

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

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 0-28082

KVH Industries, Inc.  
(Exact Name of Registrant as Specified in its Charter)

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.

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

| Date             | Class                                    | Outstanding shares |
|------------------|--|--------------------|
| November 6, 2012 | Common Stock, par value \$0.01 per share | 14,865,460         |

---

---

Table of Contents

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 September 30, 2012 and December 31, 2011 (unaudited)</u>   |
|                                      | <u>3</u>  |
|                                      | <u>Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011 (unaudited)</u>                  |
|                                      | <u>4</u>  |
|                                      | <u>Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2012 and 2011 (unaudited)</u> |
|                                      | <u>5</u>  |
|                                      | <u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 (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>15</u>   |
| ITEM 3.                              | <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>   |
|                                      | <u>23</u>   |
| ITEM 4.                              | <u>CONTROLS AND PROCEDURES</u>  |
|                                      | <u>23</u>   |
| <u>PART II. OTHER INFORMATION</u>    |   |
| ITEM 1.                              | <u>LEGAL PROCEEDINGS</u>  |
|                                      | <u>24</u>   |
| ITEM 1A.                             | <u>RISK FACTORS</u>   |
|                                      | <u>24</u>   |
| ITEM 2.                              | <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>  |
|                                      | <u>34</u>   |
| ITEM 5.                              | <u>OTHER INFORMATION</u>  |
|                                      | <u>35</u>   |
| ITEM 6.                              | <u>EXHIBITS</u>   |
|                                      | <u>34</u>   |
|                                      | <u>36</u>   |
|                                      | <u>37</u>   |
|                                      | <u>36</u>   |
|                                      | <u>37</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)

|   | September 30,<br>2012 | December 31,<br>2011 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$8,621               | \$7,017              |
| Marketable securities   | 24,296                | 23,553               |
| Accounts receivable, net of allowance for doubtful accounts of approximately \$947 as of September 30, 2012 and \$623 as of December 31, 2011   | 28,596                | 25,959               |
| Inventories   | 17,842                | 18,615               |
| Prepaid expenses and other assets   | 2,807                 | 2,552                |
| Deferred income taxes   | 410                   | 1,281                |
| Total current assets  | 82,572                | 78,977               |
| Property and equipment, less accumulated depreciation of \$30,539 as of September 30, 2012 and \$27,508 as of December 31, 2011   | 36,157                | 34,010               |
| Intangible assets, less accumulated amortization of \$717 as of September 30, 2012 and \$434 as of December 31, 2011  | 1,730                 | 1,903                |
| Goodwill  | 4,609                 | 4,426                |
| Other non-current assets  | 4,251                 | 3,835                |
| Deferred income taxes   | 4,782                 | 5,405                |
| Total assets  | \$134,101             | \$128,556            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                      |
| Current liabilities:  |                       |                      |
| Accounts payable  | \$6,612               | \$6,141              |
| Accrued compensation and employee-related expenses  | 5,150                 | 4,285                |
| Accrued other   | 7,796                 | 5,026                |
| Accrued product warranty costs  | 921                   | 933                  |
| Deferred revenue  | 1,956                 | 2,684                |
| Current portion of long-term debt   | 136                   | 131                  |
| Total current liabilities   | 22,571                | 19,200               |
| Other long-term liabilities   | 132                   | 135                  |
| Line of credit  | 7,000                 | 9,000                |
| Long-term debt excluding current portion  | 3,450                 | 3,553                |
| Total liabilities   | 33,153                | 31,888               |
| 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, 16,524,451 and 16,207,268 shares issued at September 30, 2012 and December 31, 2011; and 14,865,460 and 14,548,277 shares outstanding at September 30, 2012 and December 31, 2011, respectively | 165                   | 162                  |
| Additional paid-in capital  | 109,770               | 106,592              |
| Retained earnings   | 4,549                 | 3,727                |
| Accumulated other comprehensive loss  | (386)                 | (663)                |
|   | (13,150)              | (13,150)             |

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

Less: treasury stock at cost, common stock, 1,658,991 shares as of September 30,  
2012 and December 31, 2011

|  |           |           |
|--|-----------|-----------|
| Total stockholders' equity                 | 100,948   | 96,668    |
| Total liabilities and stockholders' equity | \$134,101 | \$128,556 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

3

---

Table of ContentsKVH INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

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

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2012                                | 2011       | 2012                               | 2011       |
| Sales:  |                                     |            |                                    |            |
| Product   | \$24,529                            | \$17,987   | \$62,653                           | \$61,203   |
| Service   | 14,293                              | 7,634      | 34,916                             | 19,400     |
| Net sales   | 38,822                              | 25,621     | 97,569                             | 80,603     |
| Costs and expenses:                               |                                     |            |                                    |            |
| Costs of product sales                            | 13,297                              | 9,745      | 37,026                             | 33,756     |
| Costs of service sales                            | 10,035                              | 5,464      | 22,659                             | 15,360     |
| Sales, marketing and support                      | 6,360                               | 5,614      | 17,239                             | 16,790     |
| Research and development                          | 2,949                               | 2,792      | 9,148                              | 8,645      |
| General and administrative                        | 3,040                               | 2,312      | 8,906                              | 7,789      |
| Total costs and expenses                          | 35,681                              | 25,927     | 94,978                             | 82,340     |
| Income (loss) from operations                     | 3,141                               | (306)      | 2,591                              | (1,737)    |
| Interest income                                   | 147                                 | 65         | 359                                | 198        |
| Interest expense                                  | 76                                  | 64         | 243                                | 177        |
| Other income, net                                 | 23                                  | 872        | 99                                 | 887        |
| Income (loss) before income tax (expense) benefit | 3,235                               | 567        | 2,806                              | (829)      |
| Income tax (expense) benefit                      | (1,490)                             | ) 33       | (1,983)                            | ) 85       |
| Net income (loss)                                 | \$1,745                             | \$600      | \$823                              | \$(744)    |
| Per share information:                            |                                     |            |                                    |            |
| Net income (loss) per share                       |                                     |            |                                    |            |
| Basic   | \$0.12                              | \$0.04     | \$0.06                             | \$(0.05)   |
| Diluted   | \$0.12                              | \$0.04     | \$0.05                             | \$(0.05)   |
| Number of shares used in per share calculation:   |                                     |            |                                    |            |
| Basic   | 14,846,249                          | 14,877,481 | 14,742,855                         | 14,842,746 |
| Diluted   | 15,023,580                          | 15,058,194 | 14,971,667                         | 14,842,746 |

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>September 30, |        | Nine Months Ended<br>September 30, |         |   |
|---|-------------------------------------|--------|------------------------------------|---------|---|
|   | 2012                                | 2011   | 2012                               | 2011    |   |
| Net income (loss)                                       | \$1,745                             | \$600  | \$823                              | \$(744) | ) |
| Other comprehensive income (loss), net of tax:          |                                     |        |                                    |         |   |
| Unrealized gain (loss) on available-for-sale securities | 1                                   | (2     | ) (2                               | ) (1    | ) |
| Currency translation adjustment gain (loss)             | 327                                 | (616   | ) 336                              | 285     | ) |
| Unrealized loss on derivatives                          | (15                                 | ) (224 | ) (57                              | ) (503  | ) |
| Other comprehensive income (loss), net of tax           | 313                                 | (842   | ) 277                              | (219    | ) |
| Total comprehensive income (loss)                       | \$2,058                             | \$(242 | ) \$1,100                          | \$(963  | ) |

See accompanying Notes to Unaudited Consolidated Financial Statements.

