PARTICIPANTS

Corporate Participants

Michael T. Burns – VP-Investor Relations & External Reporting, Harris Interactive, Inc.
Albert A. Angrisani – President, Chief Executive Officer and Vice Chairman, Harris Interactive, Inc.
Eric W. Narowski – Chief Financial Officer, Principal Accounting Officer & Global Controller, Harris Interactive, Inc.

Other Participants

Brian T. Horey – President, Aurelian Management LLC
Jim Zimmerman – Managing Member, Lowell Capital Management, LLC
Scott Smallman – Senior VP, Wedbush Morgan Securities
Bill Sutherland – Analyst, Emerging Growth Equities Ltd.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the First Quarter Fiscal 2014 Harris Interactive Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions] I would now like to turn the call over to Michael Burns.

Michael T. Burns, VP-Investor Relations & External Reporting

Good afternoon and thank you for joining us to discuss Harris Interactive's first quarter fiscal 2014 financial results. With me today are Al Angrisani, our President and Chief Executive Officer; and Eric Narowski, our Chief Financial Officer.

The format for today's call will include Al's commentary and then be followed by Eric's financial recap. After the formal remarks, both Al and Eric will be available for questions. A webcast replay of this entire call will be accessible via the Investor Relations section of our corporate website later today and will be archived there for at least 30 days. However, no telephone replay of this call will be provided. We will post a transcript of this call as soon as possible after the call.

We would like to take this opportunity to remind you that certain statements made during this conference call are forward-looking statements for purposes of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995. These statements include beliefs, predictions and expectations related to the company's future financial performance, other business and operating metrics, as well as statements regarding the company's future plans and operations.

They involve a number of risks, known and unknown, that could cause actual results, performance and/or achievements of the company to be materially different from the beliefs, predictions and expectations discussed on this call. Factors that could cause the company's results to materially differ from the forward-looking statements made today and which are incorporated by reference herein are more fully described in today's press release as well as the company's SEC filings, particularly under the Risk Factors section of the company's most recent Annual Report on Form 10-K.

You are urged to consider these factors carefully in evaluating such forward-looking statements and are cautioned not to place undue reliance on them. Forward-looking statements are only made as of the date of this presentation, and the company undertakes no obligation to publicly update them to reflect subsequent events or circumstances. We also will be discussing non-GAAP financial measures, including adjusted EBITDA. Adjusted EBITDA is reconciled to GAAP financial measures in today's press release, and that reconciliation is posted on the IR section of our website.

I'd now like to turn today's call over to Al. Al?

Albert A. Angrisani, President, Chief Executive Officer and Vice Chairman

Thank you, Mike, and good afternoon, everyone. Overall, our Q1 results were on plan, with sales up and revenue essentially flat as compared with Q1 of last fiscal year. Q1 was impacted by some planned investments in the business, as I discussed on our last earnings call, and an increase in our cost of data acquisition due to business mix. These two factors, which I'll discuss in more detail, contributed to our lower adjusted EBITDA in Q1 versus the same prior year period. Nevertheless, we generated a very healthy adjusted EBITDA margin of approximately 9% of revenue in Q1.

Let me explain a little further some of the highlights surrounding our Q1 results. First and foremost, we experienced good sales activity during the traditionally slow summer months. Next, revenues have been tracking to our internal budget targets and were essentially flat in Q1 compared with the same prior year period, despite a slower-than-usual conversion of sales to revenue during the quarter. This led to an increase in secured revenue at the end of Q1, which Eric will discuss in further detail.

Next, we continue to build cash and remain a debt-free company. And then next, in terms of profitability, the following were the primary drivers that led to the decline versus the same prior year period. Again, first and foremost, we made a technological investment to upgrade and virtualize our Canadian phone center. This upgrade will enable us to improve our margins and ability to meet the needs of our clients.

