("2013 Revolving Credit Facility") with Bank of America, N.A. (as Administrative Agent, Swing Line Lender, and L/C Issuer) and the other lenders party thereto. The 2013 Revolving Credit Facility was repaid on March 11, 2016 using the proceeds of the 2016 Secured Credit Facility.

On March 10, 2016, we entered into a secured credit facility with Wells Fargo Bank, N.A. as Administrative Agent. This facility consisted of a maximum $65.0 million revolving credit facility, and a $45.0 million term loan (collectively, the "2016 Secured Credit Facility"). A portion of the proceeds from the 2016 Secured Credit Facility was used to pay off the remaining obligation related to the 2011 Term Loan Facility and the 2013 Revolving Credit Facility.

The lenders provided waivers of our noncompliance of the minimum fixed charge coverage ratio and leverage ratios under the 2016 Secured Credit Facility as of April 30, 2016, June 30, 2016, September 30, 2016, and October 31, 2016. Additional covenants in the 2016 Secured Credit Facility included, among other things, restrictions on the company and its subsidiaries from liquidating, dissolving, suspending, or ceasing subsidiaries or a substantial portion of the business. As such, repayment of the 2016 Secured Credit Facility was mandatory following the completion of the sale of Trillium. Outstanding loans were repaid in full using the proceeds of the sale and the 2016 Secured Credit Facility was likewise terminated.

On April 17, 2017, we entered into a credit agreement with Texas Capital Bank, N.A. as Lender (the "Texas Capital Credit Facility"). The Texas Capital Credit Facility consists of a two-year $20 million credit facility secured by substantially all of our assets and is guaranteed by HHS Guaranty, LLC, an entity formed by certain members of the Shelton family, descendants of one of the company's founders. The credit facility adds additional financial flexibility to the company and will be used for working capital and general corporate purposes. See Note C, Long-Term Debt, in the Notes to Consolidated Financial Statements for further discussion.

Contractual Obligations

Contractual obligations at December 31, 2016 are as follows:

In thousands	Total	2017	2018	2019	2020	2021	Thereafter
Debt	$—	$—	$—	$—	$—	$—	$ —
Interest on debt	—	—	—	—	—	—	—
Operating lease obligation	30,076	10,812	7,482	4,991	2,842	1,597	2,352
Capital lease obligations	1,577	559	522	459	35	2	—
Unfunded pension plan benefit payments	17,405	1,686	1,676	1,664	1,692	1,720	8,967
Total contractual cash obligations	$49,058	$13,057	$9,680	$7,114	$4,569	$3,319	$ 11,319

At December 31, 2016, we had total letters of credit in the amount of $4.1 million. No amounts were drawn against these letters of credit at December 31, 2016. These letters of credit renew annually and exist to support insurance programs relating to workers' compensation, automobile, and general liability as well as facility lease obligations. We had no other off-balance sheet arrangements at December 31, 2016.

Dividends

We paid a quarterly dividend of 8.5 cents per share in the first quarter of 2016. 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 of directors, based on its business judgment.

Share Repurchase

During 2016, 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, 2016, we had authorization of $11.4 million under this program. From 1997 through December 31, 2016, we have repurchased 67.9 million shares for an aggregate of $1.2 billion.

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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.

Our recent operating and financial performance (most notably decreased cash flows from operations) have caused us to closely review our ability to continue as a going concern. We have had greater than five consecutive years of declining revenues from continuing operations, and we have not reduced costs at a pace that has allowed us to be profitable in the past two years. Among other things, these trends have caused us to reduce investments in our business, cease dividends and stock repurchases, and caused us to fall out of compliance with financial covenants in our credit facilities. These trends are also significant factors in the goodwill impairment charges we recorded in 2015 and 2016, as well as the valuation allowance we recorded for 2016 in regard to certain deferred tax assets. Changing these trends and returning to revenue growth is essential to our success.

In April of 2017, we entered into a new credit agreement with Texas Capital Bank, N.A. (the "Texas Capital Credit Facility"). Upon closing, the Texas Capital Credit Facility provided $20 million in borrowing capacity under a revolving credit line. The Texas Capital Credit Facility has far more favorable and flexible covenant requirements than the 2016 Secured Credit Facility, and was planned to be sufficient in size for our needs given the nature and performance of our operations. See Note P, Subsequent Events, for additional discussion.

We have also obtained the deferral of a significant contingent liability that otherwise would have been due in 2018. We are required (under the terms of the purchase agreement for the acquisition of 3Q Digital) to pay the former owners of 3Q Digital an additional sum contingent on achievement of certain revenue growth goals for that business. The maximum amount of future payments that could be required to be paid under the contingent consideration is $35 million. On May 1, 2017, the company entered into an Agreement (the "3Q Agreement") with 3Q Digital, which defers our obligation to pay the contingent consideration to the former owners until April 1, 2019 or the sale of the 3Q Digital business, whichever is earlier. See Note P, Subsequent Events, in the Notes to Consolidated Financial Statements for additional discussion.

We believe that, in conjunction with our current liquidity position and management's execution of the new credit facility and the 3Q Agreement, there are no 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.

We have taken actions to return the business to profitability and improve our cash, liquidity, and financial position. As we have in the past when revenues declined, in 2016 we began implementing additional significant expense reduction actions, including workforce reductions. These workforce actions are expected to continue into 2017 and will result in further expense reductions in our support functions. We also initiated the closing of our Baltimore direct mail facility in response to the declining demand for printed marketing materials. Continuing work from this facility is being transitioned to other facilities, allowing for higher utilization rates. The favorable impact of the facility closure is expected to begin in the first half of 2017, when the closure is completed.

In addition to the actions discussed above, we are taking additional steps to improve our operational and financial performance. We continue to identify and act to secure additional cost reductions and operating efficiencies. We have also focused investments toward improving product offerings that we believe will improve revenue growth. Finally, to increase financial flexibility and allow us to focus on our core business, we have taken steps to sell our 3Q Digital business (as announced in April 2017). The liquidity from the potential sale of 3Q Digital will allow us the liquidity to invest in strategies to strengthen our core offerings

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. Historically, actual results have not differed significantly from our estimates.

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

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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 when evidence of an arrangement exists, the price is fixed or determinable, the collectability is reasonably assured, and the delivery of service has occurred. Certain client programs provide for adjustments to billings based upon whether we achieve certain performance criteria. In these circumstance, revenue is recognized when 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.

We are currently evaluating the impact of the new revenue recognition standard on our consolidated financial statements.

Goodwill and Other Intangible Assets

We test goodwill for impairment annually or more frequently if events or circumstances indicate that it is more likely than not that goodwill might be impaired. Such events could include changes in the business climate in which we operate, attrition of key personnel, the current volatility in the capital markets, the company’s market capitalization compared to our book value, our recent operating performance, and financial projections.

Our determination of estimated fair value is based on a combination of the discounted cash flow method under the income approach and the guideline public company method under the market approach. These methods contain uncertainties as they require management to make significant assumptions and judgments. Significant assumptions and judgments used in estimating fair value include:

- an estimated discount rate such as the cost of equity or the weighted average cost of capital ("WACC"),
- management's assumptions of future performance and historical operating results,
- market and industry specific risk premiums,
- concentration of control owners,
- valuation multiples, and
- the economic outlook as of the valuation date.

The projected cash flows declined in the fiscal 2016 analysis, which corresponds to the continued decline in the business in the current year. As a result of the declining performance, we determined that the carrying value exceeded the fair value by $38.7 million as of December 31, 2016. The remaining carrying value of goodwill was $34.5 million as of December 31, 2016.

The estimates used to calculate fair value are subject to variability from period to period based on operating results, market conditions, and other factors. Some assumptions and projections inevitably will not materialize and unanticipated events and circumstances may occur during the forecast period. These could include changes in economic conditions, changes in interest rates, terms or availability of financing, and revisions in tax or regulatory law. Changes in the estimates used could materially affect the determination of fair value and potential goodwill impairment.

The company continues to monitor potential triggering events that could result in impairment charges.

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

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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 make adjustments to 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.