5

---

Table of Contents

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

|   | Nine Months Ended<br>September 30, |           |   |
|---|------------------------------------|-----------|---|
|   | 2012                               | 2011      |   |
| Cash flows from operating activities:   |                                    |           |   |
| Net income (loss)   | \$823                              | \$(744)   | ) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                                    |           |   |
| Provision for doubtful accounts   | 556                                | 166       |   |
| Depreciation and amortization   | 3,377                              | 3,284     |   |
| Deferred income taxes   | 1,697                              | (166)     | ) |
| Loss on interest rate swaps   | 95                                 | 100       |   |
| Compensation expense related to stock-based awards and employee stock purchase plan       | 2,747                              | 2,677     |   |
| Changes in operating assets and liabilities:  |                                    |           |   |
| Accounts receivable   | (3,197                             | ) (635    | ) |
| Inventories   | 778                                | (4,817    | ) |
| Prepaid expenses and other assets   | (257                               | ) (253    | ) |
| Other non-current assets  | (442                               | ) 1,575   |   |
| Accounts payable  | 467                                | (1,076    | ) |
| Deferred revenue  | (723                               | ) 662     |   |
| Accrued expenses  | 3,493                              | (254      | ) |
| Other long-term liabilities   | (3                                 | ) (1,254  | ) |
| Net cash provided by (used in) operating activities                                       | 9,411                              | (735      | ) |
| Cash flows from investing activities:   |                                    |           |   |
| Capital expenditures  | (5,240                             | ) (8,112  | ) |
| Purchases of marketable securities  | (13,106                            | ) (39,789 | ) |
| Maturities and sales of marketable securities   | 12,361                             | 42,222    |   |
| Net cash used in investing activities   | (5,985                             | ) (5,679  | ) |
| Cash flows from financing activities:   |                                    |           |   |
| Repayments of long-term debt  | (98                                | ) (92     | ) |
| Proceeds from stock options exercised and employee stock purchase plan                    | 784                                | 791       |   |
| Repurchase of common stock  | —                                  | (2,037    | ) |
| Payment of employee restricted stock withholdings   | (333                               | ) (625    | ) |
| Repayments of line of credit borrowings   | (2,000                             | ) —       |   |
| Proceeds from line of credit borrowings   | —                                  | 6,500     |   |
| Payment of stock registration fee   | —                                  | (10       | ) |
| Net cash (used in) provided by financing activities                                       | (1,647                             | ) 4,527   |   |
| Effect of exchange rate changes on cash and cash equivalents                              | (175                               | ) (91     | ) |
| Net increase (decrease) in cash and cash equivalents                                      | 1,604                              | (1,978    | ) |
| Cash and cash equivalents at beginning of period  | 7,017                              | 7,241     |   |
| Cash and cash equivalents at end of period  | \$8,621                            | \$5,263   |   |

See accompanying Notes to Unaudited Consolidated Financial Statements.





Table of Contents

**KVH INDUSTRIES, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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

(1) Description of Business

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

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

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

KVH's mobile communications service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, certain DIRECTV account subsidies and referral fees earned in conjunction with the sale of its products and extended warranty sales. KVH provides, for monthly fixed and usage fees, satellite connectivity sales from broadband Internet, data and Voice over Internet Protocol (VoIP) service to its TracPhone V-series customers. KVH also earns monthly usage fees for third-party satellite connectivity for voice, data and Internet services to its Inmarsat TracPhone customers who choose to activate their subscriptions with KVH. Under current DIRECTV programs, KVH is eligible to receive a one-time payment for each DIRECTV receiver activated for service and a new mobile account activation fee from DIRECTV for each applicable 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 Norway AS and KVH Industries Japan Co., Ltd (collectively, KVH or the Company), have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company has evaluated all subsequent events through the date of this filing. Given that KVH Industries A/S, KVH Industries Pte. Ltd. and KVH Industries Brasil Comunicacao Por Satelite Ltda. operate as the Company's European, Asian and Brazilian international distributors, all of their operating expenses are reflected within sales, marketing and support within the accompanying consolidated statements of operations. KVH Industries Norway AS, a subsidiary of KVH Industries A/S, develops and distributes middleware software solutions known as CommBox™ technology, which is being integrated into the Company's satellite communications products and services. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements have not been audited by our independent registered public accounting firm and include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition, results of operations, and cash flows for the periods presented. These consolidated financial statements do

not include all disclosures associated with annual financial statements and accordingly should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual report on Form 10-K for the year ended December 31, 2011 filed on March 8, 2012 with the Securities and Exchange Commission. The results for the three and nine months ended September 30, 2012 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 September 30, 2012.

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.

**Multiple-Element Revenue Arrangement**

The Company has accounted for its \$35,600 contract received in June 2012 for the Saudi Arabian National Guard to sell TACNAV defense products and services under ASC 605-25, Multiple-Element Arrangements. When a sale arrangement involves multiple deliverables, such as the sale of products that include installation, facility construction and program management services, the Company evaluates the arrangement to determine whether there are separate items that are required to be delivered under the arrangement that qualify as separate units of accounting. The Company uses vendor-specific objective evidence or VSOE, if available, to determine the selling price of each element. If VSOE is not available, the Company uses third-party evidence, or TPE to determine the selling price. If TPE is not available, the Company's best estimate is used to develop the estimated selling price. Revenue is recognized when the recognition criteria for each unit of accounting are met.

The total contract value associated with TACNAV defense products is \$21,200 for which shipments are estimated to continue through the fourth quarter of 2012 and the first half of 2013. Revenue is recognized for these product sales after transfer of title and risk of loss when inspection occurs. The total contract value associated with all services is \$14,400 which are estimated to continue through the fourth quarter 2012 until 2014. 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. Total revenue recognized on the Saudi Arabian National Guard contract through September 30, 2012, was approximately \$7,300 which was all recognized in the third quarter of 2012.

**(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 \$879 and \$851 for the three months ended September 30, 2012 and September 30, 2011, respectively, and \$2,747 and \$2,677 for the nine months ended September 30, 2012 and September 30, 2011, respectively. As of September 30, 2012, there was \$2,817 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 2.98 years. As of September 30, 2012, there was \$2,980 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 1.40 years.

The Company granted 40,000 and 43,340 restricted stock awards to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three and nine months ended September 30, 2012, respectively. The restricted stock awards vest ratably over four years from the date of grant subject to the recipient remaining employed through the applicable vesting dates. Compensation expense for restricted stock awards is measured at fair value on the date of grant based on the number of shares granted and the quoted market closing price of the Company's common stock. Such value is recognized as expense over the vesting period of the award, net of estimated forfeitures.

The Company granted 4,213 and 436,874 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 nine months ended September 30, 2012, respectively.

8

---

The fair value of stock options granted for the nine months ended September 30, 2012 was estimated as of the date of grant using the Black-Scholes option-pricing model. The weighted-average fair value per share for all options granted during the nine months ended September 30, 2012 and 2011 was \$4.72 and \$6.88, respectively. The weighted-average assumptions used to value options as of their grant date were as follows:

|                          | Nine Months Ended<br>September 30,<br>2012 |  |   |
|--------------------------|--|--|---|
| Risk-free interest rate  | 0.72                                       |  | % |
| Expected volatility      | 64.60                                      |  | % |
| Expected life (in years) | 4.22                                       |  |   |
| Dividend yield           | 0  |  | % |

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

Basic net income (loss) per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined with the treasury stock accounting method. Common stock equivalents related to options and restricted stock awards for 386,992 and 989,690 shares of common stock for the three months ended September 30, 2012 and 2011, respectively, have been excluded from the fully diluted calculation of net income per share, as inclusion would be anti-dilutive. Common stock equivalents related to options and restricted stock awards for 837,018 shares of common stock for the nine months ended September 30, 2012 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 nine months ended September 30, 2011 because the net loss causes these outstanding stock options and non-vested restricted shares to be anti-dilutive.

