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

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended: June 30, 2013

OR

o 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	05-0420589
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

50 Enterprise Center, Middletown, RI 02842
(Address of Principal Executive Offices) (Zip Code)
(401) 847-3327
(Registrant's Telephone Number, Including Area Code)

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

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 ý No o

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

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

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

Date	Class	Outstanding shares
August 7, 2013	Common Stock, par value $0.01 per share	15,571,460

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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)

	June 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$9,916	$8,978
Marketable securities	44,407	29,307
Accounts receivable, net of allowance for doubtful accounts of approximately $988 as of June 30, 2013 and $929 as of December 31, 2012	26,982	27,654
Inventories	17,355	16,203
Prepaid expenses and other assets	4,756	3,264
Deferred income taxes	817	1,146
Total current assets	104,233	86,552
Property and equipment, less accumulated depreciation of $34,032 as of June 30, 2013 and $31,657 as of December 31, 2012	36,283	36,733
Intangible assets, less accumulated amortization of $1,120 as of June 30, 2013 and $826 as of December 31, 2012	14,802	1,684
Goodwill	16,966	4,712
Other non-current assets	5,205	4,363
Deferred income taxes	566	3,524
Total assets	$178,055	$137,568
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$7,144	$7,086
Accrued compensation and employee-related expenses	5,542	6,785
Accrued other	7,126	4,595
Accrued product warranty costs	970	814
Deferred revenue	7,037	1,892
Current portion of long-term debt	1,109	138
Total current liabilities	28,928	21,310
Other long-term liabilities	1,312	140
Line of credit	30,000	7,000
Long-term debt, excluding current portion	6,671	3,414
Total liabilities	66,911	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, 16,822,549 and 16,563,836 shares issued at June 30, 2013 and December 31, 2012; and 15,163,558 and 14,904,845 shares outstanding at June 30, 2013 and December 31, 2012, respectively	168	166
Additional paid-in capital	114,642	111,514
Retained earnings	10,819	7,307
Accumulated other comprehensive loss	(1,335)	(133)
	(13,150)	(13,150)

Less: treasury stock at cost, common stock, 1,658,991 shares as of June 30, 2013 and December 31, 2012		
Total stockholders’ equity	111,144	105,704
Total liabilities and stockholders’ equity	$178,055	$137,568

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Sales:				
Product	$25,886	$21,041	$51,102	$38,124
Service	17,311	10,978	32,022	20,623
Net sales	43,197	32,019	83,124	58,747
Costs and expenses:				
Costs of product sales	14,310	12,746	28,219	23,729
Costs of service sales	10,860	6,822	21,110	12,624
Research and development	3,250	3,059	6,200	6,199
Sales, marketing and support	7,541	5,547	14,484	10,879
General and administrative	4,936	2,918	8,310	5,866
Total costs and expenses	40,897	31,092	78,323	59,297
Income (loss) from operations	2,300	927	4,801	(550)
Interest income	204	109	373	212
Interest expense	186	85	261	167
Other income, net	54	39	78	76
Income (loss) before income tax expense	2,372	990	4,991	(429)
Income tax expense	824	537	1,479	493
Net income (loss)	$1,548	$453	$3,512	$(922)
Per share information:				
Net income (loss) per share				
Basic and diluted	$0.10	$0.03	$0.23	$(0.06)
Number of shares used in per share calculation:				
Basic	15,136,568	14,776,239	15,063,315	14,690,591
Diluted	15,234,898	14,886,548	15,253,288	14,690,591

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss)	$1,548	$453	$3,512	$(922)
Other comprehensive income (loss), net of tax:				
Unrealized (loss) gain on available-for-sale securities	(29)	1	(33)	(3)
Currency translation adjustment (loss) gain	(845)	(506)	(1,235)	9
Unrealized gain (loss) on derivatives	25	(77)	66	(42)
Other comprehensive (loss) income, net of tax	(849)	(582)	(1,202)	(36)
Total comprehensive income (loss)	$699	$(129)	$2,310	$(958)

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)

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Net income (loss)	$3,512	$(922)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for doubtful accounts	338	145
Depreciation and amortization	2,669	2,206
Deferred income taxes	103	464
Loss on interest rate swaps	73	64
Compensation expense related to stock-based awards and employee stock purchase plan	2,004	1,868
Changes in operating assets and liabilities:		
Accounts receivable	2,586	3,493
Inventories	(1,164)	1,454
Prepaid expenses and other assets	(986)	(401)
Other non-current assets	(631)	(370)
Accounts payable	(481)	(333)
Deferred revenue	2,503	(22)
Accrued expenses	71	(863)
Other long-term liabilities	1,173	(7)
Net cash provided by operating activities	11,770	6,776
Cash flows from investing activities:		
Capital expenditures	(1,444)	(4,536)
Net cash paid for business acquired	(22,774)	—
Purchases of marketable securities	(27,055)	(8,705)
Maturities and sales of marketable securities	12,089	9,473
Net cash used in investing activities	(39,184)	(3,768)
Cash flows from financing activities:		
Repayments of long-term debt	(443)	(65)
Borrowings from long-term debt	4,671	—
Proceeds from stock options exercised and employee stock purchase plan	1,954	695
Payment of employee restricted stock withholdings	(828)	(333)
Repayments of line of credit borrowings	—	(2,000)
Proceeds from line of credit borrowings	23,000	—
Net cash provided by (used in) financing activities	28,354	(1,703)
Effect of exchange rate changes on cash and cash equivalents	(2)	(80)
Net increase in cash and cash equivalents	938	1,225
Cash and cash equivalents at beginning of period	8,978	7,017
Cash and cash equivalents at end of period	$9,916	$8,242

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. 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 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. 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, sales of media and entertainment distributions, engineering services provided under development contracts, sales from product repairs, DIRECTV account referral fees earned in conjunction with the sale of its products and extended warranty sales. 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. Under current DIRECTV programs, KVH is eligible to receive a new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through KVH.
KVH's guidance and stabilization service sales include product repairs, engineering services provided under development contracts and extended warranty sales.

(2) Basis of Presentation
The accompanying consolidated financial statements of KVH Industries, Inc. and its 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 Satelite Ltda. operate as the Company's European, Singaporean, Japanese and Brazilian international distributors, all of their operating expenses are reflected within sales, marketing and support within the accompanying consolidated statements of operations. KVH Industries Norway A/S, a subsidiary of KVH Industries A/S, develops and distributes middleware software solutions known as CommBox technology, 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 six months ended June 30, 2013 are not necessarily indicative of operating results for the remainder of the year.

(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 June 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 through 2014. The contract value for the services portion of the SANG TACNAV order remaining to be performed as of July 1, 2013 is approximately $6,200. 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 $923 and $851 for the three months ended June 30, 2013 and June 30, 2012, respectively and $2,004 and $1,868 for the six months ended June 30, 2013 and June 30, 2012, respectively. As of June 30, 2013, there was $2,654 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 2.54 years. As of June 30, 2013, there was $3,821 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 2.56 years.

The Company granted 20,000 and 245,625 restricted stock awards to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three and six months ended June 30, 2013. The restricted stock awards vest ratably over four years from the date of grant subject to the recipient remaining employed through the applicable vesting dates. Compensation expense for restricted stock awards is measured at fair value on the date of grant based on the number of shares granted and the quoted market closing price of the Company’s common stock. Such value is recognized as expense over the vesting period of the award, net of estimated forfeitures.

The Company granted 70,000 stock options to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three and six months ended June 30, 2013.

