

KVH INDUSTRIES INC \DE\  
Form 10-Q  
November 03, 2016

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 30, 2016

OR

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

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

Commission File Number 0-28082

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

Delaware 05-0420589  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification Number)  
50 Enterprise Center, Middletown, RI 02842  
(Address of Principal Executive Offices) (Zip Code)  
(401) 847-3327  
(Registrant's Telephone Number, Including Area  
Code)

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

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

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

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

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

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

| Date             | Class                                    | Outstanding shares |
|------------------|--|--------------------|
| November 2, 2016 | Common Stock, par value \$0.01 per share | 16,556,098         |



KVH INDUSTRIES, INC. AND SUBSIDIARIES  
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## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## KVH INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

|   | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
|   | (unaudited)           |                      |
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$ 25,099             | \$ 22,719            |
| Marketable securities   | 28,684                | 22,619               |
| Accounts receivable, net of allowance for doubtful accounts of \$3,698 and \$3,534 as of September 30, 2016 and December 31, 2015, respectively   | 31,815                | 43,895               |
| Inventories   | 21,139                | 21,589               |
| Prepaid expenses and other assets   | 7,477                 | 4,271                |
| Total current assets  | 114,214               | 115,093              |
| Property and equipment, less accumulated depreciation of \$48,614 and \$43,202 as of September 30, 2016 and December 31, 2015, respectively   | 37,927                | 39,900               |
| Intangible assets, less accumulated amortization of \$15,068 and \$11,390 as of September 30, 2016 and December 31, 2015, respectively  | 20,080                | 26,755               |
| Goodwill  | 32,741                | 36,747               |
| Other non-current assets  | 4,987                 | 3,096                |
| Non-current deferred income tax asset   | 3,747                 | 4,686                |
| Total assets  | \$ 213,696            | \$ 226,277           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                      |
| Current liabilities:  |                       |                      |
| Accounts payable  | \$ 7,703              | \$ 8,975             |
| Accrued compensation and employee-related expenses  | 4,779                 | 6,588                |
| Accrued other   | 12,326                | 13,516               |
| Accrued product warranty costs  | 2,256                 | 1,880                |
| Deferred revenue  | 9,281                 | 5,962                |
| Current portion of long-term debt   | 7,890                 | 6,638                |
| Total current liabilities   | 44,235                | 43,559               |
| Other long-term liabilities   | 1,127                 | 1,391                |
| Long-term debt, excluding current portion   | 52,132                | 58,054               |
| Non-current deferred income tax liability   | 4,153                 | 5,097                |
| Total liabilities   | \$ 101,647            | \$ 108,101           |
| Commitments and contingencies (Notes 2, 9 and 11)   |                       |                      |
| 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; 18,193,589 and 17,793,752 shares issued at September 30, 2016 and December 31, 2015, respectively; and 16,534,598 and 16,134,761 shares outstanding at September 30, 2016 and December 31, 2015, respectively | 182                   | 178                  |
| Additional paid-in capital  | 126,577               | 124,614              |
| Retained earnings   | 13,400                | 14,134               |
| Accumulated other comprehensive loss  | (14,960)              | (7,600)              |
|   | 125,199               | 131,326              |

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|  |            |   |            |   |
|--|------------|---|------------|---|
| Less: treasury stock at cost, common stock, 1,658,991 shares as of September 30, 2016<br>and December 31, 2015 | (13,150    | ) | (13,150    | ) |
| Total stockholders' equity   | 112,049    |   | 118,176    |   |
| Total liabilities and stockholders' equity   | \$ 213,696 |   | \$ 226,277 |   |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

|   | Three Months<br>Ended<br>September 30, |           | Nine Months<br>Ended<br>September 30, |            |
|---|--|-----------|---------------------------------------|------------|
|   | 2016                                   | 2015      | 2016                                  | 2015       |
| Sales:  |  |           |                                       |            |
| Product   | \$19,020                               | \$15,622  | \$54,464                              | \$48,954   |
| Service   | 26,826                                 | 28,833    | 77,728                                | 81,661     |
| Net sales   | 45,846                                 | 44,455    | 132,192                               | 130,615    |
| Costs and expenses:                                   |  |           |                                       |            |
| Costs of product sales                                | 11,001                                 | 10,275    | 34,660                                | 32,777     |
| Costs of service sales                                | 13,576                                 | 14,454    | 39,826                                | 41,407     |
| Research and development                              | 3,940                                  | 3,472     | 11,760                                | 10,704     |
| Sales, marketing and support                          | 7,978                                  | 7,889     | 25,870                                | 24,251     |
| General and administrative                            | 6,338                                  | 8,159     | 21,130                                | 23,436     |
| Total costs and expenses                              | 42,833                                 | 44,249    | 133,246                               | 132,575    |
| Income (loss) from operations                         | 3,013                                  | 206       | (1,054 )                              | (1,960 )   |
| Interest income                                       | 130                                    | 129       | 353                                   | 421        |
| Interest expense                                      | 353                                    | 363       | 1,081                                 | 1,097      |
| Other (expense) income, net                           | (56 )                                  | (382 )    | 11                                    | 654        |
| Income (loss) before income tax expense (benefit)     | 2,734                                  | (410 )    | (1,771 )                              | (1,982 )   |
| Income tax (benefit) expense                          | (129 )                                 | 53        | (1,037 )                              | (134 )     |
| Net income (loss)                                     | \$2,863                                | \$(463 )  | \$(734 )                              | \$(1,848 ) |
| Net income (loss) per common share                    |  |           |                                       |            |
| Basic   | \$0.18                                 | \$(0.03 ) | \$(0.05 )                             | \$(0.12 )  |
| Diluted   | \$0.18                                 | \$(0.03 ) | \$(0.05 )                             | \$(0.12 )  |
| Weighted average number of common shares outstanding: |  |           |                                       |            |
| Basic   | 15,845                                 | 15,661    | 15,798                                | 15,608     |
| Diluted   | 15,915                                 | 15,661    | 15,798                                | 15,608     |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

|  | Three Months<br>Ended<br>September 30,<br>2016 |           | Nine Months<br>Ended<br>September 30,<br>2015 |           |
|--|--|-----------|---|-----------|
| Net income (loss)                                | \$2,863  | \$(463 )  | \$(734 )                                      | \$(1,848) |
| Other comprehensive (loss) income, net of tax:   |  |           |   |           |
| Unrealized loss on available-for-sale securities | —  | (109 )    | —   | (111 )    |
| Foreign currency translation adjustment          | (2,238 )                                       | (2,641 )  | (7,386 )                                      | (3,906 )  |
| Unrealized gain (loss) on derivative instruments | 37   | (13 )     | 26  | 5         |
| Other comprehensive loss, net of tax             | (2,201 )                                       | (2,763 )  | (7,360 )                                      | (4,012 )  |
| Total comprehensive income (loss)                | \$662  | \$(3,226) | \$(8,094)                                     | \$(5,860) |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2016                               | 2015       |
| Cash flows from operating activities:   |                                    |            |
| Net loss  | \$(734 )                           | \$(1,848 ) |
| Adjustments to reconcile net loss to net cash provided by operating activities:     |                                    |            |
| Provision for doubtful accounts   | 379                                | 742        |
| Depreciation and amortization   | 9,090                              | 9,427      |
| Deferred income taxes   | (888 )                             | (45 )      |
| Loss on disposal of fixed assets  | 799                                | 38         |
| Compensation expense related to stock-based awards and employee stock purchase plan | 2,792                              | 2,832      |
| Unrealized loss on foreign currency transactions                                    | 894                                | 191        |
| Changes in operating assets and liabilities:  |                                    |            |
| Accounts receivable   | 10,819                             | 644        |
| Inventories   | 421                                | (3,807 )   |
| Prepaid expenses and other assets   | (2,932 )                           | (2,282 )   |
| Other non-current assets  | (2,190 )                           | 1,043      |
| Accounts payable  | (1,168 )                           | (2,145 )   |
| Deferred revenue  | 3,829                              | 355        |
| Accrued expenses  | (2,029 )                           | 5,602      |
| Other long-term liabilities   | (113 )                             | (96 )      |
| Net cash provided by operating activities   | \$18,969                           | \$10,651   |
| Cash flows from investing activities:   |                                    |            |
| Capital expenditures  | (4,791 )                           | (4,881 )   |
| Purchases of marketable securities  | (10,629 )                          | (13,807 )  |
| Maturities and sales of marketable securities                                       | 4,563                              | 11,719     |
| Net cash used in investing activities   | \$(10,857)                         | \$(6,969)  |
| Cash flows from financing activities:   |                                    |            |
| Repayments of term note borrowings  | (3,656 )                           | (3,656 )   |
| Repayments of other long-term debt  | (1,014 )                           | (980 )     |
| Payment of employee restricted stock withholdings                                   | (313 )                             | (345 )     |
| Proceeds from stock options exercised and employee stock purchase plan              | 390                                | 260        |
| Net cash used in financing activities   | \$(4,593 )                         | \$(4,721 ) |
| Effect of exchange rate changes on cash and cash equivalents                        | (1,139 )                           | (627 )     |
| Net increase (decrease) in cash and cash equivalents                                | 2,380                              | (1,666 )   |
| Cash and cash equivalents at beginning of period                                    | 22,719                             | 25,289     |
| Cash and cash equivalents at end of period  | \$25,099                           | \$23,623   |

See accompanying Notes to Unaudited Consolidated Financial Statements.



## KVH INDUSTRIES, INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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

#### (1) Description of Business

KVH Industries, Inc. (together with its subsidiaries, the Company or KVH) designs, develops, manufactures and markets mobile communication products and services for the marine and land markets, and navigation, guidance, and stabilization products for both the defense and commercial markets.

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

KVH's mobile communication service sales are comprised of satellite voice and Internet airtime services and from product repairs. KVH provides, for monthly fixed and usage fees, satellite connectivity services, including broadband Internet, data and Voice over Internet Protocol (VoIP) services, to its TracPhone V-series customers. Mobile communication services sales also include the distribution of commercially licensed entertainment, including news, sports, music, and movies to commercial and leisure customers in the maritime, hotel, and retail markets through KVH Media Group, the media and entertainment service company that KVH acquired on May 11, 2013, and the distribution of training films and e-Learning computer-based training courses to commercial customers in the maritime market through Super Dragon Limited and Videotel Marine Asia Limited (together referred to as Videotel), a maritime training services company that KVH acquired on July 2, 2014. KVH also earns monthly usage fees from third-party satellite connectivity services, including voice, data and Internet services, provided to its Inmarsat and Iridium customers who choose to activate their subscriptions with KVH. Mobile communication service sales also include sales from product repairs and extended warranty sales.

KVH also offers precision fiber optic gyro (FOG)-based 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 foreign governments and government contractors, as well as through an international network of authorized independent sales representatives. In addition, KVH's guidance and stabilization products are used in numerous commercial products, such as navigation and positioning systems for various applications including precision mapping, dynamic surveying, autonomous vehicles, train location control and track geometry measurement systems, industrial robotics, and optical stabilization.

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

#### (2) Summary of Significant Accounting Policies

##### Basis of Presentation

The accompanying consolidated financial statements of KVH Industries, Inc. and its wholly owned subsidiaries 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. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements have not been audited by the Company's 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, 2015 filed on March 14, 2016 with the Securities and Exchange Commission. The results for the three and nine months ended September 30, 2016 are not necessarily indicative of operating results for the remainder of the year.

### 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, the determination of the 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 remain the most significant estimates for the nine months ended September 30, 2016. There have been no material changes to the significant accounting policies previously disclosed in the Company's annual report on Form 10-K for the year ended December 31, 2015.

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.

### (3) Recently Announced Accounting Pronouncements

#### Revenue from Contracts

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 represents the culmination of efforts by the FASB and the International Accounting Standards Board to issue a common revenue standard. In April 2015, the FASB voted to defer the effective date of the new revenue recognition standard by one year, which resulted in ASU 2014-09 becoming effective for annual periods, and interim periods within those years, beginning after December 15, 2017. The Company is currently evaluating the impact of the adoption of this standard on its financial position, results of operations and cash flows.

#### Lease Accounting

In February 2016, the FASB issued its new leases standard, ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 is aimed at putting most leases on lessees' balance sheets, but it would also change aspects of lessor accounting. ASU 2016-02 is effective for public business entities for annual periods beginning after December 15, 2018 and interim periods within those years. As a result, the Company will adopt this standard effective January 1, 2019. The Company is currently evaluating the impact of the adoption of this standard on its financial position, results of operations and cash flows.

#### Stock Compensation

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions, including accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The guidance is effective for annual reporting periods beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted for all entities. The Company is currently evaluating the impact of the adoption of this standard on its financial position, results of operations and cash flows.

