

KVH INDUSTRIES INC \DE\  
Form 10-Q  
August 04, 2011  
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, 2011

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.

<b>Date</b>	<b>Class</b>	<b>Outstanding shares</b>
August 3, 2011	Common Stock, par value \$0.01 per share	14,899,313

**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, 2011 and December 31, 2010 (unaudited)</u> 3
	<u>Consolidated Statements of Operations for the three and six months ended June 30, 2011 and 2010 (unaudited)</u> 4
	<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2010 (unaudited)</u> 5
	<u>Notes to Consolidated Financial Statements (unaudited)</u> 6
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> 22
<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> 33
	<b><u>EXHIBIT INDEX</u></b> 34

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

(in thousands, except per share amounts, unaudited)

	June 30, 2011	December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 7,924	\$ 7,241
Marketable securities	24,618	30,066
Accounts receivable, net of allowance for doubtful accounts of approximately \$582 as of June 30, 2011 and \$592 as of December 31, 2010	20,437	18,770
Inventories	17,294	14,765
Prepaid expenses and other assets	2,712	2,734
Deferred income taxes	762	944
<b>Total current assets</b>	<b>73,747</b>	<b>74,520</b>
Property and equipment, less accumulated depreciation of \$25,533 as of June 30, 2011 and \$23,518 as of December 31, 2010		
	24,993	23,044
Intangible assets, less accumulated amortization of \$295 as of June 30, 2011 and \$101 as of December 31, 2010		
	2,295	2,272
Goodwill	4,846	4,517
Other non-current assets	6,461	5,863
Deferred income taxes	5,289	4,982
<b>Total assets</b>	<b>\$ 117,631</b>	<b>\$ 115,198</b>

**LIABILITIES AND STOCKHOLDERS EQUITY**

Current liabilities:		
Accounts payable	\$ 5,167	\$ 3,922
Accrued compensation and employee-related expenses	4,140	4,415
Accrued other	4,010	3,590
Accrued product warranty costs	795	887
Deferred revenue	832	1,011
Current portion of long-term debt	127	124
<b>Total current liabilities</b>	<b>15,071</b>	<b>13,949</b>
Other long-term liabilities		
	1,379	1,263
Long-term debt excluding current portion	3,619	3,684
<b>Total liabilities</b>	<b>20,069</b>	<b>18,896</b>

Commitments and contingencies (notes 3 and 10)

Stockholders equity:

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

Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued		
Common stock, \$0.01 par value. Authorized 30,000,000 shares, 16,114,347 and 15,890,083 shares issued at June 30, 2011 and December 31, 2010; 14,913,023 and 14,688,759 shares outstanding at June 30, 2011 and December 31, 2010, respectively	161	159
Additional paid-in capital	104,707	102,728
Accumulated earnings	1,523	2,867
Accumulated other comprehensive income	642	19
Less: treasury stock at cost, common stock, 1,201,324 shares as of June 30, 2011 and December 31, 2010	(9,471)	(9,471)
<b>Total stockholders equity</b>	<b>97,562</b>	<b>96,302</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 117,631</b>	<b>\$ 115,198</b>

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,	
	2011	2010	2011	2010
<b>Sales:</b>				
Product	\$ 24,331	\$ 24,379	\$ 43,215	\$ 48,412
Service	6,241	5,118	11,766	9,067
<b>Net sales</b>	<b>30,572</b>	<b>29,497</b>	<b>54,981</b>	<b>57,479</b>
<b>Costs and expenses:</b>				
Costs of product sales	13,482	13,688	24,010	26,809
Costs of service sales	5,095	4,314	9,897	7,371
Sales, marketing and support	5,976	4,738	11,175	9,236
Research and development	2,878	2,500	5,853	5,083
General and administrative	2,550	2,316	5,477	4,681
<b>Total costs and expenses</b>	<b>29,981</b>	<b>27,556</b>	<b>56,412</b>	<b>53,180</b>
Income (loss) from operations	591	1,941	(1,431)	4,299
Interest income	67	92	132	183
Interest expense	57	59	113	82
Other income, net	1	32	15	63
Income (loss) before income taxes	602	2,006	(1,397)	4,463
Income tax (expense) benefit	(412)	3,318	53	2,927
<b>Net income (loss)</b>	<b>\$ 190</b>	<b>\$ 5,324</b>	<b>\$ (1,344)</b>	<b>\$ 7,390</b>
<b>Per share information:</b>				
<b>Net income (loss) per share</b>				
<b>Basic</b>	<b>\$ 0.01</b>	<b>\$ 0.37</b>	<b>\$ (0.09)</b>	<b>\$ 0.52</b>
<b>Diluted</b>	<b>\$ 0.01</b>	<b>\$ 0.36</b>	<b>\$ (0.09)</b>	<b>\$ 0.50</b>
<b>Number of shares used in per share calculation:</b>				
<b>Basic</b>	<b>14,901,495</b>	<b>14,373,414</b>	<b>14,825,091</b>	<b>14,298,305</b>
<b>Diluted</b>	<b>15,199,900</b>	<b>14,770,181</b>	<b>14,825,091</b>	<b>14,738,035</b>

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,	
	2011	2010
<b>Cash flows from operating activities:</b>		
Net (loss) income	\$ (1,344)	\$ 7,390
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,209	1,746
Deferred income taxes	(175)	(3,982)
Provision for doubtful accounts	113	76
Loss on interest rate swaps	36	
Compensation expense related to awards and employee stock purchase plan	1,826	1,121
Changes in operating assets and liabilities:		
Accounts receivable	(1,693)	(2,536)
Inventories	(2,519)	(809)
Prepaid expenses and other assets	30	68
Other non-current assets	(598)	262
Accounts payable	1,263	1,650
Deferred revenue	(150)	42
Accrued expenses	51	1,365
Other long-term liabilities	115	(80)
<b>Net cash (used in) provided by operating activities</b>	<b>(836)</b>	<b>6,313</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(3,964)	(3,729)
Purchases of marketable securities	(21,557)	(13,805)
Maturities and sales of marketable securities	27,005	10,684
<b>Net cash provided by (used in) investing activities</b>	<b>1,484</b>	<b>(6,850)</b>
<b>Cash flows from financing activities:</b>		
Repayments of mortgage loan	(61)	(57)
Proceeds from stock options exercised and employee stock purchase plan	791	2,236
Payment of employee restricted stock withholdings	(625)	(482)
Payment of stock registration fee	(10)	
<b>Net cash provided by financing activities</b>	<b>95</b>	<b>1,697</b>
Effect of exchange rate changes on cash and cash equivalents	(60)	
<b>Net increase in cash and cash equivalents</b>	<b>683</b>	<b>1,160</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>7,241</b>	<b>5,871</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 7,924</b>	<b>\$ 7,031</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) 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 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, sales from product repairs, engineering services provided under development contracts, certain DIRECTV and DISH Network 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 and DISH Network programs, KVH is eligible to receive a one-time subsidy for each DIRECTV receiver activated for service and a new mobile account activation fee from DIRECTV and DISH Network for each customer who activates their DIRECTV or DISH Network 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 Europe A/S, KVH Industries Asia Pte. Ltd., KVH South America Comunicacao Por Satellite Ltda. and KVH Norway (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 Europe A/S, KVH Industries Asia Pte. Ltd. and KVH South America Comunicacao Por Satellite 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 Norway, a subsidiary of KVH Europe A/S that was purchased in September 2010, develops and distributes middleware software solutions known as CommBox technology, which will be integrated into the Company's satellite communications products and services. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform with the current year presentation. 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, 2010 filed on March 14, 2011 with the Securities and Exchange Commission. The results for the three and six months ended June 30, 2011 are not necessarily indicative of operating results for the remainder of the year.



