

KVH INDUSTRIES INC \DE\  
Form 10-Q  
May 09, 2013

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: March 31, 2013

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)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)  
50 Enterprise Center, Middletown, RI 02842  
(Address of Principal Executive Offices) (Zip Code)  
(401) 847-3327  
(Registrant's Telephone Number, Including Area Code)

05-0420589  
(I.R.S. Employer  
Identification Number)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

| Date        | Class                                    | Outstanding shares |
|-------------|--|--------------------|
| May 3, 2013 | Common Stock, par value \$0.01 per share | 15,510,874         |



KVH INDUSTRIES, INC. AND SUBSIDIARIES  
 Form 10-Q  
 INDEX

|  | Page No.  |
|--|-----------|
| <u>PART I. FINANCIAL INFORMATION</u>   |           |
| ITEM 1. <u>FINANCIAL STATEMENTS</u>  |           |
| <u>Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012 (unaudited)</u>                                    | <u>3</u>  |
| <u>Consolidated Statements of Operations for the three months ended March 31, 2013 and 2012 (unaudited)</u>                  | <u>4</u>  |
| <u>Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2013 and 2012 (unaudited)</u> | <u>5</u>  |
| <u>Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012 (unaudited)</u>                  | <u>6</u>  |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>  | <u>7</u>  |
| ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>                         | <u>13</u> |
| ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>  | <u>19</u> |
| ITEM 4. <u>CONTROLS AND PROCEDURES</u>   | <u>19</u> |
| <u>PART II. OTHER INFORMATION</u>  |           |
| ITEM 1. <u>LEGAL PROCEEDINGS</u>   | <u>21</u> |
| ITEM 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>   | <u>21</u> |
| ITEM 6. <u>EXHIBITS</u>  | <u>22</u> |
| <u>SIGNATURE</u>   | <u>23</u> |
| <u>EXHIBIT INDEX</u>   | <u>24</u> |

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## KVH INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

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

|   | March 31,<br>2013 | December 31,<br>2012 |
|---|-------------------|----------------------|
| <b>ASSETS</b>   |                   |                      |
| Current assets:   |                   |                      |
| Cash and cash equivalents   | \$6,529           | \$8,978              |
| Marketable securities   | 38,316            | 29,307               |
| Accounts receivable, net of allowance for doubtful accounts of approximately \$606 as of March 31, 2013 and \$929 as of December 31, 2012   | 29,392            | 27,654               |
| Inventories   | 16,918            | 16,203               |
| Prepaid expenses and other assets   | 4,071             | 3,264                |
| Deferred income taxes   | 824               | 1,146                |
| Total current assets  | 96,050            | 86,552               |
| Property and equipment, less accumulated depreciation of \$32,834 as of March 31, 2013 and \$31,657 as of December 31, 2012   | 35,912            | 36,733               |
| Intangible assets, less accumulated amortization of \$873 as of March 31, 2013 and \$826 as of December 31, 2012  | 1,524             | 1,684                |
| Goodwill  | 4,527             | 4,712                |
| Other non-current assets  | 4,137             | 4,363                |
| Deferred income taxes   | 3,153             | 3,524                |
| Total assets  | \$145,303         | \$137,568            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                   |                      |
| Current liabilities:  |                   |                      |
| Accounts payable  | \$6,760           | \$7,086              |
| Accrued compensation and employee-related expenses  | 5,093             | 6,785                |
| Accrued other   | 5,409             | 4,595                |
| Accrued product warranty costs  | 803               | 814                  |
| Deferred revenue  | 2,074             | 1,892                |
| Current portion of long-term debt   | 1,098             | 138                  |
| Total current liabilities   | 21,237            | 21,310               |
| Other long-term liabilities   | 1,309             | 140                  |
| Line of credit  | 7,000             | 7,000                |
| Long-term debt, excluding current portion   | 7,009             | 3,414                |
| Total liabilities   | 36,555            | 31,864               |
| Commitments and contingencies (notes 3 and 9)   |                   |                      |
| Stockholders' equity:   |                   |                      |
| Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued   | —                 | —                    |
| Common stock, \$0.01 par value. Authorized 30,000,000 shares, 16,785,842 and 16,563,836 shares issued at March 31, 2013 and December 31, 2012; and 15,126,851 and 14,904,845 shares outstanding at March 31, 2013 and December 31, 2012, respectively | 168               | 166                  |
| Additional paid-in capital  | 112,947           | 111,514              |
| Retained earnings   | 9,270             | 7,307                |
| Accumulated other comprehensive loss  | (487)             | (133)                |
|   | (13,150)          | (13,150)             |

Less: treasury stock at cost, common stock, 1,658,991 shares as of March 31, 2013  
and December 31, 2012

|  |           |           |
|--|-----------|-----------|
| Total stockholders' equity                 | 108,748   | 105,704   |
| Total liabilities and stockholders' equity | \$145,303 | \$137,568 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

3

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Table of Contents

KVH INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except share and per share amounts, unaudited)

