KVH INDUSTRIES INC \DE\
Form 10-K
March 17, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2013
OR

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

For the transition period from to
Commission File Number 0-28082
KVH Industries, Inc.
(Exact Name of Registrant as Specified in its Charter)

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

50 Enterprise Center, Middletown, RI 02842
(Address of Principal Executive Offices) (Zip Code)
(401) 847-3327
(Registrant's Telephone Number, Including Area Code)
Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, $0.01 par value per share | The NASDAQ Global Market |

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x
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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o | Smaller reporting company o |
| (Do not check if a 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 x

As of June 28, 2013, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $187,494,000 based on the closing sale price of $13.31 per share as reported on the NASDAQ Global Market. Shares of common stock held by executive

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officers and directors of the registrant and their affiliates have been excluded from this calculation because such persons may be deemed affiliates.

As of March 13, 2014, the registrant had 15,927,239 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to its 2014 Annual Meeting of Stockholders are incorporated herein by reference in Part III.

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## PART I

## ITEM 1. Business

### Cautionary Statement Regarding Forward-Looking Information

In addition to historical facts, this annual report contains forward-looking statements. Forward-looking statements are merely our current predictions of future events. These statements are inherently uncertain, and actual events could differ materially from our predictions. Important factors that could cause actual events to vary from our predictions include those discussed in this annual report under the headings “Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations”, and “Item 1A. Risk Factors.” We assume no obligation to update our forward-looking statements to reflect new information or developments. We urge readers to review carefully the risk factors described in this annual report and in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

### Additional Information Available

Our principal Internet address is www.kvh.com. Our website provides a hyperlink to a third-party website through which our annual, quarterly, and current reports, as well as amendments to those reports, are available free of charge. We believe these reports are made available as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC. We do not provide any information regarding our SEC filings directly to the third-party website, and we do not check its accuracy or completeness.

### Introduction

We are a leading manufacturer of solutions that provide global high-speed Internet, television, and voice services via satellite to mobile users at sea, on land, and in the air as well as a leading provider of commercially-licensed news, sports, music, movies and training video content to commercial and leisure customers in the maritime, hotel, and/or retail markets. We are also a premier manufacturer of high-performance navigational sensors and integrated inertial systems for defense and commercial guidance and stabilization applications. Our research and development, manufacturing and quality control capabilities have enabled us to meet the demanding standards of our military, consumer and commercial customers for performance and reliability. This combination of factors has allowed us to create products offering important differentiating advantages to our customers. We are based in Middletown, Rhode Island, with subsidiaries in Belgium, Bermuda, Brazil, Cyprus, Denmark, Illinois, Japan, The Netherlands, Norway, Singapore, and the United Kingdom.

### Our Products and Services

#### Mobile Satellite Communications

We believe that there is an increasing demand for mobile access to television, voice services and the Internet on the move. Our objective is to connect mobile users on sea, land, and air to the satellite TV, communications, and Internet services they wish to use. We have developed a comprehensive family of products and services marketed under the TracVision, TracPhone, and CommBox brand names as well as the mini-VSAT Broadband airtime network to address the unique needs of our communications markets.

Our mobile satellite antenna products are typically installed on mobile platforms and use sophisticated robotics, stabilization and control software, sensing technologies, transceiver integration, and advanced antenna designs to automatically search for, identify and point directly at the selected television and communications satellite while the vehicle, vessel, or plane is in motion. Our antennas use gyros and inclinometers to measure the pitch, roll and yaw of an antenna platform in relation to the earth. Microprocessors and our proprietary stabilization and control software use that data to compute the antenna movement necessary for the antenna's motors to point the antenna properly and maintain contact with the satellite. If an obstruction temporarily blocks the satellite signal, our products continue to track the satellite's location according to the movement of the antenna platform in order to carry out automatic, rapid reacquisition of the signal when a direct line of sight to the satellite is restored.

Our Certified Support Network offers our TracVision and TracPhone customers an international network of skilled technical dealers and support centers in many locations where our customers are likely to travel. We have selected distributors based on their technical expertise, professionalism and commitment to quality and regularly provide them with extensive training in the sale, installation and support of our products.

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We offer a broad array of products to address the needs of a variety of customers seeking mobile communications in maritime, land mobile and aeronautical applications.

Maritime. In the marine market, we offer a range of mobile satellite TV and communications products.