Accounting for Contingent Consideration

Our 2015 acquisition of 3Q Digital included a contingent consideration. The contingent consideration liability is recognized at an amount equal to the present value of the contingent payment's estimated fair value each reporting period.

The fair value of the contingent consideration is sensitive to increases or decreases in revenue projections used in the assumptions. Changes in revenue performance and management's assumptions result in adjustments to the fair value of the contingent consideration, which are reflected in the results of operations in the period it is identified. Revisions could materially affect our financial position or results of operations. These assumptions are considered Level 3, as they are unobservable.

Recent Accounting Pronouncements

See Note A, Significant Accounting Policies, of 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.

We are exposed to market risk for changes in interest rates related to our credit facilities. Our earnings are affected by changes in short-term interest rates as a result of our credit facilities, which bear interest at the a base rate plus the applicable margin. Our 2016 Secured Credit Facility was terminated upon closing of the Trillium sale transaction and all debt was repaid. At December 31, 2016, the company did not have any outstanding debt.

Assuming the actual level of borrowings throughout 2016, and assuming a one percentage point change in the average interest rates, we estimate that our net income for 2016 would have changed by approximately $0.5 million. Under our newly established Texas Capital Credit Facility, we estimate that a one percentage point change in the average interest rate would have the same impact on our net income. Due to our overall debt level and cash balance at December 31, 2016, 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 $1.0 million in pre-tax currency losses in 2016 and

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$0.4 million in pre-tax currency transaction gains in 2015. 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 other than cash flow hedging. 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 74 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

As of December 31, 2016, the Company's management carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer, and Corporate Controller. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in such reports is accumulated and communicated to management, including our Chief Executive Officer, Chief Financial Officer, and Corporate Controller as appropriate to allow timely decisions regarding required disclosure.

Based upon that evaluation, the Chief Executive Officer, Chief Financial Officer, and Corporate Controller concluded that due to the material weaknesses in our internal controls over financial reporting that are described below, our disclosure controls and procedures were not effective as of December 31, 2016. Notwithstanding the material weaknesses described below, each of our Chief Executive Officer, Chief Financial Officer, and Corporate Controller concluded that the consolidated financial statements included in this report present fairly, in all material respects, our financial position, results of operations, and cash flows as of the dates and for the periods presented, in conformity with accounting principles generally accepted in the United States of America (“GAAP”).

Management’s Report on Internal Control Over Financial Reporting

We are responsible for the preparation and integrity of the consolidated financial statements appearing in our Annual Report on Form 10-K. The consolidated financial statements were prepared in conformity with GAAP and include amounts based on management’s estimates and judgments. All other information in this report has been presented on a basis consistent with information included in the consolidated financial statements.

We are responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act) is a process designed by, or under the supervision of our Chief Executive Officer and Chief Financial Officer and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

We conducted an evaluation, under the supervision and with the participation of management including, the Chief Executive Officer, Chief Financial Officer, and Corporate Controller, on the effectiveness of internal control over financial reporting as of December 31, 2016, using the criteria set forth by the Committee of Sponsoring Organization of the Treadway Commission ("COSO") in Internal Control - Integrated Framework (2013). This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion on this evaluation. Based on this assessment, management concluded that internal control over financial reporting was not effective because material weaknesses existed at December 31, 2016 as described below.

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A material weakness, as defined in Rule 12b-2 under the Exchange Act, 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 Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring

We did not maintain effective internal control over financial reporting related to the following components: control environment, risk assessment, information and communication, monitoring, and control activities. In particular, controls related to the following were not designed to operate effectively:

Control Environment

- We did not properly staff (in amount and with appropriate levels of experience and training) for the company's accounting and reporting requirements.
- We did not sufficiently establish directives, guidance, and controls to enable management and other personnel to understand and carry out their internal control responsibilities.

Risk Assessment

- We did not design and maintain internal controls that were effective in identifying, assessing and addressing risks that significantly impact our financial statements or the effectiveness of the internal controls over financial reporting. Specifically, we did not modify our controls to sufficiently address changes in risks of material misstatement as a result of changes in our operations, organizational structure and operating environment.

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. Specifically, we did not identify all relevant information systems in support of our accounting and financial reporting processes.
- We did not use an adequate level of precision in our review of information used in controls.

Monitoring

- We did not design and maintain effective monitoring of compliance with established accounting policies, procedures and controls. This weakness included our failure to design and operate effective procedures and controls whose purpose is to evaluate and monitor the effectiveness of our individual control activities.

These deficiencies are pervasive in nature and 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 weaknesses contributed to the following material weaknesses 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 revenue, the precision of management's review of controls over revenue, and the identification of relevant systems used to process revenue transactions.

Contingent Consideration

Management did not design and maintain effective controls over the review and reconciliation of the calculation of the contingent consideration liability (including the input data used), a component of the acquisition of 3Q Digital, Inc., to provide reasonable assurance that such controls will prevent or detect a material error in the financial statements.

Goodwill Impairment

Management did not design and maintain effective controls around the evaluation of goodwill for impairment, including the review of assumptions used in the analysis, at an appropriate level of precision to provide reasonable assurance that such controls will prevent or detect a material error in the financial statements.

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Recoverability of Deferred Tax Assets

Management did not design and maintain effective controls around the evaluation of the recoverability of deferred tax assets on a regular basis to provide reasonable assurance that such controls will prevent or detect a material error in the financial statements.

Financial Closing and Reporting

Management did not design and maintain effective controls over the financial closing and reporting process with sufficient precision to mitigate a potential material misstatement.

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, 2016. This audit report appears below.

Remediation Plan for Material Weaknesses in Internal Control over Financial Reporting

Subsequent to our December 31, 2016 fiscal year end, we began developing a plan to redesign processes and controls to address all of the material weaknesses, as part of this we have begun taking steps in the areas of revenue recognition, the calculation of contingent consideration, goodwill impairment and deferred income taxes. We are assessing tools and potential enhancements to document, support, and review controls to better address both the accuracy and precision of management's review. We are also evaluating our financial team, organizational structure, and certain changes to roles and responsibilities we can make to enhance controls and compliance. We expect to make further changes to our internal controls to enhance or further develop the remediation plan we have adopted. As we implement these plans, management may determine that additional steps may be necessary to remediate the material weaknesses.

While we intend to resolve all of 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.

Changes in Internal Control over Financial Reporting

Other than the identification of the material weaknesses discussed above, there have been no changes in our internal controls over financial reporting during the quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. As noted above, we have begun taking steps to implement changes to our internal control over financial reporting to address the material weaknesses described above.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Harte Hanks, Inc.
San Antonio, Texas

We have audited Harte Hanks, Inc. and subsidiaries (the "Company's") internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. 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 conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 that 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.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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 the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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. The following material weaknesses have been identified and included in management's assessment:

- Ineffective control environment, risk assessment, information and communication, and monitoring components of internal control
- Ineffective design of controls over the completeness and accuracy of information used to recognize revenue

- Insufficient level of precision with regards to management’s review controls over revenue
- Ineffective controls to ensure the identification of relevant information systems, including the relevant information technology general controls, used to process revenue transactions
- Ineffective controls over the accounting for contingent consideration
- Ineffective controls over the evaluation of goodwill for impairment
- Ineffective controls over the valuation of deferred tax assets
- Ineffective controls over the financial closing and reporting process

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, 2016, of the Company and this report does not affect our report on such financial statements.

In our opinion, because of the effect of the material weaknesses identified above 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, 2016,

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based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2016 of the Company and our report dated June 16, 2017 expressed an unqualified opinion on those financial statements.

/s/ DELOITTE & TOUCHE LLP

San Antonio, TX
June 16, 2017

ITEM 9B.   OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and related rules of the SEC require our directors and officers, and persons who own more than 10% of a registered class of our equity securities, to file initial reports of ownership and reports of changes in ownership with the SEC. These persons are required by SEC regulations to furnish us with copies of all Section 16(a) reports that they file. As with many public companies, we provide assistance to our directors and executive officers in making their Section 16(a) filings pursuant to powers of attorney granted by our insiders. To our knowledge, based solely on our review of the copies of Section 16(a) reports received by us with respect to 2016, including those reports that we have filed on behalf of our directors and executive officers pursuant to powers of attorney, or written representations from certain reporting persons, we believe that all filing requirements applicable to our directors, officers and persons who own more than 10% of a registered class of our equity securities have been satisfied on a timely basis; however, we did report on a SEC Form 5 filed August 23, 2016 a 2015 gift transaction of 400 shares of common stock by Mr. Houston H. Harte (who owns beneficially more than 10% of our common stock), which transaction had not previously been reported to us.

