

KVH INDUSTRIES INC \DE\  
Form 10-Q  
November 08, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-28082

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

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

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

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

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

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

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

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

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

Date	Class	Outstanding shares
November 5, 2013	Common Stock, par value \$0.01 per share	15,612,024



KVH INDUSTRIES, INC. AND SUBSIDIARIES  
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## 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, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$9,213	\$8,978
Marketable securities	48,364	29,307
Accounts receivable, net of allowance for doubtful accounts of approximately \$1,252 as of September 30, 2013 and \$929 as of December 31, 2012	25,731	27,654
Inventories	18,133	16,203
Prepaid expenses and other assets	3,891	3,264
Deferred income taxes	712	1,146
Total current assets	106,044	86,552
Property and equipment, less accumulated depreciation of \$35,153 as of September 30, 2013 and \$31,657 as of December 31, 2012	36,706	36,733
Intangible assets, less accumulated amortization of \$1,633 as of September 30, 2013 and \$826 as of December 31, 2012	15,181	1,684
Goodwill	18,086	4,712
Other non-current assets	4,972	4,363
Deferred income taxes	38	3,524
Total assets	\$181,027	\$137,568
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$7,930	\$7,086
Accrued compensation and employee-related expenses	5,490	6,785
Accrued other	6,969	4,595
Accrued product warranty costs	1,010	814
Deferred revenue	5,468	1,892
Current portion of long-term debt	1,044	138
Total current liabilities	27,911	21,310
Other long-term liabilities	1,121	140
Line of credit	30,000	7,000
Long-term debt, excluding current portion	6,407	3,414
Total liabilities	65,439	31,864
Commitments and contingencies (notes 3 and 9)		
Stockholders' equity:		
Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued	—	—
Common stock, \$0.01 par value. Authorized 30,000,000 shares; 16,886,063 and 16,563,836 shares issued at September 30, 2013 and December 31, 2012; and 15,227,072 and 14,904,845 shares outstanding at September 30, 2013 and December 31, 2012, respectively	169	166
Additional paid-in capital	115,970	111,514
Retained earnings	12,205	7,307
Accumulated other comprehensive income (loss)	394	(133 )
	(13,150	) (13,150 )

Less: treasury stock at cost, common stock, 1,658,991 shares as of September 30,  
2013 and December 31, 2012

Total stockholders' equity	115,588	105,704
Total liabilities and stockholders' equity	\$181,027	\$137,568

See accompanying Notes to Unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Sales:				
Product	\$20,331	\$24,529	\$71,433	\$62,653
Service	19,885	14,293	51,907	34,916
Net sales	40,216	38,822	123,340	97,569
Costs and expenses:				
Costs of product sales	11,780	13,297	39,999	37,026
Costs of service sales	11,909	10,035	33,019	22,659
Research and development	3,334	2,949	9,534	9,148
Sales, marketing and support	6,344	6,360	20,828	17,239
General and administrative	4,774	3,040	13,084	8,906
Total costs and expenses	38,141	35,681	116,464	94,978
Income from operations	2,075	3,141	6,876	2,591
Interest income	199	147	572	359
Interest expense	189	76	450	243
Other income, net	212	23	290	99
Income before income tax expense	2,297	3,235	7,288	2,806
Income tax expense	911	1,490	2,390	1,983
Net income	\$1,386	\$1,745	\$4,898	\$823
Per share information:				
Net income per share				
Basic	\$0.09	\$0.12	\$0.32	\$0.06
Diluted	\$0.09	\$0.12	\$0.32	\$0.05
Number of shares used in per share calculation:				
Basic	15,199,802	14,846,249	15,109,311	14,742,855
Diluted	15,354,459	15,023,580	15,300,118	14,971,667

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	\$ 1,386	\$ 1,745	\$ 4,898	\$ 823
Other comprehensive income, net of tax:				
Unrealized gain (loss) on available-for-sale securities	37	1	4	(2 )
Currency translation adjustment gain	1,592	327	357	336
Unrealized gain (loss) on derivative instruments	100	(15 )	166	(57 )
Other comprehensive income, net of tax	1,729	313	527	277
Total comprehensive income	\$ 3,115	\$ 2,058	\$ 5,425	\$ 1,100