**Table of Contents****(3) Significant Estimates and Assumptions**

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.

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 \$873 and \$553 for the three months ended June 30, 2011 and June 30, 2010, respectively and \$1,826 and \$1,121 for the six months ended June 30, 2011 and June 30, 2010, respectively. As of June 30, 2011, there was \$2,064 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 3.09 years. As of June 30, 2011, there was \$4,967 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 2.37 years.

The Company granted 2,500 and 132,500 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, 2011, 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 also granted 10,000 and 260,000 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, 2011, respectively.

The fair value of stock options granted for the six months ended June 30, 2011 was estimated as of the date of grant using the Black-Scholes option-pricing model. There were no options granted during the three and six months ended June 30, 2010. The weighted-average fair value per share for all options granted during the six months ended June 30, 2011 was \$6.88. The weighted-average assumptions used to value options as of their grant date were as follows:

	<b>Six months ended June 30, 2011</b>
Risk-free interest rate	1.83%
Expected volatility	59.84%
Expected life (in years)	4.23
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. The Company has excluded certain outstanding stock options and non-vested restricted shares from the calculation of diluted earnings per share for the six months ended June 30, 2011 because the net loss causes these outstanding stock options and non-vested restricted shares to be anti-dilutive. Common stock equivalents related to options and restricted stock awards for 582,553 and 526,313 shares of common stock for the three and six months ended June 30, 2011, respectively, have been excluded from the fully diluted calculation of net income (loss) per share, as inclusion would be anti-dilutive. Common stock equivalents related to options for 15,850 shares of common stock for the three and six months ended June 30, 2010, respectively, have been excluded from the fully diluted calculation of net income per share, as inclusion would 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,	
	2011	2010	2011	2010
Weighted average common shares outstanding basic	14,901,495	14,373,414	14,825,091	14,298,305
Dilutive common shares issuable in connection with stock plans	298,405	396,767		439,730
Weighted average common shares outstanding diluted	15,199,900	14,770,181	14,825,091	14,738,035

**(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, 2011 and December 31, 2010 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

	December	
	June 30, 2011	31, 2010
Raw materials	\$ 11,407	\$ 10,191
Work in process	1,372	1,369
Finished goods	4,515	3,205
	\$ 17,294	\$ 14,765

**(7) Comprehensive Income (Loss)**

Comprehensive income (loss) includes net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes the effects of unrealized gains or losses on available-for-sale marketable securities and currency translation adjustment gains that are separately included in accumulated other comprehensive income within stockholders' equity as well as unrealized losses on derivatives. The Company's comprehensive income (loss) for the periods presented is as follows:

	Three months		Six months ended	
	ended		June 30,	
	2011	2010	2011	2010
Net income (loss)	\$ 190	\$ 5,324	\$ (1,344)	\$ 7,390
Unrealized gain (loss) on available-for-sale securities	3	3	1	(37)
Currency translation adjustment gain	231		901	
Unrealized loss on derivatives	(84)	(313)	(279)	(313)
Total comprehensive income (loss)	\$ 340	\$ 5,014	\$ (721)	\$ 7,040

**(8) 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, 2011 and

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

December 31, 2010, the Company had accrued product warranty costs of \$795 and \$887, respectively. The following table summarizes product warranty activity during 2011 and 2010:

	Six months ended	
	June 30,	
	2011	2010
Beginning balance	\$ 887	\$ 1,084
Charges to expense	233	504
Costs incurred	(325)	(372)
Ending balance	\$ 795	\$ 1,216

**Table of Contents**

**(9) 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.

**Table of Contents**

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 communication and guidance and stabilization. Mobile communication 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 and DISH Network 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 communication and guidance and stabilization sales also include development contract revenue, product repairs and extended warranty sales.

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

<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>Three months ended June 30, 2010</b>	<b>Sales Originating From</b>		
	<b>Americas</b>	<b>Europe and Asia</b>	<b>Total</b>
Mobile communication sales to the United States	\$ 12,595	\$	\$ 12,595
Mobile communication sales to Canada	134		134
Mobile communication sales to Europe	213	2,505	2,718
Mobile communication sales to other geographic areas	105	1,106	1,211
Guidance and stabilization sales to the United States	5,108		5,108
Guidance and stabilization sales to Canada	1,200		1,200
Guidance and stabilization sales to Europe	6,047		6,047
Guidance and stabilization sales to other geographic areas	484		484
Intercompany sales	2,044	58	2,102
Subtotal	27,930	3,669	31,599
Eliminations	(2,044)	(58)	(2,102)
Net sales	\$ 25,886	\$ 3,611	\$ 29,497
Segment net income	\$ 5,234	\$ 90	\$ 5,324
Depreciation	\$ 912	\$ 8	\$ 920



Total assets	\$ 103,878	\$ 7,017	\$ 110,895
--------------	------------	----------	------------

**Table of Contents**

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

Six months ended June 30, 2010	Sales Originating From		
	Americas	Europe and Asia	Total
Mobile communication sales to the United States	\$ 24,078	\$	\$ 24,078
Mobile communication sales to Canada	370		370
Mobile communication sales to Europe	348	5,350	5,698
Mobile communication sales to other geographic areas	349	2,224	2,573
Guidance and stabilization sales to the United States	9,922		9,922
Guidance and stabilization sales to Canada	2,124		2,124
Guidance and stabilization sales to Europe	11,321		11,321
Guidance and stabilization sales to other geographic areas	1,393		1,393
Intercompany sales	4,296	122	4,418
Subtotal	54,201	7,696	61,897
Eliminations	(4,296)	(122)	(4,418)
Net sales	\$ 49,905	\$ 7,574	\$ 57,479
Segment net income	\$ 7,108	\$ 282	\$ 7,390
Depreciation	\$ 1,730	\$ 16	\$ 1,746
Total assets	\$ 103,878	\$ 7,017	\$ 110,895

**(10) 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.

**(11) 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, 2011, 798,676 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

**Table of Contents**

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, 2011 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, 2011.

