

KVH INDUSTRIES INC \DE\  
Form 10-Q  
August 08, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended: June 30, 2012

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from            to

Commission File Number 0-28082

**KVH Industries, Inc.**

(Exact Name of Registrant as Specified in its Charter)

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

**Delaware**  
(State or Other Jurisdiction of

**05-0420589**  
(I.R.S. Employer

**Incorporation or Organization)**

**Identification Number)**

**50 Enterprise Center, Middletown, RI 02842**

(Address of Principal Executive Offices) (Zip Code)

**(401) 847-3327**

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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  No

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Date	Class	Outstanding shares
August 6, 2012	Common Stock, par value \$0.01 per share	14,821,879

**Table of Contents**

**KVH INDUSTRIES, INC. AND SUBSIDIARIES**

**Form 10-Q**

**INDEX**

	<b>Page No.</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
ITEM 1. <b><u>FINANCIAL STATEMENTS</u></b>	
<u>Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011 (unaudited)</u>	3
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2012 and 2011 (unaudited)</u>	4
<u>Consolidated Statements of Comprehensive (Loss) Income for the three and six months ended June 30, 2012 and 2011 (unaudited)</u>	5
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011 (unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (unaudited)</u>	7
ITEM 2. <b><u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>	14
ITEM 3. <b><u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>	21
ITEM 4. <b><u>CONTROLS AND PROCEDURES</u></b>	21
<b><u>PART II. OTHER INFORMATION</u></b>	
ITEM 1. <b><u>LEGAL PROCEEDINGS</u></b>	23
ITEM 1A. <b><u>RISK FACTORS</u></b>	23
ITEM 2. <b><u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u></b>	32
ITEM 6. <b><u>EXHIBITS</u></b>	33
<b><u>SIGNATURE</u></b>	34
<b><u>EXHIBIT INDEX</u></b>	35

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****KVH INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts, unaudited)

	June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 8,242	\$ 7,017
Marketable securities	22,782	23,553
Accounts receivable, net of allowance for doubtful accounts of approximately \$592 as of June 30, 2012 and \$623 as of December 31, 2011	22,264	25,959
Inventories	17,159	18,615
Prepaid expenses and other assets	2,942	2,552
Deferred income taxes	1,033	1,281
<b>Total current assets</b>	<b>74,422</b>	<b>78,977</b>
Property and equipment, less accumulated depreciation of \$29,547 as of June 30, 2012 and \$27,508 as of December 31, 2011	36,507	34,010
Intangible assets, less accumulated amortization of \$601 as of June 30, 2012 and \$434 as of December 31, 2011	1,736	1,903
Goodwill	4,426	4,426
Other non-current assets	4,170	3,835
Deferred income taxes	5,403	5,405
<b>Total assets</b>	<b>\$ 126,664</b>	<b>\$ 128,556</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 5,819	\$ 6,141
Accrued compensation and employee-related expenses	3,756	4,285
Accrued other	4,538	4,700
Accrued product warranty costs	924	933
Accrued professional fees	278	326
Deferred revenue	2,662	2,684
Current portion of long-term debt	134	131
<b>Total current liabilities</b>	<b>18,111</b>	<b>19,200</b>
Other long-term liabilities	128	135
Line of credit	7,000	9,000
Long-term debt excluding current portion	3,485	3,553
<b>Total liabilities</b>	<b>28,724</b>	<b>31,888</b>

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

Commitments and contingencies (notes 3 and 9)

Stockholders' equity:

Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued

Common stock, \$0.01 par value. Authorized 30,000,000 shares, 16,481,244 and 16,207,268 shares issued at June 30, 2012 and December 31, 2011; and 14,822,253 and 14,548,277 shares outstanding at June 30, 2012 and December 31, 2011, respectively

	165	162
Additional paid-in capital	108,819	106,592
Retained earnings	2,805	3,727
Accumulated other comprehensive loss	(699)	(663)
Less: treasury stock at cost, common stock, 1,658,991 shares as of June 30, 2012 and December 31, 2011	(13,150)	(13,150)

**Total stockholders' equity** **97,940** **96,668**

**Total liabilities and stockholders' equity** **\$ 126,664** **\$ 128,556**

See accompanying Notes to Unaudited Consolidated Financial Statements.

**Table of Contents****KVH INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except share and per share amounts, unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
<b>Sales:</b>				
Product	\$ 21,041	\$ 24,331	\$ 38,124	\$ 43,215
Service	10,978	6,241	20,623	11,766
Net sales	32,019	30,572	58,747	54,981
<b>Costs and expenses:</b>				
Costs of product sales	12,746	13,482	23,729	24,010
Costs of service sales	6,822	5,095	12,624	9,897
Sales, marketing and support	5,547	5,976	10,879	11,175
Research and development	3,059	2,878	6,199	5,853
General and administrative	2,918	2,550	5,866	5,477
Total costs and expenses	31,092	29,981	59,297	56,412
Income (loss) from operations	927	591	(550)	(1,431)
Interest income	109	67	212	132
Interest expense	85	57	167	113
Other income, net	39	1	76	15
Income (loss) before income taxes	990	602	(429)	(1,397)
Income tax expense (benefit)	537	412	493	(53)
<b>Net income (loss)</b>	<b>\$ 453</b>	<b>\$ 190</b>	<b>\$ (922)</b>	<b>\$ (1,344)</b>
<b>Per share information:</b>				
<b>Net income (loss) per share</b>				
<b>Basic</b>	<b>\$ 0.03</b>	<b>\$ 0.01</b>	<b>\$ (0.06)</b>	<b>\$ (0.09)</b>
<b>Diluted</b>	<b>\$ 0.03</b>	<b>\$ 0.01</b>	<b>\$ (0.06)</b>	<b>\$ (0.09)</b>
<b>Number of shares used in per share calculation:</b>				
<b>Basic</b>	<b>14,776,239</b>	<b>14,901,495</b>	<b>14,690,591</b>	<b>14,825,091</b>
<b>Diluted</b>	<b>14,886,548</b>	<b>15,199,900</b>	<b>14,690,591</b>	<b>14,825,091</b>

See accompanying Notes to Unaudited Consolidated Financial Statements.

**Table of Contents****KVH INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME****(in thousands, unaudited)**

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Net income (loss)</b>	\$ 453	\$ 190	\$ (922)	\$ (1,344)
<b>Other comprehensive (loss) income, net of tax:</b>				
Unrealized gain (loss) on available-for-sale securities	1	3	(3)	1
Currency translation adjustment (loss) gain	(506)	231	9	901
Unrealized loss on derivatives	(77)	(84)	(42)	(279)
Other comprehensive (loss) income, net of tax	(582)	150	(36)	623
<b>Total comprehensive (loss) income</b>	\$ (129)	\$ 340	\$ (958)	\$ (721)

See accompanying Notes to Unaudited Consolidated Financial Statements.

**Table of Contents**

**KVH INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands, unaudited)

	Six months ended June 30,	
	2012	2011
<b>Cash flows from operating activities:</b>		
Net loss	\$ (922)	\$ (1,344)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Provision for doubtful accounts	145	113
Depreciation and amortization	2,206	2,209
Deferred income taxes	464	(175)
Loss on interest rate swaps	64	36
Compensation expense related to stock-based awards and employee stock purchase plan	1,868	1,826
Changes in operating assets and liabilities:		
Accounts receivable	3,493	(1,693)
Inventories	1,454	(2,519)
Prepaid expenses and other assets	(401)	30
Other non-current assets	(370)	(598)
Accounts payable	(333)	1,263
Deferred revenue	(22)	(150)
Accrued expenses	(863)	51
Other long-term liabilities	(7)	115
<b>Net cash provided by (used in) operating activities</b>	<b>6,776</b>	<b>(836)</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(4,536)	(3,964)
Purchases of marketable securities	(8,705)	(21,557)
Maturities and sales of marketable securities	9,473	27,005
<b>Net cash (used in) provided by investing activities</b>	<b>(3,768)</b>	<b>1,484</b>
<b>Cash flows from financing activities:</b>		
Repayments of long-term debt	(65)	(61)
Proceeds from stock options exercised and employee stock purchase plan	695	791
Payment of employee restricted stock withholdings	(333)	(625)
Repayments of line of credit borrowings	(2,000)	
Payment of stock registration fee		(10)
<b>Net cash (used in) provided by financing activities</b>	<b>(1,703)</b>	<b>95</b>
Effect of exchange rate changes on cash and cash equivalents	(80)	(60)
<b>Net increase in cash and cash equivalents</b>	<b>1,225</b>	<b>683</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>7,017</b>	<b>7,241</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 8,242</b>	<b>\$ 7,924</b>

See accompanying Notes to Unaudited Consolidated Financial Statements.





---

**Table of Contents**

**KVH INDUSTRIES, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**(Unaudited, all amounts in thousands except share and per share amounts)**

**(1) Description of Business**

KVH Industries, Inc. (the Company or KVH) designs, develops, manufactures and markets mobile communications products for the marine, land mobile and aeronautical markets, and navigation, guidance and stabilization products for both the defense and commercial markets.

KVH's mobile communications products enable customers to receive voice and Internet services, and live digital television via satellite services in marine vessels, recreational vehicles and automobiles as well as live digital television on commercial airplanes while in motion. KVH's CommBox offers a range of tools designed to increase communication efficiency, reduce costs, and manage network operations. KVH sells its mobile communications products through an extensive international network of retailers, distributors and dealers. KVH also leases products directly to end users.

KVH offers precision fiber optic gyro-based (FOG) systems that enable platform and optical stabilization, navigation, pointing and guidance. KVH's guidance and stabilization products also include tactical navigation systems that provide uninterrupted access to navigation and pointing information in a variety of military vehicles, including tactical trucks and light armored vehicles. KVH's guidance and stabilization products are sold directly to U.S. and allied governments and government contractors, as well as through an international network of authorized independent sales representatives. In addition, KVH's guidance and stabilization products have numerous commercial applications such as precision mapping, dynamic surveying, autonomous vehicles, train location control and track geometry measurement systems, industrial robotics and optical stabilization.

KVH's mobile communications service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, certain DIRECTV account subsidies and referral fees earned in conjunction with the sale of its products and extended warranty sales. KVH provides, for monthly fixed and usage fees, satellite connectivity sales from broadband Internet, data and Voice over Internet Protocol (VoIP) service to its TracPhone V-series customers. KVH also earns monthly usage fees for third-party satellite connectivity for voice, data and Internet services to its Inmarsat TracPhone customers who choose to activate their subscriptions with KVH. Under current DIRECTV programs, KVH is eligible to receive a one-time payment for each DIRECTV receiver activated for service and a new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through KVH.

KVH's guidance and stabilization service sales include product repairs, engineering services provided under development contracts and extended warranty sales.

**(2) Basis of Presentation**

The accompanying consolidated financial statements of KVH Industries, Inc. and its wholly owned subsidiaries, KVH Industries A/S, KVH Industries Pte. Ltd., KVH Industries Brasil Comunicacao Por Satelite Ltda. and KVH Industries Norway AS (collectively, KVH or the Company), have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company has evaluated all subsequent events through the date of this filing. Given that KVH Industries A/S, KVH Industries Pte. Ltd. and KVH Industries Brasil Comunicacao Por Satelite Ltda. operate as the Company's European, Asian and Brazilian international distributors, all of their operating expenses are reflected within sales, marketing and support within the accompanying consolidated statements of operations. KVH Industries Norway AS, a subsidiary of KVH Industries A/S, develops and distributes middleware software solutions known as CommBox technology, which is being integrated into the Company's satellite communications products and services. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements have not been audited by our independent registered public accounting firm and include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition, results of operations, and cash flows for the periods presented. These consolidated financial statements do not include all disclosures associated with annual financial statements and accordingly should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual report on Form 10-K for the year ended December 31, 2011 filed on March 8, 2012 with the Securities and Exchange Commission. The results for the three and six months ended June 30, 2012 are not necessarily indicative of operating results for the remainder of the year.