Directors and Executive Officers

The following table sets forth certain information about our current directors and executive officers as of May 15, 2017:

Name	Age	Position
Stephen E. Carley	64	Director (Class II)
David L. Copeland	61	Director (Class I)
William F. Farley	73	Director (Class II)
Christopher M. Harte	69	Director (Class I); Chairman of the Board
Scott C. Key	58	Director (Class I)
Judy C. Odom	64	Director (Class III)
Karen A. Puckett	56	Director (Class III); President & CEO
Carlos M. Alvarado	43	Vice President, Finance & Controller
Frank M. Grillo	51	Executive Vice President, Sales & Chief Marketing Officer
Andrew P Harrison	45	Executive Vice President, Contact Centers & CHRO
Shirish R. Lal	50	Executive Vice President, COO & CTO
Robert L. R. Munden	48	Executive Vice President, CFO, General Counsel & Secretary

Class III directors serve through our 2017 annual meeting. The term of Class I directors expires at the 2018 annual meeting of stockholders, and the term of Class II directors expires at the 2019 annual meeting of stockholders.

Stephen E. Carley joined Harte Hanks as a director on March 17, 2013. Mr. Carley recently retired as Chief Executive Officer and director of Red Robin Gourmet Burgers, Inc., a casual dining restaurant chain. Prior to joining Red Robin, Mr. Carley served from April 2001 to August 2010 as the Chief Executive Officer of El Pollo Loco, Inc., a privately held restaurant company. Prior to his service at El Pollo Loco, Mr. Carley served in various management positions with several companies, including, PhotoPoint Corp., Universal City Hollywood, PepsiCo, Inc., and the Taco Bell Group.

We believe that Mr. Carley brings to the board of directors, among his other skills and qualifications, extensive retail and consumer-focused industry experience and valuable executive leadership, which he has gained as a chief executive officer of a corporation with significant, large-scale operations. In addition, he has extensive knowledge and understanding of marketing from a retail perspective, which should prove valuable for our company given the number of our retail-based clients.

David L. Copeland has served as a director of Harte Hanks since 1996. He has been employed by SIPCO, Inc., the management and investment company for the Andrew B. Shelton family, since 1980, and currently serves as its President. Since 1998, he has served as a director of First Financial Bankshares, Inc., a financial holding company. Currently, he serves on the executive and nominating committees and is also the audit committee chairman of First Financial Bankshares.

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We believe that Mr. Copeland’s qualifications for our board include his experience serving on various committees for a publicly traded financial holding company. We also believe he offers us extensive knowledge of financial instruments, financial and economic trends and accounting expertise from serving as president of SIPCO, Inc. and on the audit committee of First Financial Bankshares. Mr. Copeland, a certified public accountant and a chartered financial analyst, would qualify as a financial expert for our audit committee.

William F. Farley has served as a director of Harte Hanks since 2003. Currently, he is a Principal with Livingston Capital, a private investment business he started in 2002. Since 2005, he has served on the board of trustees for Blue Cross Blue Shield of Minnesota and is a member of its technology committee business development committee and the chair of its investment committee. He served as Chairman and Chief Executive Officer of Science, Inc., a medical device company, from 2000 to 2002. He also served as Chairman and Chief Executive Officer of Kinnard Investments, a financial services holding company, from 1997 to 2000. From 1990 to 1996, he served as Vice Chairman of U.S. Bancorp, a financial services holding company.

We believe that Mr. Farley’s qualifications for our board include his extensive leadership experience at various financial institutions serving in roles as chairman and chief executive officer. We believe he provides important perspectives on financial markets, complex securities and financial and economic trends, as well as a broad prospective on corporate governance and risk management issues facing businesses today. Mr. Farley qualifies as a financial expert on our audit committee.

Christopher M. Harte has served as a director of Harte Hanks since 1993. Serving as our Chairman since July 1, 2013, he is also a private investor. He was Chairman and publisher of the Minneapolis Star Tribune from March 2007 through September 2009. The Minneapolis Star Tribune entered bankruptcy in January 2009 and emerged from bankruptcy in September 2009. He had previously been President and publisher of Knight-Ridder newspapers in State College, Pennsylvania and Akron, Ohio, and later President of a newspaper in Portland, Maine. He was a director of Geokinetics, Inc. (from 1997 to 2013) and Crown Resources Corporation (from 2002 until its merger with Kinross Gold Corporation in 2006).

We believe that Mr. Harte’s qualifications for our board include his extensive experience in managing, investing in and serving on the board of directors of a number of communications and other public and private companies. He offers the perspective of a seasoned board member, having served on our board of directors through several major transitions, both when the company was private as well as after its most recent public offering.

Scott C. Key joined the Harte Hanks board on March 17, 2013. Through June 2015, Mr. Key served as President and Chief Executive Officer of IHS, Inc. Mr. Key also served on IHS’ board of directors. Mr. Key joined IHS in 2003, and served in a variety of roles of progressively greater responsibility, most recently as IHS’ Chief Operating Officer (in 2011), Senior Vice President, Global Products and Services (in 2010) and President and Chief Operating Officer of IHS Global Insight (September 2008 - December 2009). From 2007-2008, he served as President and Chief Operating Officer of IHS Jane's and chairman of IHS Fairplay, and led an integrated sales team on a global basis. From 2003-2007, he served as IHS Senior Vice President of Corporate Strategy and Marketing, and led Energy Strategy, Products, Marketing and Software Development.

We believe Mr. Key’s extensive experience in global data- and analytics-intensive businesses brings a keen perspective as our company continues to develop more and different data-driven marketing offerings for our clients. In addition, his recent service as Chief Executive Officer of a fast growing company will provide a valuable perspective on our board as we deploy our new strategy.

Judy C. Odom has served as a director of Harte Hanks since 2003. Since November 2002, Ms. Odom has served on the board of directors of Leggett & Platt, Incorporated, a diversified manufacturing company, where she also serves as chair of the audit committee and as a member of its compensation and nominating and governance committees. In March 2014, Ms. Odom joined the board of directors of Sabre Corporation, a leading technology solutions provider to the global travel and tourism industry; she also serves as the chair of Sabre’s Audit Committee. From 1985 until 2002, she held numerous positions, most recently chief executive officer and chairman of the board, at Software Spectrum, Inc., a global business to business software services company, which she co-founded in 1983. Prior to founding Software Spectrum, she was a partner with the international accounting firm, Grant Thornton.

We believe that Ms. Odom’s qualifications to serve on our board include her board service with several companies allowing her to offer a broad leadership perspective on strategic and operating issues facing companies today. Her experience co-founding Software Spectrum, growing it to a large public company before selling it to another public company and serving as board chair provides the insight and perspective of a successful entrepreneur and long-serving chief executive officer with international operating experience. As a partner in an international accounting firm she supervised audits of many companies in various industries.

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Karen A. Puckett has served as a director of Harte Hanks since 2009, and was appointed our President & Chief Executive Officer (CEO) in September 2015. Ms. Puckett served in several executive positions with CenturyLink, Inc. and its predecessor companies for over 15 years until her departure in June 2015, most recently as its President of Global Markets and Chief Operating Officer. CenturyLink is the third largest telecom communications company in the U.S. and a leader in network services as well as a global leader in cloud infrastructure and hosted IT solutions for enterprise customers. CenturyLink provides data voice and managed services in local, national and select international markets. Ms. Puckett also serves as a director (and member of the finance and personnel committees) of Entergy Corporation, an integrated energy company engaged primarily in electric power production and retail distribution operations.

We believe that Ms. Puckett's qualifications for our board include her essential perspective as our current President & CEO, and her extensive prior leadership and operating experience at CenturyLink. We believe her involvement in the transformation and expansion of CenturyLink will provide the board with key insights on all aspects of challenging and rapidly-changing business situations.