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

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2012                                | 2011       | 2012                               | 2011       |
| Weighted average common shares outstanding—basic               | 14,846,249                          | 14,877,481 | 14,742,855                         | 14,842,746 |
| Dilutive common shares issuable in connection with stock plans | 177,331                             | 180,713    | 228,812                            | —          |
| Weighted average common shares outstanding—diluted             | 15,023,580                          | 15,058,194 | 14,971,667                         | 14,842,746 |

#### (6) Inventories

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

|                 | September 30,<br>2012 | December 31,<br>2011 |
|-----------------|-----------------------|----------------------|
| Raw materials   | \$9,690               | \$11,039             |
| Work in process | 2,150                 | 1,805                |
| Finished goods  | 6,002                 | 5,771                |
|                 | \$17,842              | \$18,615             |



## (7) Product Warranty

The Company's products carry limited warranties that range from one to four years and vary by product. The warranty period begins on the date of retail purchase or lease by the original purchaser. The Company accrues estimated product warranty costs at the time of sale and any additional amounts are recorded when such costs are probable and can be reasonably estimated. Factors that affect the Company's warranty liability include the number of units sold or leased, historical and anticipated rates of warranty repairs and the cost per repair. Warranty and related costs are reflected within sales, marketing and support in the accompanying statements of operations. As of September 30, 2012 and December 31, 2011, the Company had accrued product warranty costs of \$921 and \$933, respectively. The following table summarizes product warranty activity during 2012 and 2011:

|                    | Nine Months Ended |        |
|--------------------|-------------------|--------|
|                    | September 30,     |        |
|                    | 2012              | 2011   |
| Beginning balance  | \$933             | \$887  |
| Charges to expense | 574               | 601    |
| Costs incurred     | (586              | ) (566 |
| Ending balance     | \$921             | \$922  |

## (8) Segment Reporting

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

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



Table of Contents

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

|  | Sales Originating From |                    |           |
|--|------------------------|--------------------|-----------|
|  | Americas               | Europe and<br>Asia | Total     |
| Three months ended September 30, 2012                      |                        |                    |           |
| Mobile communications sales to the United States           | \$16,609               | \$—                | \$16,609  |
| Mobile communications sales to Canada                      | 205                    | —                  | 205       |
| Mobile communications sales to Europe                      | 99                     | 2,856              | 2,955     |
| Mobile communications sales to other geographic areas      | 1,270                  | 1,165              | 2,435     |
| Guidance and stabilization sales to the United States      | 1,720                  | —                  | 1,720     |
| Guidance and stabilization sales to Canada                 | 2,718                  | —                  | 2,718     |
| Guidance and stabilization sales to Europe                 | 3,407                  | —                  | 3,407     |
| Guidance and stabilization sales to other geographic areas | 8,773                  | —                  | 8,773     |
| Intercompany sales   | 1,577                  | 221                | 1,798     |
| Subtotal   | 36,378                 | 4,242              | 40,620    |
| Eliminations   | (1,577                 | ) (221             | ) (1,798  |
| Net sales  | \$34,801               | \$4,021            | \$38,822  |
| Segment net income (loss)                                  | \$1,996                | \$(251             | ) \$1,745 |
| Depreciation and amortization                              | \$1,030                | \$141              | \$1,171   |
| Total assets   | \$114,039              | \$20,062           | \$134,101 |
|  | Sales Originating From |                    |           |
|  | Americas               | Europe and<br>Asia | Total     |
| Three months ended September 30, 2011                      |                        |                    |           |
| Mobile communication sales to the United States            | \$13,129               | \$—                | \$13,129  |
| Mobile communication sales to Canada                       | 204                    | —                  | 204       |
| Mobile communication sales to Europe                       | 55                     | 3,400              | 3,455     |
| Mobile communication sales to other geographic areas       | 250                    | 847                | 1,097     |
| Guidance and stabilization sales to the United States      | 3,127                  | —                  | 3,127     |
| Guidance and stabilization sales to Canada                 | 2,296                  | —                  | 2,296     |
| Guidance and stabilization sales to Europe                 | 1,911                  | —                  | 1,911     |
| Guidance and stabilization sales to other geographic areas | 402                    | —                  | 402       |
| Intercompany sales   | 2,079                  | 300                | 2,379     |
| Subtotal   | 23,453                 | 4,547              | 28,000    |
| Eliminations   | (2,079                 | ) (300             | ) (2,379  |
| Net sales  | \$21,374               | \$4,247            | \$25,621  |
| Segment net income (loss)                                  | \$642                  | \$(42              | ) \$600   |
| Depreciation and amortization                              | \$969                  | \$106              | \$1,075   |
| Total assets   | \$104,390              | \$16,722           | \$121,112 |

Table of Contents

|  | Sales Originating From |                        |            |
|--|------------------------|------------------------|------------|
|  | Americas               | Europe and<br>Asia     | Total      |
| Nine months ended September 30, 2012                       |                        |                        |            |
| Mobile communication sales to the United States            | \$47,202               | \$—                    | \$47,202   |
| Mobile communication sales to Canada                       | 571                    | —                      | 571        |
| Mobile communication sales to Europe                       | 342                    | 12,462                 | 12,804     |
| Mobile communication sales to other geographic areas       | 2,777                  | 3,725                  | 6,502      |
| Guidance and stabilization sales to the United States      | 4,848                  | —                      | 4,848      |
| Guidance and stabilization sales to Canada                 | 7,925                  | —                      | 7,925      |
| Guidance and stabilization sales to Europe                 | 7,758                  | —                      | 7,758      |
| Guidance and stabilization sales to other geographic areas | 9,959                  | —                      | 9,959      |
| Intercompany sales   | 8,208                  | 1,271                  | 9,479      |
| Subtotal   | 89,590                 | 17,458                 | 107,048    |
| Eliminations   | (8,208                 | ) (1,271               | ) (9,479 ) |
| Net sales  | \$81,382               | \$16,187               | \$97,569   |
| Segment net income (loss)                                  | \$1,621                | \$(798                 | ) \$823 )  |
| Depreciation and amortization                              | \$3,021                | \$356                  | \$3,377    |
| Total assets   | \$114,039              | \$20,062               | \$134,101  |
|  |                        | Sales Originating From |            |
|  | Americas               | Europe and<br>Asia     | Total      |
| Nine months ended September 30, 2011                       |                        |                        |            |
| Mobile communication sales to the United States            | \$37,144               | \$—                    | \$37,144   |
| Mobile communication sales to Canada                       | 680                    | —                      | 680        |
| Mobile communication sales to Europe                       | 258                    | 10,676                 | 10,934     |
| Mobile communication sales to other geographic areas       | 1,009                  | 2,877                  | 3,886      |
| Guidance and stabilization sales to the United States      | 10,508                 | —                      | 10,508     |
| Guidance and stabilization sales to Canada                 | 6,608                  | —                      | 6,608      |
| Guidance and stabilization sales to Europe                 | 6,170                  | —                      | 6,170      |
| Guidance and stabilization sales to other geographic areas | 4,673                  | —                      | 4,673      |
| Intercompany sales   | 6,696                  | 817                    | 7,513      |
| Subtotal   | 73,746                 | 14,370                 | 88,116     |
| Eliminations   | (6,696                 | ) (817                 | ) (7,513 ) |
| Net sales  | \$67,050               | \$13,553               | \$80,603   |
| Segment net loss   | \$(641                 | ) \$(103               | ) \$(744 ) |
| Depreciation and amortization                              | \$2,965                | \$319                  | \$3,284    |
| Total assets   | \$104,390              | \$16,722               | \$121,112  |

**(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.

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

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

## (11) Fair Value Measurements

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

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

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

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

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

- (a) Market approach—prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities
- (b) Cost approach—amount that would be required to replace the service capacity of an asset (replacement cost)
- (c) Income approach—techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing and excess earnings models)