**(3) Significant Estimates and Assumptions**

## Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of sales and expenses during the reporting periods. Significant estimates and assumptions by management affect the Company's revenue recognition, valuation of accounts receivable, valuation of inventory, assumptions used to determine fair value of goodwill and intangible assets, deferred tax assets and related valuation allowance, stock-based compensation, warranty and accounting for contingencies.

**Table of Contents**

Although the Company regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. The Company bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances.

**(4) Stock-Based Compensation**

The Company recognizes stock-based compensation in accordance with the provisions of Accounting Standards Codification (ASC) 718, *Compensation-Stock Based Compensation*. Stock-based compensation expense was \$851 and \$873 for the three months ended June 30, 2012 and June 30, 2011, respectively, and \$1,868 and \$1,826 for the six months ended June 30, 2012 and June 30, 2011, respectively. As of June 30, 2012, there was \$2,996 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 3.11 years. As of June 30, 2012, there was \$3,019 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 1.61 years.

The Company granted 0 and 3,340 restricted stock awards to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three and six months ended June 30, 2012, respectively. The restricted stock awards vest ratably over four years from the date of grant subject to the recipient remaining employed through the applicable vesting dates. Compensation expense for restricted stock awards is measured at fair value on the date of grant based on the number of shares granted and the quoted market closing price of the Company's common stock. Such value is recognized as expense over the vesting period of the award, net of estimated forfeitures.

The Company granted 30,161 and 432,661 stock options to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan and the Amended and Restated 2003 Incentive and Nonqualified Stock Option Plan during the three and six months ended June 30, 2012, respectively.

The fair value of stock options granted for the six months ended June 30, 2012 was estimated as of the date of grant using the Black-Scholes option-pricing model. The weighted-average fair value per share for all options granted during the six months ended June 30, 2012 and 2011 was \$4.70 and \$6.88, respectively. The weighted-average assumptions used to value options as of their grant date were as follows:

	<b>Six months ended June 30, 2012</b>
Risk-free interest rate	0.72%
Expected volatility	64.60%
Expected life (in years)	4.22
Dividend yield	0%

**(5) Net Income (Loss) per Common Share**

Basic net income (loss) per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined with the treasury stock accounting method. Common stock equivalents related to options and restricted stock awards for 1,075,765 and 582,553 shares of common stock for the three months ended June 30, 2012 and 2011, respectively, have been excluded from the fully diluted calculation of net income per share, as inclusion would be anti-dilutive. The Company has excluded all outstanding stock options and non-vested restricted shares from the calculation of diluted earnings per share for the six months ended June 30, 2012 and 2011 because the net loss causes these outstanding stock options and non-vested restricted shares to be anti-dilutive.

**Table of Contents**

A reconciliation of the basic and diluted weighted average common shares outstanding is as follows:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Weighted average common shares outstanding basic	14,776,239	14,901,495	14,690,591	14,825,091
Dilutive common shares issuable in connection with stock plans	110,309	298,405		
Weighted average common shares outstanding diluted	14,886,548	15,199,900	14,690,591	14,825,091

**Table of Contents****(6) Inventories**

Inventories are stated at the lower of cost or market using the first-in first-out costing method. Inventories as of June 30, 2012 and December 31, 2011 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Raw materials	\$ 8,690	\$ 11,039
Work in process	2,014	1,805
Finished goods	6,455	5,771
	\$ 17,159	\$ 18,615

**(7) Product Warranty**

The Company's products carry limited warranties that range from one to four years and vary by product. The warranty period begins on the date of retail purchase or lease by the original purchaser. The Company accrues estimated product warranty costs at the time of sale and any additional amounts are recorded when such costs are probable and can be reasonably estimated. Factors that affect the Company's warranty liability include the number of units sold or leased, historical and anticipated rates of warranty repairs and the cost per repair. Warranty and related costs are reflected within sales, marketing and support in the accompanying statements of operations. As of June 30, 2012 and December 31, 2011, the Company had accrued product warranty costs of \$924 and \$933, respectively. The following table summarizes product warranty activity during 2012 and 2011:

	<b>Six months ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
Beginning balance	\$ 933	\$ 887
Charges to expense	243	233
Costs incurred	(252)	(325)
Ending balance	\$ 924	\$ 795

**(8) Segment Reporting**

Under common operational management, the Company designs, develops, manufactures and markets its navigation, guidance and stabilization and mobile communications products for use in a wide variety of applications. Products are generally sold directly to third-party consumer electronic dealers and retailers, original equipment manufacturers, government contractors or to U.S. and other foreign government agencies. Primarily, sales originating in the Americas consist of sales within the United States and Canada and, to a lesser extent, Mexico and some Latin and South American countries. The Americas' sales also include all guidance and stabilization product sales throughout the world. Sales originating from the Company's European and Asian subsidiaries principally consist of sales into all European countries, both inside and outside the European Union, as well as Africa, Asia/Pacific, the Middle East and India.

The Company operates in two geographic segments, exclusively in the mobile communications, navigation and guidance and stabilization equipment industry, which it considers to be a single business activity. The Company has two primary product categories: mobile communications and guidance and stabilization. Mobile communications sales and services include marine, land mobile, automotive, and aeronautical communication equipment and satellite-based voice, television and Broadband Internet connectivity services, as well as DIRECTV account subsidies and referral fees earned in conjunction with the sale of our products. Guidance and stabilization sales and services include sales of defense-related navigation and guidance and stabilization equipment based upon digital compass and fiber optic sensor technology. Mobile communications and guidance and stabilization sales also include development contract revenue, product repairs and extended warranty

sales.

**Table of Contents**

The following table summarizes information regarding the Company's operations by geographic segment:

<b>Three months ended June 30, 2012</b>	<b>Sales Originating From</b>		
	<b>Americas</b>	<b>Europe and Asia</b>	<b>Total</b>
Mobile communications sales to the United States	\$ 16,471	\$	\$ 16,471
Mobile communications sales to Canada	217		217
Mobile communications sales to Europe	119	5,321	5,440
Mobile communications sales to other geographic areas	650	1,266	1,916
Guidance and stabilization sales to the United States	2,369		2,369
Guidance and stabilization sales to Canada	2,641		2,641
Guidance and stabilization sales to Europe	2,314		2,314
Guidance and stabilization sales to other geographic areas	651		651
Intercompany sales	3,637	626	4,263
Subtotal	29,069	7,213	36,282
Eliminations	(3,637)	(626)	(4,263)
Net sales	\$ 25,432	\$ 6,587	\$ 32,019
Segment net income (loss)	\$ 896	\$ (443)	\$ 453
Depreciation and amortization	\$ 1,012	\$ 79	\$ 1,091
Total assets	\$ 106,111	\$ 20,553	\$ 126,664

<b>Three months ended June 30, 2011</b>	<b>Sales Originating From</b>		
	<b>Americas</b>	<b>Europe and Asia</b>	<b>Total</b>
Mobile communication sales to the United States	\$ 12,969	\$	\$ 12,969
Mobile communication sales to Canada	308		308
Mobile communication sales to Europe	107	3,951	4,058
Mobile communication sales to other geographic areas	398	1,310	1,708
Guidance and stabilization sales to the United States	3,405		3,405
Guidance and stabilization sales to Canada	2,016		2,016
Guidance and stabilization sales to Europe	2,434		2,434
Guidance and stabilization sales to other geographic areas	3,674		3,674
Intercompany sales	3,039	324	3,363
Subtotal	28,350	5,585	33,935
Eliminations	(3,039)	(324)	(3,363)
Net sales	\$ 25,311	\$ 5,261	\$ 30,572
Segment net income (loss)	\$ 209	\$ (19)	\$ 190
Depreciation and amortization	\$ 994	\$ 105	\$ 1,099
Total assets	\$ 99,006	\$ 18,625	\$ 117,631

<b>Six months ended June 30, 2012</b>	<b>Sales Originating From</b>		
	<b>Americas</b>	<b>Europe and Asia</b>	<b>Total</b>
Mobile communication sales to the United States	\$ 30,593	\$	\$ 30,593
Mobile communication sales to Canada	365		365
Mobile communication sales to Europe	243	9,610	9,853
Mobile communication sales to other geographic areas	1,507	2,556	4,063



Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

Guidance and stabilization sales to the United States	3,258		3,258
Guidance and stabilization sales to Canada	5,207		5,207
Guidance and stabilization sales to Europe	4,351		4,351
Guidance and stabilization sales to other geographic areas	1,057		1,057
Intercompany sales	6,631	1,050	7,681
Subtotal	53,212	13,216	66,428
Eliminations	(6,631)	(1,050)	(7,681)
Net sales	\$ 46,581	\$ 12,166	\$ 58,747

**Table of Contents**

Three months ended June 30, 2012	Sales Originating From		
	Americas	Europe and Asia	Total
Segment net loss	\$ (375)	\$ (547)	\$ (922)
Depreciation and amortization	\$ 1,991	\$ 215	\$ 2,206
Total assets	\$ 106,111	\$ 20,553	\$ 126,664

Six months ended June 30, 2011	Sales Originating From		
	Americas	Europe and Asia	Total
Mobile communication sales to the United States	\$ 24,036	\$	\$ 24,036
Mobile communication sales to Canada	476		476
Mobile communication sales to Europe	203	7,276	7,479
Mobile communication sales to other geographic areas	757	2,010	2,767
Guidance and stabilization sales to the United States	7,383		7,383
Guidance and stabilization sales to Canada	4,312		4,312
Guidance and stabilization sales to Europe	4,259		4,259
Guidance and stabilization sales to other geographic areas	4,269		4,269
Intercompany sales	4,618	518	5,136
Subtotal	50,313	9,804	60,117
Eliminations	(4,618)	(518)	(5,136)
Net sales	\$ 45,695	\$ 9,286	\$ 54,981
Segment net loss	\$ (1,283)	\$ (61)	\$ (1,344)
Depreciation and amortization	\$ 1,996	\$ 213	\$ 2,209
Total assets	\$ 99,006	\$ 18,625	\$ 117,631

**(9) Legal Matters**

From time to time, the Company is involved in litigation incidental to the conduct of its business. In the ordinary course of business, the Company is a party to inquiries, legal proceedings and claims including, from time to time, disagreements with vendors and customers. The Company is not a party to any lawsuit or proceeding that, in management's opinion, is likely to materially harm the Company's business, results of operations, financial condition or cash flows.

**(10) Share Buyback Program**

On November 26, 2008, the Company's Board of Directors authorized a program to repurchase up to one million shares of the Company's common stock. As of June 30, 2012, 341,009 shares of the Company's common stock remain available for repurchase under the authorized program. The repurchase program is funded using the Company's existing cash, cash equivalents, marketable securities and future cash flows. Under the repurchase program, the Company, at management's discretion, may repurchase shares on the open market from time to time, in privately negotiated transactions or block transactions, or through an accelerated repurchase agreement. The timing of such repurchases depends on availability of shares, price, market conditions, alternative uses of capital, and applicable regulatory requirements. The program may be modified, suspended or terminated at any time without prior notice. The repurchase program has no expiration date. There were no other repurchase programs outstanding during the six months ended June 30, 2012 and no repurchase programs expired during the period.

The Company did not repurchase any shares of its common stock in the six months ended June 30, 2012.

**(11) Fair Value Measurements**

ASC 820, Fair Value Measurements and Disclosures, (ASC 820) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 describes three levels of inputs that may be used to measure fair value:

**Level 1:** Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. The Company's Level 1 assets are investments in money market mutual funds, government agency bonds, corporate notes, United States treasuries, and certificates of deposit.

**Table of Contents**

**Level 2:** Quoted prices for similar assets or liabilities in active markets; or observable prices that are based on observable market data, based on directly or indirectly market-corroborated inputs. The Company's Level 2 liabilities are interest rate swaps.