Carlos M. Alvarado has served as the Vice President, Finance and Controller since June 2013. Prior to joining Harte Hanks, he was Director of Accounting for Visionworks of America, Inc., a subsidiary of Highmark's vision holding company, HVHC Inc. Prior to joining HVHC, Mr. Alvarado spent six years in public accounting with Ernst & Young and Arthur Andersen, and two years at a retail grocery company.

Frank M. Grillo was appointed our Chief Marketing Officer in October of 2015, and now serves as our Executive Vice President, Sales & CMO. Mr. Grillo previously worked for CenturyLink, Inc. as a vice president of business marketing (beginning April 2012). Prior to CenturyLink, Mr. Grillo served in a variety of executive sales, operations and marketing roles for Cypress Communications (from September 2005 to January 2012) and Trinsic Communications (from March 2003 to August 2005).

Andrew P. Harrison is our Executive Vice President and Chief Human Resources Officer. Mr. Harrison also leads our contact center services. Mr. Harrison has worked in a variety of human resources and operational management and leadership roles for Harte Hanks for over 20 years.

Shirish R. Lal became our Executive Vice President, Chief Operating Officer & Chief Technology officer on March 14, 2016. Mr. Lal joined the company after working 11 years at CenturyLink, Inc. in a variety of positions of increasing responsibility within the marketing function, most recently serving as CenturyLink's Chief Marketing Officer.

Robert L. R. Munden joined the company in April 2010 as our Senior Vice President, General Counsel and Secretary. Mr. Munden began serving as our Chief Financial Officer (CFO), in addition to his other roles, beginning in January 2017. From April 2005 through March 2010, Mr. Munden served as Vice President and Corporate Counsel of Safeguard Scientifics, Inc. From June 2002 through April 2005, he served as Corporate Counsel, North America for Taylor Nelson Sofres, a market research company (now a division of WPP PLC). Prior to that, Mr. Munden served as General Counsel to an online marketing and database services firm, as an associate with a corporate law firm and as an armor and cavalry officer in the U.S. Army.

CORPORATE GOVERNANCE

We believe that strong corporate governance helps to ensure that our company is managed for the long-term benefit of our stockholders. During the past year, we continued to review our corporate governance policies and practices, the applicable federal securities laws regarding corporate governance, and the corporate governance standards of the NYSE, the stock exchange on which our common stock is listed. This review is part of our continuing effort to enhance our corporate governance and to communicate our governance policies to stockholders and other interested parties.

You can access and print, free of charge, the charters of our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee ("Governance Committee"), as well as our Corporate Governance Principles, Business Conduct Policy, Code of Ethics and certain other policies and procedures on our website at www.hartehanks.com under the "Corporate Governance" subsection of our "Investors" section. Additionally, stockholders can request copies of any of these documents free of charge by writing to the following address:

Harte Hanks, Inc. (Attention: Secretary)
9601 McAllister Freeway, Suite 610
San Antonio, Texas 78216

From time to time, these governance documents may be revised in response to changing regulatory requirements, our evaluation of evolving best practices and industry norms and input from our stockholders and other interested parties. We encourage you to check our website periodically for the most recent versions.

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Board of Directors and Board Committees

Our business is managed under the direction of our Board. The Board elects the Chief Executive Officer ("CEO") and other corporate officers, acts as an advisor to and resource for management, and monitors management’s performance. The Board, with the assistance of the Compensation Committee, also assists in planning for the succession of the CEO and certain other key positions. In addition, the Board oversees the conduct of our business and strategic plans to evaluate whether the business is being properly managed, and reviews and approves our financial objectives and major corporate plans and actions. Through the Audit Committee, the Board reviews and approves significant changes in the appropriate auditing and accounting principles and practices, and provides oversight of internal and external audit processes, financial reporting and internal controls

The Board meets on a regularly scheduled basis to review significant developments affecting our company, to act on matters requiring approval by the Board and to otherwise fulfill its responsibilities. It also holds special meetings when an important matter requires action or review by the Board between regularly scheduled meetings. The Board met 16 times and acted by unanimous written consent five times during 2016. In addition, in 2016 each director participated in at least 75% of the meetings of the Board committee(s) of which he or she was a member.

The Board has separately designated standing Audit, Compensation and Governance Committees, each composed solely of directors who the Board has determined are independent. The following table provides Board and committee membership and meeting information for each of the Board’s standing committees:

	Committee					
	Audit		Compensation		Governance	
Director	2016	2017	2016	2017	2016	2017
Stephen E. Carley			Member	Member	Member	Member
David L. Copeland	Member*		Chair			
William F. Farley	Chair*	Chair*			Member	Member
Christopher M. Harte		Member		Member		Member
Scott C. Key	Member	Member		Chair		
Judy C. Odom			Member	Member	Chair	Chair
Number of 2016 meetings	11		5		3	
Number of 2016 written consents	1		2		0	

* The Board has determined that such director is an audit committee financial expert.

In accordance with our Corporate Governance Principles the Governance Committee and Board considered the membership of the committees and the tenure of members’ service on them. In light of the many changes made to the committee composition (including the rotation of each committee chair) over the past three years, the Board made no changes to the composition of committees in 2016. In April 2017, the Board changed its committee composition as reflected in the table above when Mr. Copeland was determined to no longer qualify as independent; see Independence of Directors below.

A brief description of the principal functions of each of the Board’s three standing committees follows. The Board retains the right to exercise the powers of any committee to the extent consistent with applicable rules and regulations, and may do so from time to time. For additional information, please refer to the committee charters that are available on our website at www.hartehanks.com under the “Corporate Governance” subsection of our “Investors” section.

- Audit Committee - The primary function of the Audit Committee is to assist the Board in fulfilling its oversight of (1) the integrity of our financial statements, including the financial reporting process and systems of internal controls regarding finance, accounting, and legal compliance, (2) the qualifications and independence of our independent auditors, (3) the performance of our internal audit function and independent auditors, and (4) our compliance with legal and regulatory requirements.

- Compensation Committee - The primary functions of the Compensation Committee are to (1) review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives, and together with the other independent directors (as directed by the Board), determine and approve the CEO's compensation level based on this evaluation, (2) review and recommend to the Board (as directed by the Board) non-CEO officer compensation, incentive-compensation plans and equity-based plans, and (3) review and discuss with management the company's "Compensation Discussion and Analysis" and produce a committee report

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on executive compensation as required by the SEC to be included in our annual proxy statement or annual report on Form 10-K filed with the SEC.

- Governance Committee - The primary functions of the Governance Committee are to (1) develop, recommend to the Board, implement and maintain our company's corporate governance principles and policies, (2) identify, screen and recruit, consistent with criteria approved by the Board, qualified individuals to become Board members, (3) recommend that the Board select the director nominees for the next annual meeting of stockholders, (4) assist the Board in determining the appropriate size, function, operation and composition of the Board and its committees, and (5) oversee the evaluation of the Board and management.

Director Nomination Process

The Governance Committee is responsible for managing the process for the nomination of new directors. The Governance Committee may identify potential candidates for first-time nomination as a director using a variety of sources—recommendations from current Board members, our management, stockholders or contacts in communities served by Harte Hanks, or by conducting a formal search using an outside search firm selected and engaged by the Governance Committee.

Following the identification of a potential director nominee, the Governance Committee commences an inquiry to obtain sufficient information on the background of a potential new director nominee. Included in this inquiry is an initial review of the candidate with respect to whether the individual would be considered independent under NYSE and SEC rules and whether the individual would meet any additional requirements imposed by law or regulation on the members of the Audit and Compensation Committees of the Board. The Governance Committee evaluates candidates for director nominees in the context of the current composition of the Board, taking into account all factors it considers appropriate, including the characteristics of independence, diversity, age, skills, background and experience, financial acumen, availability of service to Harte Hanks, tenure of incumbent directors on the Board and the Board's anticipated needs. Candidates should also have the skills and fortitude to assess and challenge the way things are done and recommend alternative solutions to problems; the independence necessary to make an unbiased evaluation of management performance and effectively carry out responsibilities of oversight; an awareness of both the business and social environment in which today's corporation operates; and a sense of urgency and spirit of cooperation that will enable them to interact with other Board members in directing the future and profitable growth of the company. The Governance Committee has determined that it is desirable for the Board to have a variety of differences in viewpoints, professional experiences, educational background, skills, race, gender, and age, and considers issues of diversity and background in determining the appropriate composition of the Board and identifying director nominees. However, the company does not have a formal policy concerning diversity considerations, nor any formal means of assessing the efficacy of its diversity consideration.