The technological investment primarily relates to the acquisition and implementation of new hardware and software. As is often the case with implementation of this nature, we experienced some downtime in Q1 that impacted profitability. Next, as I mentioned earlier, we experienced a higher cost of data acquisition in Q1 versus the same prior year period, which depressed normal project profitability margins. This was due primarily to projects fielded for clients of our European operations.

And finally, in the U.S., we began the process of upgrading our sales and consulting infrastructure. Accordingly, we have increased our spending on recruiting and hiring new talent. In summary, by taking these steps, we continue to position ourselves for the future. The marketing research industry, as you know, is in transition and our goal is to be at the cutting-edge of that transition.

Now, let me turn the call over to Eric to provide more color on Q1 and full-year expectations. Eric?

Eric W. Narowski, Chief Financial Officer, Principal Accounting Officer & Global Controller

Thanks Al, and good afternoon. Recapping the first quarter, revenue was $32.4 million, down 2% from $33 million for the same prior year period. Foreign currency exchange rate differences did not have a significant impact on revenue. The decrease was driven by revenue declines in our U.S. and German operations, which were offset by revenue increases in our Canadian, French and U.K. operations. As Al mentioned, the overall decrease in revenue was mainly due to slower-than-usual bookings to revenue conversion.

Bookings were $34.8 million, down 3% compared with $33.9 million for the same prior year period. Excluding foreign currency exchange rate differences, bookings were up 2%. Bookings were up in our French, Canadian, U.K. and U.S. businesses, which offset the bookings decrease in Germany that were attributable to delayed and reduced client spending. Our operating income was $1.3 million compared with operating income of $1.8 million for the same prior year period.

Our net income was $1.3 million or $0.02 per fully diluted share, compared with net income of $1.7 million or $0.03 per fully diluted share for the same prior year period. Non-GAAP adjusted EBITDA with restructuring and other charges added back was $2.8 million compared with $3.5 million for the same prior year period. The reduction in adjusted EBITDA was mainly as a result of factors that Al mentioned in his commentary.

Cash provided by operations was $120,000 compared with $306,000 in cash provided by operations for same prior year period. Though cash provided by operations was down in Q1, as a result of normal course changes in working capital, it is in line with historical seasonal trends and exceeded our expectations. Overall, we had $15.9 million of cash at September 30, 2013, compared with $10.6 million at September 30, 2012, an increase of $5.3 million.

Secured revenue at September 30, 2013 was $48.9 million, up 13% compared with $43.4 million at September 30, 2012. Foreign currency exchange rate differences did not have a meaningful impact on secured revenue. The increase in secured revenue reflects the previously mentioned slow-than-usual conversion of bookings to revenue during the quarter.

As Al mentioned, our Q1 performance was in line with our expectations and we are reaffirming our previously provided full-year adjusted EBITDA guidance range of $14.5 million to $16.5 million. It is important to remind you that we have provided guidance on a full-year basis because we believe it's important to view our performance on a longer term basis rather than look at, at any one quarter in isolation.

That's all from my financial commentary. So, let's open up for questions. Mike, over to you.

Michael T. Burns, VP-Investor Relations & External Reporting

Operator, if you could, please open the queue for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] At this time, I'm showing no questions. [Operator Instructions] We do have a question from Brian Horey from Aurelian.

<Q – Brian Horey – Aurelian Management LLC>: Thanks for taking my question. I wondered if you could give us some color on the individual business units and how they're doing and how some of your growth efforts within them are progressing?

<A – Al Angrisani – Harris Interactive, Inc.>: Hey Brian, it's Al.

<Q – Brian Horey – Aurelian Management LLC>: Hey, Al.

<A – Al Angrisani – Harris Interactive, Inc.>: I know the last quarter, I said that we weren't going to do it and that we might do it in Q1. It's for the same reason that I don't want to get into that right now, again it's for largely competitive reasons, over the telephone. And I think at this point in time, we're going to decline to get into individual business unit performance.