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 (d) 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 September 30, 2012 and December 31, 2011 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy:

| September 30, 2012        | Total    | Level 1  | Level 2 | Level 3 | Valuation Technique |
|---------------------------|----------|----------|---------|---------|---------------------|
| Assets                    |          |          |         |         |                     |
| Money market mutual funds | \$11,027 | \$11,027 | \$—     | \$—     | (a)                 |
| Government agency bonds   | 4,077    | 4,077    | —       | —       | (a)                 |
| Corporate notes           | 4,004    | 4,004    | —       | —       | (a)                 |
| United States treasuries  | 3,687    | 3,687    | —       | —       | (a)                 |

|                         |       |       |       |     |     |
|-------------------------|-------|-------|-------|-----|-----|
| Certificates of deposit | 1,501 | 1,501 | —     | —   | (a) |
| Liabilities             |       |       |       |     |     |
| Interest rate swaps     | \$568 | \$—   | \$568 | \$— | (d) |

13

---

Table of Contents

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

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

## (12) Business and Credit Concentrations

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

|  | Three Months Ended |        | Nine Months Ended  |        |   |
|--|--------------------|--------|--------------------|--------|---|
|  | September 30, 2012 | 2011   | September 30, 2012 | 2011   |   |
| Net sales to foreign customers outside the U.S. and Canada | 45.3               | % 26.9 | % 37.9             | % 32.1 | % |
| Net sales to Customer A                                    | 18.9               | % *    | *                  | *      |   |

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

## (13) Recent Accounting Pronouncements

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

## (14) Derivative Instruments and Hedging Activities

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

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

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

| Interest Rate Derivatives | Notional | Asset<br>(Liability) | Effective Date | Maturity Date | Index | Strike Rate |
|---------------------------|----------|----------------------|----------------|---------------|-------|-------------|
|---------------------------|----------|----------------------|----------------|---------------|-------|-------------|

|                    |                   |      |   |               |               |               |      |   |
|--------------------|-------------------|------|---|---------------|---------------|---------------|------|---|
|                    | (in<br>thousands) |      |   |               |               |               |      |   |
| Interest rate swap | \$1,793           | (276 | ) | April 1, 2010 | April 1, 2019 | 1-month LIBOR | 5.91 | % |
| Interest rate swap | \$1,793           | (292 | ) | April 1, 2010 | April 1, 2019 | 1-month LIBOR | 6.07 | % |

14

---

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

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

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

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

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

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

|                            | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|----------------------------|-------------------------------------|----------|------------------------------------|----------|
|                            | 2012                                | 2011     | 2012                               | 2011     |
|                            | (in thousands)                      |          |                                    |          |
| Mobile communications      | \$22,204                            | \$17,885 | \$67,079                           | \$52,644 |
| Guidance and stabilization | 16,618                              | 7,736    | 30,490                             | 27,959   |
| Net sales                  | \$38,822                            | \$25,621 | \$97,569                           | \$80,603 |

15

---



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, 2011.

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

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

**Results of Operations**

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

|   | Three Months Ended |        | Nine months ended |        |    |
|---|--------------------|--------|-------------------|--------|----|
|   | September 30,      |        | September 30,     |        |    |
|   | 2012               | 2011   | 2012              | 2011   |    |
| Sales:  |                    |        |                   |        |    |
| Product   | 63.2               | % 70.2 | % 64.2            | % 75.9 | %  |
| Service   | 36.8               | 29.8   | 35.8              | 24.1   |    |
| Net sales   | 100.0              | 100.0  | 100.0             | 100.0  |    |
| Cost and expenses:                                |                    |        |                   |        |    |
| Costs of product sales                            | 34.3               | 38.0   | 37.9              | 41.9   |    |
| Costs of service sales                            | 25.8               | 21.4   | 23.2              | 19.1   |    |
| Sales, marketing and support                      | 16.4               | 21.9   | 17.7              | 20.8   |    |
| Research and development                          | 7.6                | 10.9   | 9.4               | 10.7   |    |
| General and administrative                        | 7.8                | 9.0    | 9.1               | 9.7    |    |
| Total costs and expenses                          | 91.9               | 101.2  | 97.3              | 102.2  |    |
| Income (loss) from operations                     | 8.1                | (1.2   | ) 2.7             | (2.2   | )  |
| Interest income                                   | 0.4                | 0.3    | 0.4               | 0.3    |    |
| Interest expense                                  | 0.2                | 0.3    | 0.2               | 0.2    |    |
| Other income, net                                 | 0.1                | 3.4    | 0.1               | 1.1    |    |
| Income (loss) before income tax (expense) benefit | 8.4                | 2.2    | 3.0               | (1.0   | )  |
| Income tax (expense) benefit                      | (3.8               | ) 0.1  | (2.0              | ) 0.1  |    |
| Net income (loss)                                 | 4.6                | % 2.3  | % 1.0             | % (0.9 | )% |

Table of Contents

Three months ended September 30, 2012 and 2011

Net Sales

Product sales for the three months ended September 30, 2012 increased \$6.5 million, or 36%, to \$24.5 million for the three months ended September 30, 2012 from \$18.0 million for the three months ended September 30, 2011. The increase was primarily due to an increase in sales of our guidance and stabilization products of approximately \$5.9 million, or 77%. Specifically, sales of our TACNAV defense products increased \$4.3 million, or 207% primarily as a result of product sales related to the previously announced Saudi Arabian National Guard contract. Also contributing to the increase in sales of our guidance and stabilization products during the three months ended September 30, 2012 was an increase in sales of our FOG products of \$1.8 million, or 34%, as compared to the three months ended September 30, 2011. We expect that our TACNAV product sales will increase significantly year-over-year during the fourth quarter of 2012, primarily due to the order for the Saudi Arabian National Guard 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. We also expect that our FOG sales will be relatively flat sequentially during the fourth quarter of 2012.

Also contributing to the increase in product sales was an increase of \$0.7 million, or 6%, in sales of our mobile communications products to \$11.0 million for the three months ended September 30, 2012 from \$10.3 million for the three months ended September 30, 2011. The increase was primarily due to an increase in sales of our marine products of \$0.8 million, or 9%, driven primarily by demand for our TracPhone V7 product as well as our new HD11 product that was released in the first quarter of 2012, and demand for our TracPhone V3 product. Partially offsetting this increase was a decrease in our land mobile products of \$0.2 million, or 12%, as compared to the three months ended September 30, 2011. The decrease in our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market. We remain cautious about the prospects for our leisure sales as a result of ongoing challenges in the global economy.

Mobile communications product sales originating from the Americas for the three months ended September 30, 2012 increased \$0.3 million, or 5%, as compared to the three months ended September 30, 2011. Mobile communications product sales originating from our European and Asian subsidiaries for the three months ended September 30, 2012 increased \$0.3 million, or 11%, as compared to the three months ended September 30, 2011.

Service sales for the three months ended September 30, 2012 increased \$6.7 million, or 87%, to \$14.3 million from \$7.6 million for the three months ended September 30, 2011. The primary reason for the increase was a \$3.4 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase in service sales was a \$2.7 million increase in contracted engineering services driven by construction and program management services provided in connection with the Saudi Arabian National Guard TACNAV contract. In addition, service repair services increased by approximately \$0.7 million as compared to the three months ended September 30, 2011.

Costs of Sales

For the three months ended September 30, 2012, costs of product sales increased by \$3.6 million, or 36%, to \$13.3 million from \$9.7 million for the three months ended September 30, 2011. 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 \$4.6 million, or 84%, to \$10.0 million for the three months ended September 30, 2012 from \$5.5 million for the three months ended September 30, 2011. 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 Saudi Arabian National Guard 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 and a \$0.3 million increase in service repair cost of sales.