The Governance Committee will consider potential nominees recommended by our stockholders taking into account the same considerations as are taken into account for other potential nominees. Stockholders may recommend candidates by writing to the Governance Committee in care of our Secretary at Harte Hanks, Inc., 9601 McAllister Freeway, Suite 610, San Antonio, Texas 78216. Our by-laws provide additional procedures and requirements for stockholders wishing to nominate a director for election as part of the official business to be conducted at an annual stockholders meeting.

Assuming a satisfactory conclusion to the Governance Committee's review and evaluation process, the Governance Committee presents the candidate's name to the Board for nomination for election as a director and, if applicable, inclusion in our proxy statement.

Board Leadership Structure

Board leadership structures should vary for companies depending on their circumstances. Although as part of our Lead Director Policy (see below) we regularly evaluate whether to combine or separate the roles of CEO and Chairman, having separated these roles with the retirement of our previous Chairman, the Board determined that maintaining this structure remained the best one for the company. The Board believes that this leadership structure will allow our CEO the time and resources to focus on leading the company in our corporate strategy and through the changes to our business that are and will be required to address our declining financial performance. Our board and stockholders likewise benefit from the continuity provided by an independent Chairman who is very familiar with the company from his long service on our board. Mr. Harte, our Chairman, leads the Board and its activities, and is responsible for the effective operation of the Board and its responsiveness to stockholders.

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The board still maintains a Lead Director Policy, which provides that:

- the Board shall conduct an annual evaluation of whether to combine (or continue combining, as the case may be) the roles of Chairman of the Board and CEO, with a view to ensuring significant independent oversight of management;
- when the Chairman of the Board is also the CEO, the independent members of the Board shall elect one of the independent Directors to serve as Lead Director, such director to serve in such role for a one-year term;
- at each regular meeting of the Board, the independent directors shall meet in executive session; and
- the Lead Director shall have the following powers and duties (1) presiding over all meetings of the Board at which the Chairman of Board is not present, (2) presiding over executive sessions of independent and/or non-management directors, (3) calling meetings of the independent directors, and (4) serving as a liaison between the Chairman of the Board and the independent directors if so requested.

We had no changes to our Board composition in 2016. The independent members of the Board meet in executive session outside the presence of our sole management director at every regular meeting of the Board, and as-needed at special meetings. We believe having a substantial majority of independent, experienced directors comprising our Board benefits the company and its stockholders by providing strong oversight and advice on the issues facing the company.

Our Board conducts an annual evaluation in order to determine whether it and its committees are functioning effectively. As part of this annual self-evaluation, the Board evaluates whether the current leadership structure continues to be optimal for Harte Hanks and its stockholders. In addition, in 2016 the Board utilized third-parties to conduct a director skills assessment and peer evaluation. Our corporate governance guidelines provide the flexibility for our Board to modify or continue our leadership structure in the future, as it deems appropriate, in light of the results of evaluations or business needs.

Executive Sessions

Our Corporate Governance Principles provide that the non-management members of the Board will hold regular executive sessions in connection with regular Board meetings to consider issues that they may determine from time to time without the presence of any member of management. If the Chairman of the Board is not a member of management, the Chairman will chair each such session and report any material issues to the full Board. If the Chairman is a member of management, the Lead Director serves as the chairman of the executive sessions. If the non-management directors include directors who are not “independent” under applicable NYSE and SEC rules, then the independent directors will hold an executive session at least once a year. The Chairman of the Board, if an independent director, will chair each such session and report any material issues to the full Board. If the Chairman is not an independent director, the Lead Director serves as the chairman of such sessions.

Risk Oversight

Our Board is responsible for overseeing the risk management process. The Board focuses on our general risk management strategy and the most significant risks we face, and ensures that appropriate risk mitigation strategies are implemented by management. The Board is also apprised of particular risk management matters in connection with its general oversight and approval of corporate matters.

In performing the risk management process, the Board reviews with management (1) our policies with respect to risk assessment and management of risks that may be material to us, (2) our system of disclosure controls and system of internal controls over financial reporting, and (3) our compliance with legal and regulatory requirements. The Board also reviews major legislative and regulatory developments that could materially impact our contingent liabilities and risks. Our other Board committees also consider and address risk as they perform their respective committee responsibilities. For example, our Compensation Committee evaluates the risks associated with our compensation plans and policies, and our Audit Committee monitors risks relating to our financial controls and reporting. All committees report to the full Board as appropriate, including when a matter rises to the level of a material or enterprise level risk. The leadership structure of our Board described above in the "Board Leadership Structure" section also ensures that management is properly overseen by independent directors.

Management is responsible for day-to-day risk management. Our finance, treasury, general counsel and internal audit functions serve as the primary monitoring and testing groups for company-wide policies and procedures, and manage the day-to-day oversight of the risk management strategy for our ongoing business. This oversight includes identifying, evaluating and addressing potential risks that may exist at the enterprise, strategic, financial and operational levels, as well as compliance and reporting.

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We believe the division of risk management responsibilities described above is an effective approach for addressing the risks facing the company and that our Board leadership structure supports this approach.

Audit Committee Financial Experts and Financial Literacy

The Board has determined that William F. Farley, Christopher M. Harte and Scott C. Key, the current members of the Audit Committee, are each financially literate as interpreted by the Board in its business judgment based on applicable NYSE rules, and that Mr. Farley further qualifies as an audit committee financial expert, as such term is defined in applicable SEC rules.

Compensation Committee Interlocks and Insider Participation

None of the members of the Compensation Committee of our Board is or has been an officer or employee of the company. All members of the Compensation Committee participate in decisions related to compensation of our executive officers. No interlocking relationship exists between our Board and the board of directors or compensation committee of any other company.

Communications with Non-Management Directors and Other Board Communications

The Board provides a process to enhance the ability of stockholders and other interested parties to communicate directly with the non-management directors as a group, the entire Board, Board committees or individual directors, including the Chairman and chair of any Board committee.

Stockholders and other interested parties may communicate by writing to: Board of Directors - Stockholder Communication, Harte Hanks, Inc., 9601 McAllister Freeway, Mail Box 8, San Antonio, Texas 78216. Our independent directors have instructed the Chair of the Governance Committee to collect and distribute all such communications to the intended recipient(s), assuming she reasonably determines in good faith that such communications do not relate to an improper or irrelevant topic.

Concerns about accounting or auditing matters may be forwarded on a confidential or anonymous basis to the Audit Committee by writing to: Audit Committee, Harte Hanks, Inc., 9601 McAllister Freeway, Mail Box 8, San Antonio, Texas 78216, in an envelope labeled “To be opened by the Audit Committee only. Submitted pursuant to Audit Committee’s whistleblower policy.” These complaints will be reviewed and addressed under the direction of the Audit Committee.

Items unrelated to the duties and responsibilities of the Board, such as mass mailings, business solicitations, advertisements and other commercial communications, surveys and questionnaires, and resumes or other job inquiries, will not be forwarded.

Director Attendance at Annual Meetings

Although we do not have a formal policy regarding director attendance at the annual meeting of stockholders, all directors are encouraged to attend. All directors other than Ms. Odom attended the 2016 annual meeting of stockholders.

Policies on Business Conduct and Ethics

We have established a corporate compliance program as part of our commitment to responsible business practices in all of the communities in which we operate. The Board has adopted a Business Conduct Policy that applies to all of our directors, officers and employees, which promotes the fair, ethical, honest and lawful conduct in our business relationships with employees, customers, suppliers, competitors, government representatives, and all other business associates. In addition, we have adopted a Code of Ethics applicable to our CEO and all of our senior financial officers. The Business Conduct Policy and Code of Ethics form the foundation of a compliance program that includes policies and procedures covering a variety of specific areas of professional conduct, including compliance with laws, conflicts of interest, confidentiality, public corporate disclosures, insider trading, trade practices, protection and proper use of company assets, intellectual property, financial accounting, employment practices, health, safety and environment, and political contributions and payments. The Business Conduct Policy forbids employees and directors from engaging in hedging activities with respect to our securities.