<Q – Brian Horey – Aurelian Management LLC>: Okay. With respect to the cost of data acquisition, is that a transitory issue that you expect will kind of cycle back down as the mix of business returns to what it's been historically or is that a shift in the revenue pattern do you think?

<A – Al Angrisani – Harris Interactive, Inc.>: Let me ask Eric to give you some color on that.

<A – Eric Narowski – Harris Interactive, Inc.>: Sure. Yeah, we view those as one-off projects right now. We do occasionally have projects that have very high data collection, and we had a few of them in our European groups. So, we don't view that as a systemic pattern that's going to be in the business on a go-forward basis.

<Q – Brian Horey – Aurelian Management LLC>: Okay. Al, maybe can you give any color on what you're seeing out of clients these days and what's the trend in budgets? I realize that they probably haven't set budgets for next year. But just relative to expectations and kind of macro influences, what are you seeing out of people from a body language standpoint?

<A – Al Angrisani – Harris Interactive, Inc.>: Yeah. Going back to sort of what I said last quarter, I don't see any difference in the pattern. The clients are being very careful with how they spend money, and I wouldn't say that we've seen any change in historical patterns, although it is really early to make a comment on that, because we really don't know the answer to that until we get closer to the end of the calendar year. So I'd say, right now, it's pretty much the same spending pattern that we saw from the previous quarter. But we might be able to provide a little more color for that with you after we see how clients react to their own budgets and historically how they spend money at the end of their fiscal years, which tend to be the calendar year.

<Q – Brian Horey – Aurelian Management LLC>: Okay. So, is it fair to say then that you haven't seen anything that would make you want to accelerate your own investment plans that you've got for growth?

<A – Al Angrisani – Harris Interactive, Inc.>: Again, I think trying to be consistent for you guys. In the – at the last call, I mentioned that we were moving into this investment sort of opportunistic model and that we were going to begin putting some money back into the business. As I mentioned, we've done that in Q1. I outlined that for you guys a little bit. And I would say going forward that we're going to try to be opportunistic around things like if we see good talent, we're going to hire it. If we see opportunities to improve our product offering, we're going to be inclined to want to do that. But we'll be watching the market carefully, of course, to see is there any macro events that would change that strategy. But I would say that, similar to what I said in Q4, we're going to try to be opportunistic and try to stay consistent on that throughout the remainder of the year.

<Q – Brian Horey – Aurelian Management LLC>: Okay. Thank you.

Operator: The next question comes from Jim Zimmerman from Lowell Capital.

<Q – Jim Zimmerman – Lowell Capital Management, LLC>: Hey, you guys. Thanks for taking the question. Question on the investments you're making, Al. Can you – you've talked a little about them, shed any more light on them and kind of what the payback might be and the confidence level you have? And just – I know you've tried to in effect these higher expenses, and maybe I'm wrong in thinking this can kind of be a multi-quarter or a year investment, sometimes in your types of businesses. Just kind of your thoughts along that line, if that makes any sense.

<A – Al Angrisani – Harris Interactive, Inc.>: Sure, I'll try. The strategy, as I laid out on the last call after we gave year-end results last year, which were better than our expectations, in that we exceeded our guidance. I think our margins were close to 11%. And it was clear to tell everyone that we needed to begin investing for the future of the company and that we would do it carefully and that we would do it opportunistically.

And I think this quarter here, to comment on that, you can see that we've sort of done that. It's very important that we upgrade our Canadian phone center and we're doing that. That is going to allow us to be much more efficient with our phone center activity going forward. That's a longer term focus, and it's the type of thing where that investment could carry into Q2 and maybe beyond. We don't know yet. It depends on how the transition goes.

The other area of major investment is in upgrading our intellectual talent and our research and consulting staff, and that's a matter of when the talent's available, you sort of hire it. So, this quarter, we saw some talent and we invested in it and we will continue to do that as it's available. In terms of the payback period on that, in service businesses like this, it's very difficult to make any predications or estimates, and I won't. But I do believe that the money that we're spending is money well spent.