There are no other recent accounting pronouncements that have been issued by the FASB that are expected to have a material impact on the financial statements of the Company.

## (4) Marketable Securities

Included in marketable securities as of September 30, 2016 and December 31, 2015 are the following:

| September 30, 2016   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| Money market mutual funds                                    | \$ 23,868         | \$                           | —\$                           | —\$23,868     |
| Certificates of deposit                                      | 4,816             | —                            | —                             | 4,816         |
| Total marketable securities designated as available-for-sale | \$ 28,684         | \$                           | —\$                           | —\$28,684     |

| December 31, 2015  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| Money market mutual funds                                    | \$ 13,244         | \$ —                         | \$                            | —\$13,244     |
| United States treasuries                                     | 1,002             | —                            | —                             | 1,002         |
| Corporate notes  | 2,283             | 1                            | —                             | 2,284         |
| Certificates of deposit                                      | 6,089             | —                            | —                             | 6,089         |
| Total marketable securities designated as available-for-sale | \$ 22,618         | \$ 1                         | \$                            | —\$22,619     |

The amortized costs and fair value of debt securities as of September 30, 2016 and December 31, 2015 are shown below by effective maturity. Effective maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

| September 30, 2016                      | Amortized<br>Cost | Fair<br>Value |
|---|-------------------|---------------|
| Due in less than one year               | \$ 4,275          | \$4,275       |
| Due after one year and within two years | 541               | 541           |
|   | \$ 4,816          | \$4,816       |
| December 31, 2015                       | Amortized<br>Cost | Fair<br>Value |
| Due in less than one year               | \$ 5,515          | \$5,516       |
| Due after one year and within two years | 3,859             | 3,859         |
|   | \$ 9,374          | \$9,375       |

Interest income from marketable securities was \$26 and \$27 during the three months ended September 30, 2016 and 2015, respectively, and \$66 and \$88 during the nine months ended September 30, 2016 and 2015, respectively.

## (5) Stock-Based Compensation

## (a) Equity and Incentive Plan

Stock-based compensation expense was \$911 and \$958 for the three months ended September 30, 2016 and 2015, respectively, and \$2,792 and \$2,832 for the nine months ended September 30, 2016 and 2015, respectively. As of September 30, 2016, there was \$1,072 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 2.07 years. As of September 30, 2016, there was \$5,039 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 2.54 years.

On June 15, 2016, at the Company's 2016 Annual Meeting of Stockholders, the stockholders of the Company approved the 2016 Equity and Incentive Plan (2016 Plan). The 2016 Plan authorizes the Company to issue up to 3,000 shares of common stock (plus an additional 1,690 shares intended to roll over into the 2016 Plan shares subject to awards outstanding on June 15, 2016 under earlier plans that may be forfeited, canceled, reacquired by the Company or terminated) pursuant to stock options, restricted stock awards and other stock-based awards.



The Company granted 40 and 419 restricted stock awards, subject to the terms of the 2016 Plan or the Amended and Restated 2006 Stock Incentive Plan (2006 Plan), as applicable, to employees during the three and nine months ended September 30, 2016, respectively, and 40 and 203 restricted stock awards, subject to the terms of the 2006 Plan, to employees during the three and nine months ended September 30, 2015, respectively.

The Company granted 0 and 60 stock options to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three and nine months ended September 30, 2016, respectively, and 0 and 95 stock options during the three and nine months ended September 30, 2015, respectively.

#### (b) Employee Stock Purchase Plan

On June 15, 2016, at the Company's 2016 Annual Meeting of Stockholders, the stockholders of the Company also approved amendments to the Company's Amended and Restated 1996 Employee Stock Purchase Plan (ESPP) that, among other things, increased the number of shares of common stock reserved for issuance by 1,000 to a total of 1,650. As amended, the ESPP affords eligible employees the right to purchase common stock, via payroll deductions, through various offering periods at a purchase price equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. The Company recorded compensation charges of \$0 and \$14 for the three months ended September 30, 2016 and 2015, respectively, and \$0 and \$43 for the nine months ended September 30, 2016 and 2015, respectively, related to the ESPP.

#### (6) 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 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. For the three months ended September 30, 2015, and the nine months ended September 30, 2016 and 2015, due to the net loss in each of those periods, the Company excluded all outstanding stock options and non-vested restricted shares from its diluted loss per share calculation, as inclusion of these securities would have reduced the net loss per share. Common stock equivalents related to options and restricted stock awards of 919 shares of common stock for the three months ended September 30, 2016 have been excluded from the fully diluted calculation of net income per share.

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

|  | Three Months Ended |                    | Nine Months Ended  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2016 | September 30, 2015 | September 30, 2016 | September 30, 2015 |
| Weighted average common shares outstanding—basic               | 15,845             | 15,661             | 15,798             | 15,608             |
| Dilutive common shares issuable in connection with stock plans | 70                 | —                  | —                  | —                  |
| Weighted average common shares outstanding—diluted             | 15,915             | 15,661             | 15,798             | 15,608             |

#### (7) Inventories

Inventories are stated at the lower of cost or market using the first-in first-out costing method. Inventories as of September 30, 2016 and December 31, 2015 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

|                 | September 30, 2016 | December 31, 2015 |
|-----------------|--------------------|-------------------|
| Raw materials   | \$ 12,910          | \$ 12,833         |
| Work in process | 2,288              | 2,778             |
| Finished goods  | 5,941              | 5,978             |

\$ 21,139      \$ 21,589



## (8) Product Warranty

The Company's products carry standard limited warranties that 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 consolidated statements of operations. As of September 30, 2016 and December 31, 2015, the Company had accrued product warranty costs of \$2,256 and \$1,880, respectively.

The following table summarizes product warranty activity during 2016 and 2015:

|                    | Nine Months<br>Ended<br>September 30, |         |
|--------------------|---------------------------------------|---------|
|                    | 2016                                  | 2015    |
| Beginning balance  | \$1,880                               | \$1,853 |
| Charges to expense | 1,543                                 | 811     |
| Costs incurred     | (1,167 )                              | (961 )  |
| Ending balance     | \$2,256                               | \$1,703 |

## (9) Debt

Long-term debt consists of the following:

|   | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
| Term note                                 | \$ 55,250             | \$ 58,906            |
| Mortgage loan                             | 2,993                 | 3,114                |
| Equipment loan                            | 1,779                 | 2,672                |
| Total                                     | 60,022                | 64,692               |
| Less amounts classified as current        | 7,890                 | 6,638                |
| Long-term debt, excluding current portion | \$ 52,132             | \$ 58,054            |

## Term Note and Line of Credit

On July 1, 2014, the Company entered into a five-year senior secured credit facility agreement (the Credit Agreement) with Bank of America, N.A., as Administrative Agent, and the lenders named from time to time as parties thereto (the Lenders), for an aggregate amount of up to \$80,000, including a revolving credit facility of up to \$15,000 and a term loan of \$65,000 to be used for general corporate purposes. As of September 30, 2016, there were no borrowings outstanding under the revolving credit facility.

The Credit Agreement contains two financial covenants, a Maximum Consolidated Leverage Ratio and a Minimum Consolidated Fixed Charge Coverage Ratio, each as defined in the Credit Agreement. The Company was in compliance with these financial covenants as of September 30, 2016.

## Mortgage Loan

The Company's mortgage loan contains one financial covenant, a Fixed Charge Coverage Ratio, which applies in the event that the Company's consolidated cash, cash equivalents and marketable securities balance falls below \$25,000 at any time. As the Company's consolidated cash, cash equivalents, and marketable securities balance was above the minimum threshold throughout the nine months ended September 30, 2016, the Fixed Charge Coverage Ratio did not apply.

## (10) Segment Reporting

Under common operational management, the Company designs, develops, manufactures and markets its navigation, guidance and stabilization and mobile communication 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 communication, navigation and guidance and stabilization equipment industry, which it considers to be a single business activity. The Company has two primary product categories: mobile communication and guidance and stabilization. Mobile communication sales and services include marine, land mobile, and automotive communication equipment and satellite-based voice, television and Broadband Internet connectivity services; the distribution of commercially licensed news, sports, movies, and music content for commercial and leisure customers in the maritime, hotel, and retail markets; and the distribution of training films and e-Learning computer-based training courses to commercial customers in the maritime market.

Guidance and stabilization sales and services include sales of defense-related and commercial navigation and guidance and stabilization equipment based upon digital compass and FOG sensor technology. Mobile communication and guidance and stabilization sales also include development contract revenue, product repairs and extended warranty sales.

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

| Three months ended September 30, 2016                      | Sales Originating From |                 |           |
|--|------------------------|-----------------|-----------|
|  | Americas               | Europe and Asia | Total     |
| Mobile communication sales to the United States            | \$25,093               | \$ 708          | \$25,801  |
| Mobile communication sales to Canada                       | 166                    | 75              | 241       |
| Mobile communication sales to Europe                       | 123                    | 6,179           | 6,302     |
| Mobile communication sales to other geographic areas       | 643                    | 3,467           | 4,110     |
| Guidance and stabilization sales to the United States      | 2,720                  | —               | 2,720     |
| Guidance and stabilization sales to Canada                 | 4,768                  | —               | 4,768     |
| Guidance and stabilization sales to Europe                 | 659                    | —               | 659       |
| Guidance and stabilization sales to other geographic areas | 1,245                  | —               | 1,245     |
| Intercompany sales   | 539                    | 754             | 1,293     |
| Subtotal   | 35,956                 | 11,183          | 47,139    |
| Eliminations   | (539 )                 | (754 )          | (1,293 )  |
| Net sales  | \$35,417               | \$ 10,429       | \$45,846  |
| Segment net income   | \$553                  | \$ 2,310        | \$2,863   |
| Depreciation and amortization                              | \$1,140                | \$ 1,695        | \$2,835   |
| Total assets   | \$136,175              | \$ 77,521       | \$213,696 |

| Three months ended September 30, 2015                      | Sales Originating From |                    |           |
|--|------------------------|--------------------|-----------|
|  | Americas               | Europe and<br>Asia | Total     |
| Mobile communication sales to the United States            | \$22,755               | \$ 361             | \$23,116  |
| Mobile communication sales to Canada                       | 326                    | 29                 | 355       |
| Mobile communication sales to Europe                       | 113                    | 4,937              | 5,050     |
| Mobile communication sales to other geographic areas       | 1,607                  | 7,461              | 9,068     |
| Guidance and stabilization sales to the United States      | 2,425                  | —                  | 2,425     |
| Guidance and stabilization sales to Canada                 | 2,424                  | —                  | 2,424     |
| Guidance and stabilization sales to Europe                 | 1,200                  | —                  | 1,200     |
| Guidance and stabilization sales to other geographic areas | 817                    | —                  | 817       |
| Intercompany sales   | 1,198                  | 1,137              | 2,335     |
| Subtotal   | 32,865                 | 13,925             | 46,790    |
| Eliminations   | (1,198 )               | (1,137 )           | (2,335 )  |
| Net sales  | \$31,667               | \$ 12,788          | \$44,455  |
| Segment net (loss) income                                  | \$(728 )               | \$ 265             | \$(463 )  |
| Depreciation and amortization                              | \$1,211                | \$ 1,984           | \$3,195   |
| Total assets   | \$143,297              | \$ 87,795          | \$231,092 |

| Nine months ended September 30, 2016                       | Sales Originating From |                    |           |
|--|------------------------|--------------------|-----------|
|  | Americas               | Europe and<br>Asia | Total     |
| Mobile communication sales to the United States            | \$69,948               | \$ 1,983           | \$71,931  |
| Mobile communication sales to Canada                       | 865                    | 463                | 1,328     |
| Mobile communication sales to Europe                       | 712                    | 21,680             | 22,392    |
| Mobile communication sales to other geographic areas       | 2,601                  | 10,355             | 12,956    |
| Guidance and stabilization sales to the United States      | 6,416                  | —                  | 6,416     |
| Guidance and stabilization sales to Canada                 | 11,391                 | —                  | 11,391    |
| Guidance and stabilization sales to Europe                 | 2,601                  | —                  | 2,601     |
| Guidance and stabilization sales to other geographic areas | 3,177                  | —                  | 3,177     |
| Intercompany sales   | 3,885                  | 2,167              | 6,052     |
| Subtotal   | 101,596                | 36,648             | 138,244   |
| Eliminations   | (3,885 )               | (2,167 )           | (6,052 )  |
| Net sales  | \$97,711               | \$ 34,481          | \$132,192 |
| Segment net (loss) income                                  | \$(3,593 )             | \$ 2,859           | \$(734 )  |
| Depreciation and amortization                              | \$3,572                | \$ 5,518           | \$9,090   |
| Total assets   | \$136,175              | \$ 77,521          | \$213,696 |

| Nine months ended September 30, 2015                       | Sales Originating From |                 |            |
|--|------------------------|-----------------|------------|
|  | Americas               | Europe and Asia | Total      |
| Mobile communication sales to the United States            | \$67,076               | \$ 1,220        | \$68,296   |
| Mobile communication sales to Canada                       | 1,282                  | 63              | 1,345      |
| Mobile communication sales to Europe                       | 432                    | 16,120          | 16,552     |
| Mobile communication sales to other geographic areas       | 4,021                  | 21,657          | 25,678     |
| Guidance and stabilization sales to the United States      | 5,496                  | —               | 5,496      |
| Guidance and stabilization sales to Canada                 | 6,216                  | —               | 6,216      |
| Guidance and stabilization sales to Europe                 | 3,592                  | —               | 3,592      |
| Guidance and stabilization sales to other geographic areas | 3,440                  | —               | 3,440      |
| Intercompany sales   | 4,874                  | 2,982           | 7,856      |
| Subtotal   | 96,429                 | 42,042          | 138,471    |
| Eliminations   | (4,874 )               | (2,982 )        | (7,856 )   |
| Net sales  | \$91,555               | \$ 39,060       | \$130,615  |
| Segment net loss   | \$(1,805 )             | \$(43 )         | \$(1,848 ) |
| Depreciation and amortization                              | \$3,552                | \$ 5,875        | \$9,427    |
| Total assets   | \$143,297              | \$ 87,795       | \$231,092  |

## (11) 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 the Company's opinion, is likely to materially harm its business, results of operations, financial condition or cash flows.