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2013                            | 2012       |
| Sales:  |                                 |            |
| Product   | \$25,216                        | \$17,083   |
| Service   | 14,711                          | 9,645      |
| Net sales   | 39,927                          | 26,728     |
| Costs and expenses:                               |                                 |            |
| Costs of product sales                            | 13,909                          | 10,983     |
| Costs of service sales                            | 10,249                          | 5,802      |
| Research and development                          | 2,950                           | 3,141      |
| Sales, marketing and support                      | 6,943                           | 5,332      |
| General and administrative                        | 3,374                           | 2,947      |
| Total costs and expenses                          | 37,425                          | 28,205     |
| Income (loss) from operations                     | 2,502                           | (1,477 )   |
| Interest income                                   | 168                             | 103        |
| Interest expense                                  | 76                              | 82         |
| Other income, net                                 | 24                              | 37         |
| Income (loss) before income tax expense (benefit) | 2,618                           | (1,419 )   |
| Income tax expense (benefit)                      | 655                             | (44 )      |
| Net income (loss)                                 | \$1,963                         | \$(1,375 ) |
| Per share information:                            |                                 |            |
| Net income (loss) per share                       |                                 |            |
| Basic and diluted                                 | \$0.13                          | \$(0.09 )  |
| Number of shares used in per share calculation:   |                                 |            |
| Basic   | 14,989,248                      | 14,604,942 |
| Diluted   | 15,219,043                      | 14,604,942 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

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

|  | Three Months Ended<br>March 31, |          |   |
|--|---------------------------------|----------|---|
|  | 2013                            | 2012     |   |
| Net income (loss)                                | \$ 1,963                        | \$(1,375 | ) |
| Other comprehensive income (loss), net of tax:   |                                 |          |   |
| Unrealized loss on available-for-sale securities | (5                              | ) (4     | ) |
| Currency translation adjustment (loss) gain      | (391                            | ) 515    |   |
| Unrealized gain on derivatives                   | 42                              | 35       |   |
| Other comprehensive (loss) income, net of tax    | (354                            | ) 546    |   |
| Total comprehensive income (loss)                | \$ 1,609                        | \$(829   | ) |

See accompanying Notes to Unaudited Consolidated Financial Statements.

5

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Table of Contents

KVH INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands, unaudited)

|  | Three Months Ended |           |   |
|--|--------------------|-----------|---|
|  | March 31,          |           |   |
|  | 2013               | 2012      |   |
| Cash flows from operating activities:  |                    |           |   |
| Net income (loss)  | \$ 1,963           | \$(1,375  | ) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                    |           |   |
| Provision for doubtful accounts  | 72                 | —         |   |
| Depreciation and amortization  | 1,224              | 1,115     |   |
| Deferred income taxes  | 683                | 102       |   |
| Loss on interest rate swaps  | 31                 | 32        |   |
| Compensation expense related to stock-based awards and employee stock purchase plan      | 1,082              | 1,017     |   |
| Changes in operating assets and liabilities:   |                    |           |   |
| Accounts receivable  | (1,825             | ) 7,614   |   |
| Inventories  | (721               | ) 1,098   |   |
| Prepaid expenses and other assets  | (813               | ) (66     | ) |
| Other non-current assets   | 227                | 152       |   |
| Accounts payable   | (332               | ) (1,044  | ) |
| Deferred revenue   | 182                | (1,610    | ) |
| Accrued expenses   | (565               | ) (1,962  | ) |
| Other long-term liabilities  | 1,170              | 6         |   |
| Net cash provided by operating activities  | 2,378              | 5,079     |   |
| Cash flows from investing activities:  |                    |           |   |
| Capital expenditures   | (790               | ) (2,206  | ) |
| Purchases of marketable securities   | (12,705            | ) (19,440 | ) |
| Maturities and sales of marketable securities  | 3,701              | 17,221    |   |
| Net cash used in investing activities  | (9,794             | ) (4,425  | ) |
| Cash flows from financing activities:  |                    |           |   |
| Repayments of long-term debt   | (116               | ) (32     | ) |
| Borrowings from long-term debt   | 4,671              | —         |   |
| Proceeds from stock options exercised and employee stock purchase plan                   | 1,199              | 218       |   |
| Payment of employee restricted stock withholdings  | (828               | ) (333    | ) |
| Repayments of line of credit borrowings  | —                  | (2,000    | ) |
| Net cash provided by (used in) financing activities                                      | 4,926              | (2,147    | ) |
| Effect of exchange rate changes on cash and cash equivalents                             | 41                 | 26        |   |
| Net (decrease) in cash and cash equivalents  | (2,449             | ) (1,467  | ) |
| Cash and cash equivalents at beginning of period   | 8,978              | 7,017     |   |
| Cash and cash equivalents at end of period   | \$6,529            | \$5,550   |   |

See accompanying Notes to Unaudited Consolidated Financial Statements.



Table of Contents

**KVH INDUSTRIES, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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

(1) Description of Business

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

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

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

KVH's mobile communications service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, DIRECTV account 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 our TracPhone V-series customers. KVH also earns monthly usage fees for third-party satellite connectivity for voice, data and Internet services to its Inmarsat TracPhone customers who choose to activate their subscriptions with KVH. Under current DIRECTV programs, KVH is eligible to receive a new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through KVH.

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

(2) Basis of Presentation

The accompanying consolidated financial statements of KVH Industries, Inc. and its wholly-owned subsidiaries, KVH Industries A/S, KVH Industries Pte. Ltd., KVH Industries Brasil Comunicacao Por Satelite Ltda., KVH Industries Japan Co. Ltd., and KVH Industries Norway A/S (collectively, KVH or the Company), have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company has evaluated all subsequent events through the date of this filing. Given that KVH Industries A/S, KVH Industries Pte. Ltd., KVH Industries Japan Co. Ltd., and KVH Industries Brasil Comunicacao Por Satelite Ltda. operate as the Company's European, Singaporean, Japanese and Brazilian international distributors, all of their operating expenses are reflected within sales, marketing and support within the accompanying consolidated statements of operations. KVH Industries Norway A/S, a subsidiary of KVH Industries A/S, develops and distributes middleware software solutions known as CommBox technology, which is included in the Company's satellite communications products and services. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements have not been audited by our independent registered public accounting firm and include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition, results of operations, and cash flows for the periods presented. These consolidated financial statements do not include all disclosures associated with annual financial

statements and accordingly should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual report on Form 10-K for the year ended December 31, 2012 filed on April 2, 2013 with the Securities and Exchange Commission. The results for the three months ended March 31, 2013 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. As described in the Company's annual report on Form 10-K, the most 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. The Company has reviewed these estimates and determined that these, as well as the additional revenue recognition discussion below, remain the most significant estimates for the quarter ended March 31, 2013.