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net income	\$4,898	\$823
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	726	556
Depreciation and amortization	4,301	3,377
Deferred income taxes	923	1,697
(Gain) loss on derivative instruments	(73)	) 95
Compensation expense related to stock-based awards and employee stock purchase plan	2,988	2,747
Changes in operating assets and liabilities:		
Accounts receivable	3,573	(3,197)
Inventories	(1,831)	) 778
Prepaid expenses and other assets	(84)	) (257)
Other non-current assets	(387)	) (442)
Accounts payable	278	467
Deferred revenue	796	(723)
Accrued expenses	(117)	) 3,493
Other long-term liabilities	982	(3)
Net cash provided by operating activities	16,973	9,411
Cash flows from investing activities:		
Capital expenditures	(3,031)	) (5,240)
Net cash paid for business acquired	(22,943)	) —
Purchases of marketable securities	(35,221)	) (13,106)
Maturities and sales of marketable securities	16,166	12,361
Net cash used in investing activities	(45,029)	) (5,985)
Cash flows from financing activities:		
Repayments of long-term debt	(772)	) (98)
Borrowings from long-term debt	4,671	—
Proceeds from stock options exercised and employee stock purchase plan	2,360	784
Payment of employee restricted stock withholdings	(828)	) (333)
Repayments of line of credit borrowings	—	(2,000)
Proceeds from line of credit borrowings	23,000	—
Payment of stock registration fee	(5)	) —
Net cash provided by (used in) financing activities	28,426	(1,647)
Effect of exchange rate changes on cash and cash equivalents	(135)	) (175)
Net increase in cash and cash equivalents	235	1,604
Cash and cash equivalents at beginning of period	8,978	7,017
Cash and cash equivalents at end of period	\$9,213	\$8,621

See accompanying Notes to Unaudited Consolidated Financial Statements.





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**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 and land mobile 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 while in motion. The Company also distributes premium news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail markets. 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 are used in numerous commercial products, such as navigation and positioning systems for various applications including precision mapping, dynamic surveying, autonomous vehicles, train location control and track geometry measurement systems, industrial robotics and optical stabilization.

KVH's mobile communications service sales include sales earned from satellite voice and Internet airtime services, sales of media and entertainment distributions, engineering services provided under development contracts, sales from product repairs and extended warranty sales. Mobile communications services sales also include our distribution of premium news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail markets via Headland Media Limited, the media and entertainment service company that we acquired on May 11, 2013. KVH provides, for monthly fixed and usage fees, satellite connectivity sales from broadband Internet, data and Voice over Internet Protocol (VoIP) service to our TracPhone V-series customers. KVH also earns monthly usage fees for third-party satellite connectivity for voice, data and Internet services to its Inmarsat TracPhone customers who choose to activate their subscriptions with KVH.

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 subsidiaries (collectively, KVH or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company has evaluated all subsequent events through the date of this filing. Given that KVH Industries A/S, KVH Industries Pte. Ltd., KVH Industries Japan Co. Ltd., and KVH Industries Brasil Comunicacao Por Satellite Ltda. operate as the Company's European, Singaporean, Japanese and Brazilian international distributors, all of their operating expenses are reflected within sales, marketing and support within the accompanying consolidated statements of operations. KVH Industries Norway A/S, a subsidiary of KVH Industries A/S, develops and distributes middleware software solutions known as CommBox technology, and Headland Media Limited distributes premium news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail markets, and both are included in the Company's satellite communications products and services. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements have not been audited by our independent registered public accounting firm and include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the

financial condition, results of operations, and cash flows for the periods presented. These consolidated financial statements do not include all disclosures associated with annual financial statements and accordingly should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual report on Form 10-K for the year ended December 31, 2012 filed on April 2, 2013 with the Securities and Exchange Commission. The results for the three and nine months ended September 30, 2013 are not necessarily indicative of operating results for the remainder of the year.

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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, 2013.