**(12) Long-Term Aviation Antenna Development and Production Agreement**

On February 18, 2008, the Company entered into a \$20,055 long-term antenna development and production agreement with LiveTV (the Agreement) that was subsequently increased in 2009 to \$20,896. Under the terms of the Agreement, the Company designs, develops, and manufactures satellite television antennas for use on narrowbody commercial aircraft operating in the United States. The Company began shipment of the antennas in the second quarter of 2009. As of June 30, 2011, the Company has incurred \$4,669 in research and development costs related to this arrangement. In accordance with ASC 730, *Research and Development*, and the Agreement, these costs are capitalized as they are incurred and then expensed into costs of product sales as antennas are sold in proportion to the number of antennas delivered versus the total contractual antenna production requirement. The Company did not ship any satellite television antennas during the six months ended June 30, 2011. The net amount of \$2,868 in remaining capitalized research and development costs are costs that the Company has a contractual right to recover, and are reflected in other non-current assets as of June 30, 2011.

The status of this production agreement is uncertain at this time as LiveTV has asked the Company to postpone deliveries again under the contract. The Company and LiveTV have been unable to reach agreement on delivery dates and, as a result, the Company believes that the contract has terminated. LiveTV disputes this interpretation and the Company is continuing to negotiate regarding the contract and the placement of orders. However, the Company cannot be certain that these negotiations will lead to new orders. The Company has concluded, based on the terms of the contract, that it has the contractual right to recover the remaining capitalized research and development costs, and as a result has continued to capitalize these costs as of June 30, 2011.

If the Company is unable to reach agreement with LiveTV regarding the placement of new orders, it would record a charge of \$2,868 related to the write-off of capitalized aviation research and development costs and approximately \$200 related to inventory specific to the aviation antenna. The Company anticipates that the charges would be offset by a termination fee payable by LiveTV; however, LiveTV could dispute the amount of the termination fee and/or refuse to pay it, in which case the Company may incur costs to collect the fee, including potential litigation expenses.

**(13) Fair Value Measurements**

Effective January 1, 2008, the Company adopted the required provisions of 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, certificates of deposit and corporate notes.
- 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 identified in the table below and are as follows:

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

- (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)

**Table of Contents**

- (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, 2011 and December 31, 2010 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy:

June 30, 2011	Total	Level 1	Level 2	Level 3	Valuation Technique
<b>Assets</b>					
Money market mutual funds	\$ 13,564	\$ 13,564	\$	\$	(a)
Government agency bonds	6,503	6,503			(a)
Certificates of deposit	2,476	2,476			(a)
Corporate notes	2,075	2,075			(a)
<b>Liabilities</b>					
Interest rate swaps	\$ 279	\$	\$ 279	\$	(d)

December 31, 2010	Total	Level 1	Level 2	Level 3	Valuation Technique
<b>Assets</b>					
Money market mutual funds	\$ 14,607	\$ 14,607	\$	\$	(a)
Government agency bonds	11,021	11,021			(a)
Certificates of deposit	2,572	2,572			(a)
Corporate notes	1,866	1,866			(a)
<b>Liabilities</b>					
Interest rate swaps	\$ 243	\$	\$ 243	\$	(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.

**(14) Recent Accounting Pronouncements**

In January 2010, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update 2010-06, *Improving Disclosures about Fair Value Measurements*, which amends ASC 820, *Fair Value Measurements and Disclosures* (ASC 820). This amendment requires new disclosures, including the reasons for and amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and separate presentation of purchases, sales, issuances and settlements in the reconciliation of activity for Level 3 fair value measurements. It also clarified guidance related to determining the appropriate classes of assets and liabilities and the information to be provided for valuation techniques used to measure fair value. This guidance with respect to Level 3 fair value measurements is effective for the Company in its interim and annual reporting periods beginning after December 15, 2010. Adoption of this guidance did not have a significant impact on the determination or reporting of the Company's financial results.

In December 2010, the FASB issued Accounting Standards Update 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. The amendments in this update clarify the acquisition date that should be used for reporting the pro forma financial information disclosures in Topic 805 when comparative financial statements are presented. The amendments also improve the usefulness of the pro forma revenue and earnings disclosures by requiring a description of the nature and amount of material, nonrecurring pro forma adjustments that are directly attributable to the business combination(s). The amendments in this update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The effects of this guidance will depend on any future acquisitions the Company may complete.

In May 2011, the FASB issued Accounting Standards Update 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, which amended ASC 820, *Fair Value Measurements and Disclosures*. This guidance addresses efforts to achieve convergence between U.S. GAAP and International Financial Reporting Standards (IFRS) requirements for measurement of and disclosures about fair value. The amendments are not expected to have a significant impact on companies applying U.S. GAAP. Key provisions of the amendment include: a prohibition on



**Table of Contents**

grouping financial instruments for purposes of determining fair value, except when an entity manages market and credit risks on the basis of the entity's net exposure to the group; an extension of the prohibition against the use of a blockage factor to all fair value measurements (that prohibition currently applies only to financial instruments with quoted prices in active markets); and a requirement that for recurring Level 3 fair value measurements, entities disclose quantitative information about unobservable inputs, a description of the valuation process used and qualitative details about the sensitivity of the measurements. In addition, for items not carried at fair value but for which fair value is disclosed, entities will be required to disclose the level within the fair value hierarchy that applies to the fair value measurement disclosed. This guidance is effective for the Company in its interim and annual reporting periods beginning after December 15, 2011. The Company is currently evaluating the impact that adoption of the guidance will have on the determination and reporting of its financial results.

In June 2011, the FASB issued Accounting Standards Update 2011-05, Comprehensive Income (ASC Topic 220): Presentation of Comprehensive Income, (ASU 2011-05) which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 will be effective for public companies during the interim and annual periods beginning after December 15, 2011 with early adoption permitted. The adoption of ASU 2011-05 will not have an impact on the Company's consolidated financial position, results of operations or cash flows as it only requires a change in the format of the current presentation.