Gross margin from product sales for the three months ended September 30, 2012 was 46%, which was consistent with the gross margin from product sales for the three months ended September 30, 2011.

Table of Contents

Gross margin from service sales for the three months ended September 30, 2012 increased to 30% from 28% in the year-ago period. The increase in our gross margin from service sales was primarily attributable to the increase in airtime sales for our mini-VSAT Broadband service. Gross margin for mini-VSAT Broadband service sales increased to 31% from 19% in the year-ago period. We anticipate that the gross margin percentage for mini-VSAT Broadband service for the remainder of the year will remain relatively comparable to the level of the third quarter of 2012, driven by the incremental network cost impact of our implementation of C-band coverage in June 2012 for the TracPhone V11 introduction. In 2013, we expect mini-VSAT Broadband service margins to increase primarily from increased TracPhone V11 activations and an overall increase in our customer base, but at a more modest rate than the recent year-over-year gross margin growth. Partially offsetting the increase in gross margin for the mini-VSAT Broadband service sales was a 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 Saudi Arabian National Guard TACNAV contract. The total contract value for the services portion of the Saudi Arabian National Guard TACNAV order is \$14.4 million. These project management services are estimated to continue to be performed well into 2014.

Operating Expenses

Sales, marketing and support expense for the three months ended September 30, 2012 increased by \$0.7 million, or 13%, to \$6.4 million from \$5.6 million for the three months ended September 30, 2011. The primary reason for the increase in 2012 was a \$0.9 million increase in variable sales expense primarily as a result of sales relating to the Saudi Arabian National Guard TACNAV order and related facility construction that commenced in the third quarter of 2012. Also contributing to the increase in 2012 was a \$0.3 million increase in bad debt expense. Partially offsetting these increases was a \$0.3 million decrease in sales, marketing and support expense related to demonstration equipment, marketing literature, trade shows and dealer seminars. As a percentage of net sales, sales, marketing and support expense for the quarter ended September 30, 2012 was 16% as compared to 22% for the quarter ended September 30, 2011.

Research and development expense for the three months ended September 30, 2012 increased by \$0.2 million, or 6%, to \$3.0 million from \$2.8 million for the three months ended September 30, 2011. The primary reason for the increase in 2012 expense was a \$0.3 million increase in U.S.-based employee compensation. As a percentage of net sales, research and development expense for the quarter ended September 30, 2012 was 8% as compared to 11% for the quarter ended September 30, 2011.

General and administrative expense for the three months ended September 30, 2012 increased by \$0.7 million, or 31%, from \$2.3 million for the three months ended September 30, 2011 to \$3.0 million for the three months ended September 30, 2012. The primary reason for the increase in 2012 expense was a \$0.4 million increase in U.S.-based employee compensation. Also contributing to the increase was a \$0.2 million increase in facility expenditures. As a percentage of net sales, general and administrative expense for the quarter ended September 30, 2012 was 8% as compared to 9% for the quarter ended September 30, 2011.

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 Saudi Arabian National Guard TACNAV order.

Interest and Other Income

Interest income and other income, net for the three months ended September 30, 2012 was \$0.1 million as compared to \$0.9 million for the three months ended September 30, 2011. The primary reason for the decrease was a \$0.8 million net benefit in other income in September 2011 resulting from reaching agreement with LiveTV regarding the termination of our original antenna development and production agreement.

Income Tax (Expense) Benefit

Income tax expense for the three months ended September 30, 2012 was \$1.5 million as compared to \$0.0 million for the three months ended September 30, 2011. The increase in income tax expense is primarily due to a \$2.7 million increase in pre-tax income. We estimate our effective tax rate for 2012 to be 50% or higher, as a result of the tax effect

of discrete events such as stock option exercise activity and restricted stock vesting.

18

---

Table of Contents

Nine months ended September 30, 2012 and 2011

Net Sales

Product sales for the nine months ended September 30, 2012 increased by \$1.5 million, or 2%, to \$62.7 million from \$61.2 million for the nine months ended September 30, 2011. The primary reason for the increase in 2012 was an increase of \$3.6 million, or 11%, in sales of our mobile communications products to \$37.3 million for the nine months ended September 30, 2012 from \$33.7 million for the nine months ended September 30, 2011. The increase was primarily due to an increase in sales of our marine products of \$4.4 million, or 15%, driven primarily by demand for our new HD11 product that were released in the first quarter of 2012, as well as our TracPhone V7 and TracPhone V3. Also contributing to the marine products increase was increased sales of our HD7 product. Partially offsetting this increase was a decrease in our land mobile products of \$0.8 million, or 17%, as compared to the nine months ended September 30, 2011. The decrease in our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market.

Partially offsetting the increase in sales of our mobile communications products was a decrease in sales of our guidance and stabilization products of \$2.2 million, or 8%. Specifically, sales of our FOG products decreased by \$1.8 million, or 10%.

Mobile communications product sales originating from our European and Asian subsidiaries increased \$3.3 million, or 31%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. Mobile communications product sales originating from the Americas increased \$0.3 million, or 1%, from the nine months ended September 30, 2011 to the nine months ended September 30, 2012.

Service sales for the nine months ended September 30, 2012 increased \$15.5 million, or 80%, to \$34.9 million from \$19.4 million for the nine months ended September 30, 2011. The primary reason for the increase was a \$9.3 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase in service sales was a \$4.3 million increase in contracted engineering services driven by the Saudi Arabian order as well as a separate TACNAV-related development effort, a \$1.7 million increase in service repair services, and a \$0.2 million increase in Inmarsat service sales.

Costs of Sales

For the nine months ended September 30, 2012, costs of product sales increased by \$3.3 million, or 10%, to \$37.0 million from \$33.8 million for the nine months ended September 30, 2011. The primary reason for the increase was the increase in sales of our mobile communications products discussed above.

Costs of service sales increased by \$7.3 million, or 48%, to \$22.7 million for the nine months ended September 30, 2012 from \$15.4 million for the nine months ended September 30, 2011. The primary reason for the increase was a \$3.7 million increase in airtime costs of sales for our mini-VSAT Broadband service. Also contributing to the increase was a \$2.7 million increase in engineering services cost of sales due primarily to the services provided in connection with the Saudi Arabian National Guard contract as well as a \$0.7 million increase in cost of service repair sales and a \$0.2 million increase in cost of Inmarsat service sales.

Gross margin from product sales for the nine months ended September 30, 2012 decreased to 41% from 45% in the year-ago period. The decrease in our gross margin from product sales was primarily due to the decrease in the FOG sales discussed above, which generally have higher margins than our mobile communications products.

Gross margin from service sales for the nine months ended September 30, 2012 increased to 35% from 21% in the year-ago period. The increase in gross margin was primarily due to the increase in gross margin for mini-VSAT Broadband service sales, which increased to 31% from 12% in the year-ago period. Partially offsetting the increase in gross margin for the mini-VSAT Broadband service sales was a decrease in the gross margin for engineering services to 39% from 53% in the year-ago period primarily due to the facility construction and program management services in Saudi Arabia, as these construction services have a gross margin of approximately 10%.

Table of Contents

## Operating Expenses

Sales, marketing and support expense for the nine months ended September 30, 2012 increased by \$0.4 million, or 3%, to \$17.2 million from \$16.8 million for the nine months ended September 30, 2011. The primary reasons for the increase in 2012 was a \$0.4 million increase in variable sales expense primarily as a result of the sales related to the Saudi Arabian National Guard TACNAV order and related facility construction that commenced in the third quarter of 2012, and a \$0.4 million increase in bad debt expense. Also contributing to the increase was a \$0.4 million increase in sales, marketing and support expense related to our Danish and Singaporean subsidiaries, and a \$0.1 million increase in trade shows. Partially offsetting these increases was a \$0.3 million decrease in U.S.-based compensation for sales, marketing and support, a \$0.3 million total decrease in marketing literature, cooperative advertising expense, and dealer seminars, a \$0.1 million decrease in facility expenditures, and a \$0.1 million decrease in Norwegian-based compensation for sales, marketing and support. As a percentage of net sales, sales, marketing and support expense decreased during the nine months ended September 30, 2012 to 18% from 21% for the nine months ended September 30, 2011.