Satellite TV. Our TracVision HD-series satellite TV antennas are designed to offer a high definition TV experience comparable to what a home DIRECTV HDTV subscriber would enjoy. Our TracVision HD7 uses a 61-cm diameter satellite TV antenna to receive signals from two DIRECTV Ka-band satellites and one DIRECTV Ku-band satellite simultaneously. It includes an Internet Protocol enabled antenna control unit as well as optional antenna control via a free TracVision application for use on an Apple iPhone. We believe the TracVision HD7 was the first marine antenna to offer this combination of capabilities. Our TracVision HD11 uses a 1-meter diameter antenna to receive all Ku-band and DIRECTV Ka-band satellite television signals without changing out hardware elements. The Ku-band will work with any modern satellite television service in the world. The Ka-band will receive DIRECTV HDTV. Like the TracVision HD7, it features a customer application for the Apple iPhone or iPad to enable easy control of the system.

Our TracVision M-series satellite TV antennas are designed with the full spectrum of vessel sizes in mind, ranging from recreational vessels as small as 20 to 25 feet to large commercial vessels. The award-winning family of marine TracVision products include the 32-cm diameter TracVision M1, 37-cm diameter TracVision M3, 45-cm diameter TracVision M5, 60-cm diameter TracVision M7, and 81.3-cm in diameter TracVision M9, each of which employs a high-efficiency circular antenna. These products are compatible with Ku-band HDTV programming as well as high-powered regional satellite TV services around the globe, based on available signal strength and antenna size requirements.

Satellite Phone & Internet. Our mini-VSAT Broadband network offers an end-to-end solution for offshore connectivity. This unified C/Ku-band Broadband service enables us to offer commercial, leisure and government customers an integrated hardware and service solution for mobile communications and seamless region-to-region roaming. We design and manufacture the onboard TracPhone terminals, own the hub equipment installed in leased earth stations, lease the satellite capacity, manage the network, and provide 24/7/365 after-sale support. Because we manufacture the onboard hardware, we can integrate the full rack of discrete below decks equipment typically used on traditional VSAT systems into a single, streamlined unit that is significantly easier to deploy than competing VSAT solutions. Our mini-VSAT Broadband network utilizes ArcLight spread spectrum modem technology, developed by ViaSat. This spread spectrum approach reduces the broadcast power requirements and the pointing accuracy necessary to track the high-bandwidth C and Ku-band satellites that carry the service. The resulting efficiencies allowed us to develop and bring to market our TracPhone terminals. Our 60-cm diameter TracPhone V7 Ku-band antenna is 85% smaller by volume and 75% lighter than alternative 1-meter VSAT antennas. Our 37-cm diameter TracPhone V3 Ku-band antenna is practical for use on smaller vessels as well as land vehicles. We believe that the TracPhone V3 is the smallest maritime VSAT system currently available. Our dual-mode TracPhone V11 antenna seamlessly tracks both C- and Ku-band satellites, making it the only 1-meter maritime VSAT antenna to deliver seamless, fully global coverage outside of the far polar regions. In June 2013, we introduced our new TracPhone V-IP Series product line for the mini-VSAT Broadband network, which is an upgrade to the existing TracPhone V-Series, enabling easier installation along with network management tools and multicast reception.

We offer a variety of rate plans that typically require an initial commitment of one or more years with a one year auto renewal feature. Fixed rate plan prices vary depending on the data rate, and while customers can consume unlimited data, there are restrictions over the use of certain protocols such as those that stream video content. Metered plans are billed monthly based on the amount of data consumed. Introduced in 2013, unrestricted plan prices vary depending on a minimum monthly data quota with the ability to add more data for an incremental charge. Unrestricted plans allow users to consume unlimited data with no protocol restrictions, meaning customers can stream video content to their vessels or use popular voice services like Skype™.

The high bandwidth offered by the Ku-band satellites also permits faster data rates than those supported by Inmarsat's L-band satellites. TracPhone V7-IP and V11-IP customers may select service packages with Internet data connections offering ship-to-shore satellite data rates as fast as 1 megabits per second or Mbps, and shore-to-ship satellite data rates as fast as 4 Mbps. The TracPhone V3-IP, due to its smaller dish diameter, offers ship-to-shore data rates as fast

as 128 kilobits per second, or Kbps, and shore-to-ship satellite data rates as fast as 2 Mbps. In addition, subscriptions include Voice over Internet Protocol (VoIP) telephone services optimized for use over satellite connections. The TracPhone V7-IP and V11-IP can support two or more simultaneous calls while the TracPhone V3-IP can support one call at a time.
Our mini-VSAT Broadband network currently uses a combination of 19 Ku-band and three global C-band transponders to provide coverage throughout the northern hemisphere and all of the major continents in the southern hemisphere. We currently offer our Ku-band mini-VSAT Broadband service in the Americas, Europe, the Middle East, Africa, Asia-Pacific, and Australian and New Zealand waters. It is our long-term plan to continue to invest in and enhance the mini-VSAT Broadband