**(15) Business and Credit Concentrations**

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

	Three months		Six months ended	
	ended		ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Net sales to foreign customers outside the U.S. and Canada	38.8%	35.5%	34.1%	36.5%
Net sales to Customer A	*	19.2%	*	18.1%
Net sales to Customer B	11.2%	*	*	*

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

**(16) 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, 2011, 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, 2011, 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)	Liability				
Interest rate swap	\$ 1,873	130	April 1, 2010	April 1, 2019	1-month LIBOR	5.91%
Interest rate swap	\$ 1,873	149	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*

**Table of Contents**

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.

**Overview**

We 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. 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, sales from product repairs, engineering services provided under development contracts, certain DIRECTV and DISH Network 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 sales from 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 and DISH Network programs, we are eligible to receive a one-time subsidy for each DIRECTV receiver activated for service and a new mobile account activation fee from DIRECTV and DISH Network for each customer who activates their DIRECTV or DISH Network 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,	
	2011	2010	2011	2010
	(in thousands)			
Mobile communications	\$ 19,043	\$ 16,658	\$ 34,758	\$ 32,719
Guidance and stabilization	11,529	12,839	20,223	24,760
Sales	\$ 30,572	\$ 29,497	\$ 54,981	\$ 57,479

We have historically derived a substantial portion of our sales from sales to customers located outside the United States. Notes 9 and 15 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, 2010.

**Table of Contents**

As described in our Form 10-K for the year ended December 31, 2010, 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, 2011.

Readers should refer to our 2010 Form 10-K under Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Significant Estimates for the detailed descriptions of these policies.

**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,	
	2011	2010	2011	2010
<b>Sales:</b>				
Product	79.6%	82.6%	78.6%	84.2%
Service	20.4	17.4	21.4	15.8
Net sales	100.0	100.0	100.0	100.0
<b>Cost and expenses:</b>				
Costs of product sales	44.1	46.4	43.7	46.7
Costs of service sales	16.7	14.6	18.0	12.8
Sales, marketing and support	19.6	16.0	20.3	16.1
Research and development	9.4	8.5	10.6	8.8
General and administrative	8.3	7.9	10.0	8.1
Total costs and expenses	98.1	93.4	102.6	92.5
Income (loss) from operations	1.9	6.6	(2.6)	7.5
Interest income	0.2	0.3	0.2	0.3
Interest expense	0.2	0.2	0.2	0.1
Other income, net	0.1	0.1	0.1	0.1
Income (loss) before income taxes	2.0	6.8	(2.5)	7.8
Income tax (expense) benefit	(1.4)	11.2	0.1	5.1
Net income (loss)	0.6%	18.0%	(2.4)%	12.9%

**Three Months Ended June 30, 2011 and 2010****Net Sales**

Product sales for the three months ended June 30, 2011 remained consistent with product sales for the three months ended June 30, 2010, decreasing less than \$0.1 million to \$24.3 million from \$24.4 million for the three months ended June 30, 2010. Sales of our guidance and stabilization products decreased approximately \$0.9 million, or 7%. Specifically, sales of our FOG products decreased \$4.5 million, or 42%, driven largely by a slowdown of the U.S. Army's procurement of Common Remotely Operated Weapon Stations (CROWS) under existing contracts, as the industry awaits updates on the outcome of the U.S. Army procurement for the next CROWS program contract, which is in the presolicitation phase. Although we expect FOG sales will grow over the long term, sales on a quarter to quarter basis could be very uneven. Largely as a result of uncertainty regarding future remotely operated weapons stations programs, we expect our FOG sales to decline in 2011 from 2010. This decrease in FOG product sales during the three months ended June 30, 2011 was partially offset by an increase in sales of our

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

TACNAV defense products of \$3.7 million, or 301%, as compared to the three months ended June 30, 2010, primarily driven by a \$3.4 million international order. Although we expect TACNAV product sales will continue to increase throughout the second half of 2011 as compared to the second half of 2010, we do not expect the increase in TACNAV product sales will be anywhere near such a percentage growth rate realized in the second quarter of 2011. We also anticipate that TACNAV product sales on a quarter-to-quarter basis could continue to be very uneven.

Offsetting the decrease in our guidance and stabilization products was an increase of \$0.9 million, or 7% in our mobile communications product sales for the three months ended June 30, 2011 to \$12.9 million from \$12.1 million for the three months ended June 30, 2010.

---

**Table of Contents**

The increase was primarily due to an increase in sales of our marine products of \$2.3 million, or 25%, driven primarily by demand for our new TracPhone V3 that was released in the second quarter of 2011, as well as increased sales of our TracPhone V7 product and sales of network management products from our Norwegian subsidiary, which was acquired in September 2010. Partially offsetting the increase was a decrease in marine satellite television product sales. We expect a decline in 2011 from 2010 in leisure marine and recreational vehicle satellite television product sales due to what we believe is renewed weakness in general consumer confidence, historically high fuel prices, declining sales of new boats greater than thirty-five feet in length, as well as weakness in recreational vehicle sales. Also offsetting the increase was a \$1.5 million decrease in sales of our satellite television antenna used on narrowbody commercial aircraft. We began shipping this antenna to LiveTV in the second quarter of 2009. The status of our aeronautical satellite television antenna business is in flux at this time as LiveTV has asked us to postpone deliveries again under our contract. We were unable to reach agreement with LiveTV on delivery dates and, as a result, we believe that the contract terminated. LiveTV disputes our interpretation and we are continuing to negotiate regarding the contract and the placement of orders. However, we cannot be certain that our negotiations will lead to new orders.

Mobile communications product sales originating from the Americas decreased \$0.7 million, or 9%, from the three months ended June 30, 2010 to the three months ended June 30, 2011. Mobile satellite product sales originating from our European and Asian subsidiaries increased \$1.6 million, or 44%, from the three months ended June 30, 2010 to the three months ended June 30, 2011.

Service sales for the three months ended June 30, 2011 increased \$1.1 million, or 22%, to \$6.2 million from \$5.1 million for the three months ended June 30, 2010. The primary reason for the increase was a \$1.6 million increase in airtime sales for our mini-VSAT Broadband service. Partially offsetting this increase was a decline of \$0.4 million in contracted engineering services. The decrease in contracted engineering services is attributed to our decision to concentrate our engineering efforts on initiatives associated with our global roll-out of the mini-VSAT network and our FOG products and de-emphasize non-strategic engineering services requested by customers.

***Costs of Sales***

For the three months ended June 30, 2011, costs of product sales decreased by \$0.2 million, or 2%, to \$13.5 million from \$13.7 million for the three months ended June 30, 2010. The primary reason for the decrease was the decrease in sales of FOG and aeronautical products discussed above.