**Level 3:** Unobservable inputs that are supported by little or no market activity, and are developed based on the best information available given the circumstances. The Company has no Level 3 inputs.

Assets and liabilities measured at fair value are based on one or more of four valuation techniques. The four valuation techniques are as follows:

- (a) Market approach prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities
- (b) Cost approach amount that would be required to replace the service capacity of an asset (replacement cost)
- (c) Income approach techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing and excess earnings models)
- (d) The valuations of the interest rate swaps intended to mitigate the Company's interest rate risk are determined with the assistance of a third party financial institution using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each instrument. This analysis utilizes observable market-based inputs, including interest rate curves and interest rate volatility, and reflects the contractual terms of these instruments, including the period to maturity.

The following tables present financial assets and liabilities at June 30, 2012 and December 31, 2011 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy:

June 30, 2012	Total	Level 1	Level 2	Level 3	Valuation Technique
<b>Assets</b>					
Money market mutual funds	\$ 10,158	\$ 10,158	\$	\$	(a)
Government agency bonds	4,008	4,008			(a)
Corporate notes	3,686	3,686			(a)
United States treasuries	3,005	3,005			(a)
Certificates of deposit	1,925	1,925			(a)
<b>Liabilities</b>					
Interest rate swaps	\$ 553	\$	\$ 553	\$	(d)

December 31, 2011	Total	Level 1	Level 2	Level 3	Valuation Technique
<b>Assets</b>					
Government agency bonds	\$ 9,015	\$ 9,015	\$	\$	(a)
Money market mutual funds	8,818	8,818			(a)
Corporate notes	3,019	3,019			(a)
Certificates of deposit	2,701	2,701			(a)
<b>Liabilities</b>					
Interest rate swaps	\$ 510	\$	\$ 510	\$	(d)

Certain financial instruments are carried at cost on the consolidated balance sheets, which approximates fair value due to their short-term, highly liquid nature. These instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses.



**Table of Contents****(12) Business and Credit Concentrations**

Significant portions of the Company's net sales are as follows:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Net sales to foreign customers outside the U.S. and Canada	32.2%	38.8%	32.9%	34.1%
Net sales to Customer A	*	11.2%	*	*

\* Represents less than 10% of net sales in the respective period.

**(13) Recent Accounting Pronouncements**

On July 27, 2012, the Financial Accounting Standards Board issued ASU No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which allows an organization to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test for indefinite-lived intangible assets. An organization that elects to perform a qualitative assessment no longer is required to calculate the fair value of an indefinite-lived intangible asset unless it determines that it is *more likely than not* that the asset is impaired. The ASU, which applies to all public, private, and not-for-profit organizations, is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The Company is currently evaluating the impact that adoption of the guidance would have on the Company's financial statements.

**(14) Derivative Instruments and Hedging Activities**

Effective April 1, 2010, in order to reduce the volatility of cash outflows that arise from changes in interest rates, the Company entered into two interest rate swap agreements. These interest rate swap agreements are intended to hedge the Company's mortgage loan related to its headquarters facility in Middletown, Rhode Island by fixing the interest rates specified in the mortgage loan to 5.91% for half of the principal amount outstanding and 6.07% for the remaining half of the principal amount outstanding as of April 1, 2010 until the mortgage loan expires on April 16, 2019.

As required by ASC Topic 815, *Derivatives and Hedging*, the Company records all derivatives on the balance sheet at fair value. As of June 30, 2012, the fair value of the derivatives is included in other accrued liabilities and the unrealized gain is included in other comprehensive income.

As of June 30, 2012, the Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

Interest Rate Derivatives	Notional		Effective Date	Maturity Date	Index	Strike Rate
	(in thousands)	Asset (Liability)				
Interest rate swap	\$ 1,810	(268)	April 1, 2010	April 1, 2019	1-month LIBOR	5.91%
Interest rate swap	\$ 1,810	(285)	April 1, 2010	April 1, 2019	1-month LIBOR	6.07%

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Introduction**

The statements included in this quarterly report on Form 10-Q, other than statements of historical fact, are forward-looking statements. Examples of forward-looking statements include statements regarding our future financial results, operating results, business strategies, projected costs, products, competitive positions and plans, customer preferences, consumer trends, anticipated product development, and objectives of management for future operations. In some cases, forward-looking statements can be identified by terminology such as *may*, *will*, *should*, *would*, *expects*, *plans*, *anticipates*, *believes*, *estimates*, *predicts*, *potential*, *continue*, or the negative

*of these terms or other comparable terminology. Any expectations based on these forward-looking statements are subject to risks and uncertainties and other important factors, including those discussed in the section entitled "Risk Factors" in Item 1A of Part II of this quarterly report. These and many other factors could affect our future financial and operating results, and could cause actual results to differ materially from expectations based on forward-looking statements made in this document or elsewhere by us or on our behalf. For example, our expectations regarding certain items as a percentage of sales assume that we will achieve our anticipated sales goals. The following discussion and analysis should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this report.*

**Table of Contents****Overview**

We design, develop, manufacture and market mobile communications products for the marine, land mobile and aeronautical markets, and navigation, guidance and stabilization products for both the defense and commercial markets.

Our mobile communications products enable customers to receive voice and Internet services and live digital television via satellite services in marine vessels, recreational vehicles and automobiles as well as live digital television on commercial airplanes while in motion. Our CommBox offers a range of tools designed to increase communication efficiency, reduce costs, and manage network operations. We sell our mobile communications products through an extensive international network of retailers, distributors and dealers. We also lease products directly to end users.

We offer precision fiber optic gyro-based (FOG) systems that enable platform and optical stabilization, navigation, pointing and guidance. Our guidance and stabilization products also include tactical navigation systems that provide uninterrupted access to navigation and pointing information in a variety of military vehicles, including tactical trucks and light armored vehicles. Our guidance and stabilization products are sold directly to U.S. and allied governments and government contractors, as well as through an international network of authorized independent sales representatives. In addition, our guidance and stabilization products have numerous commercial applications such as precision mapping, dynamic surveying, autonomous vehicles, train location control and track geometry measurement systems, industrial robotics and optical stabilization.

Our mobile communications service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, and certain DIRECTV account subsidies and referral fees earned in conjunction with the sale of our products and extended warranty sales. We provide, for monthly fixed and usage fees, satellite connectivity services for broadband Internet, data and Voice over Internet Protocol (VoIP) service to our TracPhone V-series customers. We also earn monthly usage fees for third-party satellite connectivity for voice, data and Internet services to our Inmarsat TracPhone customers who choose to activate their subscriptions with us. Under current DIRECTV programs, we are eligible to receive a one-time payment for each DIRECTV receiver activated for service and a new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through us.

Our guidance and stabilization service sales include engineering services provided under development contracts, product repairs, and extended warranty sales.

We generate sales primarily from the sale of our mobile satellite systems and services and our guidance and stabilization products and services. The following table provides, for the periods indicated, our sales by industry category:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
	(in thousands)			
Mobile communications	\$ 24,044	\$ 19,043	\$ 44,874	\$ 34,758
Guidance and stabilization	7,975	11,529	13,873	20,223
Net Sales	\$ 32,019	\$ 30,572	\$ 58,747	\$ 54,981

We have historically derived a substantial portion of our sales from sales to customers located outside the United States. Notes 8 and 12 of the notes to the consolidated financial statements provide information regarding our sales to specific geographic regions.

**Critical Accounting Policies and Significant Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, sales and expenses, and related disclosure at the date of our financial statements. Our significant accounting policies are summarized in note 1 of the notes to the consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2011.



## Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

As described in our annual report on Form 10-K for the year ended December 31, 2011, our most critical accounting policies and estimates upon which our consolidated financial statements were prepared were those relating to revenue recognition, allowances for accounts receivable, inventories, income taxes and deferred income tax assets and liabilities, warranty, stock-based compensation, goodwill and intangible assets and contingencies. We have reviewed our policies and estimates and determined that these remain our most critical accounting policies and estimates for the quarter ended June 30, 2012.

**Table of Contents**

Readers should refer to our annual report on Form 10-K for the year ended December 31, 2011 under Management's Discussion and Analysis of Financial Condition and Results of Operation Critical Accounting Policies and Significant Estimates for descriptions of these policies and estimates.

**Results of Operations**

The following table provides, for the periods indicated, certain financial data expressed as a percentage of net sales:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
<b>Sales:</b>				
Product	65.7%	79.6%	64.9%	78.6%
Service	34.3	20.4	35.1	21.4
Net sales	100.0	100.0	100.0	100.0
<b>Cost and expenses:</b>				
Costs of product sales	39.8	44.1	40.4	43.7
Costs of service sales	21.3	16.7	21.5	18.0
Sales, marketing and support	17.3	19.6	18.5	20.3
Research and development	9.6	9.4	10.6	10.6
General and administrative	9.1	8.3	10.0	10.0
Total costs and expenses	97.1	98.1	101.0	102.6
Income (loss) from operations	2.9	1.9	(1.0)	(2.6)
Interest income	0.3	0.2	0.4	0.2
Interest expense	0.3	0.2	0.3	0.2
Other income, net	0.1	0.1	0.1	0.1
Income (loss) before income taxes	3.0	2.0	(0.8)	(2.5)
Income tax expense (benefit)	1.6	1.4	0.8	(0.1)
Net income (loss)	1.4%	0.6%	(1.6)%	(2.4)%

**Three Months Ended June 30, 2012 and 2011****Net Sales**

Product sales for the three months ended June 30, 2012 decreased \$3.3 million, or 14%, from the three months ended June 30, 2011. The decrease was primarily due to a decrease in sales of our guidance and stabilization products of approximately \$4.1 million, or 36%. Specifically, sales of our TACNAV defense products decreased \$3.4 million, or 69%. Also contributing to the decrease in sales of our guidance and stabilization products during the three months ended June 30, 2012 was a decrease in sales of our FOG products of \$0.5 million, or 8%, as compared to the three months ended June 30, 2011. We expect that our TACNAV product sales will increase significantly year-over-year during the second half of 2012, primarily due to a \$22.3 million TACNAV equipment order for the Saudi Arabian National Guard that we estimate will begin shipping in September 2012. Although we expect that TACNAV sales will continue to grow over the long term, sales on a quarter-to-quarter or year-to-year basis could continue to be very uneven. We also expect that our FOG sales will show quarterly sequential improvement during the second half of 2012, although we now expect FOG sales for the full year of 2012 will be comparable to FOG sales in 2011.

Partially offsetting the decrease in sales of our guidance and stabilization products was an increase of \$0.9 million, or 6%, in sales of our mobile communications products to \$13.8 million for the three months ended June 30, 2012 from \$12.9 million for the three months ended June 30,

## Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

2011. The increase was primarily due to an increase in sales of our marine products of \$1.1 million, or 10%, driven primarily by demand for our TracPhone V7 product as well as our new HD11 product that was released in the first quarter of 2012. Partially offsetting this increase was a decrease in our land mobile products of \$0.3 million, or 19%, as compared to the three months ended June 30, 2011. The decrease in our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market. We remain cautious about the prospects for our leisure sales as a result of ongoing challenges in the global economy.

Mobile communications product sales originating from the Americas for the three months ended June 30, 2012 decreased \$0.1 million, or 2%, as compared to the three months ended June 30, 2011. Mobile communications product sales originating from our European and Asian subsidiaries for the three months ended June 30, 2012 increased \$1.0 million, or 19%, as compared to the three months ended June 30, 2011.

---

**Table of Contents**

Service sales for the three months ended June 30, 2012 increased \$4.7 million, or 76%, to \$11.0 million from \$6.2 million for the three months ended June 30, 2011. The primary reason for the increase was a \$3.4 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase in service sales was a \$0.7 million increase in service repair services and a \$0.6 million increase in contracted engineering services driven by a TACNAV-related development effort.

***Costs of Sales***

For the three months ended June 30, 2012, costs of product sales decreased by \$0.7 million, or 5%, to \$12.7 million from \$13.5 million for the three months ended June 30, 2011. The primary reason for the decrease was the decrease in sales of our TACNAV and FOG products discussed above.