<Q – Jim Zimmerman – Lowell Capital Management, LLC>: So you are identifying areas of sort of attractive margins, good revenue that you can potentially put money investment into where you're looking to get a return, I guess?

<A – Al Angrisani – Harris Interactive, Inc.>: Yes. We do what any responsible public company does or any responsible company. We look at the areas where we think there is the greatest return. We do our own internal ROI. We set priories, because you never have enough money to do everything. And you can see in this quarter that it does impact profitability, and it did impact profitability this quarter. So you never have enough money to do everything you want. So, you pick your spots and you try to make the very best investments that you can, which is a factor of quite a different things too complex to get into here on this earnings call. But we're being very careful about how we do it.

<Q – Jim Zimmerman – Lowell Capital Management, LLC>: Well, I think you've done a great job so far, and I think you got a great balance sheet and I think I'm optimistic you'll make good choices, as you guys have so far. So, appreciate the color.

<A – Al Angrisani – Harris Interactive, Inc.>: Thank you. Thank you for your confidence in us.

Operator: The next question comes from Scott Smallman from Wedbush.

<Q – Scott Smallman – Wedbush Morgan Securities>: Hi, Al. Can you comment at all on the evolution of the relationship with Google and whether there was any contribution this quarter from that?

<A – Al Angrisani – Harris Interactive, Inc.>: Hi, Scott. Sure, I can – similar to what I said last quarter, the relationship is moving along very nicely. It is becoming a little bit more part of our business every quarter. Our Business Unit Leader, Mike de Vere, that oversees that relationship, is paying a lot of attention to it. But I don't think I'd care to quantify at this point in time what its contribution is to the quarter obviously for mostly competitive reasons, if you know what I'm saying. It's a very unique partnership that we've constructed with Google around this product offering and I'd soon keep it between us and Google for the moment.

<Q – Scott Smallman – Wedbush Morgan Securities>: Can you comment on the direction now in terms of is it contributing more revenue this quarter than it did last quarter for example?

<A – Al Angrisani – Harris Interactive, Inc.>: Unfortunately, Scott, I'm not going to comment on that. Sorry.

<Q – Scott Smallman – Wedbush Morgan Securities>: Okay. That's fine.

Operator: The next question comes from Bill Sutherland from Emerging Growth Equities.

<Q – Bill Sutherland – Emerging Growth Equities Ltd.>: Thanks. I just have one at this point, Al, and maybe you've touched on this in the prepared remarks. I apologize if you already covered this. But on the gross margin which – I know that's where we're going to see the impact of – primarily the investment impact there. Is it – I'm trying to foot kind of where it is as of the first quarter, which is just under 38%, with kind of where it needs to get to, to fit with your thoughts on full-year EBITDA. So should we think about getting there by offsetting with further control of SG&A or is there going to be any factors that the trend line in gross margin will be moving up from this point? Thanks.

<A – Al Angrisani – Harris Interactive, Inc.>: Sure. Thanks Bill. I think – and I may turn this over to Eric. I think the question you're asking is the bridge between Q1 and the confirmation of our full-year guidance and what are the factors. Eric, you might be more inclined [ph] to me and want to (0:19:56) try to fill that in a little bit, if you can.

<A – Eric Narowski – Harris Interactive, Inc.>: Sure, sure. Yeah. Specifically, I think this quarter, as Al mentioned, we saw some higher than normal data collection cost. And I think as we were talking, we do see [ph] that data (0:20:09) is down in Q1. We do see that going back to more of our historical trends. So, again that is a direct factor of, Bill, what you're seeing in our gross profit number. And as we talked about for Q1, Q1 did meet our expectations, our internal numbers, and we're reaffirming our full-year guidance right now. So, we're comfortable where we're at in our performance in our tracking right now.