network in cooperation with ViaSat under the terms of a 10-year agreement announced in July 2008. In April and July 2013, we more than doubled our mini-VSAT Broadband network capacity in Brazil, Africa and the Asia-Pacific region, following the upgrades in the Caribbean and the European and Middle Eastern regions in late 2012. Under the terms of our revenue sharing arrangement with ViaSat, these types of expansions position us to earn revenue not only from the maritime and land-based use of the mini-VSAT Broadband service but also from aeronautical applications that roam throughout our network.

We are actively engaged in sales efforts for the TracPhone V- IP Series and mini-VSAT Broadband service to government agencies for maritime, military, and emergency responder use. In September 2010, the U.S. Coast Guard awarded us a 10-year, up to $42 million contract to supply TracPhone V7 systems and mini-VSAT Broadband airtime to as many as 216 U.S. Coast Guard cutters. As of December 31, 2013, we have supplied TracPhone V7 systems for approximately 125 U.S. Coast Guard vessels. We are also taking steps to expand our ability to support the commercial maritime market. In March 2011, we signed a contract to provide TracPhone V7 and mini-VSAT Broadband service to Vroon B.V. and its fleet of more than 125 commercial vessels, as of December 31, 2013, approximately 100 systems have shipped. In March 2012, V.Ships, the world's largest independent ship manager serving a fleet of over 1,000 vessels, selected our mini-VSAT Broadband service as its preferred satellite communications solution. In June 2012, Tokyo-based shipping and logistics company, Nippon Yusen Kaisha (NYK Line), selected our TracPhone V7 and mini-VSAT Broadband service, as of December 31, 2013, approximately 120 systems have shipped.

In September 2010, we acquired Virtek Communication, a Norwegian firm that developed CommBox, a ship-to-shore network management product. CommBox, which comprises shipboard hardware, a KVH-hosted or privately owned shore-based hub, and a suite of software applications, offers a range of tools designed to increase communication efficiency, reduce costs, and manage network operations. Key functions include web and data compression and optimization to increase network capacity; remote PC management for customer IT departments; integrated e-mail, web compression, firewalls, and security; least-cost routing; and bandwidth management on multiple communication carriers. CommBox is offered as an option for all TracPhone V Series and TracPhone V-IP Series products (TracPhone VSAT products) and for our Inmarsat-compatible TracPhone and Iridium OpenPort systems. CommBox sales include both the shipboard hardware and optional private shore-based hub, subscriptions to the selected software applications, and monthly system maintenance fees.

We offer Iridium OpenPort hardware and service to be used in conjunction with our mini-VSAT service. Iridium OpenPort service provides data rates up to 128Kpbs and covers the entire world, including the polar regions. We offer the Iridium hardware and service along with our own mini-VSAT solution and our CommBox, which will switch over to the Iridium service if the mini-VSAT service is not available. Our customers might choose to add the Iridium service to expand the geographic coverage of the system, or as a backup service.

In addition to our TracPhone VSAT products and mini-VSAT Broadband service, we also offer a family of Inmarsat-compatible TracPhone products that provide in-motion access to global satellite communications. These products rely on services offered by Inmarsat, a satellite service provider that supports links for phone, fax and data communications as fast as 432 Kbps. The TracPhone FB150, FB250, and FB500 antennas use the Inmarsat FleetBroadband service to offer voice as well as high-speed Internet service. The TracPhone FB150, FB250, and FB500 are manufactured by Thrane & Thrane A/S of Denmark and distributed on an OEM basis by us in North America under the KVH TracPhone brand and distributed in other markets on a non-exclusive basis.

Unlike mini-VSAT Broadband, where we control and sell the airtime, we purchase Inmarsat and Iridium airtime from a distributor and resell it to our customers.

In May 2013, we acquired acquired Headland Media Limited (now known as KVH Media Group), a media and entertainment service company based in the United Kingdom that distributes commercially-licensed news, sports, music, movies and training video content to commercial and leisure customers in the maritime, hotel, and/or retail markets. Sales from KVH Media Group are included in our mobile communications services sales.