Costs of service sales increased by \$1.7 million, or 34%, to \$6.8 million for the three months ended June 30, 2012 from \$5.1 million for the three months ended June 30, 2011. The primary reason for the increase was a \$1.2 million increase in airtime costs of sales for our mini-VSAT Broadband service. Also contributing to the increase was a \$0.4 million increase in service repair and engineering services cost of sales.

Gross margin from product sales for the three months ended June 30, 2012 was 39% as compared to 45% for the three months ended June 30, 2011. The decrease in our gross margin from product sales was primarily due to the decrease in the TACNAV and FOG sales discussed above, which generally have higher margins than our mobile communications products. FOG sales during the second quarter of 2012 were also weighted toward relatively lower gross margin products. We expect the gross margin from product sales to improve during the remainder of 2012 as we begin shipments to the Saudi Arabian National Guard for TACNAV equipment, and when FOG production levels increase, which is expected to improve labor and overhead absorption for FOG products sold.

Gross margin from service sales for the three months ended June 30, 2012 increased to 38% from 18% in the year-ago period. The increase in our gross margin from service sales was primarily attributable to the increase in airtime sales for our mini-VSAT Broadband service. Gross margin for mini-VSAT Broadband service sales increased to 33% from 11% in the year-ago period. We anticipate that the gross margin percentage for mini-VSAT Broadband service for the remainder of the year will remain relatively comparable to the level of the second quarter of 2012, driven by the incremental network cost impact of our implementation of C-band coverage in June 2012 for the upcoming TracPhone V11 introduction. In 2013, we expect mini-VSAT Broadband service margins to increase primarily from increased TracPhone V11 activations and an overall increase in our customer base, but at a more modest rate than the recent year-over-year gross margin growth. Also contributing to the gross margin increase was an increase in contracted engineering and service repair services discussed above, which together had a 240 basis point improvement year-over-year. We anticipate the gross margin percentage for contracted engineering services will decrease significantly for the next several quarters as a result of the commencement of the facility and program management services portion of the Saudi Arabian National Guard TACNAV contract beginning in the third quarter of 2012. The total contract value for the services portion related to the Saudi Arabian National Guard TACNAV order is \$13.3 million. These services are estimated to be performed through 2014.

***Operating Expenses***

Sales, marketing and support expense for the three months ended June 30, 2012 decreased by \$0.4 million, or 7%, to \$5.5 million from \$6.0 million for the three months ended June 30, 2011. The primary reason for the decrease in 2012 was a \$0.5 million decrease in variable sales expense primarily as a result of a large international TACNAV order that was shipped during the second quarter of 2011. Also contributing to the decrease in 2012 was a \$0.1 million decrease in U.S.-based compensation for sales, marketing and support and a \$0.1 million decrease in warranty-related costs. Partially offsetting these decreases was a \$0.3 million increase in sales, marketing and support expense related to our Danish and Brazilian subsidiaries. As a percentage of sales, sales, marketing and support expense for the quarter ended June 30, 2012 was 17% as compared to 20% for the quarter ended June 30, 2011.

Research and development expense for the three months ended June 30, 2012 increased by \$0.2 million, or 6%, to \$3.1 million from \$2.9 million for the three months ended June 30, 2011. The primary reason for the increase in 2012 expense was a \$0.1 million increase in U.S.-based employee compensation and a \$0.1 million increase in research and development expense related to our Norwegian subsidiary. As a percentage of sales, research and development expense for the quarter ended June 30, 2012 was 10% as compared to 9% for the quarter ended June 30, 2011.

General and administrative expense for the three months ended June 30, 2012 increased by \$0.4 million, or 14%, from \$2.6 million for the three months ended June 30, 2011 to \$2.9 million for the three months ended June 30, 2012. The primary reason for the increase in 2012 expense was a \$0.3 million increase in U.S.-based employee compensation. Also contributing to the increase was a \$0.1 million increase in facility expenditures and a \$0.1 million increase in software maintenance expense. Partially offsetting these increases was a \$0.2 million decrease in legal expense. As a percentage of sales, general and administrative expense for the quarter ended June 30, 2012 was 9% as compared to 8% for

the quarter ended June 30, 2011.

We expect total operating expenses will increase sequentially on an absolute basis for the remainder of the year, but should decline as a percentage of total sales. This sequential increase will be driven largely by costs, including contracted commissions, for the execution of the Saudi Arabian National Guard TACNAV order. We currently estimate shipments will begin on this order in September 2012.

---

**Table of Contents*****Interest Income and Other Expense***

Interest income and other expense for the three months ended June 30, 2012 was \$0.1 million as compared to \$0.0 million for the three months ended June 30, 2011. The primary reason for the increase was a \$0.1 million increase in interest income on our marketable securities and other income.

***Income Tax Expense***

Income tax expense for the three months ended June 30, 2012 was \$0.5 million as compared to \$0.4 million for the three months ended June 30, 2011. The increase in income tax expense is primarily due to a \$0.4 million increase in pre-tax income. We estimate our effective tax rate for 2012 to be 45% or higher, subject to the tax effect of discrete events such as stock option exercise activity and restricted stock vesting.

**Six Months Ended June 30, 2012 and 2011*****Net Sales***

Product sales for the six months ended June 30, 2012 decreased by \$5.1 million, or 12%, to \$38.1 million from \$43.2 million for the six months ended June 30, 2011. The primary reason for the decrease in 2012 was a decrease in sales of our guidance and stabilization products of \$8.0 million, or 41%. Specifically, sales of our TACNAV defense products decreased by \$4.3 million, or 62%. Also contributing to the decrease in sales of our guidance and stabilization products during the six months ended June 30, 2012 was a decrease in sales of our FOG products of \$3.6 million, or 29%, as compared to the six months ended June 30, 2011.

Partially offsetting the decrease in sales of our guidance and stabilization products was an increase of \$2.9 million, or 13%, in sales of our mobile communications products to \$26.4 million for the six months ended June 30, 2012 from \$23.4 million for the six months ended June 30, 2011. The increase was primarily due to an increase in sales of our marine products of \$3.6 million, or 18%, driven primarily by demand for our new HD11 product that was released in the first quarter of 2012, as well as our TracPhone V3 that was released in the second quarter of 2011. Also contributing to the marine products increase was increased sales of our TracPhone V7 and HD7 products. Partially offsetting this increase was a decrease in our land mobile products of \$0.6 million, or 19%, as compared to the six months ended June 30, 2011. The decrease in our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market.

Mobile communications product sales originating from the Americas increased \$0.6 million, or 5%, from the six months ended June 30, 2012 to the six months ended June 30, 2011. Mobile communications product sales originating from our European and Asian subsidiaries increased \$2.3 million, or 25%, from the six months ended June 30, 2012 to the six months ended June 30, 2011.

Service sales for the six months ended June 30, 2012 increased \$8.9 million, or 75%, to \$20.6 million from \$11.8 million for the six months ended June 30, 2011. The primary reason for the increase was a \$5.9 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase in service sales was a \$1.6 million increase in contracted engineering services driven by a TACNAV-related development effort, a \$1.0 million increase in service repair services, and a \$0.3 million increase in Inmarsat service sales.

***Costs of Sales***

For the six months ended June 30, 2012, costs of product sales decreased by \$0.3 million, or 1%, to \$23.7 million from \$24.0 million for the six months ended June 30, 2011. The primary reason for the decrease was the decrease in sales of our TACNAV and FOG products discussed above.

Costs of service sales increased by \$2.7 million, or 28%, to \$12.6 million for the six months ended June 30, 2012 from \$9.9 million for the six months ended June 30, 2011. The primary reason for the increase was a \$2.0 million increase in airtime costs of sales for our mini-VSAT Broadband service. Also contributing to the increase was a \$0.7 million increase in service repair, engineering and Inmarsat cost of service sales.

Gross margin from product sales for the six months ended June 30, 2012 decreased to 38% from 44% in the year-ago period. The decrease in our gross margin from product sales was primarily due to the decrease in the TACNAV and FOG sales discussed above, which generally have higher margins than our mobile communications products.

Gross margin from service sales for the six months ended June 30, 2012 increased to 39% from 16% in the year-ago period. The increase in gross margin was primarily due to the increase in gross margin for mini-VSAT Broadband service sales, which increased to 31% from 8% in the

year-ago period. Also contributing to the gross margin increase was an increase in contracted engineering and service repair services discussed above, which together had a 300 basis point improvement year-over-year.

---

**Table of Contents*****Operating Expenses***

Sales, marketing and support expense for the six months ended June 30, 2012 decreased by \$0.3 million, or 3%, to \$10.9 million from \$11.2 million for the six months ended June 30, 2011. The primary reason for the decrease in 2012 was a \$0.5 million decrease in variable sales expense primarily as a result of a large international TACNAV order that was shipped during the second quarter of 2011. Also contributing to the decrease in 2012 was a \$0.3 million decrease in U.S.-based compensation for sales, marketing and support and a \$0.1 million decrease in Norwegian-based compensation for sales, marketing and support. Partially offsetting these decreases was a \$0.5 million increase in sales, marketing and support expense related to our Danish, Brazilian and Singaporean subsidiaries. As a percentage of sales, sales, marketing and support expense decreased during the six months ended June 30, 2012 to 19% from 20% for the six months ended June 30, 2011.

Research and development expense for the six months ended June 30, 2012 increased by \$0.3 million, or 6%, to \$6.2 million from \$5.9 million for the six months ended June 30, 2011. The primary reason for the increase in 2012 expense was a \$0.3 million increase in research and development expense related to our Norwegian subsidiary. As a percentage of sales, research and development expense for the six months ended June 30, 2012 was 11%, which was consistent with the six months ended June 30, 2011.

General and administrative expense for the six months ended June 30, 2012 increased by \$0.4 million, or 7%, to \$5.9 million from \$5.5 million for the six months ended June 30, 2011. The primary reason for the increase in 2012 expense was a \$0.3 million increase in facility expenditures. Also contributing to the increase was a \$0.2 million increase in U.S.-based employee compensation, a \$0.2 million increase in software maintenance expense and equipment lease expense, and a \$0.1 million increase in recruiting expense. Partially offsetting these increases was a \$0.4 million decrease in legal expense. As a percentage of sales, general and administrative expense for the six months ended June 30, 2012 was 10%, which was consistent with the six months ended June 30, 2011.

***Interest Income and Other Expense***

Interest income and other expense for the six months ended June 30, 2012 was \$0.1 million as compared to \$0.0 million for the six months ended June 30, 2011. The primary reason for the increase was a \$0.1 million increase in interest income on our marketable securities and other income.

***Income Tax Expense (Benefit)***

Income tax expense (benefit) for the six months ended June 30, 2012 decreased by \$0.5 million to a \$0.5 million tax expense from a \$0.1 million tax benefit for the six months ended June 30, 2011. The increase in income tax expense is primarily due to \$0.4 million of income tax expense associated with tax shortfalls for non-qualified stock options expirations, as well as shortfalls associated with restricted stock awards vesting during the six months ended June 30, 2012. Also contributing to the increase in income tax expense was a \$1.0 million reduction in pre-tax loss.

***Backlog***

Backlog is not a meaningful indicator for predicting revenue in future periods. Commercial resellers for our mobile satellite communications products and legacy products do not carry extensive inventories and rely on us to ship products quickly. Generally due to the rapid delivery of our commercial products, our backlog for those products is not significant.

Our backlog for all products and services was approximately \$59.8 million and \$22.1 million on June 30, 2012 and December 31, 2011, respectively. The increase in backlog of \$37.7 million from December 31, 2011 was primarily a result of a \$35.6 million order for TACNAV products and services received in June 2012 for the Saudi Arabian National Guard. Product shipments for this order are estimated to begin in September 2012.