The fair value of stock options granted during the six months ended June 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 six months ended June 30, 2013 and 2012 was $5.44 and $4.70, respectively. The weighted-average assumptions used to value options as of their grant date were as follows:

	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
Risk-free interest rate	0.67	%	0.72	%
Expected volatility	52.31	%	64.6	%
Expected life (in years)	4.24		4.22	
Dividend yield	0	%	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 487,156 and 1,075,765 shares of common stock for the three months ended June 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 481,990 shares of common stock for the six months ended June 30, 2013 have been excluded from the fully diluted calculation of net income per share, as inclusion would be anti-dilutive. The Company has excluded all outstanding stock options and non-vested restricted shares from the calculation of diluted earnings per share for the six months ended June 30, 2012 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Weighted average common shares outstanding—basic	15,136,568	14,776,239	15,063,315	14,690,591
Dilutive common shares issuable in connection with stock plans	98,330	110,309	189,973	—
Weighted average common shares outstanding—diluted	15,234,898	14,886,548	15,253,288	14,690,591

(6) Inventories

Inventories are stated at the lower of cost or market using the first-in first-out costing method. Inventories as of June 30, 2013 and December 31, 2012 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

	June 30, 2013	December 31, 2012
Raw materials	$8,819	$9,173
Work in process	3,846	1,789
Finished goods	4,690	5,241
	$17,355	$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 June 30, 2013 and December 31, 2012, the Company had accrued product warranty costs of $970 and $814, respectively.

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

	Six Months Ended June 30, 2013	2012
Beginning balance	$814	$933
Charges to expense	515	243
Costs incurred	(359)	(252)
Ending balance	$970	$924

(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, as well as DIRECTV referral fees earned in conjunction with the sale of our products. 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 June 30, 2013	Americas	Europe and Asia	Total
Mobile communications sales to the United States	$19,945	$177	$20,122
Mobile communications sales to Canada	121	—	121
Mobile communications sales to Europe	110	4,796	4,906
Mobile communications sales to other geographic areas	726	1,377	2,103
Guidance and stabilization sales to the United States	1,826	—	1,826
Guidance and stabilization sales to Canada	4,593	—	4,593
Guidance and stabilization sales to Europe	1,748	—	1,748
Guidance and stabilization sales to other geographic areas	7,778	—	7,778
Intercompany sales	1,935	457	2,392
Subtotal	38,782	6,807	45,589
Eliminations	(1,935)	(457)	(2,392)
Net sales	$36,847	$6,350	$43,197
Segment net income (loss)	$2,414	$(866)	$1,548
Depreciation and amortization	$1,123	$322	$1,445

Total assets	$130,208	$47,847	$178,055

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

	Sales Originating From		
Six months ended June 30, 2013	Americas	Europe and Asia	Total
Mobile communication sales to the United States	$37,497	$177	$37,674
Mobile communication sales to Canada	283	—	283
Mobile communication sales to Europe	228	8,281	8,509
Mobile communication sales to other geographic areas	1,565	2,128	3,693
Guidance and stabilization sales to the United States	2,863	—	2,863
Guidance and stabilization sales to Canada	7,883	—	7,883
Guidance and stabilization sales to Europe	4,458	—	4,458
Guidance and stabilization sales to other geographic areas	17,761	—	17,761
Intercompany sales	2,540	834	3,374
Subtotal	75,078	11,420	86,498
Eliminations	(2,540)	(834)	(3,374)
Net sales	$72,538	$10,586	$83,124
Segment net income (loss)	$3,614	$(102)	$3,512
Depreciation and amortization	$2,273	$396	$2,669
Total assets	$130,208	$47,847	$178,055

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Six months ended June 30, 2012	Sales Originating From Americas	Europe and Asia	Total
Mobile communication sales to the United States	$30,593	$—	$30,593
Mobile communication sales to Canada	365	—	365
Mobile communication sales to Europe	243	9,610	9,853
Mobile communication sales to other geographic areas	1,507	2,556	4,063
Guidance and stabilization sales to the United States	3,258	—	3,258
Guidance and stabilization sales to Canada	5,207	—	5,207
Guidance and stabilization sales to Europe	4,351	—	4,351
Guidance and stabilization sales to other geographic areas	1,057	—	1,057
Intercompany sales	6,631	1,050	7,681
Subtotal	53,212	13,216	66,428
Eliminations	(6,631)	(1,050)	(7,681)
Net sales	$46,581	$12,166	$58,747
Segment net loss	$(375)	$(547)	$(922)
Depreciation and amortization	$1,991	$215	$2,206
Total assets	$106,111	$20,553	$126,664

(9) Legal Matters

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

(10) Share Buyback Program

On November 26, 2008, the Company's Board of Directors authorized a program to repurchase up to one million shares of the Company's common stock. As of June 30, 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 six months ended June 30, 2013 and no repurchase programs expired during the period.

The Company did not repurchase any shares of its common stock in the six months ended June 30, 2013.

(11) Fair Value Measurements

Effective January 1, 2008, the Company adopted the required provisions of ASC 820, Fair Value Measurements and Disclosures. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 describes three levels of inputs that may be used to measure fair value:

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

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

(b) The valuations of the interest rate swaps intended to mitigate the Company's interest rate risk are determined with the assistance of a third-party financial institution using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each instrument. This analysis utilizes observable market-based inputs, including interest rate curves and interest rate volatility, and reflects the contractual terms of these instruments, including the period to maturity.

(c) 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 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 June 30, 2013 and December 31, 2012 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy:

June 30, 2013	Total	Level 1	Level 2	Level 3	Valuation Technique
Assets					
Money market mutual funds	$14,070	$14,070	$—	$—	(a)
Government agency bonds	8,504	8,504	—	—	(a)
United States treasuries	11,114	11,114	—	—	(a)
Corporate notes	8,086	8,086	—	—	(a)
Certificates of deposit	2,530	2,530	—	—	(a)
Liabilities					
Interest rate swaps	$369	$—	$369	$—	(b)
Foreign currency forward contracts	106	—	106	—	(c)

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 six months ended June 30, 2013. As of June 30, 2013, we did not have any other non-financial

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assets and liabilities that were carried at fair value on a recurring basis in the condensed 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 approximately £15,500 ($24,000 at the exchange rate of £1.00: $1.5517 on May 11, 2013). The acquisition was consummated on the same day. 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 is 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		$24,000	
Book value of net assets acquired	$282		
Fair value adjustments to deferred revenue	123		
Fair value of tangible net assets acquired		$405	
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		$12,841	

Our fair value estimate of assets acquired and liabilities assumed is pending completion of several elements, including the finalization of valuations of the assets acquired and liabilities assumed and final review by our management. The primary areas that are not yet finalized relate to the fair value of certain tangible assets acquired and liabilities assumed, the valuation of intangible assets acquired, and income and non-income based taxes. The final determination of the assets acquired and liabilities assumed will be 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 final determination of the purchase price, fair values and resulting goodwill may differ significantly from what is reflected.

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 $12,841 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.

Total service revenue of approximately $1,900 from Headland Media Limited is included in the Company's results for the three months ended June 30, 2013.

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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:

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Pro forma net revenues	$87,887	$65,012
Pro forma net income (loss)	3,704	(625)
Basic pro forma net income (loss) per share	$0.25	$(0.04)
Diluted pro forma net income (loss) per share	$0.24	$(0.04)

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 six months ended June 30, 2013:

	Amounts
Balance at December 31, 2012	$4,712
Goodwill allocated to Headland Media Limited	12,841
Foreign currency translation adjustment	(587)
Balance at June 30, 2013	$16,966

In the six months ended June 30, 2013, there were no triggering events, as defined by FASB ASC Topic 350, Intangibles—Goodwill and Other (“FASB ASC 350”), which required an interim goodwill impairment test. We perform our annual goodwill impairment test as of August 31 each year.