Land Mobile. We design, manufacture, and sell a range of TracVision satellite TV antenna systems for use on a broad array of vehicles, including recreational vehicles, buses, conversion vans, and automobiles.

In the RV/bus market, we offer TracVision satellite TV products, intended for both stationary and in-motion use. Our TracVision R1 delivers DIRECTV or DISH network service through a small 31.75cm” diameter dome. Our TracVision

A7 uses hybrid phased-array antenna technology to provide in-motion reception of satellite TV programming in the continental United States using the DIRECTV service. The TracVision A7 product includes a mobile satellite television antenna and an integrated 12V mobile DIRECTV receiver/controller designed specifically for the mobile environment by KVH and DIRECTV. The TracVision A7 stands approximately five inches high and mounts either to a vehicle's roof rack or directly to the vehicle's roof, making it practical for use aboard minivans, SUVs and other passenger vehicles. The TracVision A7 is also popular for tall motor coaches and buses. Automotive customers subscribe to DIRECTV's TOTAL CHOICE MOBILE satellite TV



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programming package, which is specifically promoted for automotive applications. Local channels and network programming are also available as an option for TracVision A7 users as a result of the system's integrated GPS and mobile receiver. At this time, we are the only company authorized by DIRECTV to sell, promote, and activate mobile users for the TOTAL CHOICE MOBILE programming package.

Aeronautical Applications. We designed, developed, and manufactured DIRECTV-compatible satellite TV antennas for use on narrowbody commercial aircraft, such as Boeing's 737 and the Airbus A320, operating in the United States.

Guidance and Stabilization Products

We offer a portfolio of digital compass and fiber optic gyro (FOG)-based systems that address the rigorous requirements of military and commercial customers. Our systems provide reliable, easy-to-use and continuously available navigation and pointing data. Our guidance and stabilization products include our inertial measurement unit for precision guidance, FOGs for tactical navigation as well as pointing and stabilization systems, and digital compasses that provide accurate heading information for demanding applications.

Guidance and Stabilization. Our FOG products use an all-fiber design that has no moving parts, resulting in an affordable combination of precision, accuracy and durability. Our FOG products support a broad range of military applications, including stabilization of remote weapons stations, antennas, radar, optical devices or turrets; image stabilization and synchronization for shoulder-or tripod-mounted weapon simulators; precision tactical navigation systems for military vehicles, and guidance for weapons and unmanned autonomous vehicles. Our FOG products are also 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.

Our TG-6000 IMU is a guidance system that provides precise measurement of motion and acceleration in three dimensions. It uses a three-axis configuration of our high-performance DSP-based (digital signal processing) FOGs integrated with three accelerometers. We believe that this configuration provides outstanding performance, high reliability, low maintenance and easy system integration. The TG-6000 IMU is a component in the U.S. Navy's MK54 lightweight torpedo and is suitable for use in other applications that involve flight control, orientation, instrumentation and navigation, such as unmanned aerial vehicles. The CG-5100, our first commercial-grade IMU, is focused on a wide range of applications such as 3D augmented reality, mobile mapping, platform navigation and GPS augmentation for unmanned vehicle programs, precise mapping and imagery.

Our CNS-5000 continuous navigation system is a self-contained navigation system that combines our FOG-based inertial measurement technology with GPS technology from NovAtel. This navigation solution provides precise position and orientation of a host platform on a continuous basis, even during periods where GPS signals are blocked by natural or man-made obstructions or conditions. The CNS-5000 is designed for demanding commercial applications, such as dynamic surveying, mobile mapping, precision agriculture, container terminal management, and autonomous vehicle navigation, where the ability to determine the precise position and orientation of a piece of equipment or a mobile platform is critical. The CNS-5000 is a commercial-off-the-shelf (COTS) product consisting of a FOG-based inertial measurement unit tightly integrated with GPS within a single enclosure. This design reduces the operational complexities for customers whose products cross international boundaries.

Our open-loop DSP-1750, DSP-3000, and DSP-4000 FOGs provide precision measurement of the rate and angle of a platform's turning motion for significantly less cost than competing closed-loop gyros. These DSP-based products deliver performance superior to analog signal processing devices, which experience greater temperature-sensitive drift and rotation errors. Applications for these products include inertial measurement units, integrated navigation systems, attitude/heading/reference systems, and stabilization of antenna, radar and optical equipment.