Research and development expense for the nine months ended September 30, 2012 increased by \$0.5 million, or 6%, to \$9.1 million from \$8.6 million for the nine months ended September 30, 2011. The primary reason for the increase in 2012 expense was a \$0.4 million increase in U.S.-based employee compensation. Also contributing to the increase was a \$0.2 million increase in research and development expense related to our Norwegian subsidiary. As a percentage of net sales, research and development expense decreased during the nine months ended September 30, 2012 to 9% from 11% for the nine months ended September 30, 2011.

General and administrative expense for the nine months ended September 30, 2012 increased by \$1.1 million, or 14%, to \$8.9 million from \$7.8 million for the nine months ended September 30, 2011. The primary reason for the increase in 2012 expense was a \$0.7 million increase in U.S.-based employee compensation. Also contributing to the increase was a \$0.6 million increase in facility expenditures, a \$0.2 million increase in equipment lease expense and software maintenance expense, and a \$0.1 million increase in recruiting expense. Partially offsetting these increases was a \$0.4 million decrease in legal expense. As a percentage of net sales, general and administrative expense decreased during the nine months ended September 30, 2012 to 9% from 10% for the nine months ended September 30, 2011.

## Interest and Other Income

Interest and other income, net for the nine months ended September 30, 2012 was \$0.2 million as compared to \$0.9 million for the nine months ended September 30, 2011. The primary reason for the decrease was a \$0.8 million net benefit in other income in September 2011 resulting from reaching agreement with LiveTV regarding the termination of our original antenna development and production agreement.

## Income Tax (Expense) Benefit

Income tax expense for the nine months ended September 30, 2012 was \$2.0 million as compared to an income tax benefit of \$0.1 million for the nine months ended September 30, 2011. The increase in income tax expense is primarily due to a \$3.6 million increase in pre-tax income.

## 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 \$48.3 million and \$22.1 million on September 30, 2012 and December 31, 2011, respectively. The increase in backlog of \$26.2 million from December 31, 2011 was primarily a result of the order for TACNAV products and services received in June 2012 for the Saudi Arabian National Guard.

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

canceled, we generally recover actual costs incurred through the date of cancellation and the costs resulting from termination. As of September 30, 2012, our backlog included approximately \$12.7 million in orders that are subject to cancellation for convenience by the customer. Individual orders for guidance and stabilization products are often large and may require procurement of specialized long-lead components and allocation of manufacturing resources. The complexity of planning and executing larger orders generally requires customers to order well in advance of the required delivery date, resulting in backlog.

Table of Contents

## Liquidity and Capital Resources

We have historically funded our operations primarily from operating cash flows, net proceeds from public and private equity offerings, bank financings and proceeds received from exercises of stock options. As of September 30, 2012, we had \$32.9 million in cash, cash equivalents, and marketable securities, of which \$1.5 million, \$0.3 million and \$1.9 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 September 30, 2012. As of September 30, 2012, we had \$60.0 million in working capital.

Net cash provided by operations was \$9.4 million for the nine months ended September 30, 2012 as compared to net cash used in operations of \$0.7 million for the nine months ended September 30, 2011. The increase is primarily due to a \$5.6 million decrease in cash outflows as a result of decreased inventory levels as well as a \$1.6 million increase in net income. Also contributing to the increase was a decrease in cash outflows of approximately \$5.3 million related to accounts payable and accrued liabilities primarily as a result of accrued expenses related to the construction of the facility for the Saudi Arabian contract. In addition, we experienced a decrease in cash outflows of approximately \$1.3 million related to other long-term liabilities. Partially offsetting the increase in cash inflows is an increase in cash outflows of approximately \$2.6 million attributable to accounts receivable and an increase in cash outflows of approximately \$2.0 million related to other long-term assets. In addition, there was a decrease in cash inflows of approximately \$1.4 million related to deferred revenue.

Net cash used in investing activities was \$6.0 million for the nine months ended September 30, 2012 as compared to net cash used in investing activities of \$5.7 million for the nine months ended September 30, 2011. The increase in cash outflows is due to a \$3.2 million increase in our net investment in marketable securities. Partially offsetting the increase in cash outflows is a decrease in capital expenditures of approximately \$2.9 million.

Net cash used in financing activities was \$1.6 million for the nine months ended September 30, 2012 compared to cash provided by financing activities of \$4.5 million for the nine months ended September 30, 2011. The increase in cash used in financing activities is primarily due to payments of \$2.0 million on our line of credit in 2012 as compared to the \$6.5 million increase in borrowings under our line of credit as of September 30, 2011, which were used to finance the construction of our new manufacturing facility. Partially offsetting the increase in cash outflows was a decrease in common stock repurchases in the amount of \$2.0 million.

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





Table of Contents

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 September 30, 2012, we were not in default of either covenant. Subject to the terms of the agreement and so long as no event of default has occurred, until September 30, 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 September 30, 2012, we had \$7.0 million outstanding under the facility, the repayment of which is due no later than the maturity date of December 31, 2014. These funds were used to finance construction of our new manufacturing facility in Middletown, RI, which was completed in the first quarter of 2012.

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 September 30, 2012, 341,009 shares of our common stock remain available for repurchase under the program. We did not purchase any shares of our common stock in the nine months ended September 30, 2012.

It is our intent to continue to invest in the mini-VSAT Broadband network on a global basis in cooperation with ViaSat under the terms of a 10-year agreement announced in July 2008. As part of this arrangement, we agreed to acquire satellite capacity from Ku-band satellite operators. In addition, in December 31, 2011, we entered into a five-year agreement to lease C-band satellite capacity from a satellite operator, effective February 1, 2012, and we have also purchased three hubs to support this C-band service. The total cost of the five-year satellite capacity agreement, the hubs, and teleport services is approximately \$12.2 million, of which approximately 22% relates to the cost of the hubs. Each satellite hub represents a substantial capital investment. As part of the future potential capacity expansion, we would plan to seek to acquire additional satellite capacity from satellite operators, expend funds to seek regulatory approvals and permits, develop product enhancements in anticipation of the expansion, and hire additional personnel. We anticipate these costs will be funded by cash, cash equivalents and marketable securities on hand, as well as cash flows from operations.

We believe that the \$32.9 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 September 30, 2012, a 10% unfavorable movement in the foreign exchange rates for our subsidiary locations would not expose us to material losses in earnings or cash flows.

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

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 September 30, 2012, a hypothetical 100 basis-point increase in interest rates would have resulted in an immaterial decrease in the fair value of our investments that had maturities of greater than one year. Due to the conservative nature of our investments and the relatively short duration of their maturities, we believe interest rate risk is substantially mitigated. As of September 30, 2012, 75% of the \$24.3 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 September 30, 2012. To the extent that we borrow against our variable-rate credit facility, we will be subject to interest rate risk, as we will pay interest on any outstanding amounts at a rate equal to the BBA LIBOR Daily Floating Rate plus 1.25%. There was \$7.0 million in borrowings outstanding under this facility at September 30, 2012.

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

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

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 September 30, 2012.

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

Under the supervision and with the participation of our CEO and CFO, our management has evaluated our internal control over financial reporting during the third quarter of 2012. Based on that evaluation, our CEO and CFO did not identify any change in our internal control over financial reporting during the third quarter of 2012 that has materially

affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors in evaluating our business. If any of these risks, or other risks not presently known to us or that we currently believe are not significant, develops into an actual event, then our business, financial condition and results of operations could be adversely affected. If that happens, the market price of our common stock could decline. Our revenues and results of operations have been and may continue to be adversely impacted by worldwide economic turmoil, credit tightening, high fuel prices and associated declines in consumer spending.