Both our Business Conduct Policy and our Code of Ethics are available on our website at www.hartehanks.com, under the “Corporate Governance” subsection of our “Investors” section. In accordance with NYSE and SEC rules, we intend to disclose any future amendments to our Code of Ethics, or waivers from our Code of Ethics for our CEO, Chief Financial Officer (“CFO”) and Controller, by posting such information on our website (www.hartehanks.com) within the time period required by applicable SEC and NYSE rules.

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Indemnification of Officers and Directors

Our certificate of incorporation and bylaws require us to indemnify our officers and directors to the fullest extent permitted by the Delaware General Corporation Law. These documents also contain provisions that provide for the indemnification of our directors for third party actions and actions by or in the right of Harte Hanks that mirror Section 145 of the Delaware General Corporation Law.

Our certificate of incorporation also states that Harte Hanks has the power to purchase and maintain insurance, at its expense, to protect itself and any such director, officer, employee or agent of Harte Hanks or another corporation, partnership, joint venture, trust or other enterprise against such expense, liability or loss, whether or not we would have the power to indemnify such person against such expense, liability or loss under the Delaware General Corporation Law. We also have and intend to maintain director and officer liability insurance, if available on reasonable terms.

Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended (the “Securities Act”), may be permitted to directors, officers or persons controlling us under the foregoing provisions, we have been informed that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

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 June 13, 2016.

ITEM 11. EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

This Compensation Discussion and Analysis (“CD&A”) provides a discussion of the compensation philosophy and objectives that underlie our executive compensation program and how we evaluated and set our executives’ compensation for 2016. This CD&A provides qualitative information concerning how 2016 compensation was awarded to and earned by our executives, identifies the most significant factors relevant to our 2016 executive compensation decisions and gives context to the data presented in the tables included below in this Form 10-K. “Committee” within this CD&A means the Compensation Committee of the Board. Our “executive officers” are our senior executives who are listed above under the heading “Directors and Executive Officers.” Our “named executive officers” listed in the Summary Compensation Table and other compensation tables that follow are listed below, and are drawn from executive officers who served in 2016:

- Karen Puckett - President and Chief Executive Officer;
- Shirish R. Lal - Executive Vice President, COO & CTO;
- Doug Shepard - Executive Vice President and CFO (resigned December 31, 2016);
- Robert Munden - Executive Vice President, General Counsel & Secretary, and CFO from January 1, 2017; and
- Andrew Harrison - Executive Vice President, Contact Centers & Chief Human Resources Officer.

Executive Summary

We seek to design and implement executive compensation programs that align our executives' interests and motivations with those of our stockholders, while avoiding the encouragement of inappropriate risk-taking. In 2016, our total direct compensation program for our named executive officers consisted of base salary, annual cash incentives (based on pre-established financial goals), long-term equity incentives (stock options, time-vesting restricted stock and performance units) and limited perquisites.

As further detailed below, 2016 brought important changes for Harte Hanks as we secured new leadership for some key roles to deploy an evolving strategy and focus in the face of declining financial performance. Our most significant changes were:

- New Operations and Technology Leadership: Shirish R. Lal joined the company as its Chief Operating and Chief Technology officer, replacing incumbents in those positions to drive growth and reorganization to align our operations with client needs and market expectations, and improve quality of execution.
- Trillium Software Sale: We sold our Trillium Software business in December, having terminated (without replacement) its CEO in April.

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- CFO Transition: Mr. Shepard resigned from the company effective December 31, 2016, and Mr. Munden assumed the duties of CFO.
- Smaller Leadership Team: Through reorganized and consolidated roles, and in response to divestitures and other changes in our business, by the end of 2016 we reduced our senior leadership team by approximately half.
- Equity Program: In light of poor share performance and limitations to the shares available for issuance under the company's equity incentive plan, the company reduced the value of grants to mitigate dilution and used new cash-settled awards of phantom stock.

The company began 2016 with the objective of creating modest revenue growth while maintaining reasonable profitability as it sought to adapt its operational structure to a strategy that was refined and refocused by its new leadership team. Despite making progress on improving client satisfaction and operational performance, financial performance suffered as continued client turnover and volume declines presented significant obstacles to stability and growth. The company sold its Trillium Software business (which allowed the company's debt facility to be repaid), but most meaningful indicators of corporate performance from continuing operations declined, including revenue (down 9%). Reflecting the impact of declining revenue and the loss on the sale of Trillium Software, operating loss from continuing operations (a loss of $55.8 million) and loss per share (a loss of $1.46) likewise suffered. As a result of performance and the requirements of our credit facility, we also discontinued stockholder dividends after payment of our first quarter dividend. Our stock price declined accordingly, decreasing 54%, and with the effect of dividends paid, total stockholder return was (52)% for the year.

Based on the economic environment, the company's recent performance, anticipated changes to the company and its leadership, and the Committee's compensation philosophy and objectives, the Committee took the following annual compensation actions for the named executive officers for 2016:

- Established target compensation for new officers which was largely consistent with market benchmarks.
- Established goals for our short term annual incentive plan (the "2016 AIP") with a view to motivating our executives toward objectives fundamental to improving stockholder value.
- Due to company performance, made no payments under the 2016 AIP.
- Granted long-term equity awards with a lower value (compared to prior years), comprised of restricted stock awards, performance units and phantom stock to align participants with the company's achievement of long-term stockholder value creation.
- Due to the decline in the company's share price and the limited number of shares available for issuance under our 2013 Omnibus Incentive Plan (the "2013 Plan"), we added cash-settling awards, which also had the effect of decreasing the dilution of awards granted.
- Eliminated executive car allowances (offset by corresponding salary increases).
- Held base salaries constant (other than the car allowance adjustment) in light of poor performance.
- Adopted an optional benefit allowing senior executive officers to be reimbursed for an annual comprehensive health examination.

The Committee engaged Meridian Compensation Partners, LLC ("Meridian") as its independent compensation advisor to assist with benchmarking of executive officer compensation on an as-needed basis during the year (including development of a new peer group), but Meridian was not engaged to perform a comprehensive survey or analysis; for incumbent officers, the Committee relied on Meridian's report from prior years. Meridian has been engaged by the Committee to perform a comprehensive analysis of the company's executive compensation program for 2017.
The remainder of this CD&A provides further detail on the compensation philosophy, process, and decisions for 2016. Certain information regarding our other periods' compensation determinations and policies is also included to the extent we believe it provides helpful context for our discussion of 2016 executive compensation.

Executive Compensation Philosophy and Objectives

Our executive compensation program is designed to achieve a number of key objectives and thereby support our overall efforts to create long-term value for our stockholders:

- Attract and Retain Top Talent - Attract and retain high-performing individuals who will significantly contribute to our long-term success and the creation of long-term stockholder value by providing competitive compensation compared to peer companies, competitors or companies in the same market for executive talent.

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- Pay for Performance - Motivate our executives to work in the best interests of our stockholders by closely tying compensation to company and individual performance on both a short-term and long-term basis.
- Place Significant Portion of Pay At Risk - Align executive compensation with stockholder interests by placing a significant portion of total direct compensation at risk, such that the executive will not realize value unless company performance goals are achieved (for example, annual bonuses and performance units with vesting dependent upon company performance) or our stock price appreciates (for example, stock options or phantom stock).
- Require Significant Ongoing Executive Stock Ownership - Align executive and stockholder interests by including a significant equity component in our total compensation awards and by requiring executives to accumulate and maintain a sizable equity position through our stock ownership guidelines.