Backlog consists of orders evidenced by written agreements and specified delivery dates for customers who are acceptable credit risks. We do not include satellite connectivity service sales in our backlog even though many of our satellite connectivity customers have signed annual service contracts providing for a fixed monthly fee. Military orders included in backlog are generally subject to cancellation for the convenience of the customer. When orders are cancelled, we generally recover actual costs incurred through the date of cancellation and the costs resulting from termination. As of June 30, 2012, our backlog included approximately \$15.7 million in orders that are subject to cancellation for convenience by the customer. Individual orders for guidance and stabilization products are often large and may require procurement of specialized long-lead components and allocation of manufacturing resources. The complexity of planning and executing larger orders generally requires customers to order well in advance of the required delivery date, resulting in backlog.





---

**Table of Contents*****Liquidity and Capital Resources***

We have historically funded our operations primarily from operating cash flows, net proceeds from public and private equity offerings, bank financings and proceeds received from exercises of stock options. As of June 30, 2012, we had \$31.0 million in cash, cash equivalents, and marketable securities, of which \$1.0 million, \$0.4 million and \$1.8 million in cash equivalents were held in a local currency by our foreign subsidiaries located in Denmark, Brazil and Norway, respectively. There were no marketable securities held by our foreign subsidiaries as of June 30, 2012. As of June 30, 2012, we had \$56.3 million in working capital.

Net cash provided by operations was \$6.8 million for the six months ended June 30, 2012 as compared to net cash used in operations of \$0.8 million for the six months ended June 30, 2011. The increase is primarily due to a \$5.2 million increase in cash inflows attributable to accounts receivable. Also contributing to the increase was a decrease in cash outflows of approximately \$4.0 million as a result of decreased inventory levels as well as a \$0.4 million decrease in net loss. The increase in cash inflows was partially offset by an increase in cash outflows of approximately \$2.5 million related to accounts payable and accrued expenses and a \$0.4 million increase in cash outflows related to prepaid expenses.

Net cash used in investing activities was \$3.8 million for the six months ended June 30, 2012 as compared to net cash provided by investing activities of \$1.5 million for the six months ended June 30, 2011. The increase in cash outflows is due to a \$0.6 million increase in capital expenditures primarily related to the completion of the construction of our new manufacturing facility in Middletown, Rhode Island as well as a \$4.7 million increase in our net investment in marketable securities. We currently expect that capital expenditures for the year will be between \$7.0 million to \$8.0 million, including the purchase of three hubs for our C-band network.

Net cash used in financing activities was \$1.7 million for the six months ended June 30, 2012 compared to cash provided by financing activities of \$0.1 million for the six months ended June 30, 2011. The increase in cash used in financing activities is primarily due to payments of \$2.0 million on our line of credit.

On April 6, 2009, we entered into a mortgage loan in the amount of \$4.0 million related to our headquarters facility in Middletown, Rhode Island. The loan term is 10 years, with a principal amortization of 20 years, and the interest rate will be a rate per year adjusted periodically based on a defined interest period equal to the BBA LIBOR Rate plus 2.25 percentage points. On June 9, 2011, we entered into an amendment to the mortgage loan, providing for an adjustment of the interest rate from the BBA LIBOR Rate plus 2.25 percentage points to the BBA LIBOR Rate plus 2.00 points. Land, building and improvements with an approximate carrying value of \$4.4 million as of June 30, 2012 secure the mortgage loan. The monthly mortgage payment is approximately \$11,100 plus interest and increases in increments of approximately \$600 each year throughout the life of the mortgage. Due to the difference in the term of the loan and amortization of the principal, a balloon payment of \$2.6 million is due on April 1, 2019. The loan contains one financial covenant, a Fixed Charge Coverage Ratio, which applies in the event that our consolidated cash, cash equivalents and marketable securities balance falls below \$25.0 million at any time. As our consolidated cash, cash equivalents, and marketable securities balance was above \$25.0 million throughout the six months ended June 30, 2012, the Fixed Charge Coverage Ratio did not apply. Under the mortgage loan we may prepay our outstanding loan balance subject to certain early termination charges as defined in the mortgage loan agreement. If we were to default on our mortgage loan, the land, building and improvements would be used as collateral. As discussed in note 14 to the consolidated financial statements, effective April 1, 2010, in order to reduce the volatility of cash outflows that arise from changes in interest rates, we entered into two interest rate swap agreements that are intended to hedge our mortgage interest obligations by fixing the interest rates specified in the mortgage loan to 5.91% for half of the principal amount outstanding and 6.07% for the remaining half of the principal amount outstanding as of April 1, 2010 until the mortgage loan expires on April 16, 2019.

We currently have a revolving loan agreement with a bank that provides for a maximum available credit of \$15.0 million and will expire on December 31, 2014. We pay interest on any outstanding amounts at a rate equal to the BBA LIBOR Daily Floating Rate plus 1.25%. The line of credit contains two financial covenants, a Liquidity Covenant, which requires us to maintain at least \$20.0 million in unencumbered liquid assets, as defined in the loan agreement, and a Fixed Charge Coverage Ratio. As of June 30, 2012, we were not in default of either covenant. Subject to the terms of the agreement and so long as no event of default has occurred, until September 30, 2012, we have the option of converting up to \$12.0 million of revolving loans into one or more term loans at a floating interest rate equal to LIBOR plus 1.75%. We may terminate the loan agreement prior to its full term without penalty; provided we give 30 days advance written notice to the bank. As of June 30, 2012, we had \$7.0 million outstanding under the facility, the repayment of which is due no later than the maturity date of December 31, 2014.

On November 26, 2008, our Board of Directors authorized a program to repurchase up to one million shares of our common stock. The share repurchase program is funded using our existing cash, cash equivalents, marketable securities and future cash flows. As of June 30, 2012, 341,009 shares of our common stock remain available for repurchase under the program. We did not purchase any shares of our common stock in the six months ended June 30, 2012.



**Table of Contents**

It is our intent to continue to invest in the mini-VSAT Broadband network on a global basis in cooperation with ViaSat under the terms of a 10-year agreement announced in July 2008. As part of this arrangement, we agreed to acquire satellite capacity from Ku-band satellite operators. In addition, we have recently entered into a five-year agreement to lease C-band satellite capacity from a satellite operator. We are contractually committed to purchase three hubs by June 2013 to support this C-band service, although we currently plan to complete the purchase of these hubs during the second half of 2012. The total cost of the five-year satellite capacity agreement, the hubs, and teleport services is approximately \$12.2 million, of which approximately 22% relates to the cost of the hubs. Each satellite hub represents a substantial capital investment. As part of the future potential capacity expansion, we would plan to seek to acquire additional satellite capacity from satellite operators, expend funds to seek regulatory approvals and permits, develop product enhancements in anticipation of the expansion, and hire additional personnel. We anticipate these costs will be funded by cash, cash equivalents and marketable securities on hand, as well as cash flows from operations.

In April 2011, we began construction of a new manufacturing facility near our Middletown location. The construction is complete. Our net borrowings on our line of credit as of June 30, 2012 were \$7.0 million.

We believe that the \$31.0 million we hold in cash, cash equivalents and marketable securities, together with our other existing working capital and cash flows from operations, will be adequate to meet planned operating and capital requirements through at least the next twelve months. However, as the need or opportunity arises, we may seek to raise additional capital through public or private sales of securities or through additional debt financing. There are no assurances that we will be able to obtain any additional funding or that such funding will be available on terms acceptable to us.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our primary market risk exposure is in the area of foreign currency exchange risk. We are exposed to currency exchange rate fluctuations related to our subsidiary operations in Denmark, Norway, Brazil and Singapore. Certain transactions in these locations are made in the local currency, yet are reported in the U.S. dollar, the functional currency. For foreign currency exposures existing at June 30, 2012, a 10% unfavorable movement in the foreign exchange rates for our subsidiary locations would not expose us to material losses in earnings or cash flows.

From time to time, we purchase foreign currency forward contracts generally having durations of no more than five months. These forward contracts are intended to offset the impact of exchange rate fluctuations on cash flows of our foreign subsidiaries. Foreign exchange contracts are accounted for as cash flow hedges and are recorded on the balance sheet at fair value until executed. Changes in the fair value are recognized in earnings. We did not enter into any such contracts during the six months ended June 30, 2012.

The primary objective of our investment activities is to preserve principal and maintain liquidity, while at the same time maximize income. We have not entered into any instruments for trading purposes. Some of the securities that we invest in may have market risk. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities that can include United States treasuries, certificates of deposit, investment grade asset-backed corporate securities, money market mutual funds and government agency and non-government debt securities. As of June 30, 2012, a hypothetical 100 basis-point increase in interest rates would have resulted in an immaterial decrease in the fair value of our investments that had maturities of greater than one year. Due to the conservative nature of our investments and the relatively short duration of their maturities, we believe interest rate risk is substantially mitigated. As of June 30, 2012, 77% of the \$22.8 million classified as available-for-sale marketable securities will mature or reset within one year. Accordingly, long-term interest rate risk is not considered material. We did not invest in any financial instruments denominated in foreign currencies as of June 30, 2012.

To the extent that we borrow against our variable-rate credit facility, we will be subject to interest rate risk, as we will pay interest on any outstanding amounts at a rate equal to the BBA LIBOR Daily Floating Rate plus 1.25%. There was \$7.0 million in borrowings outstanding under this facility at June 30, 2012.

As previously discussed in note 14 to the consolidated financial statements, effective April 1, 2010, in order to reduce the volatility of cash outflows that arise from changes in interest rates, we entered into two interest rate swap agreements. These interest rate swap agreements are intended to hedge our mortgage loan related to our headquarters facility in Middletown, Rhode Island by fixing the interest rates specified in the mortgage loan to 5.91% for half of the principal amount outstanding and 6.07% for the remaining half of the principal amount outstanding as of April 1, 2010 until the mortgage loan expires on April 16, 2019.

**ITEM 4. CONTROLS AND PROCEDURES**  
*Evaluation of Disclosure Controls and Procedures*

## Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, which are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our President, Chief Executive Officer and Chairman of the Board, or CEO, and Chief Financial and Accounting Officer, or CFO, as appropriate to allow timely decisions regarding required disclosure.

**Table of Contents**

Under the supervision and with the participation of our CEO and CFO, our management has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this interim report. Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of June 30, 2012.

***Evaluation of Changes in Internal Control over Financial Reporting***

Under the supervision and with the participation of our CEO and CFO, our management has evaluated our internal control over financial reporting during the second quarter of 2012. Based on that evaluation, our CEO and CFO did not identify any change in our internal control over financial reporting during the second quarter of 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

From time to time, we are involved in litigation incidental to the conduct of our business. In the ordinary course of business, we are a party to inquiries, legal proceedings and claims including, from time to time, disagreements with vendors and customers. We are not a party to any lawsuit or proceeding that, in our opinion, is likely to materially harm our business, results of operations, financial condition or cash flows.

**ITEM 1A. Risk Factors**

*An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors in evaluating our business. If any of these risks, or other risks not presently known to us or that we currently believe are not significant, develops into an actual event, then our business, financial condition and results of operations could be adversely affected. If that happens, the market price of our common stock could decline.*

**Our revenues and results of operations have been and may continue to be adversely impacted by worldwide economic turmoil, credit tightening, high fuel prices and associated declines in consumer spending.**

Worldwide economic conditions have experienced a significant downturn over the last several years, including slower economic activity, tightened credit markets, inflation and deflation concerns, increased fuel prices, decreased consumer confidence, reduced corporate profits, reduced or canceled capital spending, adverse business conditions and liquidity concerns. These conditions make it difficult for businesses, governments and consumers to accurately forecast and plan future activities. Many governments are experiencing significant deficits that may cause them to curtail spending significantly or reallocate funds away from defense programs. For example, sales of our TACNAV and FOG products (which include same non-defense related FOG sales) declined 62% and 29%, respectively, from the six months ended June 30, 2011 to the six months ended June 30, 2012. There can be no assurances that government responses to the disruptions in the economy will remedy these problems. As a result of these and other factors, customers could slow or suspend spending on our products and services. We may also incur increased credit losses and need to increase our allowance for doubtful accounts, which would have a negative impact on our earnings and financial condition. We cannot predict the timing, duration or ultimate impact of this downturn. We expect our business to continue to be adversely impacted by this downturn.