Costs of service sales increased by \$0.8 million, or 18%, to \$5.1 million for the three months ended June 30, 2011 from \$4.3 million for the three months ended June 30, 2010. The primary reason for the increase was a \$1.3 million increase in airtime costs of sales for our mini-VSAT Broadband service primarily as a result of increased costs related to the build-out and operation of the network and support infrastructure for our mini-VSAT Broadband service. This increase was partially offset by a decrease of \$0.5 million in contracted engineering services costs of sales.

Gross margin from product sales for the three months ended June 30, 2011 increased to 45% from 44% in the year-ago period. The primary reason for the increase in gross margin was a 301% increase in our relatively higher margin TACNAV product sales.

Gross margin from service sales for the three months ended June 30, 2011 increased to 18% from 16% in the year-ago period. The increase in our gross margin from service sales was primarily attributable to a \$1.6 million increase in airtime sales for our mini-VSAT Broadband service. We expect the gross margin from service sales to continue to improve when and as sales increase in upcoming quarters, as the build-out of the initial global network is now complete. However, we do expect future cost increases as capacity may need to be expanded for growth in the number of active accounts as well as for potential expansion into new coverage areas.

***Operating Expenses***

Sales, marketing and support expense for the three months ended June 30, 2011 increased by \$1.2 million, or 26%, to \$6.0 million from \$4.7 million for the three months ended June 30, 2010. The primary reasons for the increase in 2011 was a \$0.7 million increase in commission expense primarily as a result of a \$3.4 million international TACNAV order and as a result of the increase in mini-VSAT Broadband service sales discussed above, and a \$0.3 million increase in sales, marketing and support expense related to our Singaporean and Norwegian subsidiaries, which were incorporated or acquired during 2010. Also contributing to the increase was a \$0.1 million increase in bad debt expense primarily as a result of one commercial lease customer, and a \$0.1 million increase in U.S.-based employee compensation for sales, marketing and support, primarily in connection with the global expansion of our mini-VSAT Broadband satellite communication service. As a percentage of sales, sales, marketing and support expense increased during the quarter ended June 30, 2011 to 20% from 16% for the quarter ended June 30, 2010, due primarily to the increase in commission expense and foreign subsidiaries added in 2010 as discussed above.

Research and development expense for the three months ended June 30, 2011 increased by \$0.4 million, or 15%, to \$2.9 million from \$2.5 million for the three months ended June 30, 2010. The primary reason for the increase in 2011 expense was a \$0.3 million decrease in

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

customer-funded engineering costs for contracted engineering services. Also contributing to the increase was a \$0.1 million increase in research and development expense related to our Norwegian subsidiary, which was acquired in September 2010. As a percentage of sales, research and development expense increased during the quarter ended June 30, 2011 to 9% from 8% for the quarter ended June 30, 2010, due primarily to the decrease in FOG and aeronautical product sales discussed above.

**Table of Contents**

General and administrative expense for the three months ended June 30, 2011 increased by \$0.2 million, or 10%, to \$2.6 million from \$2.3 million for the three months ended June 30, 2010. The primary reason for the increase in 2011 expense was a \$0.2 million increase in general and administrative expenses related to our Norwegian subsidiary, which was acquired in September 2010. Also contributing to the increase was a \$0.1 million increase in U.S.-based employee compensation for the general and administrative department. As a percentage of sales, general and administrative expense remained consistent during the quarter ended June 30, 2011 at 8%, approximately equal to the percentage for the quarter ended June 30, 2010.

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

Income tax expense for the three months ended June 30, 2011 increased \$3.7 million to \$0.4 million as compared to a \$3.3 million tax benefit for the three months ended June 30, 2010. The primary reason for the increase in 2011 was based upon our conclusion in 2010 that \$3.3 million of deferred tax asset valuation allowance was no longer required. Also contributing to the increase in income tax expense was a reduction in our annual estimated effective income tax rate in the second quarter of 2011, which resulted in a reduction to the previous tax benefit recorded at a higher estimated income tax rate. The decrease in our annual estimated effective income tax rate was driven by an anticipated decline in leisure marine and recreational vehicle satellite television product sales for the remainder of 2011, as well as our ability to capture additional Rhode Island state tax credits from the construction of our new production facility that began in the second quarter of 2011. We now estimate our effective income tax rate for 2011 will be less than ten percent.

**Six Months Ended June 30, 2011 and 2010*****Net Sales***

Product sales for the six months ended June 30, 2011 decreased by \$5.2 million, or 11% to \$43.2 million from \$48.4 million for the six months ended June 30, 2010. The primary reason for the decrease in 2011 was a decrease in sales of our guidance and stabilization products of \$4.0 million, or 17%. Specifically, sales of our FOG products decreased \$4.5 million, or 42%, driven largely by a slowdown of the U.S. Army's procurement of Common Remotely Operated Weapon Stations (CROWS) under existing contracts, as the industry awaits updates on the outcome of the U.S. Army procurement for the next CROWS program contract, which is in the presolicitation phase. This decrease in FOG product sales during the six months ended June 30, 2011 was partially offset by an increase in sales of our TACNAV defense products of \$4.0 million, or 134%, as compared to the six months ended June 30, 2010 primarily due to a \$3.4 million international order.

Mobile communications product sales for the six months ended June 30, 2011 decreased by \$1.2 million, or 5% to \$23.4 million from \$24.7 million for the six months ended June 30, 2010. The decrease was primarily due to a \$4.4 million decrease in sales of our satellite television antenna used on narrowbody commercial aircraft. The decrease in LiveTV product sales was partially offset by an increase in sales of our marine products of \$2.8 million, or 16%, driven primarily by demand for our TracPhone V7 and V3 products and sales of our network management products from our Norwegian subsidiary, which was acquired in September 2010. Partially offsetting the increase was a decrease in marine satellite television product sales. Sales of our land mobile satellite products increased \$0.3 million, or 11%, driven primarily by increased sales to original equipment manufacturers in the recreational vehicle market.

Mobile communications product sales originating from the Americas decreased \$2.9 million, or 17%, from the six months ended June 30, 2010 to the six months ended June 30, 2011. Mobile communications product sales originating from our European and Asian subsidiaries increased \$1.7 million, or 22%, from the six months ended June 30, 2010 to the six months ended June 30, 2011.

Service sales for the six months ended June 30, 2011 increased \$2.7 million, or 30%, to \$11.8 million from \$9.1 million for the six months ended June 30, 2010. The primary reason for the increase was a \$3.3 million increase in airtime sales for our mini-VSAT Broadband service. Partially offsetting this increase was a decrease of \$0.5 million resulting from decreases in contracted engineering services and service repair sales.