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.

The Company has accounted for its \$35,600 contract received in June 2012 from the Saudi Arabian National Guard, or SANG, to purchase TACNAV products and services under Accounting Standards Codification (ASC) 605-25, Multiple-Element Arrangements.

The total contract value associated with TACNAV products is \$21,200 for which shipments are estimated to be substantially completed in the second quarter of 2013. Revenue is recognized for these product sales after transfer of title and risk of loss after inspection occurs. The total contract value associated with all services is \$14,400 which are estimated to continue through 2014. The contract value for the services portion of the SANG TACNAV order remaining to be performed as of April 1, 2013 is approximately \$8,500. The revenue for these services is recognized using the percentage of completion accounting method. The Company limits the amount of revenue recognized for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations, or subject to customer-specific return or refund privileges.

### (4) Stock-Based Compensation

The Company recognizes stock-based compensation in accordance with the provisions of ASC 718, Compensation-Stock Based Compensation. Stock-based compensation expense was \$1,082 and \$1,017 for the three months ended March 31, 2013 and March 31, 2012, respectively. As of March 31, 2013, there was \$2,682 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 2.60 years. As of March 31, 2013, there was \$4,242 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 2.78 years.

The Company granted 225,625 restricted stock awards to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three months ended March 31, 2013. 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.

No stock options were granted 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 months ended March 31, 2013.

The fair value of stock options granted during 2012 was estimated as of the date of grant using the Black-Scholes option-pricing model. The weighted-average fair value per share for all options granted during the three months ended March 31, 2012 was \$4.67.

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

Basic net income (loss) per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined with the treasury stock accounting method. Common stock equivalents related to options and restricted stock awards for 439,970 shares of common stock for the three months ended March 31, 2013 have been excluded from the fully diluted calculation of net income per share, as inclusion would be anti-dilutive. The Company has excluded all outstanding stock options and non-vested restricted shares from the calculation of diluted earnings per share for the three months ended March 31, 2012 because the net loss causes these outstanding stock options and non-vested restricted shares to be anti-dilutive.

Table of Contents

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

|  | Three Months Ended<br>March 31, |            |
|--|---------------------------------|------------|
|  | 2013                            | 2012       |
| Weighted average common shares outstanding—basic               | 14,989,248                      | 14,604,942 |
| Dilutive common shares issuable in connection with stock plans | 229,795                         | —          |
| Weighted average common shares outstanding—diluted             | 15,219,043                      | 14,604,942 |

**(6) Inventories**

Inventories are stated at the lower of cost or market using the first-in first-out costing method. Inventories as of March 31, 2013 and December 31, 2012 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

|                 | March 31,<br>2013 | December 31,<br>2012 |
|-----------------|-------------------|----------------------|
| Raw materials   | \$9,162           | \$9,173              |
| Work in process | 2,194             | 1,789                |
| Finished goods  | 5,562             | 5,241                |
|                 | \$16,918          | \$16,203             |

**(7) Product Warranty**

The Company's products carry limited warranties that typically range from one to two 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 March 31, 2013 and December 31, 2012, the Company had accrued product warranty costs of \$803 and \$814, respectively. The following table summarizes product warranty activity during 2013 and 2012:

|                    | Three Months Ended<br>March 31, |        |
|--------------------|---------------------------------|--------|
|                    | 2013                            | 2012   |
| Beginning balance  | \$814                           | \$933  |
| Charges to expense | 315                             | 161    |
| Costs incurred     | (326                            | ) (146 |
| Ending balance     | \$803                           | \$948  |

**(8) Segment Reporting**

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

The Company operates in two geographic segments, exclusively in the mobile communications, navigation and guidance and stabilization equipment industry, which it considers to be a single business activity. The Company has two primary product categories: mobile communications and guidance and stabilization. Mobile communication sales and services include marine, land mobile, automotive, and aeronautical communication equipment and satellite-based voice, television and Broadband

Table of Contents

Internet connectivity services, as well as DIRECTV 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:

| Three months ended March 31, 2013                          | Sales Originating From |                 | Total      |
|--|------------------------|-----------------|------------|
|  | Americas               | Europe and Asia |            |
| Mobile communications sales to the United States           | \$17,482               | \$—             | \$17,482   |
| Mobile communications sales to Canada                      | 162                    | —               | 162        |
| Mobile communications sales to Europe                      | 118                    | 3,484           | 3,602      |
| Mobile communications sales to other geographic areas      | 910                    | 751             | 1,661      |
| Guidance and stabilization sales to the United States      | 1,443                  | —               | 1,443      |
| Guidance and stabilization sales to Canada                 | 2,954                  | —               | 2,954      |
| Guidance and stabilization sales to Europe                 | 2,710                  | —               | 2,710      |
| Guidance and stabilization sales to other geographic areas | 9,913                  | —               | 9,913      |
| Intercompany sales   | 605                    | 377             | 982        |
| Subtotal   | 36,297                 | 4,612           | 40,909     |
| Eliminations   | (605                   | ) (377          | ) (982     |
| Net sales  | \$35,692               | \$4,235         | \$39,927   |
| Segment net income   | \$1,200                | \$763           | \$1,963    |
| Depreciation and amortization                              | \$1,150                | \$74            | \$1,224    |
| Total assets   | \$125,565              | \$19,738        | \$145,303  |
| Three months ended March 31, 2012                          | Sales Originating From |                 | Total      |
|  | Americas               | Europe and Asia |            |
| Mobile communications sales to the United States           | \$14,050               | \$—             | \$14,050   |
| Mobile communications sales to Canada                      | 148                    | —               | 148        |
| Mobile communications sales to Europe                      | 125                    | 4,290           | 4,415      |
| Mobile communications sales to other geographic areas      | 928                    | 1,290           | 2,218      |
| Guidance and stabilization sales to the United States      | 913                    | —               | 913        |
| Guidance and stabilization sales to Canada                 | 2,566                  | —               | 2,566      |
| Guidance and stabilization sales to Europe                 | 2,037                  | —               | 2,037      |
| Guidance and stabilization sales to other geographic areas | 381                    | —               | 381        |
| Intercompany sales   | 2,993                  | 424             | 3,417      |
| Subtotal   | 24,141                 | 6,004           | 30,145     |
| Eliminations   | (2,993                 | ) (424          | ) (3,417   |
| Net sales  | \$21,148               | \$5,580         | \$26,728   |
| Segment net loss   | \$(1,271               | ) \$(104        | ) \$(1,375 |
| Depreciation and amortization                              | \$980                  | \$135           | \$1,115    |
| Total assets   | \$102,716              | \$19,337        | \$122,053  |

## (9) Legal Matters

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

cash flows.

10

---



Table of Contents

## (10) Share Buyback Program

On November 26, 2008, the Company's Board of Directors authorized a program to repurchase up to one million shares of the Company's common stock. As of March 31, 2013, 341,009 shares of the Company's common stock remain available for repurchase under the authorized program. The repurchase program is funded using the Company's existing cash, cash equivalents, marketable securities and future cash flows. Under the repurchase program, the Company, at management's discretion, may repurchase shares on the open market from time to time, in privately negotiated transactions or block transactions, or through an accelerated repurchase agreement. The timing of such repurchases depends on availability of shares, price, market conditions, alternative uses of capital, and applicable regulatory requirements. The program may be modified, suspended or terminated at any time without prior notice. The repurchase program has no expiration date. There were no other repurchase programs outstanding during the three months ended March 31, 2013 and no repurchase programs expired during the period.

The Company did not repurchase any shares of its common stock in the three months ended March 31, 2013.

## (11) 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, United States treasuries, corporate notes, and certificates of deposit.
- 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 assets.

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:

- (a) Market approach—prices and other relevant information generated by market transactions involving identical or comparable assets
- (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)
- 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
- (d) 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 March 31, 2013 and December 31, 2012 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy:

| March 31, 2013            | Total    | Level 1  | Level 2 | Level 3 | Valuation Technique |
|---------------------------|----------|----------|---------|---------|---------------------|
| Assets                    |          |          |         |         |                     |
| Money market mutual funds | \$15,852 | \$15,852 | \$—     | \$—     | (a)                 |
| Government agency bonds   | 7,801    | 7,801    | —       | —       | (a)                 |
| United States treasuries  | 8,615    | 8,615    | —       | —       | (a)                 |
| Corporate notes           | 3,679    | 3,679    | —       | —       | (a)                 |

|                         |       |       |       |     |     |
|-------------------------|-------|-------|-------|-----|-----|
| Certificates of deposit | 2,369 | 2,369 | —     | —   | (a) |
| Liabilities             |       |       |       |     |     |
| Interest rate swaps     | \$500 | \$—   | \$500 | \$— | (d) |

11

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Table of Contents

| December 31, 2012         | Total   | Level 1 | Level 2 | Level 3 | Valuation Technique |
|---------------------------|---------|---------|---------|---------|---------------------|
| Assets                    |         |         |         |         |                     |
| Money market mutual funds | \$9,921 | \$9,921 | \$—     | \$—     | (a)                 |
| Government agency bonds   | 6,817   | 6,817   | —       | —       | (a)                 |
| United States treasuries  | 6,089   | 6,089   | —       | —       | (a)                 |
| Corporate notes           | 4,679   | 4,679   | —       | —       | (a)                 |
| Certificates of deposit   | 1,800   | 1,800   | —       | —       | (a)                 |
| Liabilities               |         |         |         |         |                     |
| Interest rate swaps       | \$542   | \$—     | \$542   | \$—     | (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.

## (12) Business and Credit Concentrations

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

|  | Three Months Ended |      |   |
|--|--------------------|------|---|
|  | March 31, 2013     | 2012 |   |
| Net sales to foreign customers outside the U.S. and Canada | 45                 | % 34 | % |
| Net sales to Customer A                                    | 23                 | % *  |   |

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

## (13) 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 March 31, 2013, the fair value of the derivatives is included in other accrued liabilities and the unrealized gain is included in other comprehensive income.