Acquired intangible assets consisted of the following:

	Useful Life	Cost	Accumulated Amortization	Net Carrying Value
June 30, 2013				
Subscriber relationships	10	$8,106	$113	$7,993
Distribution rights	15	4,791	45	4,746
Internally developed software	3	532	25	507
Proprietary content	2	182	13	169
Intellectual property	7	2,372	985	1,387
		$15,983	$1,181	$14,802
December 31, 2012				
Intellectual property	7	$2,372	$688	$1,684
		$2,372	$688	$1,684

Estimated future amortization expense remaining at June 30, 2013, for intangible assets acquired as part of the Headland Media Limited acquisition, is as follows:

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	Year Ending December 31,
2013	$699
2014	1,399
2015	1,340
2016	1,194
2017	1,130
Thereafter	7,653
Total future amortization expense	$13,415

(14) Business and Credit Concentrations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net sales to foreign customers outside the U.S. and Canada	38.3 %	32.2 %	41.4 %	32.9 %
Net sales to Customer A	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 June 30, 2013, the fair value of the derivatives is included in other accrued liabilities and the unrealized gain is included in other comprehensive income.

As of June 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	$1,737	(177)	April 1, 2010	April 1, 2019	1-month LIBOR	5.91 %
Interest rate swap	$1,737	(192)	April 1, 2010	April 1, 2019	1-month LIBOR	6.07 %

Hedges of Foreign Currency Risk

As a result of the acquisition of Headland Media Limited on May 11, 2013, the Company inherited foreign currency forward contracts that Headland Media Limited owned and that were intended to hedge currency fluctuations between the British Pound and U.S. Dollar and the British Pound and the Euro. As the Company's functional currency is the U.S. dollar and the majority of Headland Media Limited's foreign currency forward contracts were designated to hedge the U.S. dollar, it is expected there will be no additional purchases of any of these contracts going forward. These outstanding foreign currency forward contracts qualify as cash flow hedges intended to offset the effect of exchange rate fluctuations on forecasted sales, all of which were deemed effective.

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period in which the hedged forecasted transaction affects earnings. For the three and six months ended June 30, 2013, an immaterial amount was recognized in earnings. As of June 30, 2013, we estimated that $100 thousand in net losses will be reclassified from accumulated other comprehensive income to earnings during the twelve months ending June 30, 2014.

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As of June 30, 2013, we had the following outstanding foreign currency forward contracts:

Notional (in millions)	Effective Date	Maturity Date	Index	Weighted-Average Strike Rate	Hedge Designation
0.9 USD	Various from September 2013 to December 2013	Various from September 2013 to December 2013	U.S. Dollar to GBP Exchange Rate	1.58 USD	Designated
1.8 USD	Various from January 2014 to December 2014	Various from January 2014 to December 2014	U.S. Dollar to GBP Exchange Rate	1.57 USD	Designated
0.24 EUR	Various from October 2013 to December 2013	Various from October 2013 to December 2013	Euro to GBP Exchange Rate	1.24 EUR	Designated
0.48 EUR	Various from January 2014 to December 2014	Various from January 2014 to December 2014	Euro to GBP Exchange Rate	1.16 EUR	Designated

The notional amounts above represent the total quantities we have outstanding over the remaining contracted periods.

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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, and land mobile markets, and navigation, guidance and stabilization products for both the defense and commercial markets. We also distribute premium news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail 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. 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 FOG systems that enable platform and optical stabilization, navigation, pointing and guidance. Our guidance and stabilization products also include tactical navigation systems that provide uninterrupted access to navigation and pointing information in a variety of military vehicles, including tactical trucks and light armored vehicles. Our guidance and stabilization products are sold directly to U.S. and allied governments and government contractors, as well as through an international network of authorized independent sales representatives. In addition, our guidance and stabilization products have numerous commercial applications such as precision mapping, dynamic surveying, autonomous vehicles, train location control and track geometry measurement systems, industrial robotics and optical stabilization.

Our mobile communications service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, and DIRECTV account referral fees earned in conjunction with the sale of our products and extended warranty sales. Our 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, our media and entertainment service company that we acquired on May 11, 2013. We provide, for monthly fixed and usage fees, satellite connectivity services for broadband Internet, data and VoIP service to our TracPhone V-series customers. We also earn monthly usage fees for third-party satellite connectivity for voice, data and Internet services to our Inmarsat TracPhone customers who choose to activate their subscriptions with us. Under current DIRECTV programs, we are eligible to receive a new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through us. Our service sales have grown from 18% of our net sales in 2010 to 24% in 2011 to 34% in 2012. We expect our service sales will continue to increase as a percentage of our net sales as a result of our recent acquisition of Headland Media Limited and the growth that we anticipate in our mini-VSAT Broadband customer base.

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

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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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Mobile communications	$27,252	$24,044	$50,159	$44,874
Guidance and stabilization	15,945	7,975	32,965	13,873
Net sales	$43,197	$32,019	$83,124	$58,747

We have historically derived a substantial portion of our sales from sales to customers located outside the United States. Notes 8 and 14 of the notes to the consolidated financial statements provide information regarding our sales to specific geographic regions.

Critical Accounting Policies and Significant Estimates

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

As described in our annual report on Form 10-K for the year ended December 31, 2012, our most critical accounting policies and estimates upon which our consolidated financial statements were prepared were those relating to revenue recognition, allowances for accounts receivable, inventories, income taxes and deferred income tax assets and liabilities, warranty, stock-based compensation, goodwill and intangible assets and contingencies. We have reviewed our policies and estimates and determined that these remain our most critical accounting policies and estimates for the quarter ended June 30, 2013.

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

Results of Operations

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

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Sales:				
Product	59.9 %	65.7 %	61.5 %	64.9 %
Service	40.1	34.3	38.5	35.1
Net sales	100.0	100.0	100.0	100.0
Cost and expenses:				
Costs of product sales	33.1	39.8	34.0	40.4
Costs of service sales	25.1	21.3	25.4	21.5
Research and development	7.5	9.6	7.5	10.6
Sales, marketing and support	17.5	17.3	17.4	18.5
General and administrative	11.4	9.1	10.0	10.0
Total costs and expenses	94.6	97.1	94.3	101.0
Income (loss) from operations	5.4	2.9	5.7	(1.0)
Interest income	0.5	0.3	0.4	0.4
Interest expense	0.4	0.3	0.3	0.3
Other income, net	0.1	0.1	0.1	0.1
Income (loss) before income tax expense	5.6	3.0	5.9	(0.8)
Income tax expense	1.9	1.6	1.8	0.8
Net income (loss)	3.7 %	1.4 %	4.1 %	(1.6)%

Three Months Ended June 30, 2013 and 2012

Net Sales

Product sales for the three months ended June 30, 2013 increased $4.8 million, or 23%, to $25.9 million for the three months ended June 30, 2013 from $21.0 million for the three months ended June 30, 2012. The increase was primarily due to an increase in sales of our guidance and stabilization products of approximately $6.0 million, or 82%. Specifically, sales of our TACNAV defense products increased $3.5 million, or 227%, primarily as a result of product sales related to the previously announced Saudi Arabian National Guard (SANG) contract. SANG hardware shipments were completed in the second quarter of 2013. Also contributing to the increase in sales of our guidance and stabilization products during the three months ended June 30, 2013 was an increase in sales of our FOG products of $2.4 million, or 43%, as compared to the three months ended June 30, 2012. We expect that our TACNAV product sales will decrease significantly quarter-over-quarter during the remainder of 2013, primarily due to the completion of the SANG hardware order discussed above and indications of a slowdown in future U.S. defense sales resulting from the implementation of sequestration measures. 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 increase year-over-year, primarily due to increased demand for new commercial applications. Offsetting the increase in guidance and stabilization product sales was a decrease of $1.2 million, or 8%, in sales of our mobile communications products to $12.6 million for the three months ended June 30, 2013 from $13.8 million for the three months ended June 30, 2012. The decrease was primarily due to a decrease in sales of our marine products of $0.8 million, or 7%, driven primarily by decreased sales of our TracPhone V7 product and satellite television products in Europe. Also contributing to this decrease was a decrease in our land mobile products of $0.3 million, or 27%, as compared to the three months ended June 30, 2012. 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 decrease in mobile communications products was increased sales of our TracPhone V11, which was released in the fourth quarter of 2012. We remain cautious about the prospects for our marine leisure sales, specifically in Europe, as a result of ongoing challenges in the global economy.