As an integral part of our compensation philosophy and objectives, we seek to design an executive compensation program that does not encourage inappropriate risks that would threaten the long-term value of our company.We believe our compensation philosophy has assisted in achieving our goals. The Committee reviews our compensation philosophy on a periodic basis to judge whether the goals and objectives are being met, and what, if any, changes may be needed to the philosophy. The Committee considered our compensation philosophy and objectives in establishing the elements and amounts of 2016 compensation for each of our named executive officers. Although a variety of modifications and alternatives were considered, our 2016 compensation philosophy was consistent for all of our executive officer positions, and was consistent with the philosophy for our 2015 compensation program.

Elements of 2016 Executive Compensation Program

The following table highlights the elements of our 2016 executive compensation program and the primary purpose of each element, which were consistent with our 2015 executive compensation program elements. The elements are also generally consistent for all of our executive officer positions. Each element is discussed in further detail below.

Element	Objectives and Basis	Form
Base Salary	Provide base compensation that is competitive for each role to reward and motivate individual performance	Cash
Annual Incentive Plan	Annual incentive or “bonus” to drive company performance consistent with immediate or short-term objectives	Cash
Bonus Restricted Stock Elections	Encourage greater stock ownership by executive officers by allowing each to elect to receive up to 30% of their bonus in the form of restricted stock vesting on the first anniversary of the grant, with executive officers receiving 125% of the value of the forgone cash bonus in shares of restricted stock	Restricted stock
Long-Term Incentive Awards	Long-term incentive to drive company performance and align executives’ interests with stockholders’ interests, and to retain executives through long-term vesting and potential wealth accumulation	Restricted stock, performance awards, and cash-settled phantom stock
Perquisites	Enhance the competitiveness of our executive compensation program through limited additional benefits	Health examination and death benefits
Severance Agreements	Attract and retain key talent by providing certain compensation in the event of a change in control	Cash severance, equity vesting and COBRA reimbursement
Qualified Deferred Compensation	Provide tax-deferred means to save for retirement	Same benefit made generally available to our employees to participate in our 401(k) plan with a company match
	Provide tax-deferred means to save for retirement	

Non-Qualified Deferred Compensation		Participation in our non-qualified deferred compensation program
Other	Offer other competitive benefits, such as medical, dental, and other health and welfare benefits	Same benefit made generally available to our employees

Compensation Committee

The Committee currently consists of Messrs. Key (Chair), Carley and Harte and Ms. Odom. The Board has determined that each member of the Committee meets the independence requirements of the rules of the NYSE. Each person serving on the Committee qualified as an “outside director” in accordance with Section 162(m) of the Internal Revenue Code (the “Code”), and a “non-employee director” as defined in Rule 16b-3 under the Exchange Act with regard to compensation and benefit plans subject to SEC Rule 16b-3. Each member of the Committee either currently serves, or has served, as a director or senior

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executive of a large corporation, and has had significant experience with compensation matters relating to senior executives of these organizations.

The Committee's purpose is to assist the Board in fulfilling its oversight responsibilities for compensation of executive officers and administration of the company's equity incentive plans, with the goals of (1) supporting the company's business objectives, (2) attracting, motivating and retaining high quality leadership, and (3) linking compensation with business objectives and performance. In accordance with its charter and NYSE rules, the Committee's responsibilities include the following:

- reviewing and approving corporate goals and objectives relevant to CEO compensation, evaluating the CEO's performance in light of those goals and objectives, and together with the other independent directors (as directed by the Board), determining and approving the CEO's compensation level based on this evaluation;
- making recommendations to the Board with respect to non-CEO officer compensation, and incentive-compensation and equity-based plans that are subject to board approval;
- assisting the Board by (i) evaluating potential candidates for officer positions, (ii) recommending terms for the hiring, promotion and severance of officers, and (iii) overseeing the development of officer succession plans;
- participating with management in reviewing the annual goals and objectives with respect to compensation for the company's officers and, to the extent the Committee deems necessary or appropriate, other key employees of the company or its subsidiaries (collectively, "Principal Executives");
- periodically (but no less frequently than annually) evaluating the performance of the Principal Executives in light of established goals and objectives and, based upon this evaluation and any compensation recommendations for the Principal Executives made by the CEO, approving or (in the case of officers, and as directed by the Board) making recommendations to the Board with respect to the compensation for the Principal Executives; and
- periodically (but no less frequently than annually) evaluating the competitiveness of the company's executive compensation program in reference to its peers and broader trends, including consideration of base salaries, annual incentives, long-term incentives and equity-based compensation, considering (among other things) the company's performance and relative stockholder return, the value of similar incentive awards to similarly situated executives at comparable companies, and the awards given to such person in prior years.

The Committee may appoint subcommittees for any purpose that it deems appropriate and may delegate to subcommittees such power and authority as it deems appropriate. However, no subcommittee may consist of fewer than two members, and no subcommittee may be delegated any power or authority required by any law, regulation or listing standard to be exercised by the Committee as a whole. No subcommittees were formed or met in 2016. The Committee has delegated to our CEO a limited authority to grant stock options and restricted stock to non-officers, and monitors grant activity through regular reports. The Committee also delegated to the CEO the limited authority to allocate non-officer annual equity awards amongst employees. You may view the Committee's full charter in the "Investors" section of our website at www.hartehanks.com under the "Corporate Governance."

The Committee meets in executive session at most of its meetings (as it deems appropriate) to review and consider executive compensation matters without the presence of our executive officers. These executive sessions may also include other non-employee directors and outside experts retained by the Committee. The Committee met in executive session with other non-employee directors at four of its five 2016 meetings.

Other Participants in the Executive Compensation Process

In addition to the Committee and other non-Committee members of the Board who also may be in attendance at the Committee's meetings, our management and, when engaged by the Committee from time to time, outside compensation consultants also participate in and contribute to our executive compensation process. Ultimately, the Committee exercises its independent business judgment with respect to recommendations and opinions of these other participants and the Committee (or our independent directors as a group) makes final determinations about our executive officer compensation.

Management and Chairman of the Board

Mr. Harte, our Chairman, participated in the Committee's executive compensation processes throughout 2016 and assisted the Committee and regularly attended Committee meetings. Mr. Harte provided his perspective to the Committee regarding executive compensation matters generally and the performance of the company and its executive officers based on his long experience with the company.

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Ms. Puckett, our CEO, likewise participated in the Committee's executive compensation processes and attended all Committee meetings; however, she did not attend sessions when elements of her compensation were being considered. The company's Chief Human Resources Officer (Mr. Harrison) attended most meetings (as appropriate), and the General Counsel (Mr. Munden) also attended each meeting. Our former CFO (Mr. Shepard) attended selected meetings. Officers were excluded from executive sessions.

Working with Messrs. Harrison and Munden, Ms. Puckett presented recommendations to the Committee on the full range of annual executive compensation decisions made in March (other than with respect to herself), including (1) the company's 2016 Annual Incentive Plan (the "2016 AIP") structure and participants, (2) long-term incentive compensation strategy, (3) competitive positioning of our executive compensation program, and (4) total direct compensation for each executive officer, including base salary adjustments, 2016 AIP targets, equity grants and perquisites. The Committee made final decisions about each officer's 2016 compensation without the applicable executive officer being present, taking into account Ms. Puckett's recommendations and views.

Compensation Consultants

The Committee believes that engaging a consultant for comprehensive reviews on a periodic basis is more appropriate than having regular annual engagements. The Committee engaged Meridian to assist the Committee with its evaluations and determinations for our 2014 executive compensation program. In this review, Meridian performed a comprehensive evaluation of our compensation philosophy, policies and practices for executive officers and other executive positions, and reviewed a new annual incentive plan design to be applied company-wide (including officers). Having considered Meridian's report and recommendations, the Committee implemented a variety of changes in 2014. The Committee did not think it was necessary to engage Meridian to conduct another full-scale assessment for 2016, and used Meridian's 2014 review as the baseline for 2016 Compensation determinations for incumbent positions.

Nevertheless, the Committee did refer ad-hoc queries and issues to Meridian as they arose from time-to-time. For example, Meridian was engaged to help establish benchmark compensation for our executive hired in 2016—Mr. Lal—as well as queries on long term incentive plan considerations and award design. As previously mentioned, the Committee did engage Meridian to assist in the development of a new peer group, and to perform a comprehensive executive compensation analysis for its 2017 compensation determinations.