As of March 31, 2013, the Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

| Interest Rate Derivatives | Notional<br>(in thousands) | Asset<br>(Liability) | Effective Date | Maturity Date | Index         | Strike Rate |
|---------------------------|----------------------------|----------------------|----------------|---------------|---------------|-------------|
| Interest rate swap        | \$1,760                    | (242 )               | April 1, 2010  | April 1, 2019 | 1-month LIBOR | 5.91 %      |
| Interest rate swap        | \$1,760                    | (258 )               | April 1, 2010  | April 1, 2019 | 1-month LIBOR | 6.07 %      |

Table of Contents

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

Introduction

The statements included in this quarterly report on Form 10-Q, other than statements of historical fact, are forward-looking statements. Examples of forward-looking statements include statements regarding our future financial results, operating results, business strategies, projected costs, products, competitive positions and plans, customer preferences, consumer trends, anticipated product development, and objectives of management for future operations. In some cases, forward-looking statements can be identified by terminology such as "may," "will," "should," "would," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continue," or the negative of these 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 I of our annual report on Form 10-K for the year ended December 31, 2012. 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 design, develop, manufacture and market mobile communications products for the marine, land mobile and aeronautical markets, and navigation, guidance and stabilization products for both the defense and commercial markets.

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

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

Our mobile communications service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, and DIRECTV account referral fees earned in conjunction with the sale of our products and extended warranty sales. We provide, for monthly fixed and usage fees, satellite connectivity services for broadband Internet, data and Voice over Internet Protocol (VoIP) service to our TracPhone V-series customers. We also earn monthly usage fees for third-party satellite connectivity for voice, data and Internet services to our Inmarsat TracPhone customers who choose to activate their subscriptions with us. Under current DIRECTV programs, we are eligible to receive a new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through us. Our service sales have grown from 18% of our net sales in 2010 to 24% in 2011 to 34% in 2012.

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 |          |
|----------------------------|--------------------|----------|
|                            | March 31,          |          |
|                            | 2013               | 2012     |
|                            | (in thousands)     |          |
| Mobile communications      | \$22,907           | \$20,831 |
| Guidance and stabilization | 17,020             | 5,897    |
| Net sales                  | \$39,927           | \$26,728 |

13

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Table of Contents

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

**Critical Accounting Policies and Significant Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, sales and expenses, and related disclosure at the date of our financial statements. Our significant accounting policies are summarized in note 1 of the notes to the consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2012.

As described in our annual report on Form 10-K for the year ended December 31, 2012, 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 March 31, 2013.

Readers should refer to our annual report on Form 10-K for the year ended December 31, 2012 under “Management’s Discussion and Analysis of Financial Condition and Results of Operation—Critical Accounting Policies and Significant Estimates” for descriptions of these policies and estimates.

**Results of Operations**

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

|   | Three months ended |        |    |
|---|--------------------|--------|----|
|   | March 31,          |        |    |
|   | 2013               | 2012   |    |
| Sales:  |                    |        |    |
| Product   | 63.2               | % 63.9 | %  |
| Service   | 36.8               | 36.1   |    |
| Net sales   | 100.0              | 100.0  |    |
| Cost and expenses:                                |                    |        |    |
| Costs of product sales                            | 34.8               | 41.1   |    |
| Costs of service sales                            | 25.7               | 21.7   |    |
| Sales, marketing and support                      | 17.4               | 19.9   |    |
| Research and development                          | 7.4                | 11.8   |    |
| General and administrative                        | 8.5                | 11.0   |    |
| Total costs and expenses                          | 93.8               | 105.5  |    |
| Income (loss) from operations                     | 6.2                | (5.5   | )  |
| Interest income                                   | 0.4                | 0.4    |    |
| Interest expense                                  | 0.2                | 0.3    |    |
| Other income, net                                 | 0.1                | 0.1    |    |
| Income (loss) before income tax expense (benefit) | 6.5                | (5.3   | )  |
| Income tax expense (benefit)                      | 1.6                | (0.2   | )  |
| Net income (loss)                                 | 4.9                | % (5.1 | )% |

Table of Contents

Three months ended March 31, 2013 and 2012

Net Sales

Product sales for the three months ended March 31, 2013 increased \$8.1 million, or 48%, to \$25.2 million for the three months ended March 31, 2013 from \$17.1 million for the three months ended March 31, 2012. The increase was primarily due to an increase in sales of our guidance and stabilization products of approximately \$9.4 million, or 210%. Specifically, sales of our TACNAV defense products increased \$6.6 million, or 586% primarily as a result of product sales related to the previously announced Saudi Arabian National Guard (SANG) contract. Also contributing to the increase in sales of our guidance and stabilization products during the three months ended March 31, 2013 was an increase in sales of our FOG products of \$2.9 million, or 93%, as compared to the three months ended March 31, 2012. We expect that our TACNAV product sales will increase significantly year-over-year during the second quarter of 2013, primarily due to the order for SANG discussed above. Although we expect that TACNAV sales will continue to grow over the long term, sales on a quarter-to-quarter or year-to-year basis could continue to be very uneven. For example, we expect that TACNAV sales will decline from the second quarter of 2013 to the third quarter of 2013 unless we obtain substantial new orders to replace the SANG contract. We also expect that our FOG sales will increase year-over-year in 2013.

Offsetting the increase in guidance and stabilization product sales was a decrease of \$1.3 million, or 10%, in sales of our mobile communications products to \$11.3 million for the three months ended March 31, 2013 from \$12.6 million for the three months ended March 31, 2012. The decrease was primarily due to a decrease in sales of our marine products of \$0.9 million, or 8%, driven primarily by decreased sales of our TracPhone V7 product in Europe. Also contributing to this decrease was a decrease in our land mobile products of \$0.4 million, or 29%, as compared to the three months ended March 31, 2012. The decrease in our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market. We remain cautious about the prospects for our leisure sales as a result of ongoing challenges in the global economy.

Mobile communications product sales originating from our European and Asian subsidiaries for the three months ended March 31, 2013 decreased \$1.4 million, or 25%, as compared to the three months ended March 31, 2012.