## (12) Share Buyback Program

On November 26, 2008, the Company's Board of Directors authorized a program to repurchase up to 1,000 shares of the Company's common stock. As of September 30, 2016, 341 shares of the Company's common stock remain available for repurchase under the authorized program. The repurchase program is funded using the Company's existing cash, cash equivalents, marketable securities and future cash flows. Under the repurchase program, the Company, at management's discretion, may repurchase shares on the open market from time to time, in privately negotiated transactions or block transactions, or through an accelerated repurchase agreement. The timing of such repurchases depends on availability of shares, price, market conditions, alternative uses of capital, and applicable regulatory requirements. The program may be modified, suspended or terminated at any time without prior notice. The repurchase program has no expiration date. There were no other repurchase programs outstanding during the nine months ended September 30, 2016 and no repurchase programs expired during the period.

During the nine months ended September 30, 2016 and 2015, the Company did not repurchase any shares of its common stock.

## (13) Fair Value Measurements

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

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. The Company's Level 1 assets are investments in money market mutual funds, United States treasuries, 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 assets are investments in corporate notes and its Level 2 liabilities are interest rate swaps.

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

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

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

The valuations of the interest rate swaps intended to mitigate the Company's interest rate risk are determined with the assistance of a third-party financial institution using widely accepted valuation techniques, including

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

The following tables present financial assets and liabilities at September 30, 2016 and December 31, 2015 for which the Company measures fair value on a recurring basis, by level, within the fair value hierarchy:

| September 30, 2016        | Total    | Level 1  | Level 2 | Level 3 | Valuation<br>Technique |
|---------------------------|----------|----------|---------|---------|------------------------|
| Assets                    |          |          |         |         |                        |
| Money market mutual funds | \$23,868 | \$23,868 | \$ —    | —       | —(a)                   |
| Certificates of deposit   | 4,816    | 4,816    | —       | —       | (a)                    |
| Liabilities               |          |          |         |         |                        |
| Interest rate swaps       | 212      | —        | 212     | —       | (b)                    |
| December 31, 2015         | Total    | Level 1  | Level 2 | Level 3 | Valuation<br>Technique |
| Assets                    |          |          |         |         |                        |
| Money market mutual funds | \$13,244 | \$13,244 | \$ —    | —       | —(a)                   |
| United States treasuries  | 1,002    | 1,002    | —       | —       | (a)                    |
| Corporate notes           | 2,284    | —        | 2,284   | —       | (a)                    |
| Certificates of deposit   | 6,089    | 6,089    | —       | —       | (a)                    |
| Liabilities               |          |          |         |         |                        |
| Interest rate swaps       | 238      | —        | 238     | —       | (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. The carrying amount of the Company's debt approximates fair value based on currently available quoted rates of similarly structured debt.



## 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 identified during a quarter or if an impairment is identified during the annual goodwill test. There were no indicators of impairment identified during the nine months ended September 30, 2016. As of September 30, 2016, the Company did not have any other non-financial assets or liabilities that were carried at fair value on a recurring basis in the consolidated financial statements or for which a fair value measurement was required.

## (14) Acquisition

On July 2, 2014, KVH Media Group Limited (KMG UK), an indirectly wholly owned subsidiary of KVH, entered into a Share Purchase Agreement with Nigel Cleave to acquire all of the issued share capital of Super Dragon Limited and Videotel Marine Asia Limited, for an aggregate purchase price of approximately \$47,446, which excluded \$1,719 of cash consideration that was considered deferred compensation in purchase accounting. Videotel is a maritime training services company headquartered in London that produces and distributes training films and e-Learning computer-based training courses to commercial customers in the maritime market. Videotel also has sales offices in Hong Kong and Singapore. The acquisition was consummated on the same day. The purchase price was determined through arm's-length negotiation and was subject to a potential post-closing adjustment based on the value of the net assets delivered at the closing. In the second quarter of 2015, the Company finalized its valuations of the fair value of the assets acquired and liabilities assumed, which resulted in no adjustments to the purchase price.

The Share Purchase Agreement contains certain representations, warranties, covenants and indemnification provisions. The Share Purchase Agreement provides that 10% of the purchase price would be held in escrow for a period of approximately 21 months after the closing in order to satisfy valid indemnification claims that KMG UK could have asserted for specified breaches of representations, warranties and covenants. The escrow and holdback amounts of approximately \$6,000 were fully funded to the escrow account during the first quarter of 2015. In April 2016, approximately \$600 of the \$4,400 total escrow funds were released to the Company to cover post-completion accounts receivable write-offs and the balance was released to the seller. The holdback of approximately \$1,600 was released to the seller in July 2016.

## (15) Goodwill and Intangible Assets

## Goodwill

The following table sets forth the changes in the carrying amount of goodwill for the nine months ended September 30, 2016:

|   | Amounts  |
|---|----------|
| Balance at December 31, 2015            | \$36,747 |
| Foreign currency translation adjustment | (4,006 ) |
| Balance at September 30, 2016           | \$32,741 |

The Company is performing its annual goodwill impairment test as of August 31, 2016, as defined by ASC Topic 350, Intangibles—Goodwill and Other (ASC 350). ASC 350 requires that the impairment test be performed through the application of a two-step process. The first step compares the carrying value of the Company's reporting units to their estimated fair values as of the test date. If fair value is less than carrying value, a second step is performed to quantify the amount of the impairment, if any. The Company is still in the process of performing its annual impairment test for goodwill at the reporting unit level. After completing the first step, it is possible that the Company will have to conduct the second step of this test. To the extent that the finalization of the assessment of goodwill requires an impairment charge, such adjustment will be recorded in the fourth quarter of 2016.





## Intangible Assets

The changes in the carrying amount of intangible assets during the nine months ended September 30, 2016 are as follows:

|   | Amounts  |
|---|----------|
| Balance at December 31, 2015            | \$26,755 |
| Amortization expense                    | (3,678 ) |
| Foreign currency translation adjustment | (2,997 ) |
| Balance at September 30, 2016           | \$20,080 |

Intangible assets arose from an acquisition made prior to 2013, the acquisition of KVH Media Group in May 2013 and the acquisition of Videotel in July 2014. Intangibles arising from the acquisition made prior to 2013 are being amortized on a straight-line basis over an estimated useful life of 7 years. Intangibles arising from the acquisition of KVH Media Group are being amortized on a straight-line basis over the estimated useful life of: (i) 10 years for acquired subscriber relationships, (ii) 15 years for distribution rights, (iii) 3 years for internally developed software and (iv) 2 years for proprietary content. Intangibles arising from the acquisition of Videotel are being amortized on a straight-line basis over the estimated useful life of: (i) 8 years for acquired subscriber relationships, (ii) 5 years for favorable leases, (iii) 4 years for internally developed software and (iv) 5 years for proprietary content. The intangibles arising from the KVH Media Group and Videotel acquisitions were recorded in pounds sterling and fluctuations in exchange rates could cause these amounts to increase or decrease from time to time.

Acquired intangible assets are subject to amortization. The following table summarizes acquired intangible assets at September 30, 2016 and December 31, 2015, respectively:

|                               | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Value |
|-------------------------------|-----------------------------|-----------------------------|--------------------------|
| September 30, 2016            |                             |                             |                          |
| Subscriber relationships      | \$ 17,450                   | \$ 5,971                    | \$ 11,479                |
| Distribution rights           | 4,277                       | 1,114                       | 3,163                    |
| Internally developed software | 2,335                       | 1,620                       | 715                      |
| Proprietary content           | 8,160                       | 4,075                       | 4,085                    |
| Intellectual property         | 2,284                       | 1,974                       | 310                      |
| Favorable lease               | 642                         | 314                         | 328                      |
|                               | \$ 35,148                   | \$ 15,068                   | \$ 20,080                |
| December 31, 2015             |                             |                             |                          |
| Subscriber relationships      | \$ 19,161                   | \$ 4,426                    | \$ 14,735                |
| Distribution rights           | 4,736                       | 895                         | 3,841                    |
| Internally developed software | 2,457                       | 1,244                       | 1,213                    |
| Proprietary content           | 8,812                       | 2,879                       | 5,933                    |
| Intellectual property         | 2,283                       | 1,729                       | 554                      |
| Favorable lease               | 696                         | 217                         | 479                      |
|                               | \$ 38,145                   | \$ 11,390                   | \$ 26,755                |

Estimated future amortization expense remaining at September 30, 2016 for acquired intangible assets is as follows:

|                                   | Year<br>Ending<br>December<br>31, |
|-----------------------------------|-----------------------------------|
| 2016                              | \$ 1,134                          |
| 2017                              | 4,435                             |
| 2018                              | 4,002                             |
| 2019                              | 2,989                             |
| 2020                              | 2,191                             |
| Thereafter                        | 5,329                             |
| Total future amortization expense | \$ 20,080                         |

For intangible assets, the Company assesses the carrying value of these assets whenever events or circumstances indicate that the carrying value may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset, or asset group, to the future undiscounted cash flows expected to be generated by the asset, or asset group. There were no events or changes in circumstances during the third quarter of 2016 which indicated that an assessment of the impairment of goodwill and intangible assets was required.

#### (16) Business and Credit Concentrations

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

|  | Three Months<br>Ended<br>September 30,<br>2016 |       | Nine Months<br>Ended<br>September 30,<br>2015 |       |
|--|--|-------|---|-------|
| Net sales to foreign customers outside the U.S. and Canada | 26.9%  | 36.2% | 31.1%   | 37.7% |

No single customer accounted for 10% or more of consolidated net sales for the three or nine months ended September 30, 2016 or 2015. The Company had one customer that accounted for 12% of accounts receivable as of September 30, 2016 and 17% as of December 31, 2015.

#### (17) Derivative Instruments and Hedging Activities

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

As required by ASC Topic 815, Derivatives and Hedging, the Company records all derivatives on the balance sheet at fair value. As of September 30, 2016, the fair value of the derivatives is included in other accrued liabilities and the unrealized loss is included in accumulated other comprehensive loss.

As of September 30, 2016, the Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk:

| Interest Rate Derivatives | Notional<br>(in thousands) | Asset<br>(Liability) | Effective Date | Maturity Date | Index         | Strike Rate |
|---------------------------|----------------------------|----------------------|----------------|---------------|---------------|-------------|
| Interest rate swap        | \$ 1,496                   | (103 )               | April 1, 2010  | April 1, 2019 | 1-month LIBOR | 5.91 %      |
| Interest rate swap        | \$ 1,496                   | (109 )               | April 1, 2010  | April 1, 2019 | 1-month LIBOR | 6.07 %      |



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

### Introduction

The statements included in this quarterly report on Form 10-Q, other than statements of historical fact, are forward-looking statements. Examples of forward-looking statements include statements regarding our future financial results, operating results, business strategies, projected costs, products, competitive positions and plans, customer preferences, consumer trends, anticipated product development, and objectives of management for future operations. In some cases, forward-looking statements can be 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 on Form 10-Q and Item 1A of Part I of our annual report on Form 10-K for the year ended December 31, 2015. 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 communication products and services for the marine and land markets, and navigation, guidance and stabilization products for both the defense and commercial markets. Our mobile communication products enable customers to receive voice and Internet services and live digital television via satellite services in marine vessels, recreational vehicles, buses and automobiles. Our CommBox offers a range of tools designed to increase communication efficiency, reduce costs, and manage network operations. We sell and lease our mobile communication products through an extensive international network of dealers and distributors. We also sell and lease products directly to end users.

