MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen and thank you for standing by. And welcome to the Second Quarter 2011 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 follow at that time. [Operator Instructions] As a reminder, this conference is being recorded.

And now I'll turn the program over to Michael Burns, Vice President of Investor Relations and External Reporting. Sir, please go ahead.

Michael T. Burns, Vice President, Investor Relations and External Reporting

Good afternoon and thank you for joining us to discuss Harris Interactive's second quarter fiscal 2011 financial results. With me today are Kimberly Till, our President and Chief Executive Officer; Pavan Bhalla, our Executive Vice President, Chief Financial Officer and Treasurer; and Eric Narowski, our Principal Accounting Officer and Senior Vice President, Global Controller.

The format for today's call will include formal remarks by both Kimberly and Pavan on the state of the business and our performance for the second quarter. After the formal remarks, Kimberly, Pavan 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 this evening and will be archived there for at least 30 days. However, no telephone replay of this call will be provided. We will post transcript of this call as soon as we can 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 and 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, as updated quarterly in our quarterly reports on Form 10-Q to reflect additional material risks.

You are urged to consider these factors carefully in evaluating such forward-looking statements and are cautioned not to place undue reliance on them. The 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 will also be discussing non-GAAP financial measures including adjusted EBITDA with the add-back of restructuring and other charges. These items are reconciled to GAAP financial measures in today's press release and are posted on the Investor Relations section of our website.

It is now my pleasure to turn the call over to Harris Interactive's President and Chief Executive Officer, Kimberly Till. Kimberly?

Kimberly Till, President, Chief Executive Officer and Director

Thank you, Mike. Good afternoon everyone and thank you for joining us. As many of you will recall, last year's Q2 was our most profitable quarter since Q2 fiscal 2008. I am pleased to report that we experienced growth in bookings, revenue and operating income in this year's Q2 versus the same period last year.

Pavan will cover our Q2 results in more detail later, but let me touch briefly on some of the highlights of the quarter. Our consolidated revenue for Q2 was up 2% in the quarter compared with last year's Q2 excluding foreign currency exchange rate differences due to revenue increases in the U.K., Canada, France, Germany and Asia. Our consolidated bookings for Q2 were up 4% compared with Q2 of last year excluding foreign currency exchange rate differences. This growth was driven by increased bookings in Canada, France and Germany.

Q2 operating income for Q2 was 874,000 representing an improvement of nearly 300,000 or 47% of our last year's Q2. Q2 operating income included 679,000 in restructuring and other charges compared with 383,000 for last year's Q2.

Q2 adjusted EBITDA with the add back of restructuring and other charges was 3.7 million, a 14% improvement from 3.2 million for last year's Q2. As these numbers show, we continue to make progress in stabilizing our overall business. I'll share further commentary regarding Q2 performance as well as our plans after Pavan provides more detail on our Q2 numbers. Pavan?

Pavan Bhalla, Chief Financial Officer, Treasurer and Executive Vice President

Thank you, Kimberly and good afternoon everyone.

Consolidated revenue for Q2 was $44.9 million, up 1% when compared with $44.6 million for last year's Q2. Excluding foreign currency exchange rate differences, consolidated Q2 revenue was up 2% from the same prior-year period. To better understand Q2 revenue we will now look at it geographically and in local currency compared with last year's Q2.

U.S. revenue was down 8% driven mainly by two sectors. The healthcare sector was down 17% due to the continued revenue and sector bookings decreases experienced during the second half of FY '10 and the beginning of Q1. As we have previously shared, we changed management in the sector in Q1. New management made significant enhancements to the staffing of the sales and research teams.

The other sector that significantly contributed to the revenue decline in the U.S. was financial services, which experienced a 25% revenue decrease versus last year's Q2. This is due, in large part, to the continued impact of the loss of a large tracking study in the prior year.

The revenue decline from the healthcare and financial services sectors were partially offset by revenue increases of 13% in technology media and telecom, and 30% in our service bureau research business.

U.K. revenue was up 16%, driven primarily by revenue from work performed on a large tracking study that was deferred from Q1 into Q2, along with revenue generated from projects won with new clients across several industry sectors.

French revenue was up 5%, and German revenue was up 47%, in both cases due to continued success in selling to new and existing clients across several sectors.

Canadian revenue was up 11%, driven largely by revenue from work on a large tracking study that was won in Q2.

Asia revenue, comprised of our Hong Kong and Singapore operations, was up 28%, driven primarily by revenue from work on a large tracking studies those in Q4 of the last fiscal year.

Our consolidated bookings for Q2 were 55.3 million, up 4% when compared with $53.2 million for last year's Q2. Excluding foreign currency exchange rate differences, bookings also were up 4%.