Mobile communications product sales originating from the Americas for the three months ended March 31, 2013 increased \$0.1 million, or 1%, as compared to the three months ended March 31, 2012.

Service sales for the three months ended March 31, 2013 increased \$5.1 million, or 53%, to \$14.7 million from \$9.6 million for the three months ended March 31, 2012. The primary reason for the increase was a \$2.9 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase in service sales was a \$1.8 million increase in contracted engineering services driven by construction and program management services provided in connection with the SANG contract. In addition, service repair services increased by approximately \$0.3 million as compared to the three months ended March 31, 2012.

Costs of Sales

For the three months ended March 31, 2013, costs of product sales increased by \$2.9 million, or 27%, to \$13.9 million from \$11.0 million for the three months ended March 31, 2012. The primary reason for the increase was the increase in sales of our TACNAV and FOG products discussed above.

Costs of service sales increased by \$4.4 million, or 77%, to \$10.2 million for the three months ended March 31, 2013 from \$5.8 million for the three months ended March 31, 2012. The primary reason for the increase was a \$2.5 million increase in engineering services cost of sales due primarily to the services provided in connection with the SANG contract as discussed above. Also contributing to the increase was an increase of \$1.7 million in airtime costs of sales for our mini-VSAT Broadband service.

Gross margin from product sales for the three months ended March 31, 2013 increased to 45% as compared to 36% for the three months ended March 31, 2012. The increase in our gross margin from product sales was primarily due to an increase in sales of our TACNAV and FOG products discussed above, which generally have higher margins than our mobile communications products.

Gross margin from service sales for the three months ended March 31, 2013 decreased to 30% as compared to 40% for the three months ended March 31, 2012. The decrease in our gross margin from service sales was primarily attributable to the decrease in gross margin for contracted engineering services as a result of the facility construction

services and project management services in Saudi Arabia, as these services had a gross margin of approximately 10%. We anticipate the gross margin percentage for contracted engineering services will continue to decrease for the next several quarters as a result of the facility and program management services portion of the SANG contract. The contract value for the services portion of the SANG order remaining to be performed as of April 1, 2013 is approximately \$8.5 million. These project management services are estimated to continue to be performed well into 2014. Partially offsetting the decrease in gross margin for contracted

15

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Table of Contents

engineering services was an increase in gross margin for mini-VSAT Broadband service sales to 32% from 28% in the year-ago period. In 2013, we expect mini-VSAT Broadband service margins to increase year-over-year primarily from increased TracPhone V11 activations, an overall increase in our mini-VSAT Broadband customer base, and from the introduction of new value-added services to our mini-VSAT Broadband customers, but at a more modest rate than the recent year-over-year gross margin growth from 2011 to 2012.

**Operating Expenses**

Sales, marketing and support expense for the three months ended March 31, 2013 increased by \$1.6 million, or 30%, to \$6.9 million from \$5.3 million for the three months ended March 31, 2012. The primary reason for the increase in 2013 was a \$1.0 million increase in variable sales expense primarily as a result of the sales relating to the SANG order and related facility construction that commenced in the third quarter of 2012. Also contributing to the increase in 2013 was a \$0.3 million increase in sales, marketing and support expense related to our Danish subsidiary, and a \$0.2 million increase in accrued performance-based incentive compensation. As a percentage of net sales, sales, marketing and support expense for the quarter ended March 31, 2013 was 17% as compared to 20% for the quarter ended March 31, 2012.

Research and development expense for the three months ended March 31, 2013 decreased by \$0.2 million, or 6%, to \$2.9 million from \$3.1 million for the three months ended March 31, 2012. The primary reason for the decrease in 2013 expense was a \$0.3 million increase in the absorption of customer-funded engineering costs for contracted engineering services primarily related to the SANG order. Partially offsetting this decrease was a \$0.2 million increase in accrued performance-based incentive compensation. As a percentage of net sales, research and development expense for the quarter ended March 31, 2013 was 7% as compared to 12% for the quarter ended March 31, 2012.

General and administrative expense for the three months ended March 31, 2013 increased by \$0.4 million, or 14%, to \$3.4 million from \$2.9 million for the three months ended March 31, 2012. The primary reason for the increase in 2013 expense was a \$0.4 million increase in U.S.-based employee compensation driven by increased accrued performance-based incentive compensation. As a percentage of net sales, general and administrative expense for the quarter ended March 31, 2013 was 8% as compared to 11% for the quarter ended March 31, 2012.

We expect total operating expenses will increase year-over-year on an absolute basis for the remainder of the year, but should decline as a percentage of total sales. This increase will be driven largely by costs, including contracted commissions, for the sales related to the SANG order and anticipated incremental hiring.

**Income Tax Expense (Benefit)**

Income tax expense for the three months ended March 31, 2013 was \$0.7 million as compared to \$0.0 million for the three months ended March 31, 2012. The increase in income tax expense is primarily due to a \$4.0 million increase in pre-tax income. On January 2, 2013, the President signed into law The American Taxpayer Relief Act of 2012, which extended the research and development tax credit for two years to December 31, 2013. As a result of the retroactive extension, a discrete income tax benefit of \$0.4 million was recognized for qualifying research and development amounts incurred in 2012. During three months ended March 31, 2012, a discrete income tax expense associated with tax shortfalls for non-qualified stock options expirations, as well as shortfalls associated with restricted stock awards vesting of \$0.4 million, was recognized. We estimate our effective tax rate for 2013 to be 35% or higher, as a result of the tax effect of discrete events such as stock option exercise activity and restricted stock vesting.