Our mobile communication service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, and extended warranty sales. Our mobile communication service sales also include our distribution of entertainment, including news, sports, music, and movies to commercial and leisure customers in the maritime, hotel, and retail markets through KVH Media Group, the media and entertainment services company that we acquired on May 11, 2013, and the distribution of training films and e-Learning computer-based training courses to commercial customers in the maritime market through Super Dragon Limited and Videotel Marine Asia Limited (together referred to as Videotel), a maritime training services company that we acquired on July 2, 2014. We typically recognize revenue from media content sales ratably over the period of the service contract. We provide, for monthly fixed and usage fees, satellite connectivity services for broadband Internet, data and Voice over Internet Protocol (VoIP) service to our TracPhone V-series customers. We also earn monthly usage fees for third-party satellite connectivity for voice, data and Internet services to our Inmarsat and Iridium customers who choose to activate their subscriptions with us. Our service sales have grown as a percentage of total revenue from 44% of our net sales in 2013 to 54% in 2014 to 59% in both 2015 and the nine months ended September 30, 2016, a portion of which is attributable to our acquisitions of the KVH Media Group business in May 2013 and Videotel in July 2014.

We also offer precision fiber optic gyro (FOG)-based 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 foreign governments and government contractors, as well as through an international network of authorized independent sales representatives. In addition, our guidance and stabilization products are used in numerous commercial products, such as navigation and positioning systems for various applications including precision mapping, dynamic surveying,

autonomous vehicles, train location control and track geometry measurement systems, industrial robotics and optical stabilization.

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We generate sales primarily from the sale of our mobile communication 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 |          | Nine Months Ended |           |
|----------------------------|--------------------|----------|-------------------|-----------|
|                            | September 30,      |          | September 30,     |           |
|                            | 2016               | 2015     | 2016              | 2015      |
| Mobile communication       | \$36,454           | \$37,589 | \$108,607         | \$111,871 |
| Guidance and stabilization | 9,392              | 6,866    | 23,585            | 18,744    |
| Net sales                  | \$45,846           | \$44,455 | \$132,192         | \$130,615 |

We have historically derived a substantial portion of our sales from sales to customers located outside the United States. Notes 10 and 16 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 to the consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2015.

As described in our annual report on Form 10-K for the year ended December 31, 2015, our most critical accounting policies and estimates upon which our consolidated financial statements were prepared were those relating to revenue recognition, valuation of accounts receivable, valuation of inventory, the determination of the fair value of goodwill and intangible assets, deferred tax assets and related valuation allowance, stock-based compensation, warranty and accounting for contingencies. We have reviewed our policies and estimates and determined that these remain our most critical accounting policies and estimates for the nine months ended September 30, 2016.

Readers should refer to our annual report on Form 10-K for the year ended December 31, 2015 under “Management’s Discussion and Analysis of Financial Condition and Results of Operation—Critical Accounting Policies and Significant Estimates” for descriptions of these policies and estimates.

## Results of Operations

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

|   | Three Months  |         | Nine Months   |         |
|---|---------------|---------|---------------|---------|
|   | Ended         |         | Ended         |         |
|   | September 30, |         | September 30, |         |
|   | 2016          | 2015    | 2016          | 2015    |
| Sales:  |               |         |               |         |
| Product   | 41.5 %        | 35.1 %  | 41.2 %        | 37.5 %  |
| Service   | 58.5          | 64.9    | 58.8          | 62.5    |
| Net sales   | 100.0         | 100.0   | 100.0         | 100.0   |
| Cost and expenses:                                |               |         |               |         |
| Costs of product sales                            | 24.0          | 23.1    | 26.2          | 25.1    |
| Costs of service sales                            | 29.6          | 32.5    | 30.1          | 31.7    |
| Research and development                          | 8.6           | 7.8     | 8.9           | 8.2     |
| Sales, marketing and support                      | 17.4          | 17.7    | 19.6          | 18.6    |
| General and administrative                        | 13.8          | 18.3    | 16.0          | 17.9    |
| Total costs and expenses                          | 93.4          | 99.4    | 100.8         | 101.5   |
| Income (loss) from operations                     | 6.6           | 0.6     | (0.8 )        | (1.5 )  |
| Interest income                                   | 0.3           | 0.3     | 0.3           | 0.3     |
| Interest expense                                  | 0.8           | 0.8     | 0.8           | 0.7     |
| Other (expense) income, net                       | (0.1 )        | (0.9 )  | —             | 0.5     |
| Income (loss) before income tax expense (benefit) | 6.0           | (0.8 )  | (1.3 )        | (1.4 )  |
| Income tax expense (benefit)                      | (0.3 )        | 0.1     | (0.8 )        | (0.1 )  |
| Net income (loss)                                 | 6.3 %         | (0.9 )% | (0.5 )%       | (1.3 )% |

## Three Months Ended September 30, 2016 and 2015

## Net Sales

Product sales for the three months ended September 30, 2016 increased \$3.4 million, or 22%, to \$19.0 million from \$15.6 million for the three months ended September 30, 2015. The increase was primarily due to an increase in sales of our guidance and stabilization products of approximately \$3.6 million, or 66%, partially offset by a decrease in sales of our mobile communication products of \$0.2 million, or 2%.

Specifically, sales of our TACNAV products increased \$3.6 million during the three months ended September 30, 2016 compared to the three months ended September 30, 2015, primarily due to a scheduled shipment of hardware for an international military customer. Partially offsetting this increase was a decrease in sales of marine mobile communication products of \$0.3 million, or 4%, which was slightly mitigated by an increase in sales of land mobile communication products of \$0.1, million or 12%, in the three months ended September 30, 2016, as compared to the three months ended September 30, 2015.

We anticipate that our TACNAV product sales will decrease in the fourth quarter of 2016 relative to the fourth quarter of 2015; for the full year, we expect that TACNAV product sales will be relatively flat compared to 2015. The timing of shipments under purchase orders we have not yet received is difficult to predict and may not occur in the fourth quarter. Although we expect that TACNAV sales will continue to grow over the long term, we expect that sales on a quarter-to-quarter or year-to-year basis will continue to be very uneven. We also expect that our FOG sales will be relatively flat in 2016 compared to 2015.

Mobile communication product sales decreased \$0.2 million, or 2%, to \$10.1 million for the three months ended September 30, 2016 from \$10.3 million for the three months ended September 30, 2015. Sales of marine mobile communication products for the three months ended September 30, 2016 decreased \$0.3 million compared to the three

months ended September 30, 2015. Sales of our land mobile products increased \$0.1 million for the three months ended September 30, 2016 from the same period in 2015. Sales of our marine mobile communication products have declined due to decreased demand arising from vessel lay-ups in the offshore oil and gas sector. Despite this decline in overall demand, we have experienced strong sales of our TracPhone V3 in Asian, European, and US markets.



Mobile communication product sales originating from our European and Asian subsidiaries for the three months ended September 30, 2016 decreased \$0.6 million, or 23%, compared to the three months ended September 30, 2015, primarily due to lower sales of our TracPhone V7 and V11 of \$0.4 million and TV marine products of \$0.2 million. Mobile communication product sales originating from the Americas for the three months ended September 30, 2016 increased \$0.5 million, or 7%, compared to the three months ended September 30, 2015, due to increased sales of our TV marine and land mobile products of \$0.4 million and mini-VSAT Broadband products of \$0.1 million.

Service sales for the three months ended September 30, 2016 decreased \$2.0 million, or 7%, to \$26.8 million from \$28.8 million for the three months ended September 30, 2015. The primary reasons for the decrease were a \$1.1 million decrease in our content and training service revenue, which resulted primarily from exchange rate weaknesses arising from e-Learning and maritime safety media sales recorded in pounds sterling, a \$1.0 million decrease in contracted engineering services, and a \$0.1 million decrease in Inmarsat service sales. Partially offsetting these decreases was a \$0.1 million increase in mini-VSAT service sales.

We expect that our mini-VSAT service sales will be relatively flat in 2016, from the rate we achieved in 2015 as a result of the difficult market conditions faced by our commercial maritime customers, especially those in the oil and gas industry. We expect that content and training service sales will decrease in 2016 compared to 2015 due to the exchange rate weakness of pounds sterling. We also expect a decrease in contracted engineering services in 2016 compared to 2015. We expect that contracted engineering service sales on a quarter-to-quarter or year-to-year basis will continue to be very uneven.

#### Costs of Sales

For the three months ended September 30, 2016, costs of product sales increased by \$0.7 million, or 7%, to \$11.0 million from \$10.3 million for the three months ended September 30, 2015. The primary reason for the increase was the increase in sales of our TACNAV products discussed above.

Costs of service sales decreased by \$0.9 million, or 6%, to \$13.6 million for the three months ended September 30, 2016 from \$14.5 million for the three months ended September 30, 2015. The primary reasons for the decrease were a \$0.5 million decrease in costs of contracted engineering service sales, a \$0.4 million decrease in costs of maritime safety media sales, and a \$0.1 million decrease in airtime costs associated with our mini-VSAT Broadband service, partially offset by a \$0.1 million increase in costs associated with Videotel e-Learning sales.

Gross margin from product sales for the three months ended September 30, 2016 increased to 42% as compared to 34% for the three months ended September 30, 2015. The increase in our gross margin from product sales was primarily due to the increase in sales of our TACNAV products discussed above, which generally have higher margins than our mobile communication products, as well as a decrease in sales of our mobile communication products.

Gross margin from service sales for the three months ended September 30, 2016 decreased to 49% as compared to 50% for the three months ended September 30, 2015. The gross margin from airtime service sales increased to 37% in the three months ended September 30, 2016 from 36% in the prior year period, primarily due to the increase in metered plans. This increase was more than offset by a decrease in gross margin on content and training service sales, which fell from 72% in the third quarter of 2015 to 71% in the third quarter of 2016 primarily due to exchange rate weaknesses arising from content and training service sales recorded in pounds sterling.

We expect that our mini-VSAT Broadband service revenue will remain relatively flat in 2016, but we anticipate a modest year-over-year increase in our mini-VSAT Broadband gross margin percentage from that achieved in 2015.

## Operating Expenses

Research and development expense for the three months ended September 30, 2016 increased \$0.4 million, or 11%, to \$3.9 million from \$3.5 million for the three months ended September 30, 2015. The primary reasons for the increase in the three months ended September 30, 2016 were a \$0.4 million increase in labor expenses and outside consulting fees. As a percentage of net sales, research and development expense was 9% for the three months ended September 30, 2016 and 8% for the three months ended September 30, 2015.

We expect research and development expense to modestly increase year-over-year due to the continued development efforts associated with the introductions of additional value-added services to our mini-VSAT Broadband customers, as well as new FOG and TACNAV products.

Sales, marketing and support expense for the three months ended September 30, 2016 increased by \$0.1 million, or 1%, to \$8.0 million from \$7.9 million for the three months ended September 30, 2015. The primary reasons for the increase in the three months ended September 30, 2016 were a \$0.4 million increase in employee compensation including commissions, and a \$0.2 million increase in warranty expense related primarily to our TracPhone V7 and V11 products, offset in part by a \$0.5 million decrease in bad debt expense. As a percentage of net sales, sales, marketing and support expense for the three months ended September 30, 2016 was 17% as compared to 18% for the three months ended September 30, 2015.

We expect that sales, marketing and support expense will continue to increase year-over-year, primarily driven by increased warranty expense and additional personnel.

General and administrative expense for the three months ended September 30, 2016 decreased \$1.8 million, or 22%, to \$6.3 million from \$8.2 million for the three months ended September 30, 2015. The primary reasons for the decrease were a decrease in executive bonuses and profit sharing as well as a decrease in expenses arising from the centralization of administrative functions in the UK. As a percentage of net sales, general and administrative expense for the three months ended September 30, 2016 was 14% as compared to 18% for the three months ended September 30, 2015.

We expect that general and administrative expense will modestly decrease year-over-year, primarily driven by inflationary compensation expenses.

#### Interest and Other Expense, Net

Interest income and interest expense for the three months ended September 30, 2016 were largely unchanged from the three months ended September 30, 2015.

Other expense, net decreased by \$0.3 million to \$0.1 million for the three months ended September 30, 2016 from \$0.4 million for the three months ended September 30, 2015. The primary reason for the decrease in other expense, net was foreign currency exchange losses primarily associated with our UK operations.