To better understand Q2 bookings, we now look at them geographically and in local currency compared with last year's Q2. U.S. bookings were down 4%, driven mainly by a 10% decline in our healthcare sector. However, as mentioned earlier it is important to note that healthcare bookings for the first half of fiscal 2011 are only marginally lower than the strong level of bookings we had for the first six months of last fiscal year. U.K. bookings were down 44%, driven primarily by the loss of a large tracking study during Q2, which Kimberly will address in her subsequent remarks.

French bookings were up 11%, due primarily to continued success in maintaining and growing tracking studies with existing clients, while also in selling increased levels of ad-hoc work to both new and existing clients.

German bookings were up 92%, due primarily to increased sales to an existing client and a large tracking study one with a new client.

Canadian bookings were up 111%, driven primarily by a large tracking study one with the financial services client and the early booking of two large tracking studies that were not booked until last year's Q3, excluding the two large tracking studies that booked early, Canadian bookings were up 65%.

Asia bookings, comprised of our operations in Hong Kong and Singapore, were down 24%. We focused during H1 on rebuilding the Asian sales team and believe we will have adequate sales resources in place in that region soon.

Secured revenue, formerly referred to as backlog, at December 31, 2010 was 55 million, up 8% when compared with $51.1 million at December 31, 2009. Excluding foreign currency exchange rate differences, secured revenue was up 9%.

Operating income for our Q2 was $874,000, compared with $594,000 in operating income for last year's Q2. The improvement in operating income was driven mainly by the revenue increase for the quarter. Included in Q2 operating income was $679,000 in restructuring and other charges, compared with $383,000 for last year's Q2.

Net income for Q2 was $343,000 or $0.01 for fully diluted share, compared with net income of $1.3 million or $0.02 for fully diluted share for the same prior year period. Net income for last year's Q2 included the favorable impact of a tax law change that resulted in $1.1 million tax benefit.

Non-GAAP adjusted EBITDA with restructuring and other charges added back was $3.7 million or 8.1% of revenue for the quarter compared with $3.2 million or 7.2% of revenue for last year's Q2.

Cash provided by operations in Q2 was $3.3 million compared with $2.6 million for last year's Q2. As of December 31, 2010, we had cash of $13.5 million and $13.2 million in outstanding debt and we made $2.4 million in debt principle payment during the first six months of this fiscal year. We expect that our cash position will improve over time as revenue rebuilds and profitability improves. We continue to believe that we have sufficient liquidity to meet our current operating needs as well as our debt service requirements and expect to continue to be in compliance with all of our debt covenants including minimum cash balance and our total consolidated leverage and interest coverage ratios.

In closing, I would like to make a comment about the seasonality of our business. As you are aware typically the second and fourth quarters in our fiscal year are our strongest and the first and third quarters are our weakest. In Q3, we have higher expenses due to the timing of payroll and other employee related taxes. Also during Q3 many of our clients received their yearly budgets and began planning their research for the year. After the planning stage they put research projects out to bid and sales increased later in the year. We expect fiscal 2011 to follow these seasonal trends.

I'll now turn the call back over to Kimberly.

Kimberly Till, President, Chief Executive Officer and Director

Thank you, Pavan. As we discussed before we have a three phase roadmap that takes the company from operating losses and poor performance to sustainable operating income and revenue growth. As I will share with you, we have made progress in completing the first phase of the roadmap which is to turnaround every operating unit within the company worldwide.

By turnaround we mean that there is strong leadership and proper sales and research resources in place and that the business unit is positioned well to achieve sustainable bookings revenue and profit growth. We made a lot of progress in fixing the U.S. business which represents about 60% of our total consolidated revenue. We have rebuilt several industry sectors and are applying a proven approach to improve performance in the others.

Internationally, I'm very pleased with the improvements that have been made in our Canadian business. In October, we restructured the Canadian business putting in place new management and fixing problem areas. These actions had a positive impact on performance with improved bookings revenue and operating income in Q2 versus the same period last year. This is the first time that we have experienced meaningful year-over-year improvements in bookings, revenue and operating income since we acquired the Canadian business back in August 2007.

Germany is having a very strong year. The business has successfully diversified its clients mix over the past few years and has built strong relationships with a number of blue chip companies.

France continues to perform well. Our French operating unit was cited as the fastest growing market research company in France in calendar year 2010 by marketing magazine. Our French business also has one of the highest profit margins of all our businesses.

In Asia, we've strengthened both the sales and research parts of the organization with recent additions to the sales team in Hong Kong and the reorganization of our Asia research operations. We also plan to launch the Harris poll in Asia in March which we believe will increase our brand awareness in the region.