Mobile communications product sales originating from our European and Asian subsidiaries for the three months ended June 30, 2013 decreased $1.7 million, or 28%, as compared to the three months ended June 30, 2012. Mobile communications product sales originating from the Americas for the three months ended June 30, 2013 increased $0.6

million, or 8%, as compared to the three months ended June 30, 2012.

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Service sales for the three months ended June 30, 2013 increased $6.3 million, or 58%, to $17.3 million from $11.0 million for the three months ended June 30, 2012. The primary reason for the increase was a $2.9 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase in service sales was a $1.9 million increase from Headland Media Limited, which we acquired on May 11, 2013, and a $1.8 million increase in contracted engineering services driven by construction and program management services provided in connection with the SANG contract.

Costs of Sales

For the three months ended June 30, 2013, costs of product sales increased by $1.6 million, or 12%, to $14.3 million from $12.7 million for the three months ended June 30, 2012. The primary reason for the increase was the increase in sales of our FOG and TACNAV products discussed above.

Costs of service sales increased by $4.0 million, or 59%, to $10.9 million for the three months ended June 30, 2013 from $6.8 million for the three months ended June 30, 2012. The primary reason for the increase was a $2.0 million increase in engineering services cost of sales due primarily to the services provided in connection with the SANG contract as discussed above. Also contributing to the increase was an increase of $1.7 million in airtime costs of sales for our mini-VSAT Broadband service, and a $0.5 million increase in costs of service from Headland Media Limited.

Gross margin from product sales for the three months ended June 30, 2013 increased to 45% as compared to 39% for the three months ended June 30, 2012. The increase in our gross margin from product sales was primarily due to an increase in sales of our TACNAV and FOG products discussed above, which generally have higher margins than our mobile communications products. We expect that, with the completion of product deliveries under the SANG contract during the second quarter of 2013, gross margin from product sales will decline.

Gross margin from service sales for the three months ended June 30, 2013 decreased to 37% as compared to 38% for the three months ended June 30, 2012. The decrease in our gross margin from service sales was primarily attributable to the decrease in gross margin for contracted engineering services as a result of the installation 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 remain at the second quarter 2013 level, which is well below historical levels, for the next several quarters as a result of the installation and program management services portion of the SANG contract. The contract value for the services portion of the SANG order remaining to be performed as of July 1, 2013 is approximately $6.2 million. These project management services are estimated to continue to be performed well into 2014. Partially offsetting the decrease in gross margin for contracted engineering services was an increase in gross margin for mini-VSAT Broadband service sales to 35% from 32% in the year-ago period. In 2013, we expect mini-VSAT Broadband service margins to increase year-over-year primarily from increased TracPhone V11 activations, an overall increase in our mini-VSAT Broadband customer base, and from the introduction of new value-added services to our mini-VSAT Broadband customers, but at a more modest rate than the recent year-over-year gross margin growth from 2011 to 2012.

Operating Expenses

Sales, marketing and support expense for the three months ended June 30, 2013 increased by $2.0 million, or 36%, to $7.5 million from $5.5 million for the three months ended June 30, 2012. The primary reason for the increase in 2013 was a $0.8 million increase in variable sales expense primarily as a result of the sales relating to the SANG contract and related facility construction that commenced in the third quarter of 2012. Also contributing to the increase in 2013 was a $0.6 million increase in sales, marketing and support expense related to Headland Media Limited and our Danish subsidiary. Also contributing to the increase was a $0.3 million increase in warranty expense, a $0.2 million increase in accrued performance-based incentive compensation, and a $0.1 million increase in bad debt expense. As a percentage of net sales, sales, marketing and support expense for the quarter ended June 30, 2013 was 18% as compared to 17% for the quarter ended June 30, 2012.

Research and development expense for the three months ended June 30, 2013 increased by $0.2 million, or 6%, to $3.3 million from $3.1 million for the three months ended June 30, 2012. The primary reason for the increase in 2013 expense was a $0.2 million increase in U.S.-based employee compensation. As a percentage of net sales, research and development expense for the quarter ended June 30, 2013 was 8% as compared to 10% for the quarter ended June 30, 2012.

General and administrative expense for the three months ended June 30, 2013 increased by $2.0 million, or 69%, to $4.9 million from $2.9 million for the three months ended June 30, 2012. The primary reasons for the increase in 2013 expense were a $0.9 million increase in transaction expenses related to the acquisition of Headland Media Limited and a $0.7 million increase in general administrative expense from Headland Media Limited. Also contributing to the increase was a $0.2 million increase in U.S.-based employee compensation driven by increased accrued performance-based incentive compensation, and a $0.1 million increase in legal expense. As a percentage of net sales, general and administrative expense for the quarter ended June 30, 2013 was 11% as compared to 9% for the quarter ended June 30, 2012.

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We expect total general and administrative expense will increase year-over-year on an absolute basis. We also expect general and administrative expense should decline as a percentage of total sales year-over-year, excluding the non-recurring transaction expenses related to the Headland Media Limited acquisition and the additional general and administrative expense at Headland Media Limited.

Income Tax Expense

Income tax expense for the three months ended June 30, 2013 was $0.8 million as compared to $0.5 million for the three months ended June 30, 2012. The increase in income tax expense is primarily due to a $1.4 million increase in pre-tax income. We estimate our effective tax rate for 2013 to be 35% or higher, as a result of the tax effect of discrete events such as stock option exercise activity and restricted stock vesting.

Six Months Ended June 30, 2013 and 2012

Net Sales

Product sales for the six months ended June 30, 2013 increased $13.0 million, or 34%, to $51.1 million for the six months ended June 30, 2013 from $38.1 million for the six months ended June 30, 2012. The increase was primarily due to an increase in sales of our guidance and stabilization products of approximately $15.4 million, or 131%. Specifically, sales of our TACNAV defense products increased $10.1 million, or 380%, primarily as a result of product sales related to the previously announced Saudi Arabian National Guard (SANG) contract. Also contributing to the increase in sales of our guidance and stabilization products during the six months ended June 30, 2013 was an increase in sales of our FOG products of $5.3 million, or 61%, as compared to the six months ended June 30, 2012. Offsetting the increase in guidance and stabilization product sales was a decrease of $2.4 million, or 9%, in sales of our mobile communications products to $23.9 million for the six months ended June 30, 2013 from $26.4 million for the six months ended June 30, 2012. The decrease was primarily due to a decrease in sales of our marine products of $1.7 million, or 7%, driven primarily by decreased sales of our TracPhone V7 product and satellite television products in Europe. Also contributing to this decrease was a decrease in sales of our land mobile products of $0.7 million, or 28%, as compared to the six months ended June 30, 2012. The decrease in sales of our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market. Partially offsetting the decrease in sales of these mobile communications products was increased sales of our TracPhone V11, which was released in the fourth quarter of 2012.