***Costs of Sales***

For the six months ended June 30, 2011, costs of product sales decreased by \$2.8 million, or 10%, to \$24.0 million from \$26.8 million for the six months ended June 30, 2010. The primary reason for the decrease was the decrease in sales of FOG and aeronautical products discussed above.

Costs of service sales increased by \$2.5 million, or 34%, to \$9.9 million for the six months ended June 30, 2011 from \$7.4 million for the six months ended June 30, 2010. The primary reason for the increase was a \$3.0 million increase in airtime costs of sales for our mini-VSAT Broadband service primarily as a result of increased costs related to the build-out and operation of the network and support infrastructure for our mini-VSAT Broadband service. This increase was partially offset by a decrease of \$0.5 million in contracted engineering services costs of sales.





---

**Table of Contents**

Gross margin from product sales for the six months ended June 30, 2011 decreased to 44% from 45% in the year-ago period. The primary reason for the decrease in gross margin was the decrease in FOG and aeronautical product sales discussed above.

Gross margin from service sales for the six months ended June 30, 2011 decreased to 16% from 19% in the year-ago period. The deterioration in our gross margin from service sales was primarily attributable to increased costs related to the build-out and operation of the network and support infrastructure for our mini-VSAT Broadband service.

***Operating Expenses***

Sales, marketing and support expense for the six months ended June 30, 2011 increased by \$1.9 million, or 21%, to \$11.2 million from \$9.2 million for the six months ended June 30, 2010. The primary reason for the increase in 2011 was a \$1.0 million increase in commission expense primarily as a result of a \$3.4 million international TACNAV order and as a result of the increase in mini-VSAT Broadband service sales discussed above. Also contributing to the increase was a \$0.6 million increase in sales, marketing and support expense related to our Singaporean, Norwegian and Brazilian subsidiaries, which were incorporated or acquired during 2010, as well as a \$0.4 million increase in U.S.-based employee compensation for sales, marketing and support, primarily in connection with the global expansion of our mini-VSAT Broadband satellite communication service. Partially offsetting the increase was a \$0.3 million decrease in warranty expense. As a percentage of sales, sales, marketing and support expense increased during the six months ended June 30, 2011 to 20% from 16% for the six months ended June 30, 2010, due primarily to the decrease in FOG and aeronautical product sales discussed above, as well as the increase in commission expense and foreign subsidiaries added or acquired in 2010 as discussed above.

Research and development expense for the six months ended June 30, 2011 increased by \$0.8 million, or 15%, to \$5.9 million from \$5.1 million for the six months ended June 30, 2010. The primary reason for the increase in 2011 expense was a \$0.4 million decrease in customer-funded engineering costs for contracted engineering services. Also contributing to the increase was a \$0.2 million increase in research and development expense related to our Norwegian subsidiary, which was acquired in September 2010, and a \$0.2 million increase in U.S.-based engineering-related employee compensation, material and consulting costs, primarily in connection with the general increase in development of all products and specifically of our TracPhone V3, which began shipments in the second quarter of 2011. As a percentage of sales, research and development expense increased during the six months ended June 30, 2011 to 11% from 9% for the six months ended June 30, 2010, due primarily to the decrease in FOG and aeronautical product sales discussed above, as well the addition of our Norwegian subsidiary.

General and administrative expense for the six months ended June 30, 2011 increased by \$0.8 million, or 17%, to \$5.5 million from \$4.7 million for the six months ended June 30, 2010. The primary reason for the increase in 2011 expense was a \$0.5 million increase in general and administrative expenses related to our Norwegian subsidiary, which was acquired in September 2010. Also contributing to the increase was a \$0.3 million increase in U.S.-based employee compensation for the general and administrative department. As a percentage of sales, general and administrative expense increased during the six months ended June 30, 2011 to 10% from 8% for the six months ended June 30, 2010, due primarily to the decrease in FOG and aeronautical product sales discussed above, as well as the addition of our Norwegian subsidiary.

***Income Tax Benefit***

Income tax benefit for the six months ended June 30, 2011 decreased by \$2.9 million to a \$0.1 million tax benefit from a \$2.9 million tax benefit for the six months ended June 30, 2010. The primary reason for the decrease in 2011 was based upon our conclusion in 2010 that \$3.3 million of deferred tax asset valuation allowance was no longer required. Also contributing to the decrease in income tax benefit was a reduction in our annual estimated effective income tax rate in the second quarter of 2011, which resulted in a reduction to the previous tax benefit recorded at a higher estimated income tax rate. The decrease in our annual estimated effective income tax rate was driven by an anticipated decline in leisure marine and recreational vehicle satellite television product sales for the remainder of 2011, as well as our ability to capture additional Rhode Island state tax credits from the construction of our new production facility that began in the second quarter of 2011.

***Backlog***

Our backlog for all products and services was approximately \$16.7 million and \$20.8 million on June 30, 2011 and December 31, 2010, respectively. The decrease in backlog of \$4.1 million from December 31, 2010 was primarily a result of a decrease in guidance and stabilization orders associated with our TACNAV product, as well as a reduction in fiber optic gyro product orders in support for the U.S. Navy's MK54 torpedo program.

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

---

**Table of Contents**

date of cancellation and the costs resulting from termination. As of June 30, 2011, our backlog included approximately \$14.0 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.

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.

***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, 2011, we had \$32.5 million in cash, cash equivalents and marketable securities, of which \$2.1 million, \$0.9 million and \$0.6 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, 2011. As of June 30, 2011, we had \$58.7 million in working capital.

Net cash used in operations was \$0.8 million for the six months ended June 30, 2011 as compared to net cash provided by operations of \$6.3 million for the six months ended June 30, 2010. The decrease is primarily due to an \$8.7 million decrease in net income as well as a \$1.7 million increase in cash outflows related to accounts payable and accrued expenses, a \$1.7 million increase in cash outflows due to increased inventory levels, a \$0.9 million increase in cash outflows related to other non-current assets and a \$0.2 million increase in cash outflows related to deferred revenue. The increase in cash outflows was partially offset by a \$0.8 million increase in cash inflows attributable to accounts receivable and a \$0.2 million decrease in cash outflows related to other long-term liabilities.

Net cash provided by investing activities was \$1.5 million for the six months ended June 30, 2011 as compared to net cash used in investing activities of \$6.9 million for the six months ended June 30, 2010. The increase in cash inflows is primarily due to an \$8.6 million decrease in our net investment in marketable securities. This increase in cash inflows was partially offset by a \$0.2 million increase in capital expenditures.