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

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

The total contract value associated with TACNAV products is \$21,200 for which the final shipments were completed in the second quarter of 2013. Revenue is recognized for these product sales after transfer of title and risk of loss after inspection occurs. The total contract value associated with all services is \$14,400 which are estimated to continue into the first quarter of 2014. The contract value for the services portion of the SANG TACNAV order remaining to be performed as of October 1, 2013 is approximately \$4,000. The revenue for these services is recognized using the percentage of completion accounting method. The Company limits the amount of revenue recognized for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations, or subject to customer-specific return or refund privileges.

**(4) Stock-Based Compensation**

The Company recognizes stock-based compensation in accordance with the provisions of ASC 718, Compensation-Stock Based Compensation. Stock-based compensation expense was \$984 and \$879 for the three months ended September 30, 2013 and September 30, 2012, respectively and \$2,988 and \$2,747 for the nine months ended September 30, 2013 and September 30, 2012, respectively. As of September 30, 2013, there was \$2,692 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 2.45 years. As of September 30, 2013, there was \$3,524 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 2.38 years.

The Company granted 20,000 and 265,625 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, 2013, 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 68,183 and 138,183 stock options to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three and nine months ended September 30, 2013, respectively.

The fair value of stock options granted during the nine months ended September 30, 2013 and 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, 2013 and 2012 was \$5.45 and \$4.72, respectively. The weighted-average assumptions used to value options as of their grant date were as follows:

Nine Months Ended	Nine Months Ended
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	September 30, 2013	September 30, 2012	
Risk-free interest rate	1.06	% 0.72	%
Expected volatility	50.89	% 64.60	%
Expected life (in years)	4.24	4.22	
Dividend yield	0	% 0	%

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## (5) Net Income per Common Share

Basic net income per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income 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 511,693 and 386,992 shares of common stock for the three months ended September 30, 2013 and 2012, 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 538,010 and 837,018 shares of common stock for the nine months ended September 30, 2013 and 2012 have been excluded from the fully diluted calculation of net income per share, as inclusion would be anti-dilutive.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Weighted average common shares outstanding—basic	15,199,802	14,846,249	15,109,311	14,742,855
Dilutive common shares issuable in connection with stock plans	154,657	177,331	190,807	228,812
Weighted average common shares outstanding—diluted	15,354,459	15,023,580	15,300,118	14,971,667

## (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, 2013 and December 31, 2012 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

	September 30,	December 31,
	2013	2012
Raw materials	\$9,038	\$9,173
Work in process	3,499	1,789
Finished goods	5,596	5,241
	\$18,133	\$16,203

## (7) Product Warranty

The Company's products carry limited warranties that typically range from one to two years and vary by product. The warranty period begins on the date of retail purchase or lease by the original purchaser. The Company accrues estimated product warranty costs at the time of sale and any additional amounts are recorded when such costs are probable and can be reasonably estimated. Factors that affect the Company's warranty liability include the number of units sold or leased, historical and anticipated rates of warranty repairs and the cost per repair. Warranty and related costs are reflected within sales, marketing and support in the accompanying statements of operations. As of September 30, 2013 and December 31, 2012, the Company had accrued product warranty costs of \$1,010 and \$814, respectively.

The following table summarizes product warranty activity during 2013 and 2012:

	Nine Months Ended	
	September 30,	
	2013	2012
Beginning balance	\$814	\$933
Charges to expense	746	574
Costs incurred	(550	) (586

Ending balance	\$1,010	\$921
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## (8) Segment Reporting

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

The Company operates in two geographic segments, exclusively in the mobile communications, navigation and guidance and stabilization equipment industry, which it considers to be a single business activity. The Company has two primary product categories: mobile communications and guidance and stabilization. Mobile communication sales and services include marine, land mobile, automotive, and satellite-based voice, television and Broadband Internet connectivity services. Mobile communications services sales also include our distribution of premium news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail markets via Headland Media Limited, the media and entertainment service company we acquired on May 11, 2013. Guidance and stabilization sales and services include sales of defense-related navigation and guidance and stabilization equipment based upon digital compass and fiber optic sensor technology. Mobile communication and guidance and stabilization sales also include development contract revenue, product repairs and extended warranty sales.