Mobile communications product sales originating from our European and Asian subsidiaries for the six months ended June 30, 2013 decreased $3.1 million, or 27%, as compared to the six months ended June 30, 2012. Mobile communications product sales originating from the Americas for the six months ended June 30, 2013 increased $0.7 million, or 4%, as compared to the six months ended June 30, 2012.

Service sales for the six months ended June 30, 2013 increased $11.4 million, or 55%, to $32.0 million from $20.6 million for the six months ended June 30, 2012. The primary reason for the increase was a $5.9 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase in service sales was a $3.6 million increase in contracted engineering services driven by construction and program management services provided in connection with the SANG contract, and $1.9 million increase from Headland Media Limited.

Costs of Sales

For the six months ended June 30, 2013, costs of product sales increased by $4.5 million, or 19%, to $28.2 million from $23.7 million for the six months ended June 30, 2012. The primary reason for the increase was the increase in sales of our TACNAV and FOG products discussed above.

Costs of service sales increased by $8.5 million, or 67%, to $21.1 million for the six months ended June 30, 2013 from $12.6 million for the six months ended June 30, 2012. The primary reason for the increase was a $4.6 million increase in engineering services cost of sales due primarily to the services provided in connection with the SANG contract as discussed above. Also contributing to the increase was an increase of $3.4 million in airtime costs of sales for our mini-VSAT Broadband service, and a $0.5 million increase in costs of service from Headland Media Limited.

Gross margin from product sales for the six months ended June 30, 2013 increased to 45% as compared to 38% for the six months ended June 30, 2012. The increase in our gross margin from product sales was primarily due to an increase in sales of our TACNAV and FOG products discussed above, which generally have higher margins than our mobile communications products.

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Gross margin from service sales for the six months ended June 30, 2013 decreased to 34% as compared to 39% for the six months ended June 30, 2012. The decrease in our gross margin from service sales was primarily attributable to the decrease in gross margin for contracted engineering services as a result of the facility construction, installation and project management services in Saudi Arabia, as these services had a gross margin of approximately 10%. Partially offsetting the decrease in gross margin for contracted engineering services was an increase in gross margin for mini-VSAT Broadband service sales to 34% from 31% in the year-ago period.

Operating Expenses

Sales, marketing and support expense for the six months ended June 30, 2013 increased by $3.6 million, or 33%, to $14.5 million from $10.9 million for the six months ended June 30, 2012. The primary reason for the increase in 2013 was a $1.9 million increase in variable sales expense primarily as a result of the sales relating to the SANG contract and related facility construction that commenced in the third quarter of 2012. Also contributing to the increase in 2013 was a $1.0 million increase in sales, marketing and support expense related to our Danish subsidiary, Headland Media Limited, and our Japanese subsidiary. Also contributing to the increase was a $0.3 million increase in accrued performance-based incentive compensation, a $0.3 million increase in warranty expense, and a $0.2 million increase in bad debt expense. As a percentage of net sales, sales, marketing and support expense for the six months ended June 30, 2013 was 18% as compared to 19% for the six months ended June 30, 2012.

Research and development expense for the six months ended June 30, 2013 of $6.2 million was consistent with the six months ended June 30, 2012. As a percentage of net sales, research and development expense for the six months ended June 30, 2013 was 8% as compared to 11% for the six months ended June 30, 2012. Research and development expense as a percentage of net sales decreased due to an increase in customer-funded engineering costs for SANG related contracted engineering services. We expect research and development expense as a percentage of net sales to increase as the services portion of the SANG contract is completed in 2014.

General and administrative expense for the six months ended June 30, 2013 increased by $2.4 million, or 42%, to $8.3 million from $5.9 million for the six months ended June 30, 2012. The primary reason for the increase in 2013 expense was a $0.9 million increase in transaction expenses related to the acquisition of Headland Media Limited, and $0.7 million increase in general administrative expense from Headland Media Limited. Also contributing to the increase was a $0.6 million increase in U.S.-based employee compensation driven by increased accrued performance-based incentive compensation. As a percentage of net sales, general and administrative expense for the six months ended June 30, 2013 was 10%, consistent with the six months ended June 30, 2012.

Income Tax Expense

Income tax expense for the six months ended June 30, 2013 was $1.5 million as compared to $0.5 million for the six months ended June 30, 2012. The increase in income tax expense is primarily due to a $5.4 million increase in pre-tax income. Partially offsetting the 2013 income tax expense was an income tax benefit from the American Taxpayer Relief Act of 2012, which extended the research and development tax credit for two years to December 31, 2013. As a result of the retroactive extension, a discrete income tax benefit of $0.4 million was recognized for qualifying research and development amounts incurred in 2012. During the six months ended June 30, 2012, a discrete income tax expense associated with tax shortfalls for non-qualified stock options expirations, as well as shortfalls associated with restricted stock awards vesting of $0.4 million, was recognized.

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 $30.8 million and $35.0 million on June 30, 2013 and December 31, 2012, respectively. As of June 30, 2013, our backlog was scheduled for fulfillment in 2013, except for $8.1 million scheduled for fulfillment in 2014 and $4.9 million scheduled for fulfillment in 2015. The decrease in backlog of $4.2 million from December 31, 2012 was primarily a result of completion of the SANG hardware deliverables in the second quarter of 2013.

Backlog consists of orders evidenced by written agreements and specified delivery dates for customers who are acceptable credit risks. We do not include satellite connectivity service sales in our backlog even though many of our satellite connectivity customers have signed annual service contracts providing for a fixed monthly fee. Military orders included in backlog are generally subject to cancellation for the convenience of the customer. When orders are cancelled, we generally recover actual costs incurred through the date of cancellation and the costs resulting from termination. As of June 30, 2013, our backlog included approximately $17.1 million in orders that are subject to cancellation for convenience by the customer. Individual

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orders for guidance and stabilization products are often large and may require procurement of specialized long-lead components and allocation of manufacturing resources. The complexity of planning and executing larger orders generally requires customers to order well in advance of the required delivery date, resulting in backlog.

Liquidity and Capital Resources

We have historically funded our operations primarily from operating cash flows, net proceeds from public and private equity offerings, bank financings and proceeds received from exercises of stock options. As of June 30, 2013, we had $54.3 million in cash, cash equivalents, and marketable securities, of which $5.2 million in cash equivalents were held in a local currency by our foreign subsidiaries. There were no marketable securities held by our foreign subsidiaries as of June 30, 2013. As of June 30, 2013, we had $75.3 million in working capital.

Net cash provided by operations was $11.8 million for the six months ended June 30, 2013 as compared to net cash provided by operations of $6.8 million for the six months ended June 30, 2012. The increase is primarily due to an increase in net income of $4.4 million, a $2.5 million increase in cash inflows related to deferred revenue, a $1.2 million decrease in cash outflows related to other long-term liabilities, and a decrease in cash outflows of approximately $0.9 million related to accrued expenses. Partially offsetting the increase in cash inflows is a $2.6 million increase in cash outflows as a result of increased inventory levels, a $0.9 million decrease in cash inflows attributable to accounts receivable, as well as a $0.6 million increase in cash outflows related to prepaid expenses and other current assets.

Net cash used in investing activities was $39.2 million for the six months ended June 30, 2013 as compared to net cash used in investing activities of $3.8 million for the six months ended June 30, 2012. The increase in cash outflows is primarily due to the net cash paid for the acquisition of Headland Media Limited of $22.8 million, and a $15.7 million increase in our net investment in marketable securities. Partially offsetting the increase in cash outflows is a decrease in capital expenditures of approximately $3.1 million.