<Q – Bill Sutherland – Emerging Growth Equities Ltd.>: Okay. And as far as the conversion rates on sales, can you give us any color on what kind of impacts that?

<A – Eric Narowski – Harris Interactive, Inc.>: Yeah. What that is, is we get signed – the bookings start off as we get a signed contract from a client, and then it needs to be delivered in terms of revenue. We start – we've seen some delays, probably because of the summer months, of the contracts actually starting to get worked on. So, we actually got the projects booked. They recorded sales. However, there were some slowness on the client side to actually start to convert that to revenue.

<Q – Bill Sutherland – Emerging Growth Equities Ltd.>: Okay, great.

<A – Eric Narowski – Harris Interactive, Inc.>: Remember, yeah, Q1 has historically been one of our slower quarters, summer months, client vacation and all of that. So, I think that affected us a little bit more this year than we've seen in prior years.

<Q – Bill Sutherland – Emerging Growth Equities Ltd.>: Got you. Thanks a lot.

<A – Eric Narowski – Harris Interactive, Inc.>: Sure.

Operator: The next question comes from Brian Horey from Aurelian.

<Q – Brian Horey – Aurelian Management LLC>: Hi, I had one follow-up on the Google partnership. Can you talk at all about where you're seeing demand for that product in terms of vertical or type of client and to what extent that differs from the typical client base that you've had in the past?

<A – Al Angrisani – Harris Interactive, Inc.>: I think, Brian, I'll give you the thesis behind it and then it should make sense to you. The industry, as we've said before, is in transition in many, many different ways. The Google partnership that we have addresses one of those ways. And the issue that's behind the partnership is that, in certain types of products, like products that we call omnibus, which are products where there's a three or four or five-question survey done, sort of almost like a quick survey.

There's real technology coming into that both from the standpoint of what Google has done, but there's also some other technologies coming into that part of the business or into that product suite in the mobile area, where quite frankly it's really a function of lowering your costs, so that you can provide lower price points. And what the Google relationship does is it allows us through our partnership to provide a more competitive product at a lower price.

And so, basically there is some specific product disintermediation in that omnibus area that the Google partnership allows us to be more competitive. And suffice it to say that we are continuing to look at the workings of the relationship. It's really only a full quarter is very positive right now and we're continuing to try to expand that relationship.

<Q – Brian Horey – Aurelian Management LLC>: Okay, okay. The other follow-up question was SG&A was down quarter-to-quarter and year-to-year, and I know you guys have had some restructuring efforts over the last year or so. So, maybe that reflects some of that. Is that kind of at a steady state so to speak at this point or is there more to be squeezed out of that or just where do you see that line item going?

<A – Al Angrisani – Harris Interactive, Inc.>: Well, Eric and I are always trying to squeeze money out of SG&A. I think I'll leave it there. It's just – it's a constant effort to get our SG&A – I believe it's quite frankly sort of within the right tolerance zones for a service company like ours. But we're always looking for efficiencies and we've challenged the entire organization to find efficiencies, and it's just an ongoing process. And I don't know if, Eric, you want to add something to that? I'd sort of [indiscernible] (0:24:48).

<A – Eric Narowski – Harris Interactive, Inc.>: Yeah. I agree with you, Al. I agree with you. There's nothing else to add.

<Q – Brian Horey – Aurelian Management LLC>: Okay. Thank you.

<A – Al Angrisani – Harris Interactive, Inc.>: Okay.

Operator: I am showing no further questions. I would now like to turn the call back over to Michael Burns.

Michael T. Burns, VP-Investor Relations & External Reporting

Well, thanks again to everyone for joining us this afternoon. And we look forward to speaking with you in early 2014 when we release our Q2 2014 results.

Operator: Ladies and gentlemen, that does conclude the conference for today. Again, thank you for your participation. You may all disconnect. Have a good day.