Net cash provided by financing activities was \$0.1 for the six months ended June 30, 2011 as compared to net cash provided by financing activities of \$1.7 million for the six months ended June 30, 2010. The decrease is primarily due to a \$1.4 million decrease in proceeds from exercises of stock options and purchases of shares under our employee stock purchase plan. Also contributing to the decrease in net cash provided by financing activities was a \$0.1 million increase in payments of employee restricted stock tax withholdings.

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 \$5.0 million as of June 30, 2011 secure the mortgage loan. The monthly mortgage payment is approximately \$10,500 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, 2011, 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 16 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, 2011, 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 March 31, 2012, we have the option of converting up to \$12 million of revolving loans into one or more term loans at a floating interest rate



---

**Table of Contents**

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, 2011, no borrowings were outstanding under the facility.

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, 2011, there were 798,676 shares that may yet be purchased under this program. We did not repurchase any shares of our common stock during the six months ended June 30, 2011 under the program.

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 investment, we expect that we will purchase additional hubs from ViaSat over time for capacity and/or regional expansion. Each satellite hub represents a substantial capital investment. In 2008, we entered into an agreement to lease satellite capacity in order to provide coverage in the Pacific Ocean. In 2009, we entered into several agreements with various satellite owners in order to provide satellite coverage to North American, Caribbean, African, Asia-Pacific, Indian Ocean, Australian and New Zealand waters. During the third quarter of 2010, we entered into an agreement to lease satellite capacity to provide coverage in offshore Brazilian waters. In addition to these agreements, as part of future potential capacity and coverage 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, under an agreement with an outside developer, we began construction of a new manufacturing facility near our Middletown location. The total cost of the construction, including land, building and equipment setup, is estimated to be between \$12 and \$14 million. We anticipate financing up to \$12 million of this construction project and using our existing cash and cash equivalents to fund any remaining costs.

We believe that the \$32.5 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, 2011, 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, 2011.

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, 2011, 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, 2011, 68% of the \$24.6 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, 2011.

To the extent that we borrow against our variable-rate credit facility, we will be subject to interest rate risk. There were no borrowings outstanding at June 30, 2011.

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

As previously discussed in note 16 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.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

***Evaluation of Disclosure Controls and Procedures***

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.

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, 2011.

***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 2011. 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 2011 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 two to five 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. Governments are experiencing significant declines in tax receipts, which may cause them to curtail spending significantly or reallocate funds away from defense programs. For example, sales of our FOG products declined 38% from the six months ended June 30, 2010 to the six months ended June 30, 2011. 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 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. For example, sales of those products declined 5% from the six months ended June 30, 2010 to the six months ended June 30, 2011. The pace of decline could accelerate. Some consumers have chosen not to purchase our mobile communications products due to a perception that they are luxury items, and this trend may increase. 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. 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. For example, in the second quarter of 2011, we recorded approximately \$0.1 million in bad debt expense associated with the bankruptcy liquidation of a commercial lease customer.

## **Table of Contents**

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

During 2009, we recorded \$1.3 million in inventory reserve charges to account for excess inventory that resulted from a substantial decline in customer demand due to the 2008-2009 economic downturn, design changes by our suppliers and increased price competition. During 2010 we wrote off approximately \$0.6 million of fully reserved inventory. 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. During the years ended December 31, 2009 and 2010, we experienced a significant increase in sales of our guidance and stabilization products, primarily due to an increase in our FOG product sales. However, during the first half of 2011, we experienced a 17% decline in sales of our guidance and stabilization products. 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 V7, TracPhone V3 and our mini-VSAT Broadband service in order to improve our service gross margins.**

As a result of our continued build-out of the 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. If sales of our TracPhone V7, TracPhone V3 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. For example, our overall service gross margin, which also includes Inmarsat airtime sales, contracted engineering sales and product repair sales declined from 19% for the six months ended June 30, 2010 to 16% for the six months ended June 30, 2011. 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 NaviSystem Marine Electronic Systems Srl, King Controls, Cobham Sea Tel, Inc., Raymarine, Thrane & Thrane A/S and Intellian.

In the market for maritime broadband service we compete with Speedcast, MTN/SeaMobile, CapRock, Schlumberger, Ship Equip, Vizada and Stratos.

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

In the marine market for satellite communications equipment, we compete with Cobham Sea Tel, Inc., Furuno Electric Co., Ltd., Globalstar LP, Thrane & Thrane A/S, Intellian, Ship Equip, JRC and Iridium Satellite LLC.

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

---

## **Table of Contents**

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

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 mini-VSAT Broadband service.**

Our TracPhone V7 and TracPhone V3 systems offer customers a range of benefits due to their integrated design, hardware costs that are lower than existing maritime VSAT systems, and spread spectrum technology. We currently compete against companies that offer established maritime 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. In addition, other companies could replicate some of the distinguishing features of our TracPhone V7 or TracPhone V3, 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 complete or expand coverage of our mini-VSAT Broadband service around the globe to provide sufficient service capacity to meet customer demand.**

The TracPhone V7 and V3 and 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 recently completed the rollout of our original network coverage plan and currently offer service in the north Pacific Ocean, the Americas, Caribbean, North Atlantic, Europe, the Persian Gulf, Asia-Pacific, Africa, Brazil and the remainder of South America, Australian and New Zealand waters, and the Indian Ocean. In the future, we may elect to continue the expansion of the coverage areas of the mini-VSAT Broadband service into currently unserved regions. Likewise, 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:

changes in modernization plans for military equipment;

changes in tactical navigation requirements;

global conflicts impacting troop deployment;

priorities for current battlefield operations;

allocation of funding for military programs;

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

---

**Table of Contents**

delays in the testing and acceptance of our products, including delays resulting from changes in customer specifications. These factors can cause substantial fluctuations in sales of our FOG and TACNAV 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 \$7.7 million or 38% from the first half of 2010 to the first half of 2011. Sales of FOG products have slowed as the industry awaits updates on the U.S. Army's plans for its next procurement of remote weapon systems under the Common Remotely Operated Weapon Station program. The Obama administration and Congress may change defense spending priorities, either in conjunction with the decision to commence 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 March 2011, we received a \$2.7 million fiber optic gyro products order, of which \$1.0 million was shipped during the second quarter of 2011. In April 2011, we also received a \$3.7 million TACNAV products order, which was subsequently modified to \$3.4 million and was shipped during the second quarter of 2011. 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. Our top four guidance and stabilization customers accounted for approximately 29% of our net sales during 2010. In 2011, our top four guidance and stabilization customers accounted for approximately 21% of our net sales during the first half of 2011. 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.