Worldwide economic conditions have experienced a significant downturn over the last several years, including slower economic activity, tightened credit markets, inflation and deflation concerns, increased fuel prices, decreased consumer confidence, reduced corporate profits, reduced or canceled capital spending, adverse business conditions and liquidity concerns. These conditions make it difficult for businesses, governments and consumers to accurately forecast and plan future activities. Many governments are experiencing significant deficits that may cause them to curtail spending significantly or reallocate funds away from defense programs. For example, sales of our FOG products (which include some non-defense related FOG sales) declined 10% from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. There can be no assurances that government responses to the disruptions in the economy will remedy these problems. As a result of these and other factors, customers could slow or suspend spending on our products and services. We may also incur increased credit losses and need to increase our allowance for doubtful accounts, which would have a negative impact on our earnings and financial condition. We cannot predict the timing, duration or ultimate impact of this downturn. We expect our business to continue to be adversely impacted by this downturn.

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

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

Our marine leisure business is highly seasonal and seasonality can also impact our commercial marine business. We historically have generated the majority of our marine leisure product revenues during the first and second quarters of each year, and these revenues typically decline in the third and fourth quarters of each year, compared to the first two quarters. Temporary suspensions of our airtime services typically increase in the third and fourth quarters of each year as boats are placed out of service during winter months. Our marine leisure business is also significantly affected by the weather. Unseasonably cool weather, prolonged winter conditions, hurricanes, such as the potential near-term impact from the hurricane that hit the U.S. east coast in October 2012, unusual amounts of rain, and natural and other disasters may decrease boating, which could reduce our revenues. Specifically, we may encounter a decrease in new airtime activations as well as an increase in the number of cancellations or temporary suspensions of our airtime service.

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

We are actively seeking to increase revenues from the commercial markets for our mini-VSAT Broadband service, particularly shipping companies and other companies that deploy a fleet of vessels. In marketing this service, we offer leasing arrangements for the TracPhone antennas to both commercial and leisure customers. If commercial leases become increasingly popular with our customers, we could face increased risks of default under those leases. Defaults could increase our costs of collection (including costs of retrieving leased equipment) and reduce the amount we collect from customers, which could harm our results of operations.

## Table of Contents

Changes in the competitive environment or supply chain issues may require inventory write-downs. From time to time, we have recorded significant inventory reserves and/or inventory write-offs as a result of substantial declines in customer demand. Market or competitive changes could lead to future charges for excess or obsolete inventory, especially if we are unable to appropriately adjust the supply of material from our vendors. Adverse economic conditions could result in financial difficulties or bankruptcy for any of our suppliers, which could adversely affect our business and results of operations.

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

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

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

Our mobile communications products and services historically have had lower product and service gross margins than our guidance and stabilization products. In 2011, we experienced a 14% year-over-year decline in sales of our guidance and stabilization products and we have experienced an 8% year-over-year decline in guidance and stabilization product sales during the first three quarters of 2012. A shift in our sales mix towards mobile communications products and services would likely cause lower gross margins in the future, especially if driven by reduced demand.

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

As a result of our mini-VSAT Broadband network infrastructure, our cost of service sales includes certain fixed costs that do not generally vary with the volume of service sales, and we have almost no ability to reduce these fixed costs in the short term. These fixed costs will increase if we further expand our network to accommodate additional subscriber demand and/or coverage area expansion. For example, in December 31, 2011, we entered into a five-year agreement to lease additional satellite capacity, effective February 2012, as well as an agreement to purchase three additional hubs in connection with the offering of our new C-band service at a total cost of approximately \$12.2 million. If sales of our TracPhone V3, V7 and V11 and the mini-VSAT Broadband service do not generate the level of revenue that we expect or decline, our service gross margins may remain below historical levels or decline. The failure to improve our mini-VSAT Broadband service gross margins would have a material adverse effect on our overall profitability.

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

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

In the market for marine satellite TV equipment, we compete with Intellian, Cobham SATCOM, Raymarine, NaviSystem Marine Electronic Systems Srl, and King Controls.

In the marine market for voice, fax, data and Internet communications equipment and services, we compete with Cobham SATCOM, Furuno Electric Co., Ltd., Globalstar LP, Iridium Satellite LLC, Intellian, Ship Equip and JRC.

We also face competition from providers of marine satellite data services and maritime VSAT solutions, including Inmarsat/ShipEquip/Stratos, MTN/SeaMobile, Speedcast, CapRock, Schlumberger, and Vizada/Marlink. In the market for land mobile satellite TV equipment, we compete with MotoSAT, King Controls, Cobham TracStar and Winegard Company.

25

---



## 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, Fizoptica, 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 Ku-band mini-VSAT Broadband service, or with our C/Ku-band mini-VSAT Broadband service and our new TracPhone V11.

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

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

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

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

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

- increasing budgetary pressures that may reduce funding for military programs;
- changes in modernization plans for military equipment;
- changes in tactical navigation requirements;

global conflicts impacting troop deployment, including troop withdrawals from the Middle East;  
priorities for current battlefield operations;

26

---

## Table of Contents

new military and operational doctrines that affect military equipment needs;

sales cycles that are long and difficult to predict;

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

delays in military procurement schedules; and

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

These factors can cause substantial fluctuations in sales of our TACNAV and FOG products from period to period. For example, sales of our FOG products increased \$11.4 million, or 39%, from 2009 to 2010 driven largely by increased sales for commercial applications, such as surveying and optical stabilization, and a range of government and defense applications, including weapons stabilization. However, sales of our FOG products decreased \$17.9 million, or 44%, from 2010 to 2011 and decreased \$1.8 million, or 10%, from the nine months ending September 30, 2011 to the nine months ended September 30, 2012. TACNAV product sales have remained flat for the nine months ended September 30, 2012 from the nine months ended September 30, 2011, even though our 2012 year-to-date sales reflect shipments of a portion of the largest TACNAV order in our history. We do not currently have in backlog another TACNAV order of comparable size for 2013 or future years, which could lead to a decline in our revenues compared to 2012. The U.S. government may change defense spending priorities at any time. Moreover, government customers such as the U.S. Coast Guard and their contractors can generally cancel orders for our products for convenience or decline to exercise previously disclosed contract options. Even under firm orders with government customers, funding must often be appropriated in the budget process in order for the government to complete the contract. The cancellation of or failure to fund orders for our products could further reduce our net sales and results of operations.

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

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

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

We derive a significant portion of our guidance and stabilization revenues from a small number of customers, most of whom are contractors for the U.S. Government. For example, in the three months ended September 30, 2012, one customer accounted for approximately 19% of our total sales. The loss of business from any of these customers could substantially reduce our net sales and results of operations and could seriously harm our business. Since we are often awarded a contract as a subcontractor to a major defense supplier that is engaged in a competitive bidding process as prime contractor for a major weapons procurement program, our revenues depend significantly on the success of the prime contractors with which we align ourselves.

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

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

world.

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

27

---

## Table of Contents

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

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

Our mini-VSAT Broadband service relies on spread spectrum technology developed with ViaSat, Inc., for use with satellite capacity controlled by SES, Eutelsat, Sky Perfect-JSAT, GE Satellite, Telesat, Echostar, Intelsat and Star One. Our TracPhone two-way broadband satellite terminals combines our stabilized antenna technology with ViaSat's ArcLight spread spectrum mobile broadband technology, along with ViaSat's ArcLight spread spectrum modem. The ArcLight technology is also integrated within the satellite hubs that support this service. Sales of the TracPhone V3, V7 and V11 and our mini-VSAT Broadband service could be disrupted if we fail to receive approval from regulatory authorities to provide our spread spectrum service in the waters of various countries where our customers operate or if there are issues with the availability of the ArcLight maritime modems.