#### Income Tax Benefit

Income tax benefit was \$0.1 million for the three months ended September 30, 2016 and income tax expense was \$0.1 million for the three months ended September 30, 2015. The increase resulted primarily from a discrete income tax benefit of \$0.2 million in the three months ended September 30, 2016.

#### Nine Months Ended September 30, 2016 and 2015

##### Net Sales

Product sales for the nine months ended September 30, 2016 increased \$5.5 million, or 11%, to \$54.5 million from \$49.0 million for the nine months ended September 30, 2015. The increase was primarily due to an increase in sales of our guidance and stabilization products of approximately \$6.1 million, or 38%, partially offset by a decrease in mobile communication product sales of \$0.6 million, or 2%.

Specifically, sales of our TACNAV products increased \$6.8 million during the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015, primarily due to a scheduled shipment in September 2016 of hardware under a long-term contract received in October 2015 from an international military customer. Partially offsetting this increase was a decrease in sales of FOG products of \$0.7 million, or 5%, primarily as a result of decreased shipments of FOGs for defense applications.

Mobile communication product sales decreased \$0.6 million, or 2%, to \$32.5 million for the nine months ended September 30, 2016 from \$33.1 million for the nine months ended September 30, 2015, primarily as a result a \$1.2 million decrease of marine mobile communication products offset by an increased \$0.5 million of our land mobile products for the nine months ended September 30, 2016 from the same period in 2015. Sales of our TracPhone V11 and V7 marine mobile communication products declined in international markets due to decreased demand arising from vessel lay-ups in the offshore oil and gas sector.

Mobile communication product sales originating from our European and Asian subsidiaries for the nine months ended September 30, 2016 decreased \$1.8 million, or 19% compared to the nine months ended September 30, 2015, primarily as a result of primarily due to lower sales of our TracPhone V7 and V11 of \$1.1 million and TV marine products of \$0.5 million. Mobile communication product sales originating from the Americas for the nine months ended September 30, 2016 increased \$1.2 million, or 5%, as compared to the nine months ended September 30, 2015, primarily as a result of due to increased sales of our TV marine and land mobile products of \$1.1 million and mini-VSAT Broadband products of \$0.1 million.

Service sales for the nine months ended September 30, 2016 decreased \$3.9 million, or 5%, to \$77.7 million from \$81.7 million for the nine months ended September 30, 2015. The primary reasons for the decrease were a \$2.3 million decrease in our content and training service revenue, which resulted primarily from exchange rate weaknesses arising from content and training service sales recorded in pounds sterling, a \$1.2 million decrease in contracted engineering services, and a \$0.6 million decrease in Inmarsat service sales. Partially offsetting these decreases was a \$0.1 million increase in mini-VSAT service sales and \$0.1 million increase in professional services.

#### Costs of Sales

For the nine months ended September 30, 2016, costs of product sales increased by \$1.9 million, or 6%, to \$34.7 million from \$32.8 million for the nine months ended September 30, 2015. The primary reason for the increase was the increase in sales of our TACNAV products discussed above.

Costs of service sales decreased by \$1.6 million, or 4%, to \$39.8 million for the nine months ended September 30, 2016 from \$41.4 million for the nine months ended September 30, 2015. The primary reasons for the decrease were a \$1.0 million decrease in airtime costs associated with our mini-VSAT Broadband service, and a \$0.7 million decrease in costs associated with engineering services, and a \$0.2 million decrease in costs associated with Inmarsat service sales, partially offset by a \$0.1 million increase in cost of services for our content and training service and \$0.3 million increase in cost associated with our professional services and repairs.

Gross margin from product sales for the nine months ended September 30, 2016 increased to 36% as compared to 33% for the nine months ended September 30, 2015. The increase in our gross margin from product sales was primarily due to the increase in sales of our TACNAV products discussed above, which generally have higher margins than our mobile communication products, as well as a decrease in sales of our mobile communication products.

Gross margin from service sales remained flat at 49% for the nine months ended September 30, 2016 and for the nine months ended September 30, 2015. The gross margin from content and training service sales fell from 72% in the nine months ended September 30, 2015 to 69% in the nine months ended September 30, 2016, primarily as a result of decrease in gross margin on content and training service sales. This decrease was partially offset by an increase in gross margin from airtime service sales to 37% in the nine months ended September 30, 2016 from 35% in the prior year period, primarily due to the increase in metered plans.

#### Operating Expenses

Research and development expense for the nine months ended September 30, 2016 increased by \$1.1 million, or 10%, to \$11.8 million from \$10.7 million for the nine months ended September 30, 2015. The primary reasons for the increase were a \$0.9 million increase in labor expenses and outside consulting fees and a \$0.1 million increase in expenses for materials. As a percentage of net sales, research and development expense for the nine months ended September 30, 2016 was 9% as compared to 8% for the nine months ended September 30, 2015.

Sales, marketing and support expense for the nine months ended September 30, 2016 increased by \$1.6 million, or 7%, to \$25.9 million from \$24.3 million for the nine months ended September 30, 2015. The primary reasons for the increase were a \$0.8 million increase in warranty expense mainly related to our TracPhone V7 and V11 products, a \$0.7 million increase in labor expenses and outside consulting costs, and a \$0.2 million increase in travel and trade show costs. Partially offsetting these increases was a \$0.3 million decrease in bad debt expense. As a percentage of net sales, sales, marketing and support expense was 20% for the nine months ended September 30, 2016, as compared to 19% for the nine months ended September 30, 2015.

General and administrative expense for the nine months ended September 30, 2016 decreased by \$2.3 million, or 10%, to \$21.1 million from \$23.4 million for the nine months ended September 30, 2015. The primary reasons for the decrease were a \$0.7 million decrease due to centralizing administrative functions in the UK, a \$0.5 million decrease in compensation expense for executive bonuses and profit sharing in the US, a \$0.4 million decrease in employee compensation in the UK, and a \$0.2 million decrease resulting from the weakness of the pound sterling. As a percentage of net sales, general and administrative expense was 16% for the nine months ended September 30, 2016 as compared to 18% for the nine months ended September 30, 2015.

#### Interest and Other Income, Net

Interest income remained consistent at \$0.4 million for the nine months ended September 30, 2016 and 2015. Interest expense remained consistent at \$1.1 million for the nine months ended September 30, 2016 and 2015. Other income, net for the nine months ended September 30, 2016 decreased by \$0.6 million to a negligible amount from \$0.7 million for the nine months ended September 30, 2015.

#### Income Tax Benefit

The income tax benefit for the nine months ended September 30, 2016 was \$1.0 million as compared to \$0.1 million for the nine months ended September 30, 2015. The increase resulted primarily from a decrease in the 2016 revenue forecast and a discrete income tax benefit of \$0.2 million in the three months ended September 30, 2016.

#### Backlog

Backlog is not a meaningful indicator for predicting revenue in future periods. Commercial resellers for our mobile satellite communication products and FOG 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 \$12.5 million and \$19.8 million as of September 30, 2016 and December 31, 2015, respectively. As of September 30, 2016, \$8.3 million of our backlog was scheduled for fulfillment in 2016, \$3.9 million was scheduled for fulfillment in 2017, and \$0.3 million was scheduled for fulfillment in 2018 through 2020. The decrease in backlog of \$7.3 million from December 31, 2015 was primarily the result of the fulfillment of various TACNAV and FOG product orders.

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 or multi-year service contracts providing for a fixed monthly fee. Military orders included in backlog are generally subject to cancellation for the convenience of the customer. When orders are canceled, we generally recover actual costs incurred through the date of cancellation and the costs resulting from termination. As of September 30, 2016, our backlog included approximately \$5.8 million in orders that are subject to cancellation for convenience by the customer. Individual orders for guidance and stabilization products are often large and may require procurement of specialized long-lead components and allocation of manufacturing resources. The complexity of planning and executing larger orders generally requires customers to order well in advance of the required delivery date, resulting in backlog.

#### Liquidity and Capital Resources

We have generally funded our operations primarily from operating cash flows, bank financings and proceeds received from exercises of stock options. As of September 30, 2016, we had \$53.8 million in cash, cash equivalents, and marketable securities, of which \$11.3 million in cash and cash equivalents was held in local currencies by our foreign subsidiaries. Our foreign subsidiaries held no marketable securities as of September 30, 2016. As of September 30, 2016, we had \$70.0 million in working capital.

Net cash provided by operations was \$19.0 million for the nine months ended September 30, 2016 compared to \$10.7 million for the nine months ended September 30, 2015. The \$8.3 million increase in cash provided by operations was primarily due to a \$10.2 million increase in cash inflows relating to accounts receivable, a \$4.2 million decrease in

cash outflows relating to inventories, a \$3.5 million increase in cash inflows relating to deferred revenue, a \$1.0 million decrease in cash outflows relating to accounts payable, a \$1.1 million decrease in net loss, and a \$0.7 million decrease in cash outflows relating to prepaid expenses and other current assets. Partially offsetting the increase in cash inflows were a \$7.7 million increase in cash outflows relating to accrued expenses, and a \$3.2 million increase in cash outflows related to other non-current assets.

Net cash used in investing activities was \$10.9 million for the nine months ended September 30, 2016 compared to \$7.0 million for the nine months ended September 30, 2015. The increase in cash used in investing activities of \$3.9 million was primarily due to a \$4.0 million increase in our net investment in marketable securities.

Net cash used in financing activities was \$4.6 million for the nine months ended September 30, 2016 compared to \$4.7 million for the nine months ended September 30, 2015. Net cash used in financing activities primarily consists of repayments of our term loan we undertook in connection with the acquisition of Videotel in July 2014 and other long-term debt as well as the payment of employee withholdings on stock-based awards. We also received proceeds from stock purchases under our equity incentive plans.



## Borrowing Arrangements

### Principal Credit Facility

As of September 30, 2016, there was \$55.3 million in aggregate principal amount outstanding under our principal credit facility. On July 1, 2014, we entered into a five-year senior credit agreement with Bank of America, N.A., as administrative agent, and the lenders named from time to time as parties thereto, for an aggregate amount of up to \$80.0 million, including a revolving credit facility of up to \$15.0 million and a term loan of \$65.0 million to be used for general corporate purposes, including both the refinancing of the \$30.0 million of indebtedness then outstanding under our former credit facility and permitted acquisitions. We also entered into a security agreement with respect to our grant of a security interest in substantially all of our assets in order to secure our obligations under the credit agreement and the related notes and pledge agreements with respect to our grant of a security interest in 65% of the capital stock of each of KVH Industries A/S and KVH Industries U.K. Limited held by us in order to secure our obligations under the credit agreement and the notes. We made certain amendments to the credit agreement in June and September 2015.

We executed \$65.0 million in term notes on July 1, 2014 in connection with our acquisition of Videotel. We applied proceeds in the amount of \$35.0 million toward the payment of a portion of the purchase price for Videotel, and we applied proceeds in the amount of \$30.0 million toward the refinancing of the then-outstanding balance under our former credit facility. We must make principal repayments on the term loan in the amount of approximately \$1.2 million at the end of each of the first eight three-month periods following the closing; thereafter, we must make principal repayments in the amount of approximately \$1.6 million for each succeeding three-month period until the maturity of the loan on July 1, 2019. On the maturity date, the entire remaining principal balance of the loan, including any future loans under the revolver, is due and payable, together with all accrued and unpaid interest, penalties and other amounts due and payable under the credit agreement. The credit agreement contains provisions requiring the mandatory prepayment of amounts outstanding under the term loan and the revolver under specified circumstances, including (i) 100% of the net cash proceeds from certain dispositions to the extent not reinvested in our business within a stated period, (ii) 50% of the net cash proceeds from stated equity issuances and (iii) 100% of the net cash proceeds from certain receipts of more than \$250,000 outside the ordinary course of business. The prepayments are first applied to the term loan, in inverse order of maturity, and then to the revolver. In the discretion of the administrative agent, certain mandatory prepayments made on the revolver can permanently reduce the amount of credit available under the revolver.

Loans under the credit agreement bear interest at varying rates determined in accordance with the credit agreement. Each LIBOR Rate Loan, as defined in the credit agreement, bears interest on the outstanding principal amount thereof for each interest period from the applicable borrowing date at a rate per annum equal to the LIBOR Daily Floating Rate or LIBOR Monthly Floating Rate, each as defined in the credit agreement, as applicable, plus the Applicable Rate, as defined in the credit agreement, and each Base Rate Loan, as defined in the credit agreement, bears interest on the outstanding principal amount thereof from the applicable borrowing date at a rate per annum equal to the Base Rate, as defined in the credit agreement, plus the Applicable Rate. The Applicable Rate ranges from 1.50% to 2.25%, depending on our Consolidated Leverage Ratio, as defined in the credit agreement. The highest Applicable Rate applies when the Consolidated Leverage Ratio exceeds 2.00:1.00. Upon certain defaults, including failure to make payments when due, interest becomes payable at a higher default rate.