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

	Sales Originating From		
Three months ended September 30, 2013	Americas	Europe and Asia	Total
Mobile communications sales to the United States	\$21,270	\$299	\$21,569
Mobile communications sales to Canada	108	—	108
Mobile communications sales to Europe	181	4,622	4,803
Mobile communications sales to other geographic areas	1,001	1,532	2,533
Guidance and stabilization sales to the United States	2,026	—	2,026
Guidance and stabilization sales to Canada	3,700	—	3,700
Guidance and stabilization sales to Europe	1,437	—	1,437
Guidance and stabilization sales to other geographic areas	4,040	—	4,040
Intercompany sales	746	549	1,295
Subtotal	34,509	7,002	41,511
Eliminations	(746	) (549	) (1,295
Net sales	\$33,763	\$6,453	\$40,216
Segment net income (loss)	\$1,687	\$(301	) \$1,386
Depreciation and amortization	\$1,117	\$408	\$1,525
Total assets	\$132,415	\$48,612	\$181,027



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	Sales Originating From		
	Americas	Europe and 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	\$1,118	\$514	\$1,632
Total assets	\$114,039	\$20,062	\$134,101
		Sales Originating From	
		Americas	Europe and Asia
Nine months ended September 30, 2013			Total
Mobile communication sales to the United States	\$58,767	\$476	\$59,243
Mobile communication sales to Canada	391	—	391
Mobile communication sales to Europe	409	12,903	13,312
Mobile communication sales to other geographic areas	2,566	3,660	6,226
Guidance and stabilization sales to the United States	4,889	—	4,889
Guidance and stabilization sales to Canada	11,583	—	11,583
Guidance and stabilization sales to Europe	5,895	—	5,895
Guidance and stabilization sales to other geographic areas	21,801	—	21,801
Intercompany sales	3,286	1,383	4,669
Subtotal	109,587	18,422	128,009
Eliminations	(3,286	) (1,383	) (4,669
Net sales	\$106,301	\$17,039	\$123,340
Segment net income (loss)	\$5,302	\$(404	) \$4,898
Depreciation and amortization	\$3,391	\$910	\$4,301
Total assets	\$132,415	\$48,612	\$181,027

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Nine months ended September 30, 2012	Sales Originating From		
	Americas	Europe and Asia	Total
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

## (9) Legal Matters

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

## (10) Share Buyback Program

On November 26, 2008, the Company's Board of Directors authorized a program to repurchase up to one million shares of the Company's common stock. As of September 30, 2013, 341,009 shares of the Company's common stock remain available for repurchase under the authorized program. The repurchase program is funded using the Company's existing cash, cash equivalents, marketable securities and future cash flows. Under the repurchase program, the Company, at management's discretion, may repurchase shares on the open market from time to time, in privately negotiated transactions or block transactions, or through an accelerated repurchase agreement. The timing of such repurchases depends on availability of shares, price, market conditions, alternative uses of capital, and applicable regulatory requirements. The program may be modified, suspended or terminated at any time without prior notice. The repurchase program has no expiration date. There were no other repurchase programs outstanding during the nine months ended September 30, 2013 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, 2013.

## (11) Fair Value Measurements

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

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical,

1: unrestricted assets or liabilities. The Company's Level 1 assets are investments in money market mutual funds,

Level 2: government agency bonds, United States treasuries, corporate notes, and certificates of deposit. Quoted prices for similar assets or liabilities in active markets; or observable prices that are based on observable market data, based on directly or indirectly market-corroborated inputs. The Company's Level 2 assets and liabilities are interest rate swaps and foreign currency forward contracts.

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

Assets and liabilities measured at fair value are based on the valuation techniques identified in the table below. The valuation techniques are:

(a) Market approach—prices and other relevant information generated by market transactions involving identical or comparable assets

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

(b) discounted cash flow analysis on the expected cash flows of each instrument. This analysis utilizes observable market-based inputs, including interest rate curves and interest rate volatility, and reflects the contractual terms of these instruments, including the period to maturity.