Net cash provided by financing activities was $28.4 million for the six months ended June 30, 2013 compared to cash used in financing activities of $1.7 million for the six months ended June 30, 2012. The increase in cash provided by financing activities is primarily due to $23.0 million in borrowings from our line of credit used to finance the majority of the acquisition cost of Headland Media Limited on May 11, 2013, and a $4.7 million equipment security note that we entered into on January 30, 2013. Also contributing to the increase in cash inflows was a $2.0 million reduction in payments on our line of credit and a $1.3 million increase in proceeds from exercises of stock options and purchases under our employee stock purchase plan.

On April 6, 2009, we entered into a mortgage loan in the amount of $4.0 million related to our headquarters facility in Middletown, Rhode Island. The loan term is 10 years, with a principal amortization of 20 years, and the interest rate will be a rate per year adjusted periodically based on a defined interest period equal to the BBA LIBOR Rate plus 2.25 percentage points. On June 9, 2011, we entered into an amendment to the mortgage loan, providing for an adjustment of the interest rate from the BBA LIBOR Rate plus 2.25 percentage points to the BBA LIBOR Rate plus 2.00 points. Land, building and improvements with an approximate carrying value of $5.0 million as of June 30, 2013 secure the mortgage loan. The monthly mortgage payment is approximately $11,000 plus interest and increases in increments of approximately $1,000 each year throughout the life of the mortgage. Due to the difference in the term of the loan and amortization of the principal, a balloon payment of $2.6 million is due on April 1, 2019. The loan contains one financial covenant, a Fixed Charge Coverage Ratio, which applies in the event that our consolidated cash, cash equivalents and marketable securities balance falls below $25.0 million at any time. As our consolidated cash, cash equivalents, and marketable securities balance was above $25.0 million throughout the six months ended June 30, 2013, the Fixed Charge Coverage Ratio did not apply. Under the mortgage loan we may prepay our outstanding loan balance subject to certain early termination charges as defined in the mortgage loan agreement. If we were to default on our mortgage loan, the land, building and improvements would be used as collateral. As discussed in note 15 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.

On May 9, 2013, we amended our revolving loan agreement with a bank to increase our line of credit from $15.0 million to $30.0 million. The revolving loan matures on December 31, 2014 and, as amended, no longer permits us to convert revolving loans into term loans. We pay interest on any outstanding amounts at a rate equal to the BBA LIBOR Daily Floating Rate plus 1.25%. The line of credit contains two financial covenants, a Liquidity Covenant, which requires us to maintain at least $20.0 million in unencumbered liquid assets, as defined in the loan agreement, and a Fixed Charge Coverage Ratio. As of June 30, 2013, we were not in default of either covenant. We may terminate the loan agreement prior to its full term without penalty; provided we give 30 days' advance written notice to the bank.

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On May 11, 2013, we acquired Headland Media Limited for an aggregate purchase price of approximately £15.5 million ($24.0 million at the exchange rate of £1.00: $1.5517 on May 11, 2013). The purchase price is subject to a potential post-closing adjustment based on the value of the net assets delivered at the closing.

In connection with the acquisition of Headland Media Limited, we borrowed $23.0 million under our line of credit to pay substantially all of the purchase price for the acquisition. Our obligation to repay the loan could be accelerated upon a default or event of default under the terms of the revolving loan agreement, including certain failures to pay principal or interest when due, certain breaches of representations and warranties, the failure to comply with our affirmative and negative covenants under the loan agreement, a change of control, certain defaults in payment relating to other indebtedness, the acceleration of payment of certain other indebtedness, certain events relating to our liquidation, dissolution, bankruptcy, insolvency or receivership, the entry of certain judgments against us, certain events relating to the impairment of collateral or the bank’s security interest therein, and any other material adverse change.

As of June 30, 2013, we had $30.0 million outstanding under the loan agreement, all of which we must repay on or before December 31, 2014. The monthly interest payments are presently approximately $36,000, subject to adjustment in accordance with the terms of the loan agreement.

It is our intent to continue to invest in the mini-VSAT Broadband network on a global basis in cooperation with ViaSat under the terms of a 10-year agreement announced in July 2008. As part of the future potential capacity expansion, we would plan to seek to acquire additional satellite capacity from satellite operators, expend funds to seek regulatory approvals and permits, develop product enhancements in anticipation of the expansion, and hire additional personnel. In addition, in December 2011, we entered into a five-year agreement to lease C-band satellite capacity from a satellite operator, effective February 1, 2012, and in 2012 we also purchased three satellite hubs to support this C-band service. The total cost of the five-year satellite capacity agreement, the satellite hubs, and teleport services is approximately $12.2 million, of which approximately $2.7 million related to the total cost of the three hubs. In January 2013, we borrowed $4.7 million from a bank and pledged as collateral six satellite hubs and related equipment, including the three hubs purchased in 2012. The term of the equipment loan is five years, and the loan bears interest at a fixed interest rate of 2.76% per annum. The monthly payment is $83,000, including interest expense.

On November 26, 2008, our Board of Directors authorized a program to repurchase up to one million shares of our common stock. The share repurchase program is funded using our existing cash, cash equivalents, marketable securities and future cash flows. As of June 30, 2013, 341,009 shares of our common stock remain available for repurchase under the program. We did not purchase any shares of our common stock in the six months ended June 30, 2013.

We believe that the $54.3 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.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to changes in interest rates because we finance certain operations through fixed and variable rate debt instruments.

We have $30.0 million in borrowings outstanding under over variable-rate credit facility at June 30, 2013, at an interest rate equal to the BBA LIBOR Daily Floating Rate plus 1.25%.

As previously discussed in note 15 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.

We are exposed to currency exchange rate fluctuations related to our subsidiary operations in Denmark, the United Kingdom, Norway, Brazil, Cyprus, Singapore, Japan and Philippines. Certain transactions in these locations are made in the local or functional currency, yet are reported in the U.S. dollar. For foreign currency exposures existing at June 30, 2013, a 10% unfavorable movement in the foreign exchange rates for our subsidiary locations would not expose us to material losses in earnings or cash flows.

From time to time, we purchase foreign currency forward contracts generally having durations of no more than five months. These forward contracts are intended to offset the impact of exchange rate fluctuations on cash flows of our foreign subsidiaries. Foreign exchange contracts are accounted for as cash flow hedges and are recorded on the balance sheet at fair value until executed. Changes in the fair value are recognized in earnings. We did not enter into any such contracts during the six months ended June 30, 2013. However, we did inherit cash flow hedges from our acquisition of Headland Media Limited on May 11, 2013. We do not currently anticipate that we will enter into similar agreements once the existing agreements expire.

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 June 30, 2013, a hypothetical 100 basis-point increase in interest rates would have resulted in an immaterial decrease in the fair value of our investments that had maturities of greater than one year. Due to the conservative nature of our investments and the relatively short duration of their maturities, we believe interest rate risk is substantially mitigated. As of June 30, 2013, 74% of the $44.4 million classified as available-for-sale marketable securities will mature or reset within one year. Accordingly, long-term interest rate risk is not considered material. We did not invest in any financial instruments denominated in foreign currencies as of June 30, 2013.

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 June 30, 2013, the end of the period covered by this interim report. Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were not effective as of June 30, 2013 due to the material weakness in our internal control over financial reporting described below. Our internal control over financial reporting is the process designed by and under the supervision of our CEO and CFO to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements for external reporting in accordance with accounting principles generally accepted in the United States of America.