Borrowings under the revolver are subject to the satisfaction of numerous conditions precedent at the time of each borrowing, including the continued accuracy of our representations and warranties and the absence of any default under the credit agreement. As of September 30, 2016, there were no borrowings outstanding under the revolver. The credit agreement contains two financial covenants, a Maximum Consolidated Leverage Ratio and a Minimum Consolidated Fixed Charge Coverage Ratio, each as defined in the credit agreement. In September 2015, the Maximum Consolidated Leverage Ratio was (among other things) increased from 1.00:1.00 to 1.25:1.00 for March 31, 2016 and each fiscal quarter thereafter. The Minimum Consolidated Fixed Charge Coverage Ratio may not be less than 1.25:1.00. We were in compliance with these financial ratio debt covenants as of September 30, 2016.

The credit agreement imposes certain other affirmative and negative covenants, including without limitation covenants with respect to the payment of taxes and other obligations, compliance with laws, entry into material

contracts, creation of liens, incurrence of indebtedness, investments, dispositions, fundamental changes, restricted payments, changes in the nature of our business, transactions with affiliates, corporate and accounting changes, and sale and leaseback arrangements.

Our obligation to repay loans under the credit agreement could be accelerated upon a default or event of default under the terms of the credit 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 credit 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 lenders' security interest therein, and any other material adverse change with respect to us.

#### Mortgage Loan

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. On June 9, 2011, we entered into an amendment to the mortgage loan. The loan term is ten 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 2.00 percentage points. Land, building and improvements with an approximate carrying value of approximately \$5.0 million as of September 30, 2016 secure the mortgage loan. The monthly mortgage payment is approximately \$14,000, plus interest and increases in increments of \$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 for the three months ended September 30, 2016, 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 17 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 5.9% for half of the principal amount outstanding and 6.1% for the remaining half of the principal amount outstanding as of April 1, 2010 until the mortgage loan expires on April 16, 2019.

#### Equipment Loan

On January 30, 2013, we borrowed \$4.7 million from a bank and pledged as collateral six satellite hubs and related equipment. The term of the equipment loan is five years, and the loan bears interest at a fixed rate of 2.76% per annum. The monthly payment is approximately \$83,000, including interest expense. On December 30, 2013, we borrowed \$1.2 million from a bank and pledged as collateral one satellite hub and related equipment. The term of the equipment loan is five years, and the loan bears interest at a fixed rate of 3.08% per annum. The monthly payment is approximately \$21,000, including interest expense.

#### Other Matters

We intend to continue to invest in the expansion and improvement of our mini-VSAT Broadband network on a global basis. As part of the future potential capacity expansion, we would plan to acquire additional satellite capacity from satellite operators, potentially including capacity on high throughput and non-geostationary satellite systems currently under development, expend funds to seek regulatory approvals and permits, develop product enhancements in anticipation of the expansion, and hire additional personnel. Depending on the scope of our efforts, these investments may be substantial and may include temporary transitional expenses to implement new capabilities.

On November 26, 2008, our Board of Directors authorized a program to repurchase up to one million shares of our common stock. The share repurchase program is funded using our existing cash, cash equivalents, marketable securities and future cash flows. As of September 30, 2016, 341,000 shares of our common stock remain available for repurchase under the program. We did not purchase any shares of our common stock in the nine months ended September 30, 2016.

As of September 30, 2016, we held \$53.8 million in cash, cash equivalents and marketable securities. We believe that our cash, cash equivalents and marketable securities, together with our other working capital and cash flows from operations, will be adequate to meet planned operating and capital requirements through at least the next twelve

months. However, as the need or opportunity arises, we may seek to raise additional capital through public or private sales of securities or through additional debt financing. There are no assurances that we will be able to obtain any additional funding or that such funding will be available on terms acceptable to us.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary market risk exposures are interest rate risk and foreign currency exchange rate risk.

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

We had \$55.3 million in borrowings outstanding at September 30, 2016, at an interest rate equal to the LIBOR Daily Floating Rate plus 1.75% under our variable-rate credit facility. For more information regarding our credit facility, see Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Borrowing Arrangements. A hypothetical 10% increase or decrease in interest rates would have approximately a \$0.1 million impact on our annual interest expense based on the \$55.3 million outstanding at September 30, 2016 with an interest rate of 2.27%.

As discussed in Note 17 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 5.9% for half of the principal amount outstanding and 6.1% 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 the United Kingdom, Denmark, Norway, Brazil, Singapore, Hong Kong, Cyprus, Japan, Belgium, and the Netherlands. Certain transactions in these locations are made in the local currency, yet are reported in the U.S. dollar. For foreign currency exposures existing at September 30, 2016, 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 have purchased foreign currency forward contracts. These forward contracts are intended to offset the impact of exchange rate fluctuations on cash flows of our foreign subsidiaries. Foreign exchange contracts are accounted for as cash flow hedges and are recorded on the balance sheet at fair value until executed. Changes in the fair value are recognized in earnings. We did not enter into any such contracts during the nine months ended September 30, 2016.

The primary objective of our investment activities is to preserve principal and maintain liquidity, while at the same time maximizing 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, municipal bonds, and government agency and non-government debt securities. As of September 30, 2016, 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 this interest rate risk is substantially mitigated. As of September 30, 2016, 98% of the \$28.7 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 for our investment activities. We did not invest in any financial instruments denominated in foreign currencies as of September 30, 2016.

#### 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 that 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 Chief Executive Officer and interim Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Under the supervision and with the participation of our Chief Executive Officer and interim Chief Financial Officer, our management has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2016, the end of the period covered by this interim report. Based on that evaluation, our Chief Executive Officer and interim Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2016.

##### Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of our Chief Executive Officer and interim Chief Financial Officer, our management has evaluated changes in our internal control over financial reporting that occurred during the third quarter of 2016. Based on that evaluation, our Chief Executive Officer and interim Chief Financial Officer did not identify any change in our internal control over financial reporting during the third quarter of 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

##### Important Considerations

The effectiveness of our disclosure controls and procedures and our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, there can be no assurance that any system of disclosure controls and procedures or internal control over financial reporting will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management.

## 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 and associated declines in consumer spending.

Worldwide economic conditions have experienced significant turmoil over the last several years, including slower economic activity, tightened credit markets, inflation and deflation concerns, decreased consumer confidence, reduced corporate profits, reduced or canceled capital spending, adverse business conditions, war and refugee crises in the Middle East, the United Kingdom vote to leave the European Union, 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 have caused and may continue to cause them to curtail spending significantly and/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 and government entities could continue to slow or suspend spending on our products and services. We may also incur increased credit losses and need to further 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 the turmoil in our markets. We expect our business to continue to be adversely impacted by this turmoil, particularly in Europe, Asia, and South America.

Decline in oil prices may continue to adversely affect our revenues and profitability.

Oil prices have undergone a significant and sustained decline since the peak in 2014. West Texas Intermediate oil prices dropped from a high of \$107.26 per barrel on June 20, 2014, to a low of \$26.21 per barrel on February 11, 2016. Customers of our mobile satellite business include offshore support vessel companies that participate in or depend on the offshore oil industry. The declines in worldwide oil prices have had a significant impact on the financial performance of companies in this sector of the economy, and as a result demand for new products and services has declined severely during and since 2015 as they have sought to reduce expenditures. In addition, we have experienced a higher customer churn rate primarily attributed to customers that operate in this sector, where the sale, decommissioning, or laying up of vessels has led to a higher rate of airtime plan terminations and suspensions. These trends could continue to limit or reduce demand for our satellite antenna products and airtime services from companies in this sector, which could continue to adversely affect our revenues and profitability.

Our financial performance is impacted by U.S. government contracts, which are subject to uncertain levels of funding and termination.

We have historically sold a substantial portion of our TACNAV and FOG products and services to the U.S. government and its contractors. A reduction in sales to the U.S. government or its contractors, 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.

Further, 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. The current election cycle may disrupt or delay appropriations for upcoming periods. 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, future federal sequestration measures could continue to adversely affect federal spending across the U.S. government, including the Department of Defense, and we expect that these measures will continue to limit or reduce defense spending.

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. Government customers can also decline to exercise previously disclosed contract options. 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.

We must generate a certain level of sales of the TracPhone V-IP series products and our mini-VSAT Broadband service in order to maintain or 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 have increased significantly each year as we have further expanded our network to accommodate additional subscriber demand and/or coverage areas, and we expect that this trend will continue in 2016 and beyond. Sales of our TracPhone V-IP series products declined in the three and nine months ended September 30, 2016 from the comparable periods in the prior year. If sales of our TracPhone V-IP series products and the mini-VSAT Broadband service do not generate the level of revenue that we expect or if those revenues decline, our service gross margins may decline. As our market share has increased, we have also experienced a general increase in customer termination and suspension rates, compounded by accelerated declines in sales for vessels servicing the oil supply market with some bulk carriers, and lower unit sales of our mobile communication hardware, both in the United States and Europe. The failure to improve our mini-VSAT Broadband service gross margins and unit sales would have a material adverse effect on our overall profitability.

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

The mobile communication markets and defense navigation, and 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 FOGs and FOG-based systems. As our market share in the mobile satellite communication market has grown, competition has intensified significantly, most notably from companies that seek to compete primarily on price. These companies may continue to implement price reductions and discounts for both products and

services, which have required us to reduce our prices or offer discounts in order to maintain or increase our market share. Some of our VSAT competitors have also leveraged partnerships amongst themselves in order to capture larger combined market share. We anticipate that this trend of substantial competition will continue.

In the marine market for satellite TV equipment, we compete primarily with Intellian, Cobham SATCOM, Orbit Communication Systems, RayMarine (Intellian made), KNS, and Sea King (King Controls).

In the marine market for voice, fax, data, and Internet communication equipment, we compete primarily with Intellian, Cobham SATCOM, Orbit Communication Systems, Jotron AS, KNS Inc., Inmarsat, AddValue, and Iridium Satellite LLC.

In the marine market for voice, fax, data, and Internet services, we compete primarily with Inmarsat, Globalstar LP, and Iridium Satellite LLC. We also face competition from providers of marine satellite data services and maritime VSAT solutions, including Inmarsat (and its Fleet Xpress service), Marlink, Global Eagle, SpeedCast, and Harris CapRock. We believe that certain customers have deferred purchase decisions in anticipation of Inmarsat's Fleet Xpress rollout, which may reduce demand in this market.

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

In the markets for media content, the KVH Media Group competes primarily with Swank Motion Pictures and NewspaperDirect, and Videotel competes with Seagull AS.

In the guidance and stabilization markets, we compete primarily with Honeywell International Inc., 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 generally have substantially greater financial, managerial, technical, marketing, personnel and other resources than we do, which help them to compete more effectively in the market for mobile broadband solutions for larger fleets of vessels;
- many of our prime competitors have well-established and/or growing partner programs, which pose a threat of multiplying their market influence;
- product and service improvements, new product and service developments or price reductions by competitors may weaken customer acceptance of, and reduce demand for, our products and services;
- new technology or market trends may disrupt or displace a need for our products and services;
- our competitors may have access to a broader array of media content than we do, which may cause customers to prefer competitors' media offerings; 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 smaller TracPhone V-IP series antennas and Ku-band mini-VSAT Broadband service, or with our C/Ku-band mini-VSAT Broadband service and our TracPhone V11-IP antenna.

Our TracPhone V3-IP and V7-IP 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 37-cm VSAT solution comparable to our TracPhone V3-IP, we are encountering regional competition from companies offering 60-cm VSAT systems and services, which are comparable in size to our TracPhone V7-IP. Likewise, our TracPhone V11-IP, at 1.1-meter in diameter, is approximately 85% smaller and lighter than competing C-band maritime VSAT systems, which use antennas in excess of 2.4-meters 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-IP series products, which could potentially reduce the appeal of our solution, increase price competition, and adversely affect sales. For example, Inmarsat has recently launched its Fleet Xpress service, a new global Ka-band mobile VSAT service that Inmarsat claims will be faster and have a lower price per megabit than existing Ku-band services. This service may adversely impact sales of our mini-VSAT Broadband service and related equipment.

Moreover, consumers may choose other services such as FleetBroadband or Iridium OpenPort for their service coverage at potentially lower hardware costs despite higher service costs and slower data rates.