Net sales of many of our mobile communications products are largely generated by discretionary consumer spending, and demand for these products may demonstrate slower growth or decline as a result of continuing weak regional and global economic conditions. Consumer spending tends to decline during recessionary periods and may decline at other times. Some consumers have chosen not to purchase our mobile communications products due to a perception that they are luxury items, and this could continue. As global and regional economic conditions change, including the general level of interest rates, fluctuating oil prices and demand for durable consumer products, demand for our products could continue to be materially and adversely affected.

**Our results of operations could be adversely affected if unseasonably cold weather, prolonged winter conditions, disasters or similar events occur.**

Our marine leisure business is highly seasonal and seasonality can also impact our commercial marine business. We historically have generated the majority of our marine leisure product revenues during the first and second quarters of each year, and these revenues typically decline in the third and fourth quarters of each year, compared to the first two quarters. Temporary suspensions of our airtime services typically increase in the third and fourth quarters of each year as boats are placed out of service during winter months. Our marine leisure business is also significantly affected by the weather. Unseasonably cool weather, prolonged winter conditions, hurricanes, unusual amounts of rain, and natural and other disasters may decrease boating, which could reduce our revenues. Specifically, we may encounter a decrease in new airtime activations as well as an increase in the number of cancellations or temporary suspensions of our airtime service.

**We expect that we could derive an increasing portion of our revenues from commercial leases of mobile communications equipment, rather than sales, which could increase our credit and collection risk.**

We are actively seeking to increase revenues from the commercial markets for our mini-VSAT Broadband service, particularly shipping companies and other companies that deploy a fleet of vessels. In marketing this service, we offer leasing arrangements for the TracPhone antennas to both commercial and leisure customers. If commercial leases become increasingly popular with our customers, we could face

increased risks of default under those leases. Defaults could increase our costs of collection (including costs of retrieving leased equipment) and reduce the amount we collect from customers, which could harm our results of operations.



## **Table of Contents**

### **Changes in the competitive environment or supply chain issues may require inventory write-downs.**

From time to time, we have recorded significant inventory reserves and/or inventory write-offs as a result of substantial declines in customer demand. Market or competitive changes could lead to future charges for excess or obsolete inventory, especially if we are unable to appropriately adjust the supply of material from our vendors.

### **Adverse economic conditions could result in financial difficulties or bankruptcy for any of our suppliers, which could adversely affect our business and results of operations.**

The significant downturn in worldwide economic conditions and credit tightening could present challenges to our suppliers, which could result in disruptions to our business, increase our costs, delay shipment of our products and impair our ability to generate and recognize revenue. To address their own business challenges, our suppliers may increase prices, reduce the availability of credit, require deposits or advance payments or take other actions that may impose a burden on us.

They may also reduce production capacity, slow or delay delivery of products, face challenges meeting our specifications or otherwise fail to meet our requirements. In some cases, our suppliers may face bankruptcy. We may be required to identify, qualify and engage new suppliers, which would require time and the attention of management. Any of these events could impair our ability to deliver our products to customers in a timely and cost-effective manner, cause us to breach our contractual commitments or result in the loss of customers.

### **Shifts in our product sales mix toward our mobile communications products may reduce our overall gross margins.**

Our mobile communications products historically have had lower product gross margins than our guidance and stabilization products. In 2011, we experienced a 14% year-over-year decline in sales of our guidance and stabilization products and we have experienced a 41% year-over-year decline in guidance and stabilization product sales during the first half of 2012. A shift in our product sales mix towards mobile communications products would likely cause lower gross margins in the future, especially if driven by reduced demand.

### **We must generate a certain level of sales of the TracPhone V3, V7 and V11 and our mini-VSAT Broadband service in order to improve our service gross margins.**

As a result of our mini-VSAT Broadband network infrastructure, our cost of service sales includes certain fixed costs that do not generally vary with the volume of service sales, and we have almost no ability to reduce these fixed costs in the short term. These fixed costs will increase if we further expand our network to accommodate additional subscriber demand and/or coverage area expansion. For example, we recently entered into a five-year agreement to lease additional satellite capacity as well as an agreement to purchase three additional hubs in connection with the offering of our new C-band service at a total cost of approximately \$12.2 million. If sales of our TracPhone V3, V7 and V11 and the mini-VSAT Broadband service do not generate the level of revenue that we expect or decline, our service gross margins may remain below historical levels or decline. The failure to improve our mini-VSAT Broadband service gross margins would have a material adverse effect on our overall profitability.

### **Competition may limit our ability to sell our mobile communications products and guidance and stabilization products.**

The mobile communications markets and defense navigation, guidance and stabilization markets in which we participate are very competitive, and we expect this competition to persist and intensify in the future. We may not be able to compete successfully against current and future competitors, which could impair our ability to sell our products. For example, improvements in the performance of lower cost gyros by competitors could potentially jeopardize sales of our fiber optic gyros. Foreign competition for our mobile satellite communications products has continued to intensify, most notably from companies that seek to compete primarily on price. We anticipate that this trend of substantial competition will continue.

In the market for marine satellite TV equipment, we compete with Intellian, Cobham Sea Tel, Inc., Raymarine, NaviSystem Marine Electronic Systems Srl, King Controls, and Thrane & Thrane A/S.

In the marine market for voice, fax, data and Internet communications equipment and services, we compete with Cobham Sea Tel, Inc., Thrane & Thrane A/S, Furuno Electric Co., Ltd., Globalstar LP, Iridium Satellite LLC, Intellian, Ship Equip and JRC. We also face competition from providers of marine satellite data services and maritime VSAT solutions, including Inmarsat/ShipEquip/Stratos, MTN/SeaMobile, Speedcast, CapRock, Schlumberger, and Vizada/Marlink.

In the market for land mobile satellite TV equipment, we compete with MotoSAT, King Controls, Cobham TracStar and Winegard Company.

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

In the guidance and stabilization markets, we compete primarily with Honeywell International Inc., Kearfott Guidance & Navigation Corporation, Northrop Grumman Corporation, Goodrich Aerospace, IAI, Fizoptica, SAGEM and Systron Donner Inertial.

---

## **Table of Contents**

Among the factors that may affect our ability to compete in our markets are the following:

many of our primary competitors are well-established companies that could have substantially greater financial, managerial, technical, marketing, personnel and other resources than we do;

product improvements, new product developments or price reductions by competitors may weaken customer acceptance of, and reduce demand for, our products;

new technology or market trends may disrupt or displace a need for our products; and

our competitors may have lower production costs than we do, which may enable them to compete more aggressively in offering discounts and other promotions.

**The emergence of a competing small maritime VSAT antenna and complementary service or other similar service could reduce the competitive advantage we believe we currently enjoy with our 24-inch diameter TracPhone V7 and 14.5-inch diameter TracPhone V3 antennas along with our integrated Ku-band mini-VSAT Broadband service, or with our C/Ku-band mini-VSAT Broadband service and our new TracPhone V11.**

Our TracPhone V3 and V7 systems offer customers a range of benefits due to their integrated design, hardware costs that are lower than existing maritime Ku-band VSAT systems, and spread spectrum technology. We currently compete against companies that offer established maritime Ku-band VSAT service using, in some cases, antennas 1-meter in diameter or larger. While we are unaware of any company offering a 14.5-inch VSAT solution comparable to our TracPhone V3, we are encountering regional competition from companies offering 24-inch VSAT systems and services. Likewise, our TracPhone V11 will be approximately 85% smaller and lighter than competing C-band maritime VSAT systems, which uses antennas in excess of 2.4m in diameter to provide similar global services. We are unaware of any competitor currently offering a similar size solution for global C-band coverage, but any introduction of such a product could adversely impact our success. In addition, other companies could replicate some of the distinguishing features of our TracPhone V3, V7 or V11, which could potentially reduce the appeal of our solution, increase price competition and adversely affect sales. Moreover, consumers may choose other services such as FleetBroadband or Iridium OpenPort for their service coverage and potentially lower hardware costs despite higher service costs and slower data rates. Finally, it is possible that sales of our TracPhone V3 antennas will reduce sales of our TracPhone V7 antennas.

**Our ability to compete in the maritime airtime services market may be impaired if we are unable to provide sufficient service capacity to meet customer demand.**

The TracPhone V3, V7, and V11 and our mini-VSAT Broadband service offer a range of benefits to mariners, especially in commercial markets, due to the smaller size antenna and faster, more affordable airtime. We have completed the rollout of our original network coverage plan and currently offer service in the Americas, Europe, the Middle East, Africa, Asia-Pacific, and Australian and New Zealand waters. In the future, we may need to expand capacity in existing coverage areas to support an expanding subscriber base. If we are unable to reach agreement with third-party satellite providers to support the mini-VSAT Broadband service and its spread spectrum technology or transponder capacity is unavailable should we need to increase our capacity to meet growing demand in a given region, our ability to support vessels and aeronautical applications globally will be at risk and could reduce the attractiveness of the product and service to these customers.

**The purchasing and delivery schedules and priorities of the U.S. military and foreign governments are often unpredictable.**

We sell our fiber optic gyro systems as well as vehicle navigation products to U.S. and foreign military and government customers, either directly or as a subcontractor to other contractors. These customers often use a competitive bidding process and have unique purchasing and delivery requirements, which often makes the timing of sales to these customers unpredictable. Factors that affect their purchasing and delivery decisions include:

increasing budgetary pressures that may reduce funding for military programs;

changes in modernization plans for military equipment;

changes in tactical navigation requirements;

global conflicts impacting troop deployment, including troop withdrawals from the Middle East;

priorities for current battlefield operations;

new military and operational doctrines that affect military equipment needs;

sales cycles that are long and difficult to predict;

shifting response time and/or delays in the approval process associated with the export licenses we must obtain prior to the international shipment of certain of our military products;

delays in military procurement schedules; and

delays in the testing and acceptance of our products, including delays resulting from changes in customer specifications.

---

**Table of Contents**

These factors can cause substantial fluctuations in sales of our TACNAV and FOG products from period to period. For example, sales of our FOG products increased \$11.4 million, or 39%, from 2009 to 2010 driven largely by increased sales for commercial applications, such as surveying and optical stabilization, and a range of government and defense applications, including weapons stabilization. However, sales of our FOG products decreased \$17.9 million, or 44%, from 2010 to 2011 and both TACNAV and FOG sales have continued to decline significantly during the first half of 2012. The Obama administration and Congress may change defense spending priorities, either in conjunction with troop withdrawals from Iraq and Afghanistan or for other reasons, including efforts to reduce the deficit. Moreover, government customers such as the U.S. Coast Guard and their contractors can generally cancel orders for our products for convenience or decline to exercise previously disclosed contract options. Even under firm orders with government customers, funding must often be appropriated in the budget process in order for the government to complete the contract. The cancellation of or failure to fund orders for our products could further reduce our net sales and results of operations.

**Sales of our fiber optic gyro systems and TACNAV products generally consist of a few large orders, and the delay or cancellation of a single order could substantially reduce our net sales.**

KVH products sold to customers in the defense industry are purchased through orders that can generally range in size from several hundred thousand dollars to more than one million dollars. For example, in October 2011, we received an \$8.6 million TACNAV products order and in December 2011, we received a \$2.5 million and a \$7.6 million fiber optic gyro products order. In addition, we received a \$2.8 million TACNAV products order as well as a \$35.6 million TACNAV products and services order in June 2012. Orders of this size are often unpredictable and difficult to replicate. As a result, the delay or cancellation of a single order could materially reduce our net sales and results of operations. We periodically experience repeated and unanticipated delays in defense orders, which make our revenues and operating results less predictable. Because our guidance and stabilization products typically have relatively higher product gross margins than our mobile communications products, the loss of an order for guidance and stabilization products could have a disproportionately adverse effect on our results of operations.