**Backlog**

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

Our backlog for all products and services was approximately \$39.8 million and \$35.0 million on March 31, 2013 and December 31, 2012, respectively. As of March 31, 2013, our backlog was scheduled for fulfillment in 2013, except for \$8.0 million scheduled for fulfillment in 2014 and \$4.9 million scheduled for fulfillment in 2015. The increase in backlog of \$4.8 million from December 31, 2012 was primarily a result of increased orders for fiber optic gyros.

Backlog consists of orders evidenced by written agreements and specified delivery dates for customers who are acceptable credit risks. We do not include satellite connectivity service sales in our backlog even though many of our satellite connectivity customers have signed annual service contracts providing for a fixed monthly fee. Military orders included in backlog are generally subject to cancellation for the convenience of the customer. When orders are cancelled, we generally recover actual costs incurred through the date of cancellation and the costs resulting from termination. As of March 31, 2013, our backlog included approximately \$17.6 million in orders that are subject to cancellation for convenience by the customer. Individual

Table of Contents

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.

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 March 31, 2013, we had \$44.8 million in cash, cash equivalents, and marketable securities, of which \$1.2 million, \$0.2 million, \$1.9 million, \$0.1 million and \$0.1 million in cash equivalents were held in a local currency by our foreign subsidiaries located in Denmark, Brazil, Norway, Singapore and Japan, respectively. There were no marketable securities held by our foreign subsidiaries as of March 31, 2013. As of March 31, 2013, we had \$74.8 million in working capital.

Net cash provided by operations was \$2.4 million for the three months ended March 31, 2013 as compared to net cash provided by operations of \$5.1 million for the three months ended March 31, 2012. The decrease is primarily due to a \$9.4 million decrease in cash inflows attributable to accounts receivable, a \$1.8 million increase in cash outflows as a result of increased inventory levels, as well as a \$0.7 million increase in cash outflows related to prepaid expenses and other current assets. Partially offsetting the decrease in cash inflows is an increase in net income of \$3.3 million, which reflected a \$0.6 million reduction in non-cash benefits related to deferred income taxes, a decrease in cash outflows of approximately \$2.1 million related to accrued expenses and accounts payable, a \$1.8 million increase in cash inflows related to deferred revenue, and a \$1.2 million decrease in cash outflows related to other long-term liabilities.

Net cash used in investing activities was \$9.8 million for the three months ended March 31, 2013 as compared to net cash used in investing activities of \$4.4 million for the three months ended March 31, 2012. The increase in cash outflows is due to a \$6.8 million increase in our net investment in marketable securities. Partially offsetting the increase in cash outflows is a decrease in capital expenditures of approximately \$1.4 million.

Net cash provided by financing activities was \$4.9 million for the three months ended March 31, 2013 compared to cash used in financing activities of \$2.1 million for the three months ended March 31, 2012. The increase in cash provided by financing activities is primarily due to a \$4.7 million equipment security note that we entered into on January 30, 2013. Also contributing to the increase in cash inflows was a \$2.0 million reduction in payments on our line of credit and a \$1.0 million increase in proceeds from exercises of stock options and purchases under our employee stock purchase plan.

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 March 31, 2013 secure the mortgage loan. The monthly mortgage payment is approximately \$11,000 plus interest and increases in increments of approximately \$1,000 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 three months ended March 31, 2013, 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 13 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 March 31, 2013, we were not in default of either covenant. Subject to the terms of the agreement and so long as no event of default has occurred, until September 30, 2013, we have the option of converting up to \$12.0 million of revolving loans into one or more term loans at a floating interest rate equal to LIBOR plus 1.75%. We may terminate the loan agreement prior to its full term without penalty; provided we give 30 days' advance written notice to the bank. As of March 31, 2013, we

17

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Table of Contents

had \$7.0 million outstanding under the facility, the repayment of which is due no later than the maturity date of December 31, 2014.

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 the future potential capacity expansion, we would plan to seek to acquire additional satellite capacity from satellite operators, expend funds to seek regulatory approvals and permits, develop product enhancements in anticipation of the expansion, and hire additional personnel. In addition, in December 2011, we entered into a five-year agreement to lease C-band satellite capacity from a satellite operator, effective February 1, 2012, and in 2012 we also purchased three satellite hubs to support this C-band service. The total cost of the five-year satellite capacity agreement, the satellite hubs, and teleport services is approximately \$12.2 million, of which approximately \$2.7 million related to the total cost of the three hubs. In January 2013, we borrowed \$4.7 million from a bank and pledged as collateral six satellite hubs and related equipment, including the three hubs purchased in 2012. The term of the equipment loan is five years, and the loan bears interest at a fixed interest rate of 2.76% per annum. The monthly payment is \$83,000, including interest expense.

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 March 31, 2013, 341,009 shares of our common stock remain available for repurchase under the program. We did not purchase any shares of our common stock in the three months ended March 31, 2013.

We believe that the \$44.8 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.

Table of Contents**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, Singapore and Japan. 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 March 31, 2013, 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 three months ended March 31, 2013.

The primary objectives of our investment activities are 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 March 31, 2013, 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 March 31, 2013, 83% of the \$38.3 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 March 31, 2013.

To the extent that we borrow against our variable-rate credit facility, we will be subject to interest rate risk, as we will pay interest on any outstanding amounts at a rate equal to the BBA LIBOR Daily Floating Rate plus 1.25%. There was \$7.0 million in borrowings outstanding under this facility at March 31, 2013.