For the foregoing engagements, Meridian has been selected and retained by—and reported directly to—the Committee. Meridian has not been separately engaged by our management, but has provided to management corresponding evaluations of selected non-executive officer positions and compensation policy and practice matters. Harte Hanks has no relationship with Meridian (other than the relationship undertaken by the Committee), and the Committee re-evaluated and confirmed Meridian's independence in accordance with its charter and NYSE requirements prior to engaging Meridian.

Principal Factors That Influenced 2016 Executive Compensation

When making its 2016 annual compensation decisions, the Committee considered the compensation philosophy and principles that underlie our executive compensation program, including the desire to link executive compensation to annual and long-term performance goals and to be able to attract and retain high performing individuals who will significantly contribute to our long-term success and the creation of long-term stockholder value. The Committee did not use formulas to rigidly set the compensation of our executives based solely on market data or on any one factor in isolation, or assign a specific weighting or ranking to the various factors it considered. Rather, the Committee's ultimate decisions were influenced by a number of factors that were collectively taken into consideration in the Committee's business judgment and that included a number of subjective determinations in addition to the specific formula-based performance criteria established in our annual incentive plan and long-term incentive performance awards. In establishing the individual elements and amounts of 2016 executive compensation, the principal factors taken into consideration by the Committee included the following:

- anticipated reorganization and consolidation of leadership roles, potentially resulting in fewer leaders each with greater and/or broader responsibility;
- possible divestitures and other changes in our business;
- competitive market data to assess how our executive pay compared to other companies, considering the individual elements of our compensation program, the relative mix of those compensation elements and total direct compensation amounts, with then-current market data provided by Meridian;
- input from non-Committee members of the Board (including our CEO) with regard to base salary proposals, long-term incentive awards, individual executive officer performance and related matters;

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- recent company performance compared to (i) our financial and operational expectations for our company as a whole, (ii) for our (former) Trillium and Customer Interactions segments individually and (iii) our peers and other market indicators;
- the need to attract and retain a pool of highly-qualified leadership candidates for positions necessitated by our evolving strategy and corresponding organizational changes;
- ongoing and anticipated efforts to transform our business operations in line with our strategy, that were expected to result in continued significant additional work commitments by our executive officers;
- a general assessment of individual executive officer performance and contributions in support of our strategies, individual officer responsibilities, tenure and experience in his or her position and the overall financial performance of the businesses or functional areas for which an officer is responsible;
- providing competitive compensation to reflect new or expanded roles for some of our executives;
- retention considerations in light of a recent history of relatively low bonus payouts to executive officers based on recent company performance and diminished equity compensation values because of declining stock price and earnings per share performance;
- individual officer compensation history, including the cumulative effect of equity awards granted in prior years and value realized from prior equity awards;
- internal pay equity (i.e., considering pay for similar jobs and jobs at different levels within the company and considering the relative importance of a particular position to us); and
- tax and regulatory considerations, including our policy to take reasonable and practical steps to maximize the tax deductibility of compensation payments to executives under §162(m) of the Code, the impact of expensing equity grants under ASC 718, and the impact of §409A relating to non-qualified deferred compensation.

The Committee also had to review compensation matters outside the usual annual compensation review and setting process. In connection with Mr. Shepard’s resignation, the Committee considered the immediate need to retain certain officers to provide stability. Compensation determinations for Mr. Lal (who was hired prior to our usual annual determinations) were also affected by the numerous events cited above in our Executive Summary and:

- perceived advantages, disadvantages, strengths and weaknesses of other candidates considered;
- the scope and importance of the role to the company’s success;
- the compensation received by his immediate predecessors in the company;
- timing considerations (such as when he would be available to start); and
- the compensation he received in his recent employment.

Tally Sheets

To assist the Committee in making its 2016 annual executive compensation determinations, the Committee reviewed tally sheets for each executive officer, as it has done in prior years. Tally sheets are used as a reference to ensure that Committee members understand the total compensation provided to executives each year, over a multi-year period and in various change in control or other termination events. The Committee uses tally sheets to consider individual elements of our compensation program, the relative mix of those compensation elements and total annual and long-term compensation amounts provided to a particular executive. The tally sheets illustrate, for each executive officer:

- cash compensation (base pay, bonus and (until discontinued) automobile allowance) for the current year under consideration and each of the past two years;
- values of long-term equity compensation awards granted (options, restricted stock, phantom stock and performance awards) for the current year under consideration and each of the past two years;
- salary continuation benefits (similar in effect to life insurance benefits);
- estimated pension benefits upon retirement;

- the value, and changes in value, of previous equity compensation awards;
- stock ownership guideline compliance; and
- estimated amounts the executive could realize upon a change in control or termination of employment.

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For comparison purposes, the tally sheets also incorporate applicable competitive market compensation data for base salary, annual incentive awards and long-term incentive awards.

Setting the Pay Mix-Cash Versus Equity; Fixed Versus Variable

We believe a mixture of both long-term and short-term compensation elements provides the proper balance and incentives. The Committee reviews each of these elements separately and then all of the elements combined to determine the amount and mix of compensation for our executives. As has been our practice, in 2016 all short-term incentives were payable in cash. Most of the 2016 long-term incentives were in the form of equity, but unlike prior years, some of these awards were linked to equity value but payable only in cash to reduce dilution. The following chart and table show the split of 2016 target compensation for our named executive officers between equity (including equity-linked) and cash:

2016 Target Cash v. Target Equity Compensation for Named Executive Officers
By Individual

Named Executive Officer	Cash	Equity
Karen Puckett	1,491,800	1,502,509
Shirish Lal	720,475	488,758
Doug Shepard	784,890	523,685
Robert Munden	475,050	298,028
Andrew Harrison	452,551	298,028

CEO	Equity
CEO	Cash

All NEOs	Equity
All NEOs	Cash

1) Target Cash is the sum of base salary at December 31, 2016 plus column (d) (target annual incentive) from the Grants of Plan Based Awards table below. No annual incentive award payments were made in respect of 2016.
2) Target Equity is the sum of the amounts in column (l) (grant date fair value of stock and option awards) from the Grants of Plan Based Awards table below.

The Committee believes that a substantial portion of the potential cash compensation should be subject to meeting financial performance criteria, and thus “at risk” or variable. In 2016, 43% of the potential cash compensation (assuming target annual incentive payout) for the named executive officers was “at risk” as the Committee adopted an approach that increased potential maximum payout while making minimum achievement more difficult relative to prior years. Over 57% of potential cash compensation was “at risk” assuming maximum annual incentive payout.

The Committee also reviewed the compensation risks associated with the pay mix of its executive officers, and in that context, considers risk as well as motivation when establishing performance criteria and compensation structures. For 2016, the Committee reviewed the company’s incentive compensation plans to determine whether the company’s compensation policies and practices foster risk taking above the level of risk associated with the company’s business model. In the course of its examination, the Committee evaluated, among other things:

- whether any of our businesses, operations or functions has much more inherent risk, a significantly different compensation structure, or different profitability basis or results;
- whether the compensation mix is appropriately balanced between annual and long-term incentive awards;
- the relationship between annual and long-term performance measures and payouts, and whether measures are aligned (or complementary) to ensure that they encourage consistent behaviors and sustainable results without conflict;
- whether long-term performance measures and equity vehicles encourage excessively risky behavior;
- whether targets require performance at such a high level that executives would take improper risks to achieve them;
- the overlap of performance criteria and vesting periods to reduce incentives to maximize performance in any one period;
- whether the mix of equity incentives serve the best interests of stockholders by rewarding the right measures;

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- the effect of dilution on stockholders and the company’s equity burn rate; and
- the report of Meridian regarding the risks of our compensation program.

On the basis of this review, the Committee determined that the company’s incentive compensation plans are appropriately structured to not encourage executive officers to take unnecessary or excessive risks and do not create risks that are reasonably likely to have a material adverse effect on the company.

2016 Target Cash Compensation for Named Executive Officers: Fixed vs. Variable or "At Risk"
By Individual

Named Executive Officer	Fixed	Variable
Karen Puckett	$745,900	