Now let me discuss the situation in the U.K. The U.K. business has shown negative trends in revenues and profits for the past four years. The U.K. market is highly fragmented with many strong domestic competitors. Our U.K. business has struggled to gain a differentiated positioning in that market. This fiscal year while the U.K. has shown strong new sales growth versus prior year, it has failed to retain some of its repeat business. In late October, the U.K. business lost a multi-million dollar tracker, its largest piece of business. The loss was a result of significant personnel changes at the client which led to the consolidation of seven trackers into one.

The U.K. business had performed one of the trackers for the client for six years and had achieved very strong performance on the tracker 10 out of 10 in client satisfaction. Harris laid out several major market research companies to be in the final two for all seven of the trackers. In the end, we came in second in a very closely contested bid. Coincidentally, we beat that same market research company in another large consolidated tracker bid in the United States, but the loss of this one tracker in the U.K. will have a $3.9 million negative impact on revenue in the second half of fiscal 2011 and had a $4 million negative impact on our Q2 booking.

As soon as we learned of this loss, we put in place a plan to reduce our cost base in the U.K. We eliminated 15 positions in the U.K. and incurred a charge of 347,000 for statutorily mandated severance cost during the quarter. We expect to beat head count reductions will be a savings of 473,000 for the second half of fiscal 2011 and approximately 1 million in fiscal 2012. However, the head count savings will not be enough to make up for the lost tracker profit.

Accordingly, we are putting our plan in place to substantially reposition the U.K. business to become a leading innovator with very strong execution capabilities by improving and differentiating our product offerings, enhancing our sales and delivery approach and creating more efficient resource operations. Given the magnitude of the changes we plan to make in our U.K. business, we anticipate that it will take us a few quarters to realize the benefits of these improvements.

As part of the new approach we are taking in the U.K., we have promoted the co-heads of France, Nathalie Perrio-Combeaux and Patrick Van Bloeme to also lead the U.K. business. Nathalie and Patrick have clearly demonstrated that they can rapidly grow a market research business through strong innovation and execution while achieving attractive profit margins. We believe that they will be able to lead the strategic repositioning of our U.K. business and substantially improve its financial performance.

In connection with this change in management, we have decided to eliminate the position of President, International and I will now oversee Canada, Europe and Asia together with the management teams in place in those regions.

I realize that it is taking us some time to turnaround all parts of the business. This is due in part to the magnitude of the improvements that were required and partly due to the economy particularly in the end of calendar years 2008 and 2009. We have implemented substantial improvements at the company, including upgrading the leadership team and business unit management and the research and operation teams. We also have made improvements in our product offerings, pricing, work processes, global panel and survey platforms and have continued to make quarterly payments on our outstanding debt which has enhanced our financial stability.

We believe the impact of these improvements will lead to profit and revenue growth over time. This is substantiated by the global rolling four quarter bookings and revenue figures. On a rolling four quarter basis, global bookings which has failed have gone from negative 21% in Q2 ‘10 to negative 14% in Q3 ‘10 to negative 5% in Q4 ‘10 to positive 3% in Q1 of ‘11 to positive 4% for the current quarter.

Similarly, if you look at the global rolling four quarters of revenue, they have gone from a negative 21% in Q2 of ‘10 to negative 16% in the next quarter, negative 9% in the next to negative 5%, to finally negative 1% in the current quarter. So both the bookings and revenue trends are moving in the right direction and suggest that we are stabilizing revenue and beginning to rebuild.

Let me now briefly touch on two other topics, new products and our cost base. On the product front, we continue to make progress with Research Lifestreaming, which as we’ve shared before connects the conversations that people are having online and offline with the views they express and the actions that they take through a research platform with social media research capabilities.

We are now in the process of doubling the size of our Research Lifestreaming panel and already have close to 20 million post to-date that can be mined by hundreds of demographics to drive insights for our clients. Our sales and product development continue to expand and since the launch of Research Lifestreaming a little over six months ago, we have sold close to $0.5 million in Research Lifestreaming products with approximately $1.5 million in our sales pipeline.

Our Research Lifestreaming products also have provided a means to increase our visibility in front of a large number of clients, which is increasing the number of request for proposals we are receiving and we believe have driven over 1 million in sales of our core products and solutions. The loan cycle for new market research products can be quite lengthy as prospective buyers must first learn about the new products, understand how they can help solve their business needs and then include them in their research budgets and plans before purchasing.

So, we believe the research Lifestreaming products will continue to be a growth area for us.

In addition, we have spent considerable time recently developing our mobile strategy, we currently offer routine surveying on the mobile platform, but we believe there are significant opportunities to further exploit mobile devices to generate planned insights including by surveying people at the point of experience such as when they exit a store, make a purchase, use a service or attend an event. We also believe, we can use mobile devices as a new requirement tool for our research Lifestreaming and online panels at a reduced cost.