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

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

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

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

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

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

28

---

## Table of Contents

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 manufacturing facility 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 canceled.

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

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

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

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

## Table of Contents

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

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

- match our manufacturing facilities and capacity to demand for our products in a timely manner;
- successfully attract, train, motivate and manage appropriate numbers of employees for manufacturing, sales and customer support activities;
- effectively manage our inventory and working capital; and
- improve the efficiencies within our operating, administrative, financial and accounting systems, and our procedures and controls.

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

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

Our success depends on the services of our executive officers.

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

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

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

- technical challenges we may face in adapting our mobile communications products to function with different satellite services and technology in use in various regions around the world;
- satisfaction of international regulatory requirements and delays and costs associated with procurement of any necessary licenses or permits;
- restrictions on the sale of certain guidance and stabilization products to foreign military and government customers;
- increased costs of providing customer support in multiple languages;
- increased costs of managing operations that are international in scope;
- potentially adverse tax consequences, including restrictions on the repatriation of earnings;
- protectionist laws and business practices that favor local competitors, which could slow our growth in international markets;
- potentially longer sales cycles, which could slow our revenue growth from international sales;





Table of Contents

potentially longer accounts receivable payment cycles and difficulties in collecting accounts receivable;  
losses arising from impairment charges associated with goodwill or intangible assets;  
losses arising from foreign currency exchange rate fluctuations; and  
economic and political instability in some international markets.

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

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

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

Our ability to compete depends significantly upon our patents, our source code and our other proprietary technology.

The steps we have taken to protect our technology may be inadequate to prevent others from using what we regard as our technology to compete with us. Our patents could be challenged, invalidated or circumvented, and the rights we have under our patents could provide no competitive advantages. Existing trade secrets, copyright and trademark laws offer only limited protection. In addition, the laws of some foreign countries do not protect our proprietary technology to the same extent as the laws of the United States, which could increase the likelihood of misappropriation.

Furthermore, other companies could independently develop similar or superior technology without violating our intellectual property rights. Any misappropriation of our technology or the development of competing technology could seriously harm our competitive position, which could lead to a substantial reduction in net sales.

If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome, disruptive and expensive, distract the attention of management, and there can be no assurance that we would prevail. Also, we have delivered certain technical data and information to the U.S. government under procurement contracts, and it may have unlimited rights to use that technical data and information. There can be no assurance that the U.S. government will not authorize others to use that data and information to compete with us.

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.

## Table of Contents

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

- changes in demand for our mobile communications products and services and guidance and stabilization products and services;
- the timing and size of individual orders from military customers;
- the mix of products we sell;
- our ability to manufacture, test and deliver products in a timely and cost-effective manner, including the availability and timely delivery of components and subassemblies from our suppliers;
- our success in winning competitions for orders;
- the timing of new product introductions by us or our competitors;
- expense incurred in pursuing acquisitions;
- market and competitive pricing pressures;
- general economic climate; and
- seasonality of pleasure boat and recreational vehicle usage.

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

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

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

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

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

The market price of our common stock may be volatile.

Our stock price has historically been volatile. During the period from January 1, 2011 to September 30, 2012, the trading price of our common stock ranged from \$6.90 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;

32

---

Table of Contents

- changing needs of military customers;
- changes in estimates of our performance or recommendations by securities analysts;
- the hiring or departure of key personnel;
- acquisitions or strategic alliances involving us or our competitors;
- market conditions in our industries; and
- the global macroeconomic and geopolitical environment.

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

Acquisitions may disrupt our operations or adversely affect our results.

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

- charges related to any potential acquisition from which we may withdraw;
- diversion of our management's time, attention, and resources;
- loss of key acquired personnel;
- increased costs to improve or coordinate managerial, operational, financial, and administrative systems, including compliance with the Sarbanes-Oxley Act of 2002;
- dilutive issuances of equity securities;
- the assumption of legal liabilities; and
- losses arising from impairment charges associated with goodwill or intangible assets.

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

Our certificate of incorporation, by-laws and Delaware law contain provisions that could have an anti-takeover effect and discourage, delay or prevent a change in control or an acquisition that many stockholders may find attractive.

These provisions may also discourage proxy contests and make it more difficult for our stockholders to take some corporate actions, including the election of directors. These provisions relate to:

- the ability of our Board of Directors to issue preferred stock, and determine its terms, without a stockholder vote;
- 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 nine months ended September 30, 2012 and no repurchase programs expired during the period.

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

## ITEM 5. OTHER INFORMATION

As we previously reported, Patrick J. Spratt retired as our Chief Financial Officer on October 1, 2012. Mr. Spratt has agreed to remain a part-time employee during a transition period currently expected to end on or about March 31, 2013. During the transition period, Mr. Spratt will assist with the transition of his position and perform such other tasks as we may assign. On November 6, 2012, the Compensation Committee of our Board of Directors approved revised compensation arrangements for Mr. Spratt for the transition period. Mr. Spratt's salary will be reduced to \$1,715 per week (subject to adjustment if his actual work exceeds or falls below his expected hours of service), and Mr. Spratt will continue to participate in our employee benefit plans to the extent permitted by the plans. If Mr. Spratt cannot continue to participate in our health and dental plans, we will reimburse him for the costs of COBRA coverage during the transition period. During the term of his employment, Mr. Spratt's outstanding equity awards will continue to vest, and Mr. Spratt will remain eligible to participate in our management incentive plan for 2012, except that the salary amount used to calculate any payment under the incentive plan will be reduced to his actual salary paid during 2012 (after giving effect to the reduced salary in effect during his part-time employment).

Table of Contents

## ITEM 6. EXHIBITS

## Exhibits:

| Exhibit No. | Description   | Filed with this Form 10-Q | Incorporated by Reference 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        | Seventh Amendment, dated September 17, 2012 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                            | September 19, 2012 | 10.1        |
| 31.1        | Rule 13a-14(a)/15d-14(a) certification of principal executive officer   | X                         |                                |                    |             |
| 31.2        | Rule 13a-14(a)/15d-14(a) certification of principal financial officer   | X                         |                                |                    |             |
| 32.1        | Section 1350 certification of principal executive officer   | X                         |                                |                    |             |
| 32.2        | Section 1350 certification of principal financial officer   |                           |                                |                    |             |
| 101         | Interactive Data File regarding (a) our Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (b) our Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2012 and 2011, (c) our Consolidated Statements of Other Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2012 and 2011, (d) our Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011 and (e) the Notes to such Consolidated Financial Statements. | X                         |                                |                    |             |

Table of Contents

SIGNATURE

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

Date: November 7, 2012

KVH Industries, Inc.

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

36

---



Table of Contents

## Exhibit Index

| Exhibit No. | Description   | Filed with this Form 10-Q | Incorporated by Reference 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        | Seventh Amendment, dated September 17, 2012 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                            | September 19, 2012 | 10.1        |
| 31.1        | Rule 13a-14(a)/15d-14(a) certification of principal executive officer   | X                         |                                |                    |             |
| 31.2        | Rule 13a-14(a)/15d-14(a) certification of principal financial officer   | X                         |                                |                    |             |
| 32.1        | Section 1350 certification of principal executive officer   | X                         |                                |                    |             |
| 32.2        | Section 1350 certification of principal financial officer   | X                         |                                |                    |             |
| 101         | Interactive Data File regarding (a) our Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (b) our Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2012 and 2011, (c) our Consolidated Statements of Other Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2012 and 2011, (d) our Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011 and (e) the Notes to such Consolidated Financial Statements. | X                         |                                |                    |             |