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

The markets for mobile communication products and services and guidance and stabilization products and services are each characterized by rapid technological change, frequent new product innovations, changes in customer requirements and expectations, and evolving industry standards. For example, Inmarsat is now selling its latest-generation Fleet Xpress satellite communications products and services. If we fail to make innovations in our existing products and services and reduce the costs of our products and services in a timely way, our market share may decline. For example, the introductions of our new TracVision TV-series antennas in 2014 occurred later than we had anticipated, which we believe led certain customers to

purchase competing products. Products or services using new technologies, or emerging industry standards, could render our products and services obsolete. If our competitors successfully introduce new or enhanced products or services that eliminate technological advantages our products or services may have in a market or otherwise outperform our products or services, or are perceived by consumers as doing so, we may be unable to compete successfully in the markets affected by these changes. For competitive reasons, in 2015, we increased warranty coverage for certain of our mobile communication products to include an additional year of labor coverage and other benefits, which could increase our costs and impair our profitability.

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

We sell our FOG systems and tactical navigation products and services 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, which 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;
- 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 periodically cause substantial fluctuations in sales of our TACNAV and FOG products from period to period. For example, sales of our FOG products decreased \$0.7 million, or 5%, from the first nine months of 2015 to the first nine months of 2016. Similarly, TACNAV service sales decreased \$1.2 million, or 54%, from the first nine months of 2015 to the first nine months of 2016, while sales of our TACNAV products increased \$6.8 million, or 248%, from the first nine months of 2015 to the first nine months of 2016. In October 2014, we received a \$19.0 million TACNAV product and services contract with an international military customer which include program management and engineering services expected to be delivered through 2017 and hardware shipments that were completed in the third quarter of 2016, as well as out-year support services to be provided as part of this order. These large orders contribute to the unpredictability of our revenues from period to period. Government customers may change defense spending priorities at any time.

Sales of our FOG 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 thirty million dollars. For example, we received orders for TACNAV products and services of \$1.3 million, \$1.4 million, \$1.5 million, \$4.3 million, \$19.0 million, \$5.2 million, \$7.2 million, \$35.6 million, and \$2.8 million in November 2015, September 2015, May 2015, November 2014, October 2014, May 2014, January 2013, September 2012, and September 2012, respectively. 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 communication 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 defense navigation and 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. In October 2014, we received a \$19.0 million TACNAV product and services contract from an international military customer which includes program management and engineering services expected to be delivered through 2017 and hardware shipments that occurred in 2015 and 2016, as well as out-year support services to be provided as part of this order. The loss of business from any of these customers or delays in orders 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.

Commercial sales of our guidance and stabilization products are unpredictable.

Fluctuating commercial sales of our guidance and stabilization products are making it more difficult to predict our future revenues. We have been marketing our guidance and stabilization products, particularly our FOG products and systems, to original equipment manufacturers for incorporation into commercial products, such as navigation and positioning systems for various applications, including precision mapping, dynamic surveying, autonomous vehicles, train location control and track geometry measurement systems, industrial robotics, and optical stabilization. Because we sell these products to original equipment manufacturers rather than end-users, we have less information about market trends and other developments affecting the buying patterns of end-users and, as a result, may be unable to forecast demand for these products accurately. Sales of FOGs for commercial applications increased from the first nine months of 2015 to the first nine months of 2016; however, sales can significantly increase or decrease quarter-to-quarter due to our customer mix. Moreover, sales of these products for commercial applications depend on the success of our customers' products, and any decline in sales of our customers' products would reduce demand for our products.

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

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 could derive an increasing portion of our revenues from commercial leases of mobile communication 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 or abandoning 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 and gross margin realization.

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.

We currently offer our mini-VSAT Broadband 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 our subscriber base. If we are unable to reach agreement with third-party satellite providers to support our mini-VSAT Broadband service and its technology or if transponder capacity is unavailable to meet growing demand in a given region, our ability to provide airtime services will be at risk and could reduce the attractiveness of our products and services.

Changes in foreign currency exchange rates may negatively affect our financial condition and results of operations.

Because of the scope of our foreign sales and foreign operations, we face significant exposure to movements in exchange rates for foreign currencies, particularly the British pound sterling and the euro. During recent months, the U.S. dollar has strengthened against relevant foreign currencies, which decreases our revenues reported in U.S. dollars and decreases the reported value of our assets in foreign countries. However, if the U.S. dollar weakens, our revenues reported in U.S. dollars, as well as the reported value of our assets in foreign countries, would be commensurately higher.



We also have intragroup receivables and liabilities, such as loans, that can generate significant foreign currency effects. Changes in exchange rates, particularly the U.S. dollar against the British pound sterling, could lead to the recognition of unrealized foreign exchange losses.

Moreover, certain of our products and services are sold internationally in U.S. dollars; as the U.S. dollar strengthens, the relative cost of these products and services to customers located in foreign countries increases, which adversely affects export sales. In addition, most of our financial obligations, including payments under our outstanding debt obligations, must be satisfied in U.S. dollars. Our exposures to changes in foreign currency exchange rates may change over time as our business practices evolve and could result in increased costs or reduced revenue and could adversely affect our cash flow. Changes in the relative values of currencies occur regularly and may have a significant impact on our operating results. We cannot predict with any certainty changes in foreign currency exchange rates or the degree to which we can cost-effectively mitigate this exposure.

Brexit and political uncertainty in the United Kingdom and Europe could adversely affect our revenue and results of operations and disrupt our operations.

We have significant operations in the United Kingdom, including the major portion of our KVH Media Group operations. The June 2016 referendum supporting the exit of the United Kingdom from the European Union, or Brexit, is causing significant political uncertainty in both the United Kingdom and the European Union. For example, the United Kingdom has recently experienced a transition of leadership in its principal political parties; Scotland may seek to remain in the European Union, either by seeking to block Brexit or by obtaining its independence from the United Kingdom; and other members of the European Union may also seek to depart from the European Union. The impact of Brexit and the resulting turmoil on the political and economic future of the United Kingdom and the European Union is uncertain, and we may be adversely affected in ways we do not currently anticipate. Brexit may result in a significant change in the British regulatory environment, which would likely increase our compliance costs. Customers and other businesses may curtail expenditures, including for purchases of our products and services. We may find it more difficult to conduct business in the United Kingdom and the European Union, as Brexit may result in increased restrictions on the movement of capital, goods and personnel. Depending on the outcome of negotiations between the United Kingdom and the European Union regarding the terms of Brexit, we may decide to relocate or otherwise alter our European operations to respond to the new business, legal, regulatory, tax and trade environments that may result. Brexit may materially and adversely affect our relationships with customers, suppliers and employees and could result in decreased revenue, increased expenses, higher tariffs and taxes, and lower earnings and cash flow.

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 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. Recent declines in oil prices may not result in any material increase in demand.

Our business has substantial indebtedness, which could restrict our business opportunities.

We currently have, and will likely continue to have, a substantial amount of indebtedness. Our indebtedness could, among other things, make it more difficult for us to satisfy our debt obligations, require us to use a large portion of our cash flow from operations to repay and service our debt or otherwise create liquidity problems, limit our flexibility to

adjust to market conditions, place us at a competitive disadvantage and expose us to interest rate fluctuations. As of September 30, 2016, we had total debt outstanding of \$60.0 million, which included \$55.3 million in aggregate principal amount of indebtedness outstanding under our term note that matures in 2019.

We expect to obtain the money to pay our expenses and pay the principal and interest on our indebtedness from cash flow from our operations and potentially from other debt or equity offerings. Accordingly, our ability to meet our obligations depends on our future performance and capital raising activities, which will be affected by financial, business, economic and other factors, many of which are beyond our control. If our cash flow and capital resources prove inadequate to allow us to pay the principal and interest on our debt and meet our other obligations, we could face substantial liquidity problems and might be required to dispose of material assets or operations, restructure or refinance our debt, which we may be unable to do on

acceptable terms, and forego attractive business opportunities. In addition, the terms of our existing or future debt agreements may restrict us from pursuing any of these alternatives.

The agreements governing our indebtedness subject us to various restrictions that may limit our ability to pursue business opportunities.

The agreements governing our indebtedness subject us to various restrictions on our ability to engage in certain activities, including, among other things, our ability to:

- acquire other businesses or make investments;
- raise additional capital;
- incur additional debt or create liens on our assets;
- pay dividends or make distributions;
- prepay indebtedness; and
- merge, dissolve, liquidate, consolidate, or dispose of all or substantially all of our assets.

These restrictions may limit or restrict our cash flow and our ability to pursue business opportunities or strategies that we would otherwise consider to be in our best interests.

Our secured credit facility contains certain financial and other restrictive covenants that we may not satisfy, and that, if not satisfied, could result in the acceleration of the amounts due under our secured credit facility and the limitation of our ability to borrow additional funds in the future.

The agreements governing our secured credit facility subject us to various financial and other restrictive covenants with which we must comply on an ongoing or periodic basis. These include covenants pertaining to a maximum consolidated leverage ratio, a minimum consolidated fixed charge coverage ratio, covenants requiring the mandatory prepayment of amounts outstanding under the term loan and the revolver under specified circumstances, including (i) 100% of the net cash proceeds from certain dispositions to the extent not reinvested in our business within a stated period, (ii) 50% of the net cash proceeds from stated equity issuances, and (iii) 100% of the net cash proceeds from certain receipts of more than \$250,000 outside the ordinary course of business, and limits on capital expenditures. If we violate any of these covenants, we may suffer a material adverse effect. Most notably, our outstanding debt under our secured credit facility could become immediately due and payable, our lenders could proceed against any collateral securing such indebtedness, and our ability to borrow additional funds in the future could be limited or terminated. Alternatively, we could be forced to refinance or renegotiate the terms and conditions of our secured credit facility, including the interest rates, financial and restrictive covenants and security requirements of the secured credit facility, on terms that may be significantly less favorable to us.

A default under agreements governing our indebtedness could result in a default and acceleration of indebtedness under other agreements.

Certain agreements governing our indebtedness contain cross-default provisions whereby a default under one agreement could result in a default and acceleration of our repayment obligations under other agreements. If a cross-default were to occur, we may not be able to pay our debts or borrow sufficient funds to refinance them. Even if new financing were available, it may not be available on acceptable terms. If some or all of our indebtedness is in default for any reason, our business, financial condition, and results of operations could be materially and adversely affected.

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 antenna products include the equipment necessary to utilize satellite services; we do not own the satellites that 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-IP 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- and FleetOne-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 TracPhone V-IP series antennas, and any disruption in the availability of this technology could adversely affect sales.

Our mini-VSAT Broadband service relies on spread spectrum technology developed by 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 combine 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-IP 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. Moreover, over the course of our ten-year agreement with ViaSat, which expires in 2018, satellite communications technology may continue to evolve, which could reduce the relative attractiveness of the technology we currently offer, and our technology may cease to be compatible with changes in satellite service offerings. If we decided to or had to transition to any new technology, we may encounter technological challenges, increased expenses, customer dissatisfaction, inventory obsolescence, interruptions in supply, disruptions in current relationships or arrangements and unforeseen obstacles, any of which could have a material adverse effect on our mobile satellite business, revenues and profitability.

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

Excluding the products manufactured by Videotel and KVH Media Group, which we manufacture in the United Kingdom, we currently manufacture all of our mobile communication 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. Department of Defense regulations requiring government contractors to implement processes to avoid counterfeit parts may require us to find new sources of materials or components if the current supplier cannot meet the requirements. 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.

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 competing products while also improving our profitability, in some instances we have found it desirable to source raw materials and manufactured components and assemblies from Europe, Asia, and South America. 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.

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 or delivery of services, 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 and services to customers in a timely and cost-effective manner, cause us to breach our contractual commitments or result in the loss of customers.

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

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 initiating potential price increases. Further, the licenses we obtain are limited in scope, and any violation of the terms of a license could expose us to liability for copyright infringement. We pay license fees that are based in part on the revenue we generate from sublicenses, and our licensors generally have the right to audit our records to determine whether we have paid all necessary license fees. Failure to pay required license fees could result in any combination of termination of our license rights, penalties, or damages. The loss of content could adversely affect the attractiveness of our media and entertainment offerings, which could in turn adversely affect our revenues. Any increase in the cost of content could reduce the profitability of these offerings.

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

We market and sell our mobile communication products and services through an international network of independent retailers, chain stores and distributors, as well as to manufacturers of marine vessels, recreational vehicles and buses. 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 do not have exclusive relationships with us and may sell products of other companies, including competing products, and are generally not required to purchase minimum

quantities of our products.