As we announced back in December, Marty Beard who is President of Sybase 365, which is Sybase's mobile service business has joined our Board of Directors, we are already benefiting from Marty's expertise as we implement our mobile strategy.

On the cost side, we continue to manage our operations and expenditures very carefully we have spent the last few months investigating the services at various outsourcing and offshoring partners in an effort to push as many support services and lower level research positions as possible to such partners. Although we will incur a certain non-recurring cost in the second half of fiscal 2011, we expect to generate approximately 1 million of cost savings in fiscal 2012 related to this effort.

In closing, I firmly believe that this is in the strongest position since we began the turnaround. There is always a lag between putting in place the right people and plans and impacting the numbers. We believe the trends in the business suggest we are stabilizing revenues and moving towards growth. Although we have to overcome the substantial revenue and operating income impact in the next few quarters related to the loss tracker in the U.K. that we discussed just now, and finish fixing the underperforming U.S. sectors. We are committed to working tirelessly to accomplish this in its faster timeframe as possible.

Thank you very much for joining us today. And now we're happy to respond to questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operators Instructions]

Our first questioner comes from Dishanna Megan with Voice & Associates. Please go ahead.

<Q>: Hi, I just had a quick question you might have answered this, I jumped on the call a little late, I apologize. But I did notice the cost of sales went up substantially, surprising because you did have a strong quarter, but it seems as though there should have been some type of leverage of costs. So why did the gross margins decline?

<A – Pavan Bhalla>: Yes, so our cost of services is generally given the nature of the business and ad-hoc custom marketing research business spread across eight countries. So our mix of projects typically impacts the costs of the gross margins in any given quarter. And what we work towards is ensuring our overall cost structure is effective and under control. So our total cost on the same revenues as compared to last year we did a bit more operating income which is what we are focused on, but -

<Q>: Okay.

<A – Pavan Bhalla>: ...but we do and as have our cost of services fluctuate quarter-to-quarter.

<Q>: Okay. That's all I needed to know. Thank you.

<A – Pavan Bhalla>: Sure.

Operator: Thank you. Our next questioner in queue is Jeff Oyster with BCM Capital. Please go ahead.

<Q>: Hi guys, thanks for taking the call. A couple of questions, Pavan, can you tell me what the operating income was for both the U.S. and Canada?

<A – Pavan Bhalla>: We aren't disclosing that as of today. We will be in the Q which we will file within about a week.

<Q>: Can you tell me if the U.S. was positive?

<A – Pavan Bhalla>: The U.S. was – we make sure, yes, it was positive.

<Q>: And was Canada positive?

<A – Pavan Bhalla>: Canada was – I really can't, rather we wait a week before we disclose that.

<Q>: Yes, it was just a little confusing on the comments about Canada, I thought, I guess it was may be less negative. When did we find out about the – I think you said it was October that we lost a large, I guess there was one tracking study that was going to double up in the second quarter which sounds like that happened, is that correct?

<A – Pavan Bhalla>: That's right. That happened in the U.K.

<Q>: Okay. And then there was another tracking study, I guess that we lost in October, is that correct?

<A – Pavan Bhalla>: Within the quarter may be not in October, but we did lose a large tracking study in the UK in the quarter.

<Q>: Okay. So and kind of you rolled out in the restructuring cost, last quarter – in last quarter's call – Kimberly, I think we should [inaudible], you said we continue to believe that we are well positioned to achieve revenue growth and profitability growth in fiscal 2011. Obviously, through the first six months, we are running slightly behind in revenue and behind I think 13%, 14% and the adjusted EBITDA even though we picked some up this past quarter but are we sticking by that language?

<A – Pavan Bhalla>: We aren't giving guidance for the whole year and I think this quarter we certainly as we just went over, we were better than last year for the quarter. Now in the balance of the year, I think we've given guidance on some of the specific things which are happening and some of it is we have, I think Kimberly mentioned some of the outsourcing actions offshoring, reducing the cost structure but then we also have the impact of the tracker that we lost which we've also disclosed impact of that. So those are new events which would impact how we – if you go back to our comments in the first quarter, those are impacted by these subsequent events.

<Q>: Okay, that's fair. Thanks. Thank you.

<A – Pavan Bhalla>: Sure.

Operator: Thank you, sir. [Operator Instructions] There appears to be no additional questionnaires in the queue, I'd like to turn the program back over to Michael Burns for any additional or closing remarks.

Michael T. Burns, Vice President, Investor Relations and External Reporting

Okay. Well, thanks very much to everyone for joining us today and we look forward to speaking with you again in April when we report on our third quarter results.

Operator: Thank you, sir. And ladies and gentlemen, this does conclude today's program. Thank you for your participation and have a wonderful day. Attendees you may now disconnect.