Background

As previously described in Item 9A of our annual report on Form 10-K for the year ended December 31, 2012, in March 2013, our management identified that the most senior member of our accounting staff at our Danish subsidiary had engaged in a fraudulent scheme to misappropriate assets from us over a period of at least three years. The scheme included fraudulent wire transfers to a personal bank account, fraudulent documentation, forged signatures and use of a corporate credit card for personal expenses. For the three years ended December 31, 2012, the aggregate amount of misappropriated funds in any year ranged from approximately $118,000 to $250,000, and for the six months ended June 30, 2013, the aggregate amount of misappropriated funds was approximately $84,000. In July 2013, we recovered $522,000 under our insurance policy which was the aggregate amount of misappropriated funds identified for the three years ended December 31, 2012, and for the six months ended June 30, 2013.

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

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

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

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

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

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

The following additional steps of the remediation plan were completed as of June 30, 2013:

- management review of the design and operation of our process-level and transaction-level controls at our Danish subsidiary in relation to cash management and manual journal entry review and approvals, and management implemented a master vendor payment control using available software services at our Danish bank; and
- management completed on-site training at the Danish location to reinforce control consciousness.

We continually are in the process of further reviewing, documenting and testing our cash disbursement controls and procedures at our foreign subsidiaries, and our controls over financial reporting, and accordingly may from time to time, make changes aimed at enhancing existing control and/or implement additional controls. Because the implementation of our remediation plan was ongoing as of June 30, 2013 and because there was insufficient time as of

June 30, 2013 to demonstrate that the new controls implemented as part of the remediation plan were operating effectively as of that date, management concluded that the material weakness described in our annual report still existed as of June 30, 2013.

Evaluation of Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of our CEO and CFO, our management has evaluated changes in our internal control over financial reporting that occurred during the first quarter of 2013. Based on that evaluation, except for the changes described above, our CEO and CFO did not identify any change in our internal control over financial reporting during the first quarter of 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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. 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. For example, sales of our mobile products decreased 9% from the six months ended June 30, 2013 to the six months ended June 30, 2012, and the declines were more extensive in certain areas such as Europe. 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 these trends could continue or accelerate. As global and regional economic conditions change, including uncertainty regarding federal budgetary pressures, 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 financial performance is impacted by U.S. government contracts, which are subject to uncertain levels of funding and termination.

We sell a substantial portion of our fiber optic gyro systems and tactical navigation products to the U.S. government, either directly or as a subcontractor to other contractors. The termination of these U.S. government contracts, whether due to lack of funding, for convenience, or otherwise, or the occurrence of delays, could negatively impact our results of operations and financial condition.

The funding of U.S. government programs is subject to congressional appropriations. Congress generally appropriates funds on a fiscal year basis even though a program may extend over several fiscal years. Consequently, programs are often only partially funded initially and additional funds are committed only as Congress makes further appropriations. If appropriations for any program in which we participate become unavailable, or are reduced or delayed, our contract or subcontract under such program may be terminated or adjusted by the government, which could have a negative impact on our future sales under such contract or subcontract. When a formal appropriation bill has not been signed into law before the end of the U.S. government's fiscal year, which has become more frequent in recent years, Congress may pass a continuing resolution that authorizes agencies of the U.S. government to continue to operate, generally at the same funding levels from the prior year, but that typically does not authorize new spending initiatives, during this period. Appropriations can also be impacted by other budgetary considerations, such as failure to increase the statutory debt ceiling of the U.S. government. During such periods (or until the regular appropriation bills are passed), delays can occur in procurement of products and services due to lack of funding, and these delays can affect our results of operations during the period of delay.

Appropriations can also be affected by legislation that addresses larger budgetary issues of the U.S. government. For example, federal sequestration measures are adversely affecting federal spending across the U.S. government, including the Department of Defense, and we expect that these measures will result in a slowdown of defense spending, including spending for our guidance and stabilization products.

In addition, U.S. government contracts generally also permit the government to terminate the contract, in whole or in part, without prior notice, at the government's convenience or for default based on performance. If one of our contracts is terminated for convenience, we would generally be entitled to payments for our allowable costs and would receive some allowance for profit on the work performed. If one of our contracts is terminated for default, we would generally be entitled to payments for our work that has been accepted by the government. A termination arising out of our default could expose us to liability and adversely affect our ability to obtain future contracts and orders. Furthermore, on contracts for which we are a subcontractor and not the prime contractor, the U.S. government could terminate the prime contract for convenience or otherwise, irrespective of our performance as a subcontractor.

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

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

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

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. As a result of the completion of the product delivery portion of the SANG contract and other factors, we expect a shift in our sales mix towards mobile communications products and services, which would likely cause lower gross margins in the future

We must generate a certain level of sales of the TracPhone V-series products 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. If sales of our TracPhone V-series products 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 services 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 Inmarsat, Cobham SATCOM, Furuno Electric Co., Ltd., Globalstar LP, Iridium Satellite LLC, Intellian, and JRC. We also face competition from providers of marine satellite data services and maritime VSAT solutions, including Inmarsat, MTN/SeaMobile, Speedcast, CapRock, Schlumberger, and Astrium.

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

In the market for media content, we compete with Filmbank Distributors Limited, Swank Motion Pictures and NewspaperDirect.

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, which are comparable in size

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to our TracPhone V7. 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 V-series products, 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.

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 V-series products 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 and tactical 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 or delay funding for military programs;
- changes in modernization plans for military equipment;
- changes in tactical navigation requirements;
- global conflicts impacting troop deployment, including troop withdrawals from the Middle East;
- priorities for current battlefield operations;
- new military and operational doctrines that affect military equipment needs;
- sales cycles that are long and difficult to predict;
- shifting response time and/or delays in the approval process associated with the export licenses we must obtain prior to the international shipment of certain of our military products;
- delays in military procurement schedules; and
- delays in the testing and acceptance of our products, including delays resulting from changes in customer specifications.

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 $5.3 million, or 61%, from the six months ended June 30, 2012 to the six months ended June 30, 2013. TACNAV product sales, which for 2013 include shipments of a portion of the largest TACNAV order in our history, have increased $10.1 million, or 380% during the same period. We do not currently have in backlog another TACNAV order of comparable size for 2013 or future years, and as a result we expect that our TACNAV revenues will decline in 2013 from 2012 for the remaining six months of the year. 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, we received orders for TACNAV products and services of $7.2 million, $35.6 million and $2.8 million in January 2013, June 2012 and June 2012, respectively, and we received orders for fiber optic gyro products of $2.5 million and $7.6 million in December 2011. 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, many of whom are contractors for the U.S. government. For example, in the six months ended June 30, 2013, SANG accounted for approximately 14% of our total sales, and product deliveries to this customer under our existing contract are now complete. 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, Telesat, EchoStar, Intelsat and Star One currently provide the satellite capacity to support the mini-VSAT Broadband service and our TracPhone V-series products. Intelsat also currently provides our C-Band satellite coverage. 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 FleetBroadband compatible TracPhone products.

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

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

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, 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 V-series products 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.

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 effect on our operations and financial performance.

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

Excluding the CommBox product, which we manufacture in Norway, we currently manufacture all of our mobile communications products at our 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 and services.

We market and sell our mobile communications products and services 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.

Our new media and entertainment business relies on licensing arrangements with content providers, and the loss of or changes in those arrangements could adversely affect ourbusiness.

Through our new Headland Media Limited subsidiary, we distribute premium news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail markets. We do not generate this content but instead license the content from third parties on a non-exclusive basis. We do not have long-term license agreements with any content provider. Accordingly, any content provider could terminate our existing arrangements with little or no advance notice or could adversely modify the terms of the arrangement, including potential price increases. The loss of content could adversely affect the attractiveness of our media and entertainment offerings, which could adversely affect our revenues. Any increase in the cost of content could reduce the profitability of these offerings.