**The future of our aviation business is uncertain.**

In February 2008, we entered into a \$20.1 million long-term antenna development and production agreement with LiveTV that in 2009 was increased to \$20.9 million. Under the terms of the agreement with LiveTV, we manufacture a satellite television antenna for use on narrowbody commercial aircraft operating in the United States. We began shipment of the antennas in the second quarter of 2009.

The status of this production agreement is uncertain at this time as LiveTV has asked us to postpone deliveries again under the contract. We were unable to reach agreement with LiveTV on delivery dates and, as a result, we believe that the contract has terminated. LiveTV disputes this interpretation and we are continuing to negotiate regarding the contract and the placement of orders. However, we cannot be certain that these negotiations will lead to new orders. If we are unable to reach agreement with LiveTV regarding the placement of new orders, we would record a charge of approximately \$3.1 million related to the write-off of capitalized aviation research and development costs and inventory specific to the aviation antenna. We anticipate that the charges would be offset by a termination fee payable by LiveTV; however, LiveTV could dispute the amount of the termination fee and/or refuse to pay it, in which case we may incur costs to collect the fee, including potential litigation expenses.

If we receive no orders from LiveTV, our future net sales and results of operations would be negatively impacted, as we currently do not have another customer in the aviation market.

---

## **Table of Contents**

### **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 World Skies, Eutelsat, Sky Perfect-JSAT, GE Satellite, Telesat, EchoStar, Optus and Star One currently provide the satellite capacity to support the mini-VSAT Broadband service and our TracPhone V7 and V3. In addition, we have agreements with various teleports and Internet Service Providers (ISPs) 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 and our 14.5-inch diameter TracPhone V3 antenna, which commenced shipping during the second quarter of 2011, and any disruption in the availability of this technology could adversely affect sales.**

Our mini-VSAT Broadband service relies on spread spectrum technology developed with ViaSat, Inc., for use with satellite capacity controlled by SES World Skies, Eutelsat, Sky Perfect-JSAT, GE Satellite, Telesat, Echostar, Star One and Optus. Our TracPhone V7 and V3 two-way broadband satellite terminal combines our stabilized antenna technology with ViaSat's ArcLight spread spectrum mobile broadband technology, along with a new maritime version of ViaSat's ArcLight spread spectrum modem. The ArcLight technology is also integrated within the satellite hubs that support this service. Sales of the TracPhone V7 and V3 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 the initial 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 the 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 and we expect to purchase new regional satellite hubs from ViaSat. Each satellite hub represents a substantial capital investment. During the initial deployment period, we have 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 an increase in costs if we pursue expanded coverage in the future. In the short term, KVH and ViaSat will be covering the operational cost per transponder access until sufficient subscribers join the network and allow us to reach acceptable gross margin levels relating to our transponder and other network service costs, which may not occur. We currently estimate that, on average, it will require 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 historically high fuel prices, tight credit, environmental protection laws and ongoing low levels of consumer confidence are continuing to 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 has reduced demand for both these vehicles and vessels and our mobile satellite TV products. Moreover, in the current credit markets, financing for these purchases has been unavailable or more difficult to obtain. The increased cost of operating these vehicles and vessels is adversely affecting and may continue to adversely affect



demand for our mobile satellite TV products.

---

## **Table of Contents**

### **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 in the U.S., 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 from foreign countries such as China and Mexico. 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 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. 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 in connection with the build-out of our mini-VSAT network. This growth placed a strain on our personnel, management, financial and other resources. Although both our guidance and stabilization product revenue and our mobile

## **Table of Contents**

communications product revenue increased dramatically in 2010, they have both declined dramatically in earlier periods as well as declined during the first half of 2011 in response to economic conditions, weak consumer demand and other factors. If, in the future, 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.

### **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 and 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 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;

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

## **Table of Contents**

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.

### **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;

**Table of Contents**

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.

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 carryforwards. 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 November 1, 2008 to June 30, 2011, the trading price of our common stock ranged from \$2.81 to \$16.68. 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, such as our 2010 acquisition of Virtek Communication, now named KVH Norway. The expenses we incur evaluating and pursuing this and other such acquisitions could have a material adverse effect on our results of operations. For example, we incurred \$0.6 million of transaction expenses in 2010 in connection with the Virtek Communication acquisition. If we acquire a business, we may be unable to manage it profitably or

**Table of Contents**

successfully integrate its operations with our own. Moreover, we may be unable to realize the 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;

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, 2011 and no repurchase programs expired during the period.

Period		Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares That May Yet be Purchased Under the Programs
April 1, 2011	April 30, 2011				798,676
May 1, 2011	May 31, 2011				798,676
June 1, 2011	June 30, 2011				798,676

Total

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

Exhibit No.	Description	Filed with		Incorporated by Reference	
		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
10.1	Fifth Amendment and Note Modification Agreement, dated June 9, 2011 by and between KVH Industries, Inc. (the Borrower ) and Bank of America, N.A. (the Lender ), amending the Amended and Restated Credit and Security Agreement, dated July 17, 2003, as amended		8-K	June 14, 2011	10.1
10.2	Second Amendment, dated June 9, 2011 by and between KVH Industries, Inc. (the Borrower ) and Bank of America, N.A. (the Lender ), amending the Loan Agreement, dated April 6, 2009, as amended		8-K	June 14, 2011	10.2
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, 2011 and December 31, 2010, (b) our Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2011 and 2010, and (c) our Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2011 and 2010 and (d) the Notes to such Consolidated Financial Statements.				

\* To be filed by amendment.

**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 4, 2011

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**

<b>Exhibit</b>	<b>Description</b>	<b>Filed with</b>		<b>Incorporated by Reference</b>	
		<b>this Form</b>			
<b>No.</b>		<b>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
10.1	Fifth Amendment and Note Modification Agreement, dated June 9, 2011 by and between KVH Industries, Inc. (the Borrower ) and Bank of America, N.A. (the Lender ), amending the Amended and Restated Credit and Security Agreement, dated July 17, 2003, as amended		8-K	June 14, 2011	10.1
10.2	Second Amendment, dated June 9, 2011 by and between KVH Industries, Inc. (the Borrower ) and Bank of America, N.A. (the Lender ), amending the Loan Agreement, dated April 6, 2009, as amended		8-K	June 14, 2011	10.2
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, 2011 and December 31, 2010, (b) our Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2011 and 2010, and (c) our Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2011 and 2010 and (d) the Notes to such Consolidated Financial Statements.				

\* To be filed by amendment.