The valuations of foreign currency forward contracts are determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each instrument. This analysis utilizes

(c) observable market-based inputs, including commodity forward curves, and reflects the contractual terms of these instruments, including the period to maturity. The specific contractual terms utilized as inputs in determining fair value and a discussion of the nature of the risks being mitigated by these instruments are detailed in Note 15,

"Derivative Instruments and Hedging Activities," under the caption "Hedges of Foreign Currency Risk."

The following tables present financial assets and liabilities at September 30, 2013 and December 31, 2012 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy:

September 30, 2013	Total	Level 1	Level 2	Level 3	Valuation Technique
Assets					
Money market mutual funds	\$18,153	\$18,153	\$—	\$—	(a)
Government agency bonds	9,529	9,529	—	—	(a)
United States treasuries	10,061	10,061	—	—	(a)
Corporate notes	8,052	8,052	—	—	(a)
Certificates of deposit	2,569	2,569	—	—	(a)
Foreign currency forward contracts	50	—	50	—	(c)
Liabilities					
Interest rate swaps	\$376	\$—	\$376	\$—	(b)

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

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.

#### Assets Measured and Recorded at Fair Value on a Nonrecurring Basis

The Company's non-financial assets and liabilities, such as goodwill, intangible assets, and other long-lived assets resulting from business combinations are measured at fair value using income approach valuation methodologies at

the date of acquisition and subsequently re-measured if there are indicators of impairment. There were no indicators of impairment identified during the three and nine months ended September 30, 2013. As of September 30, 2013, we did not have any other

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non-financial assets and liabilities that were carried at fair value on a recurring basis in the consolidated financial statements or for which a fair value measurement was required.

## (12) Acquisition

On May 11, 2013, KVH Industries U.K. Limited, a newly formed, wholly owned subsidiary of KVH, entered into a Share Purchase Agreement with Oakley Capital Private Equity L.P., Mark Woodhead, Andrew Michael Galvin and the Trustees of the Headland Media Limited Employee Benefit Trust to acquire all of the issued share capital of Headland Media Limited, a media and entertainment service company based in the United Kingdom that distributes premium news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail markets, for an aggregate purchase price of £15,576 (\$24,169 at the exchange rate of £1.00: \$1.5517 on May 11, 2013). The aggregate purchase price includes \$169 in payments made in July 2013 related to finalizing the post-closing adjustment. The acquisition of Headland Media Limited was accounted for under the acquisition method of accounting for the business combination. The purchase price was determined as a result of arms-length negotiation and was subject to a potential post-closing adjustment based on the value of the net assets delivered at the closing. The Share Purchase Agreement contains certain representations, warranties, covenants and indemnification provisions. The Share Purchase Agreement provides that 10% of the purchase price shall be held in escrow for a period of at least eighteen months after the closing in order to satisfy valid indemnification claims that KVH may assert for specified breaches of representations, warranties and covenants.

The total purchase price and related preliminary excess total purchase price over fair value of net assets acquired is as follows, excluding approximately \$8,200 of acquired intercompany debt due KVH from Headland Media Limited (in thousands):

Consideration transferred - cash		\$24,169	
Book value of net assets acquired	\$163		
Fair value adjustments to deferred revenue	123		
Fair value of tangible net assets acquired		\$286	
Identifiable intangibles at acquisition-date fair value			
Subscriber relationships	\$8,271		
Distribution rights	4,888		
Internally developed software	543		
Proprietary content	186		
		\$13,888	
Deferred income taxes		(3,134	)
Goodwill		\$13,129	

The final determination of the assets acquired and liabilities assumed is based on the established fair value of the assets acquired and the liabilities assumed as of the acquisition date. The excess of the purchase price over the fair value of net assets acquired is allocated to goodwill.

The acquired finite-lived intangible assets from the Headland Media Limited acquisition were recorded at their estimated fair value of \$13,888 on the acquisition date. The weighted-average useful life of the acquired intangible assets is estimated at approximately 11 years.