**Only a few customers account for a substantial portion of our guidance and stabilization revenues, and the loss of any of these customers could substantially reduce our net sales.**

We derive a significant portion of our guidance and stabilization revenues from a small number of customers, most of whom are contractors for the U.S. Government. The loss of business from any of these customers could substantially reduce our net sales and results of operations and could seriously harm our business. Since we are often awarded a contract as a subcontractor to a major defense supplier that is engaged in a competitive bidding process as prime contractor for a major weapons procurement program, our revenues depend significantly on the success of the prime contractors with which we align ourselves.

**Our mobile satellite products currently depend on satellite services and facilities provided by third parties, and a disruption in those services could adversely affect sales.**

Our satellite products include only the equipment necessary to utilize satellite services; we do not broadcast satellite television programming or own the satellites to directly provide two-way satellite communications. We currently offer satellite television products compatible with the DIRECTV and DISH Network services in the United States, the Bell TV service in Canada, the Sky Mexico service and various other regional satellite TV services in other parts of the world.

SES, Eutelsat, Sky Perfect-JSAT, GE Satellite, Telesat, EchoStar, Intelsat and Star One currently provide the satellite capacity to support the mini-VSAT Broadband service and our TracPhone V3, V7 and V11. In addition, we have agreements with various teleports and internet service providers around the globe to support the mini-VSAT Broadband service. We rely on Inmarsat for satellite communications services for our mini-M, Fleet and FleetBroadband compatible TracPhone products.

If customers become dissatisfied with the programming, pricing, service, availability or other aspects of any of these satellite services, or if any one or more of these services becomes unavailable for any reason, we could suffer a substantial decline in sales of our satellite products. There may be no alternative service provider available in a particular geographic area, and our modem or other technology may not be compatible with the technology of any alternative service provider that may be available. In addition, the unexpected failure of a satellite could disrupt the availability of programming and services, which could reduce the demand for, or customer satisfaction with, our products.

**We rely upon spread spectrum communications technology developed by ViaSat and transmitted by third-party satellite providers to permit two-way broadband Internet via our 24-inch diameter TracPhone V7 antenna, our 14.5-inch diameter TracPhone V3 antenna, and our 1-meter diameter TracPhone V11, and any disruption in the availability of this technology could adversely affect sales.**

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

Our mini-VSAT Broadband service relies on spread spectrum technology developed with ViaSat, Inc., for use with satellite capacity controlled by SES, Eutelsat, Sky Perfect-JSAT, GE Satellite, Telesat, Echostar, Intelsat and Star One. Our TracPhone two-

---

## **Table of Contents**

way broadband satellite terminals combines our stabilized antenna technology with ViaSat's ArcLight spread spectrum mobile broadband technology, along with ViaSat's ArcLight spread spectrum modem. The ArcLight technology is also integrated within the satellite hubs that support this service. Sales of the TracPhone V3, V7 and V11 and our mini-VSAT Broadband service could be disrupted if we fail to receive approval from regulatory authorities to provide our spread spectrum service in the waters of various countries where our customers operate or if there are issues with the availability of the ArcLight maritime modems.

**Deployment of our mini-VSAT Broadband service has required significant capital investment and initial network costs of service, as well as operating expenses that may not be recouped if we fail to meet the subscriber levels necessary to cover those costs on an ongoing basis.**

It is our intent to continue to invest in our mini-VSAT Broadband network in cooperation with ViaSat under the terms of a 10-year agreement announced in July 2008. As part of this arrangement, we agreed to acquire satellite capacity from Ku-band satellite operators. In addition, we have agreed to acquire satellite capacity from a C-band satellite operator. We are contractually committed to purchase three hubs by June 2013 to support this C-band service, although we currently plan to complete the purchase of these hubs during the second half of 2012. Each satellite hub represents a substantial capital investment. During the initial deployment period, we incurred a substantial increase in costs associated with the build out of the mini-VSAT Broadband global infrastructure and support capability and may continue to incur additional costs if we pursue expanded coverage in the future. As the network deployment progressed, KVH and ViaSat covered the operational cost per transponder access as new subscribers joined the network. Although we have made progress toward achieving acceptable gross margins, we may not reach our longer-term objectives if we do not continue to increase subscriber levels to the point necessary to cover our operational costs on an ongoing basis. We estimate that, on average, it requires at least nine months to reach the breakeven point for a discrete region, i.e., offsetting these incremental network costs, once the service is turned on for a new coverage region. However, certain regions that are essential for our global coverage may exceed this time period before being profitable or may not be profitable. In addition, should an insufficient number of subscribers activate within a region, our operations may continue below the breakeven level for a longer duration and adversely affect our operating results and cash levels.

**High fuel prices, tight credit availability, environmental concerns and ongoing low levels of consumer confidence are adversely affecting sales of our mobile satellite TV products.**

Factors such as high fuel prices, tight credit, environmental protection laws and ongoing low levels of consumer confidence can materially and adversely affect sales of larger vehicles and vessels for which our mobile satellite TV products are designed. Many customers finance their purchases of these vehicles and vessels, and tightened credit availability can reduce demand for both these vehicles and vessels and our mobile satellite TV products. Moreover, in the current credit markets, financing for these purchases has sometimes been unavailable or more difficult to obtain. The increased cost of operating these vehicles and vessels can adversely affect demand for our mobile satellite TV products.

**We may continue to increase the use of international suppliers to source components for our manufacturing operations, which could disrupt our business.**

Although we have historically manufactured and sourced raw materials for the majority of our products domestically, in order for us to compete with lower priced competitive products while also improving our profitability, we have found it desirable to source raw materials and manufactured components and assemblies from Europe, Asia and South America. Our increased reliance on foreign manufacturing and/or raw material supply has lengthened our supply chain and increased the risk that a disruption in that supply chain could have a material adverse affect on our operations and financial performance.

**We have single dedicated manufacturing facilities for each of our mobile communications and guidance and stabilization product categories, and any significant disruption to a facility could impair our ability to deliver our products.**

Excluding the CommBox product, which we manufacture in Norway, we currently manufacture all of our mobile communications products at our headquarters in Middletown, Rhode Island, and the majority of our guidance and stabilization products at our facility in Tinley Park, Illinois. Some of our production processes are complex, and we may be unable to respond rapidly to the loss of the use of either production facility. For example, our production facilities use some specialized equipment that may take time to replace if they are damaged or become unusable for any reason. In that event, shipments would be delayed, which could result in customer or dealer dissatisfaction, loss of sales and damage to our reputation. Finally, we have only a limited capability to increase our manufacturing capacity in the short term. If short-term demand for our products exceeds our manufacturing capacity, our inability to fulfill orders in a timely manner could also lead to customer or dealer dissatisfaction, loss of sales and damage to our reputation.

**We depend on sole or limited source suppliers, and any disruption in supply could impair our ability to deliver our products on time or at expected cost.**

We obtain many key components for our products from third-party suppliers, and in some cases we use a single or a limited number of suppliers. Any interruption in supply could impair our ability to deliver our products until we identify and qualify a new



---

## **Table of Contents**

source of supply, which could take several weeks, months or longer and could increase our costs significantly. Suppliers might change or discontinue key components, which could require us to modify our product designs. For example, in the past, we have experienced changes in the chemicals used to coat our optical fiber, which changed its characteristics and thereby necessitated design modifications. In general, we do not have written long-term supply agreements with our suppliers but instead purchase components through purchase orders, which expose us to potential price increases and termination of supply without notice or recourse. It is generally not our practice to carry significant inventories of product components, and this could magnify the impact of the loss of a supplier. If we are required to use a new source of materials or components, it could also result in unexpected manufacturing difficulties and could affect product performance and reliability. In addition, from time to time, lead times for certain components can increase significantly due to imbalances in overall market supply and demand. This, in turn, could limit our ability to satisfy the demand for certain of our products on a timely basis, and could result in some customer orders being rescheduled or cancelled.

### **Any failure to maintain and expand our third-party distribution relationships may limit our ability to penetrate markets for mobile communications products.**

We market and sell our mobile communications products through an international network of independent retailers, chain stores and distributors, as well as to manufacturers of marine vessels and recreational vehicles. If we are unable to maintain or improve our distribution relationships, it could significantly limit our sales. Some of our distribution relationships are new, and our new distributors may not be successful in marketing and selling our products and services. In addition, our distribution partners may sell products of other companies, including competing products, and are generally not required to purchase minimum quantities of our products.

### **If we are unable to improve our existing mobile communications and guidance and stabilization products and develop new, innovative products, our sales and market share may decline.**

The markets for mobile communications products and guidance and stabilization products are each characterized by rapid technological change, frequent new product innovations, changes in customer requirements and expectations, and evolving industry standards. If we fail to make innovations in our existing products and reduce the costs of our products, our market share may decline. Products using new technologies, or emerging industry standards, could render our products obsolete. If our competitors successfully introduce new or enhanced products that eliminate technological advantages our products may have in a market or otherwise outperform our products, or are perceived by consumers as doing so, we may be unable to compete successfully in the markets affected by these changes.

### **If we cannot effectively manage changes in our rate of growth, our business may suffer.**

We have previously expanded our operations to pursue existing and potential market opportunities, and we are continuing to expand our international operations. This growth placed a strain on our personnel, management, financial and other resources. Our guidance and stabilization product revenue decreased significantly during 2011 and has continued to decline significantly in the first half of 2012. Our mobile communications product revenue showed no growth between 2010 and 2011 but then increased significantly during the first half of 2012. If any portion of our business grows more rapidly than we anticipate and we fail to manage that growth properly, we may incur unnecessary expenses, and the efficiency of our operations may decline. If we are unable to adjust our operating expenses on a timely basis in response to changes in revenue cycles, our results of operations may be harmed. To manage changes in our rate of growth effectively, we must, among other things:

match our manufacturing facilities and capacity to demand for our products in a timely manner;

successfully attract, train, motivate and manage appropriate numbers of employees for manufacturing, sales and customer support activities;

effectively manage our inventory and working capital; and

improve the efficiencies within our operating, administrative, financial and accounting systems, and our procedures and controls.

**We may be unable to hire and retain the skilled personnel we need to expand our operations.**

To meet our growth objectives, we must attract and retain highly skilled technical, operational, managerial and sales and marketing personnel. If we fail to attract and retain the necessary personnel, we may be unable to achieve our business objectives and may lose our competitive position, which could lead to a significant decline in net sales. We face significant competition for these skilled professionals from other companies, research and academic institutions, government entities and other organizations.

**Our success depends on the services of our executive officers.**

Our future success depends to a significant degree on the skills and efforts of Martin Kits van Heyningen, our co-founder, President, Chief Executive Officer, and Chairman of the Board. If we lost the services of Mr. Kits van Heyningen, our business and operating results could be seriously harmed. We also depend on the ability of our other executive officers to work effectively as a team. The loss of one or more of our executive officers could impair our ability to manage our business effectively.

**Table of Contents**

**Our international business operations expose us to a number of difficulties in coordinating our activities abroad and in dealing with multiple regulatory environments.**

Historically, sales to customers outside the United States and Canada have accounted for a significant portion of our net sales. We have foreign sales offices in Denmark, Singapore and Norway, as well as a subsidiary in Brazil that manages local sales. We otherwise support our international sales from our operations in the United States. Our limited operations in foreign countries may impair our ability to compete successfully in international markets and to meet the service and support needs of our customers in countries where we have little to no infrastructure. We are subject to a number of risks associated with our international business activities, which may increase our costs and require significant management attention. These risks include:

technical challenges we may face in adapting our mobile communications products to function with different satellite services and technology in use in various regions around the world;

satisfaction of international regulatory requirements and delays and costs associated with procurement of any necessary licenses or permits;

restrictions on the sale of certain guidance and stabilization products to foreign military and government customers;

increased costs of providing customer support in multiple languages;

increased costs of managing operations that are international in scope;

potentially adverse tax consequences, including restrictions on the repatriation of earnings;

protectionist laws and business practices that favor local competitors, which could slow our growth in international markets;

potentially longer sales cycles, which could slow our revenue growth from international sales;

potentially longer accounts receivable payment cycles and difficulties in collecting accounts receivable;

losses arising from impairment charges associated with goodwill or intangible assets;

losses arising from foreign currency exchange rate fluctuations; and

economic and political instability in some international markets.