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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 have accounted for a significant portion of our net sales, and our acquisitions of Videotel in July 2014 and KVH Media Group in May 2013 increased our sales in new foreign markets. We derived 37%, 48%, 41%, and 46% of our revenues in the nine months ended September 30, 2016 and the years ended December 31, 2015, 2014, and 2013, respectively, from sales to customers outside the United States. We have foreign sales offices in Denmark, the United Kingdom, Singapore, Hong Kong, Japan, Norway, Cyprus and the Philippines, as well as a subsidiary in Brazil that manages local sales. However, aside from these international sales offices, substantially all of our personnel and operations, particularly for our mobile satellite communications equipment business and our guidance and stabilization business, are located 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. Our acquisitions of Videotel and KVH Media Group have augmented these risks. These risks include:

- technical challenges we may face in adapting our mobile communication 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;
- the potential unavailability of content licenses covering international waters and foreign locations;
- 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; and
- economic and political instability in some international markets.

We could incur additional legal compliance costs associated with our international operations and could become subject to legal penalties if we do not comply with certain regulations.

As a result of our expanding international operations, we are subject to a number of legal requirements, including the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act and the customs, export, trade sanctions and anti-boycott laws of the United States, including those administered by the U.S. Customs and Border Protection, the Bureau of Industry and Security, the Department of Commerce, the Department of State, and the Office of Foreign Assets Control of the Treasury Department, as well as those of other nations in which we do business. Compliance with these laws and regulations is complex and involves significant costs. These risks are heightened for acquired businesses that have historically been managed outside the United States, where these laws and regulations may not have applied to the same extent. Our assessment of compliance with these laws and regulations by businesses that we have acquired may not have uncovered instances of non-compliance, and we may face liability for such non-compliance. In addition, our training and compliance programs and our other internal control policies may be insufficient to protect us from acts committed by our employees, agents or third-party contractors. Any violation of these requirements by us or our employees, agents or third-party contractors may subject us to significant criminal and civil liability.

Exports of certain guidance and stabilization products are subject to the U.S. Export Administration Regulations and 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 or reclassifications of our products 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.

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 acquisitions of Videotel in July 2014 and KVH Media Group in May 2013. The expenses we incur evaluating and pursuing these and other such acquisitions could have a material adverse effect on our results of operations. For example, during 2014, we incurred significant expenses related to the acquisition of Videotel. 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, and any acquisition may increase our overall operating expenses. 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;
- entry into new or unfamiliar geographic regions;
- increased expenses associated with the amortization of acquired intangible assets;
- increased exposure to fluctuations in foreign currency exchange rates;
- 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.

For example, we incurred additional expenses to implement internal control over financial reporting appropriate for a public company at Videotel, which previously operated as a private company not subject to U.S. generally accepted accounting principles.

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 expanded our service offerings through the acquisitions of Videotel in 2014 and KVH Media Group in 2013. This growth placed a strain on our personnel, management, financial and other resources and increased our operating expenses. 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 and services in a timely manner;
- secure appropriate satellite capacity to match changes in demand for airtime services in a timely manner;
- successfully attract, train, motivate and manage appropriate numbers of employees for manufacturing, sales, marketing and customer support activities;
- effectively manage our inventory and working capital;
- maintain the efficiencies within our operating, administrative, financial and accounting systems; and

ensure that our procedures and internal controls are revised and updated to remain appropriate for the size and scale of our business operations.

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. We are currently seeking to hire a new Chief Financial Officer. 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 business may suffer if we cannot protect our proprietary technology.

Our ability to compete depends significantly upon our patents, copyrights, source code, and 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 expire or be challenged, invalidated or circumvented, and the rights we have under our patents could provide no competitive advantages. Existing trade secret, copyright, and trademark laws offer only limited protection. Customers or others with access to our proprietary or licensed media content could copy that content without permission or otherwise violate the terms of our customer agreements, which would adversely affect our revenues and could impair our relationships with content providers. 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. For example, we were sued for patent infringement in 2015, and we settled this claim in January 2016 with a payment of cash to Advanced Media Network. Any claim of infringement could cause us to incur substantial costs defending against or settling 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 disrupt our operations, expose us to liability, damage our reputation, and require us to incur significant costs or otherwise adversely affect our financial results.

We are highly dependent on information technology networks and systems, including the Internet, to securely process, transmit and store electronic information, including personal information of our customers. We also retain sensitive data, including intellectual property, proprietary business information, personally identifiable information, credit card information, and usage data of our employees and customers on our computer networks. Although we take certain protective measures and endeavor to modify them as we believe circumstances warrant, invasive technologies and techniques continue to evolve rapidly, and our computer systems, software and networks are vulnerable to disruption, shutdown, unauthorized access, misuse, erasure, alteration, employee error, phishing, 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' sensitive information. Public reports suggest that cybersecurity incidents are happening more often and with increasingly severe consequences. We may be required to expend substantial additional resources to augment our efforts to address potential cybersecurity risks, which could adversely affect our results of operations.

If any of these events were to occur, they could disrupt our operations, distract our management, cause us to lose existing customers and fail to attract new customers, as well as subject us to regulatory actions, litigation, fines, damage to our reputation or competitive position, or orders or decrees requiring us to modify our business practices, any of which could have a material adverse effect on our financial position, results of operations or cash flows.

In addition, the interpretation and application of consumer and data protection laws in the United States, Europe and elsewhere are often uncertain, contradictory and in flux. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, this could result in government-imposed fines or orders requiring that we change our data practices, which could have an adverse effect on our business. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

Our media business may expose us to claims regarding our media content.

Our media business produces training films and e-Learning computer-based training courses, including programs on safety, maintenance, security and regulatory compliance, and also provides commercially licensed maritime charting and navigation information. Our efforts to ensure the accuracy and reliability of the content we provide could be inadequate, and we could face claims of liability based on this content. Contractual and other measures we take to limit our liability may be inadequate to protect us from these claims. Although we have certain rights of indemnification from third parties for certain portions of the content we provide to customers, it may be time-consuming and expensive to enforce our rights, and the third parties may lack the resources to fulfill their obligations to us. Further, our insurance coverage is subject to deductibles, exclusions and limitations of coverage, and there can be no assurance that our insurance coverage would be available to satisfy any claims against us. Any such claims may have a material adverse effect on our financial condition and results of operations.

We identified material weaknesses in our internal control over financial reporting as of December 31, 2014, and the occurrence of these or any other material weaknesses could have a material adverse effect on our ability to report accurate financial information in a timely manner.

As described in "Item 9A. Controls and Procedures" of our annual report on Form 10-K for the year ended December 31, 2014, our management concluded that we had material weaknesses in our internal control over financial reporting as of December 31, 2014 and therefore did not maintain effective internal control over financial reporting or effective disclosure controls and procedures, both of which are requirements of the Securities Exchange Act of 1934, as of that

date. 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. The material weaknesses related to guidance and stabilization contracts where revenue is recognized on a bill and hold basis, the accounting for income taxes and the accounting for multiple-element lease transactions. Following the identification of the material weaknesses in March 2015, management implemented remediation plans and successfully tested the control remediation as of December 31, 2015. On that basis, management concluded that the material weaknesses had been remediated as of December 31, 2015.

The remedial measures we took may not be adequate to prevent future misstatements or avoid other control deficiencies or material weaknesses. The effectiveness of our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any



evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, there can be no assurance that any system of or internal control over financial reporting will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management. As a result, 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, declines in our stock price, unanticipated legal, accounting and other expenses, delays in filing required financial disclosures, breach of contractual commitments to lenders or others, enforcement actions by government authorities, fines, penalties, the delisting of our common stock and liabilities arising from stockholder litigation.

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 communication products and services and guidance and stabilization products and services;
- the timing and size of individual orders from military customers, which may be delayed or cancelled for various reasons;
- the mix of products and services we sell, including the mix of fixed rate and metered contracts for airtime services;
- 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;
- expenses incurred in pursuing acquisitions;
- expenses incurred in expanding, maintaining, or improving our mini-VSAT Broadband network;
- market and competitive pricing pressures;
- unanticipated charges or expenses, such as increases in warranty claims;
- general economic climate; and
- seasonality of pleasure boat and recreational vehicle usage.

In late 2015, we introduced new rate plans for our airtime services, including various rate plans that offer higher data speeds with usage caps. Under our new rate plans, customers receive a base level of service for a fixed fee and pay additional fees for usage over the base level. Accordingly, the revenue we generate from a customer may vary with that customer's usage. We are unable to predict accurately the extent to which customers will transition to particular metered rate plans or the degree to which usage, and therefore our revenue, may vary from quarter to quarter.

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 or as quickly 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.

The market price of our common stock may be volatile.

Our stock price has historically been volatile. During the period from January 1, 2013 to September 30, 2016, the trading price of our common stock ranged from \$7.31 to \$15.79. 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, in the first quarter of 2009 and in January 2016. 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.

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. As of September 30, 2016, we had liabilities for uncertain tax positions of \$1.0 million, the majority of which relates to uncertain tax positions held on Videotel's balance sheet as of the acquisition date.

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.

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.

If goodwill or other intangible assets that we have recorded in connection with our acquisitions of other businesses become impaired, we could have to take significant charges against earnings.

As a result of our acquisitions, we have recorded, and may continue to record, a significant amount of goodwill and other intangible assets. Under current accounting guidelines, we must assess, at least annually and potentially more

frequently, whether the value of goodwill and other intangible assets has been impaired. Any reduction or impairment of the value of goodwill or other intangible assets will result in additional charges against earnings, which could materially reduce our reported results of operations in future periods.

Compliance with conflict minerals disclosure rules may further increase our costs and adversely affect our results of operations.

We are subject to the SEC's 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 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. The European Union is considering the adoption of conflict minerals disclosure requirements, which may apply to us

and may be more extensive than those adopted by the SEC. We may incur increased 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 would adversely affect our results of operations. Because our supply chain is complex, the country of origin inquiry and 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 with customers, investors, non-governmental organizations or others and lead to a decline in our stock price. In the conflict minerals report that we filed in 2016, we concluded that the origins of the relevant conflict minerals we used in 2015 were "DRC conflict undeterminable," as a result of which we were not required to obtain an independent private sector audit of our conflict minerals report. The temporary rules permitting issuers to report that the origins of the conflict minerals they use are "DRC conflict undeterminable" have expired; however, as a result of pending litigation, the requirement to obtain an independent private sector audit is subject to a temporary stay unless an issuer wishes to report that its products are "DRC conflict-free." It is possible that the stay could be lifted, in which case we expect that the expenses of preparing our conflict minerals report and obtaining any necessary private sector audit will increase. 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 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.

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. As of September 30, 2016, 341,000 shares of common stock remain available for repurchase under the program. The repurchase program is funded using our existing cash, cash equivalents, marketable securities, and future cash flows. Under the repurchase program, at management's discretion, we may repurchase shares on the open market from time to time, in privately negotiated transactions or block transactions, or through an accelerated repurchase agreement. The timing of such repurchases depends on availability of shares, price, market conditions, alternative uses of capital, and applicable regulatory requirements. The program may be modified, suspended or terminated at any time without prior notice. The repurchase program has no expiration date. There were no other repurchase programs outstanding during the nine months ended September 30, 2016, and no repurchase programs expired during the period.

In the nine months ended September 30, 2016, we did not repurchase any shares of our common stock.

## ITEM 6. EXHIBITS

## Exhibits:

| Exhibit No. | Description  | Filed with this Form 10-Q | Incorporated by Reference Form Filing Date | Exhibit No. |
|-------------|--|---------------------------|--|-------------|
| 3.1         | Amended and Restated Certificate of Incorporation, as amended  |                           | 10-Q August 6, 2010                        | 3.1         |
| 3.2         | Amended and Restated Bylaws  |                           | 8-K April 30, 2014                         | 3.1         |
| 4.1         | Specimen certificate for the common stock  |                           | S-1/A March 22, 1996                       | 4.1         |
| 31.1        | Rule 13a-14(a)/15d-14(a) certification of principal executive officer  | X                         |  |             |
| 31.2        | Rule 13a-14(a)/15d-14(a) certification of principal financial officer  | X                         |  |             |
| 32.1        | Section 1350 certification of principal executive officer and principal financial officer  | X                         |  |             |
| 101         | The following financial information from KVH Industries, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets (unaudited), (ii) the Consolidated Statements of Operations (unaudited), (iii) the Consolidated Statements of Comprehensive Income (Loss) (unaudited), (iv) the Consolidated Statements of Cash Flows (unaudited), and (v) the Notes to Consolidated Financial Statements (unaudited). | X                         |  |             |

SIGNATURE

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

Date: November 3, 2016

KVH Industries, Inc.

By: /s/ JOHN F. MCCARTHY

John F. McCarthy

(Duly Authorized Officer and Interim Chief Financial  
Officer)



## Exhibit Index

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