As previously discussed in note 13 to the consolidated financial statements, effective April 1, 2010, in order to reduce the volatility of cash outflows that arise from changes in interest rates, we entered into two interest rate swap agreements. These interest rate swap agreements are intended to hedge our mortgage loan related to our headquarters facility in Middletown, Rhode Island by fixing the interest rates specified in the mortgage loan to 5.91% for half of the principal amount outstanding and 6.07% for the remaining half of the principal amount outstanding as of April 1, 2010 until the mortgage loan expires on April 16, 2019.

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

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 March 31, 2013, 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 not effective as of March 31, 2013 due to the material weakness in our internal control over financial reporting described below. Our internal control over financial reporting is the process designed by and under the supervision of our CEO and CFO to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements for external reporting in accordance with accounting principles generally accepted in the United States of America.

Background

As, previously described in Item 9A of our annual report on Form 10-K for the year ended December 31, 2012, in March 2013, our management identified that the most senior member of our accounting staff at our Danish subsidiary had engaged in a fraudulent scheme to misappropriate assets from us over a period of at least three years. The scheme included fraudulent wire transfers to a personal bank account, fraudulent documentation, forged signatures and use of a corporate credit card for personal

19

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expenses. For the three years ended December 31, 2012, the aggregate amount of misappropriated funds in any year ranged from approximately \$118,000 to \$250,000, and for the three months ended March 31, 2013, the aggregate amount of misappropriated funds was approximately \$84,000. Management is seeking to determine whether any of the losses may be covered by our insurance policies.

In the process of preparing our annual report on Form 10-K for the year ended December 31, 2012, management performed its assessment of the effectiveness of our internal control over financing reporting as of December 31, 2012 and concluded that our internal control over financial reporting as of that date was not effective because of a material weakness. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Management's assessment identified the following control deficiencies in our internal control over financial reporting at our Danish subsidiary as a material weakness as of December 31, 2012:

- override of access controls over banking security devices and personal identification numbers enabling the unauthorized execution of wire transfers;
- ineffective review controls over the supporting documentation by the subsidiary country general manager over expenditures and expenses; and
- override of review controls designed to address the accuracy and approval of manual journal entries at the Danish subsidiary.

The material weakness resulted in immaterial misstatements related to cost of goods sold and sales and marketing expenses and, as a result, we concluded that, as of December 31, 2012, there was a reasonable possibility that material misstatements could occur in the consolidated financial statements.

Our independent registered public accounting firm, KPMG LLP, issued an adverse report regarding the effectiveness of our internal control over financial reporting as of December 31, 2012, and that report was included in Item 8 of our annual report on Form 10-K for the year ended December 31, 2012.

Following the identification of the foregoing control deficiencies in March 2013, management implemented a remediation plan. Management believes that the implementation of this plan will remediate the control deficiencies described above. The following steps of the remediation plan were completed as of the filing of our annual report on April 2, 2013:

- termination of the employment of the individual involved and reassignment of his duties to an interim controller for our Danish subsidiary;
- implementation of a new corporate-level control to review manual journal entries of foreign subsidiaries; and
- implementation of new controls regarding the physical safekeeping of banking security devices and personal identification numbers, which are designed to prevent one person from gaining access to two devices and personal identification numbers required to execute wire transfers.

The following steps of the remediation plan are currently in process, and management may determine to enhance existing controls and/or implement additional controls as the implementation progresses:

management is continuing to review the design and operation of our process-level and transaction-level controls at our foreign subsidiaries in relation to cash management and manual journal entry review and approvals, and management is implementing a master vendor payment control using available software services at our Danish bank ; and

management is in the process of conducting training sessions at its various locations to reinforce control consciousness.

Because the implementation of our remediation plan was ongoing as of March 31, 2013 and because there was insufficient time as of March 31, 2013 to demonstrate that the new controls implemented as part of the remediation plan were operating effectively as of that date, management concluded that the material weakness described in our annual report still existed as of March 31, 2013.



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 changes in our internal control over financial reporting that occurred during the first quarter of 2013. Based on that evaluation, except for the changes described above, our CEO and CFO did not identify any change in our internal control over financial reporting during the first quarter of 2013 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 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 three months ended March 31, 2013, and no repurchase programs expired during the period.

We did not repurchase any shares of our common stock in the three months ended March 31, 2013.

Table of Contents

## ITEM 6. EXHIBITS

## Exhibits:

| Exhibit No. | Description  | Filed with this Form 10-Q | Incorporated by Reference Form | Reference 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        | Master Loan and Security Agreement, dated as of January 30, 2013, by and between Banc of America Leasing & Capital, LLC and KVH Industries, Inc.   |                           | 8-K                            | February 5, 2013      | 10.1        |
| 10.2        | Equipment Security Note, dated as of January 30, 2013, by and between Banc of America Leasing & Capital, LLC and KVH Industries, Inc.  |                           | 8-K                            | February 5, 2013      | 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 and principal financial officer  | X                         |                                |                       |             |
| 101         | Interactive Data File regarding (a) our Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012, (b) our Consolidated Statements of Operations for the Three Months Ended March 31, 2013 and 2012, (c) our Consolidated Statements of Other Comprehensive Income (Loss) for the Three Months Ended March 31, 2013 and 2012, (d) our Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2013 and 2012 and (e) the Notes to such Consolidated Financial Statements. | X                         |                                |                       |             |

Table of Contents

SIGNATURE

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

Date: May 9, 2013

KVH Industries, Inc.

By: /s/ PETER A. RENDALL  
Peter A. Rendall  
(Duly Authorized Officer and Chief Financial  
Officer)

23

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Table of Contents

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