**Exports of certain guidance and stabilization products are subject to the International Traffic in Arms Regulations and require a license from the U.S. Department of State prior to shipment.**

We must comply with the United States Export Administration Regulations and the International Traffic in Arms Regulations, or ITAR. Certain of our products have military or strategic applications and are on the munitions list of the ITAR and require an individual validated license in order to be exported to certain jurisdictions. Any changes in export regulations may further restrict the export of our products, and we may cease to be able to procure export licenses for our products under existing regulations. The length of time required by the licensing process can vary, potentially delaying the shipment of products and the recognition of the corresponding revenue. Any restriction on the export of a product line or any amount of our products could cause a significant reduction in net sales.

**Our business may suffer if we cannot protect our proprietary technology.**

Our ability to compete depends significantly upon our patents, our source code and our other proprietary technology. The steps we have taken to protect our technology may be inadequate to prevent others from using what we regard as our technology to compete with us. Our patents could be challenged, invalidated or circumvented, and the rights we have under our patents could provide no competitive advantages. Existing trade secrets, copyright and trademark laws offer only limited protection. In addition, the laws of some foreign countries do not protect our proprietary technology to the same extent as the laws of the United States, which could increase the likelihood of misappropriation. Furthermore, other companies could independently develop similar or superior technology without violating our intellectual property rights. Any misappropriation of our technology or the development of competing technology could seriously harm our competitive position, which could lead to a substantial reduction in net sales.

If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome, disruptive and expensive, distract the attention of management, and there can be no assurance that we would prevail.

Also, we have delivered certain technical data and information to the U.S. government under procurement contracts, and it may have unlimited rights to use that technical data and information. There can be no assurance that the U.S. government will not authorize others to use that data and information to compete with us.

## **Table of Contents**

### **Claims by others that we infringe their intellectual property rights could harm our business and financial condition.**

Our industries are characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. We cannot be certain that our products do not and will not infringe issued patents, patents that may be issued in the future, or other intellectual property rights of others.

We do not generally conduct exhaustive patent searches to determine whether the technology used in our products infringes patents held by third parties. In addition, product development is inherently uncertain in a rapidly evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies.

From time to time we have faced claims by third parties that our products or technology infringe their patents or other intellectual property rights, and we may face similar claims in the future. Any claim of infringement could cause us to incur substantial costs defending against the claim, even if the claim is invalid, and could distract the attention of our management. If any of our products are found to violate third-party proprietary rights, we may be required to pay substantial damages. In addition, we may be required to re-engineer our products or obtain licenses from third parties to continue to offer our products. Any efforts to re-engineer our products or obtain licenses on commercially reasonable terms may not be successful, which would prevent us from selling our products, and, in any case, could substantially increase our costs and have a material adverse effect on our business, financial condition and results of operations.

### **Fluctuations in our quarterly net sales and results of operations could depress the market price of our common stock.**

We have at times experienced significant fluctuations in our net sales and results of operations from one quarter to the next. Our future net sales and results of operations could vary significantly from quarter to quarter due to a number of factors, many of which are outside our control. Accordingly, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of future performance. It is possible that our net sales or results of operations in a quarter will fall below the expectations of securities analysts or investors. If this occurs, the market price of our common stock could fall significantly. Our results of operations in any quarter can fluctuate for many reasons, including:

changes in demand for our mobile communications products and services and guidance and stabilization products and services;

the timing and size of individual orders from military customers;

the mix of products we sell;

our ability to manufacture, test and deliver products in a timely and cost-effective manner, including the availability and timely delivery of components and subassemblies from our suppliers;

our success in winning competitions for orders;

the timing of new product introductions by us or our competitors;

expense incurred in pursuing acquisitions;

market and competitive pricing pressures;

general economic climate; and

seasonality of pleasure boat and recreational vehicle usage.

A large portion of our expenses, including expenses for network infrastructure, facilities, equipment, and personnel, are relatively fixed. Accordingly, if our net sales decline or do not grow as much as we anticipate, we might be unable to maintain or improve our operating margins. Any failure to achieve anticipated net sales could therefore significantly harm our operating results for a particular fiscal period.

**We may have exposure to additional tax liabilities, which could negatively impact our income tax expense, net income and cash flow.**

We are subject to income taxes and other taxes in both the U.S. and the foreign jurisdictions in which we currently operate. The determination of our worldwide provision for income taxes and current and deferred tax assets and liabilities requires judgment and estimation. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are subject to regular review and audit by both domestic and foreign tax authorities and to the prospective and retrospective effects of changing tax regulations and legislation. Although we believe our tax estimates are reasonable, the ultimate tax outcome may materially differ from the tax amounts recorded in our consolidated financial statements and may materially affect our income tax benefit or expense, net loss or income, and cash flows in the period in which such determination is made.

## **Table of Contents**

Deferred tax assets are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carry forwards. A valuation allowance reduces deferred tax assets to estimated realizable value, which assumes that it is more likely than not that we will be able to generate sufficient future taxable income to realize the net carrying value. We review our deferred tax assets and valuation allowance on a quarterly basis. As part of our review, we consider positive and negative evidence, including cumulative results in recent years.

If, during our quarterly reviews of our deferred tax assets, we determine that it is more likely than not that we will not be able to generate sufficient future taxable income to realize the net carrying value of our deferred tax assets, we will record a valuation allowance to reduce the tax assets to estimated realizable value. This could result in a material income tax charge.

### **The market price of our common stock may be volatile.**

Our stock price has historically been volatile. During the period from January 1, 2011 to June 30, 2012, the trading price of our common stock ranged from \$7.06 to \$16.42. Many factors may cause the market price of our common stock to fluctuate, including:

variations in our quarterly results of operations;

the introduction of new products and services by us or our competitors;

changing needs of military customers;

changes in estimates of our performance or recommendations by securities analysts;

the hiring or departure of key personnel;

acquisitions or strategic alliances involving us or our competitors;

market conditions in our industries; and

the global macroeconomic and geopolitical environment.

In addition, the stock market can experience extreme price and volume fluctuations. Major stock market indices experienced dramatic declines in 2008 and in the first quarter of 2009. These fluctuations are often unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of our common stock. When the market price of a company's stock drops significantly, stockholders often institute securities litigation against that company. Any such litigation could cause us to incur significant expenses defending against the claim, divert the time and attention of our management and result in significant damages.

### **Acquisitions may disrupt our operations or adversely affect our results.**

We evaluate strategic acquisition opportunities to acquire other businesses as they arise. The expenses we incur evaluating and pursuing this and other such acquisitions could have a material adverse effect on our results of operations. If we acquire a business, we may be unable to manage it profitably or successfully integrate its operations with our own. Moreover, we may be unable to realize the strategic, financial, operational and other benefits we anticipate from any acquisition. Competition for acquisition opportunities could increase the price we pay for businesses we acquire and could reduce the number of potential acquisition targets. Further, our approach to acquisitions may involve a number of special financial and business risks, such as:

charges related to any potential acquisition from which we may withdraw;

diversion of our management's time, attention, and resources;

loss of key acquired personnel;

increased costs to improve or coordinate managerial, operational, financial, and administrative systems, including compliance with the Sarbanes-Oxley Act of 2002;

dilutive issuances of equity securities;

the assumption of legal liabilities; and

losses arising from impairment charges associated with goodwill or intangible assets.

**Our charter and by-laws and Delaware law may deter takeovers.**

Our certificate of incorporation, by-laws and Delaware law contain provisions that could have an anti-takeover effect and discourage, delay or prevent a change in control or an acquisition that many stockholders may find attractive. These provisions may also discourage proxy contests and make it more difficult for our stockholders to take some corporate actions, including the election of directors. These provisions relate to:

the ability of our Board of Directors to issue preferred stock, and determine its terms, without a stockholder vote;



**Table of Contents**

the classification of our Board of Directors, which effectively prevents stockholders from electing a majority of the directors at any one annual meeting of stockholders;

the limitation that directors may be removed only for cause by the affirmative vote of the holders of two-thirds of our shares of capital stock entitled to vote;

the prohibition against stockholder actions by written consent;

the inability of stockholders to call a special meeting of stockholders; and

advance notice requirements for stockholder proposals and director nominations.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On November 26, 2008, our Board of Directors authorized a program to repurchase up to one million shares of our common stock. The repurchase program is funded using our existing cash, cash equivalents, marketable securities, and future cash flows. Under the repurchase program, at management's discretion, we may repurchase shares on the open market from time to time, in privately negotiated transactions or block transactions, or through an accelerated repurchase agreement. The timing of such repurchases depends on availability of shares, price, market conditions, alternative uses of capital, and applicable regulatory requirements. The program may be modified, suspended or terminated at any time without prior notice. The repurchase program has no expiration date. There were no other repurchase programs outstanding during the six months ended June 30, 2012 and no repurchase programs expired during the period.

We did not repurchase any shares of our common stock in the six months ended June 30, 2012.

**Table of Contents****ITEM 6. EXHIBITS****Exhibits:**

<b>Exhibit</b>		<b>Incorporated by Reference</b>			
<b>No.</b>	<b>Description</b>	<b>Filed with this Form 10-Q</b>	<b>Form</b>	<b>Filing Date</b>	<b>Exhibit No.</b>
3.1	Amended and Restated Certificate of Incorporation, as amended		10-Q	August 6, 2010	3.1
3.2	Amended, Restated and Corrected Bylaws of KVH Industries, Inc.		8-K	July 31, 2007	3
4.1	Specimen certificate for the common stock		S-1/A	March 22, 1996	4.1
31.1	Rule 13a-14(a)/15d-14(a) certification of principal executive officer	X			
31.2	Rule 13a-14(a)/15d-14(a) certification of principal financial officer	X			
32.1	Section 1350 certification of principal executive officer	X			
32.2	Section 1350 certification of principal financial officer				
101	Interactive Data File regarding (a) our Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011, (b) our Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2012 and 2011, (c) our Consolidated Statements of Other Comprehensive Loss for the Three and Six Months Ended June 30, 2012 and 2011, (d) our Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2012 and 2011 and (e) the Notes to such Consolidated Financial Statements.				
		X			

**Table of Contents**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 8, 2012

KVH Industries, Inc.

By: */s/* PATRICK J. SPRATT  
**Patrick J. Spratt**  
**(Duly Authorized Officer and Chief Financial  
and Accounting Officer)**

**Table of Contents****Exhibit Index**

Exhibit	Description	Filed with	Incorporated by Reference		
		this Form 10-Q	Form	Filing Date	Exhibit No.
3.1	Amended and Restated Certificate of Incorporation, as amended		10-Q	August 6, 2010	3.1
3.2	Amended, Restated and Corrected Bylaws of KVH Industries, Inc.		8-K	July 31, 2007	3
4.1	Specimen certificate for the common stock		S-1/A	March 22, 1996	4.1
31.1	Rule 13a-14(a)/15d-14(a) certification of principal executive officer	X			
31.2	Rule 13a-14(a)/15d-14(a) certification of principal financial officer	X			
32.1	Section 1350 certification of principal executive officer	X			
32.2	Section 1350 certification of principal financial officer	X			
101	Interactive Data File regarding (a) our Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011, (b) our Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2012 and 2011, (c) our Consolidated Statements of Other Comprehensive Loss for the Three and Six Months Ended June 30, 2012 and 2011, (d) our Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2012 and 2011 and (e) the Notes to such Consolidated Financial Statements.	X			