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

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

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

We have previously expanded our operations to pursue existing and potential market opportunities, and we are continuing to expand our international operations. For example, we recently opened a new sales office in Japan to service local customers. This growth placed a strain on our personnel, management, financial and other resources. 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 identified a material weakness in our internal control over financial reporting as of December 31, 2012, and the occurrence of this or any other material weakness could have a material adverse effect on our ability to report accurate financial information in a timely manner.

As previously described in Item 9A of our annual report on Form 10-K for the year ended December 31, 2012, in March 2013, our management identified that the most senior member of our accounting staff at our Danish subsidiary had engaged in a fraudulent scheme to misappropriate assets from us over a period of at least three years. The scheme included fraudulent wire transfers to a personal bank account, fraudulent documentation, forged signatures and use of a corporate credit card for personal expenses. Management performed its assessment of the effectiveness of our internal control over financing reporting as of December 31, 2012 and concluded that our internal control over financial reporting as of that date was not effective because of a material weakness. Management's assessment identified three control deficiencies in our internal control over financial reporting.

Following the identification of the control deficiencies in March 2013, management implemented a remediation plan. We are in the process of further reviewing, documenting and testing our cash disbursement controls and procedures at our foreign subsidiaries, and our controls over financial reporting, and may from time to time, make changes aimed at enhancing existing control and/or implement additional controls. Because the implementation of our remediation plan was ongoing as of June 30, 2013 and because there was insufficient time as of June 30, 2013 to demonstrate that the new controls implemented as part of the remediation plan were operating effectively as of that date, management concluded that the material weakness described in our annual report still existed as of June 30, 2013.

Accordingly, it is possible that our financial statements will not comply with generally accepted accounting principles, will contain a material misstatement or will not be available on a timely basis, any of which could cause investors to lose confidence in us and lead to, among other things, unanticipated legal, accounting and other expenses, delays in filing required financial disclosures, enforcement actions by government authorities, fines, penalties, the delisting of our common stock and liabilities arising from stockholder litigation.

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

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

Cybersecurity breaches could expose us to liability, damage our reputation, require us to incur significant costs or otherwise adversely affect our financial results.
We retain sensitive data, including intellectual property, proprietary business information and personally identifiable information of our employees and customers on our computer networks. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software and networks may be vulnerable to unauthorized access, misuse, computer viruses or other malicious code and other events that could have a security impact. Any security breach may compromise information stored on our networks and may result in significant data losses or theft of our, our customers', our business partners' or our employees' intellectual property, proprietary business information or personally identifiable information.
If any of these events were to occur, they could lead to the loss of sensitive information, cause us to lose existing customers and fail to attract new customers, as well as subject us to regulatory actions, litigation, fines or damage to our reputation, and could have a material adverse effect on our financial position, results of operations or cash flows.
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 December 31, 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;
- 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.

Compliance with the SEC's new conflict minerals rules will increase our costs and adversely affect our results of operations.

We are subject to the SEC's new disclosure requirements for public companies that manufacture, or contract to manufacture, products for which certain minerals and their derivatives, namely tin, tantalum, tungsten and gold, known as “conflict minerals,” are necessary to the functionality or production of those products. These regulations will require us to determine which of our products contain conflict minerals and, if so, to perform an extensive inquiry into our supply chain in an effort to determine whether or not such conflict minerals originate from the Democratic Republic of Congo, or DRC, or an adjoining country. We expect to incur additional costs to comply with these disclosure requirements, including costs related to determining the source of any of the relevant minerals used in our products, which will adversely affect our results of operations. Because our supply chain is complex, the due diligence procedures that we implement may not enable us to ascertain the origins of any conflict minerals that we use or determine that these minerals did not originate from the DRC or an adjoining country, which may harm our reputation. We may also face difficulties in satisfying customers who may require that our products be certified as DRC conflict-free, which could harm our relationships with these customers and lead to a loss of revenue. These new requirements could also have the effect of limiting the pool of suppliers from which we source these minerals, and we may be unable to obtain conflict-free minerals at competitive prices, which could increase our costs and adversely affect our manufacturing operations and our profitability.

Acquisitions may disrupt our operations or adversely affect our results.

We evaluate strategic acquisition opportunities to acquire other businesses as they arise, such as our acquisition of Headland Media Limited in May 2013. The expenses we incur evaluating and pursuing this and other such acquisitions could have a material adverse effect on our results of operations. For example, we incurred approximately $0.9 million in connection with the acquisition of Headland Media Limited. 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:

- entry into new and unfamiliar lines of business or markets, which may present challenges or risks that we did not anticipate;
- charges related to any potential acquisition from which we may withdraw;
- diversion of our management’s time, attention, and resources;
- loss of key acquired personnel;
- increased costs to improve or coordinate managerial, operational, financial, and administrative systems, including compliance with the Sarbanes-Oxley Act of 2002;
- dilutive issuances of equity securities;
- the assumption of legal liabilities; and
- losses arising from impairment charges associated with goodwill or intangible assets.

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

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

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

- the classification of our Board of Directors, which effectively prevents stockholders from electing a majority of the directors at any one annual meeting of stockholders;
- the limitation that directors may be removed only for cause by the affirmative vote of the holders of two-thirds of our shares of capital stock entitled to vote;
- the prohibition against stockholder actions by written consent;
- the inability of stockholders to call a special meeting of stockholders; and
- advance notice requirements for stockholder proposals and director nominations.

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

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

We did not repurchase any shares of our common stock in the six months ended June 30, 2013.

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ITEM 6. EXHIBITS
Exhibits:

Exhibit No.	Description	Filed with this Form 10-Q	Incorporated by Reference Form	Filing Date	Exhibit No.
2.1	Share Purchase Agreement, dated as of May 11, 2013, by and among KVH Industries, Inc., Oakley Capital Private Equity L.P. and the other parties thereto		8-K	May 14, 2013	2.1
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	Eighth Amendment to the Credit Agreement, dated as of May 9, 2013, by and between Bank of America, N.A. and KVH Industries, Inc.		8-K	May 14, 2013	10.1
10.2	Amended and Restated Revolving Credit Note, dated as of May 9, 2013, by and between Bank of America, N.A. and KVH Industries, Inc.		8-K	May 14, 2013	10.2
31.1	Rule 13a-14(a)/15d-14(a) certification of principal executive officer	X			
31.2	Rule 13a-14(a)/15d-14(a) certification of principal financial officer	X			
32.1	Section 1350 certification of principal executive officer and principal financial officer	X			
101	Interactive Data File regarding (a) our Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012, (b) our Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2013 and 2012, (c) our Consolidated Statements of Other Comprehensive Income (Loss) for the Three and Six Months Ended June 30, 2013 and 2012, (d) our Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2013 and 2012 and (e) the Notes to such	X			

Consolidated Financial Statements.

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SIGNATURE

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

Date: August 9, 2013

KVH Industries, Inc.

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

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Exhibit Index

Exhibit No.	Description	Filed with this Form 10-Q	Incorporated by Reference Form	Filing Date	Exhibit No.
2.1	Share Purchase Agreement, dated as of May 11, 2013, by and among KVH Industries, Inc., Oakley Capital Private Equity L.P. and the other parties thereto		8-K	May 14, 2013	2.1
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	Eighth Amendment to the Credit Agreement, dated as of May 9, 2013, by and between Bank of America, N.A. and KVH Industries, Inc.		8-K	May 14, 2013	10.1
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