The goodwill of \$13,129 arising from the Headland Media Limited acquisition largely reflects the expansion of our service offerings complementary to our existing products. The Headland Media Limited acquisition was intended to expand our future VSAT broadband communications product offerings by offering new media content to our customers.

Since the date of the acquisition, May 11, 2013, the Company has recorded approximately \$5,200 of service revenue attributable to Headland Media Limited within its condensed consolidated financial statements for the nine months ended September 30, 2013.

Pro Forma Financial Information

The following table summarizes the supplemental statements of operations information on an unaudited pro forma basis as if the Headland Media Limited acquisition had occurred on January 1, 2012:

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	Nine Months Ended September 30,	
	2013	2012
Pro forma net revenues	\$128,103	\$107,128
Pro forma net income	\$5,537	\$1,718
Basic pro forma net income per share	\$0.37	\$0.12
Diluted pro forma net income per share	\$0.36	\$0.11

The pro forma results presented above are for illustrative purposes only for the periods presented and do not purport to be indicative of the actual results which would have occurred had the transaction been completed as of the beginning of the period, nor are they indicative of results of operations which may occur in the future.

## (13) Goodwill and Intangible Assets

The following table sets forth the changes in the carrying amount of goodwill for the nine months ended September 30, 2013:

	Amounts
Balance at December 31, 2012	\$4,712
Goodwill allocated to Headland Media Limited	13,129
Foreign currency translation adjustment	245
Balance at September 30, 2013	\$18,086

During the quarter ended September 30, 2013, the Company performed its annual goodwill impairment test as of August 31, 2013, as defined by FASB ASC Topic 350, Intangibles—Goodwill and Other (“ASC 350”). ASC 350 requires that the impairment test be performed through the application of a two-step process. The first step compares the carrying value of the Company’s reporting units to their estimated fair values as of the test date. If fair value is less than carrying value, a second step is performed to quantify the amount of the impairment, if any. As of August 31, 2013, the Company performed its annual impairment test for goodwill at the reporting unit level and, after conducting the first step, determined that it was not necessary to conduct the second step as it concluded that the fair value of its reporting units substantially exceeded their carrying value. Accordingly, the Company determined no adjustment to goodwill was necessary.

For intangible assets, the Company assesses the carrying value of these assets whenever events or circumstances indicate that the carrying value may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset, or asset group, to the future undiscounted cash flows expected to be generated by the asset, or asset group.

Acquired intangible assets are subject to amortization. The following table summarizes acquired intangible assets at September 30, 2013 and December 30, 2012, respectively:

	Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
September 30, 2013				
Subscriber relationships	10	\$8,600	\$335	\$8,265
Distribution rights	15	5,083	133	4,950
Internally developed software	3	565	74	491
Proprietary content	2	194	39	155
Intellectual property	7	2,372	1,052	1,320
		\$16,814	\$1,633	\$15,181
December 31, 2012				
Intellectual property	7	\$2,372	\$688	\$1,684
		\$2,372	\$688	\$1,684



Estimated future amortization expense remaining at September 30, 2013 for intangible assets acquired is as follows:

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	Year Ending December 31,
2013	\$453
2014	1,811
2015	1,749
2016	1,594
2017	1,456
Thereafter	8,118
Total future amortization expense	\$15,181

## (14) Business and Credit Concentrations

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

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2013	2012	2013	2012	
Net sales to foreign customers outside the U.S. and Canada	31.9	% 45.3	% 38.3	% 37.9	%
Net sales to Customer A	*	18.9	% 14.2	% *	

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

## (15) 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, 2013, the fair value of the derivatives is included in other accrued liabilities and the unrealized gain is included in accumulated other comprehensive income (loss).

As of September 30, 2013, the Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

Interest Rate Derivatives	Notional (in thousands)	Asset (Liability)	Effective Date	Maturity Date	Index	Strike Rate
Interest rate swap	\$1,725	(181 )	April 1, 2010	April 1, 2019	1-month LIBOR	5.91 %
Interest rate swap	\$1,725	(195 )	April 1, 2010	April 1, 2019	1-month LIBOR	6.07 %

## Hedges of Foreign Currency Risk

As a result of the acquisition of Headland