The DSP-1750, which we believe to be the world's smallest high performance FOG, is the first to use our E•Core ThinFiber® technology. This thin fiber, which is created at our Tinley Park, Illinois manufacturing facility, is only 170 microns in diameter, enabling longer lengths of fiber to be wound into smaller housings. Since the length of the fiber used in a FOG directly relates to gyro accuracy and performance, this technology enables us to produce smaller and more accurate gyros. The small size and weight of the DSP-1750 make it well suited for applications with size and weight restrictions, such as night vision and thermal imaging systems, aircraft-mounted gimbaled cameras for law enforcement and homeland security, and shipboard optical systems.

The DSP-3000 and DSP-3100 are each slightly larger than a deck of playing cards and offers a variety of interface options to support a range of applications. High-performance 2-axis and 3-axis configurations can be realized by integrating multiple DSP-3000 and DSP-3100 units. Currently, the DSP-3000 and DSP-3100 are used in an array of pointing and

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stabilization applications, including the U.S. Army's Common Remotely Operated Weapon Station (CROWS) to provide the image and gun stabilization necessary to ensure that the weapon remains aimed at its target. We estimate that more than 20 companies have developed or are developing stabilized remote weapons stations that we believe will require similar FOG stabilization capabilities. The larger, militarized dual axis DSP-4000 is designed for use in high-shock and highly dynamic environments, such as gun turret stabilization.

Our 1750 IMU is an advanced 6-degrees-of-freedom sensor designed to integrate easily into the most demanding stabilization, pointing, and navigation applications. It offers enhanced performance at a lower cost than competing systems. The 1750 IMU marries the groundbreaking E•Core ThinFiber® technology of our DSP-1750 FOGs with very low noise, solid state MEMS accelerometers to create a commercial-off-the-shelf IMU. The 1750 IMU offers exceptional precision in a very small form factor, making it suitable for applications where space is limited, such as unmanned and autonomous systems.

In October 2013, we introduced the new DSP-1760 single-axis and multi-axis FOGs offerings with improved performance and ease of integration relative to the DSP-1750. Many customers using our DSP-1750 single-axis and dual-axis FOGs also had requirements for packaged DSP-1750s. Rather than simply designing a housing for the DSP-1750s sensors, we used the 1750 IMU housing and combined it with an improved DSP-1750 design. The result is the DSP-1760 product line, consisting of packaged one, two, or three axes of FOGs, each with two different interface connector options.

Tactical Navigation. Our TACNAV tactical navigation product line employs digital compass sensors and KVH FOGs to offer vehicle-based navigation and pointing systems with a range of capabilities, including GPS backup and enhancement, vehicle position, hull azimuth and navigation displays. Because our digital compass products measure the earth's magnetic field rather than detect satellite signals from the GPS, they are not susceptible to GPS jamming devices.

TACNAV systems vary in size and complexity to suit a wide range of vehicles. Our TACNAV Light is a low-cost, digital compass-based battlefield navigation system specifically designed for non-turreted vehicles, such as high mobility multi-wheeled vehicles (HMMWVs) and trucks. Our TACNAV TLS, a digital compass-based tactical navigation and targeting system, offers a FOG upgrade for enhanced accuracy designed for turreted vehicles, including reconnaissance vehicles, armored personnel carriers and light armored vehicles. Our TACNAV II Fiber Gyro Navigation system offers a compact design, continuous output of heading and pointing data, and a flexible architecture that allows it to function as either a stand-alone navigation module or as the central component of an expanded, multifunctional navigation system.

Our navigation systems function as standalone tools and also aggregate, integrate and communicate critical information from a variety of on-board systems. TACNAV can receive data from systems such as the vehicle's odometer, military and commercial GPS devices, laser rangefinders, turret angle indicators and laser warning systems. TACNAV can also output this data to an on-board computer for retransmission through the vehicle's communications systems to a digital battlefield management application.

Our TACNAV digital compass products have been sold for use aboard U.S. Army, Marine Corps, and Navy vehicles as well as to many foreign countries, including Australia, the United Kingdom, Canada, Germany, Italy, New Zealand, Saudi Arabia, Spain, Sweden, Taiwan, Malaysia and Switzerland. We believe that we are among the leading manufacturers of such systems. Our standard TACNAV products can be customized to our customers' specifications. At customer request, we offer training and other services on a time-and-materials basis.

Sales, Marketing and Support

Our sales, marketing and support efforts target markets that are substantial and require dedicated dealers and distributors to reach end customers. These channels vary from time to time, but currently include targeted efforts to reach the commercial and leisure maritime markets, the RV, high-end automotive and bus markets, and the commercial, industrial and government markets. We believe our brands are well known and well respected by customers within their respective niches. These brands include:

•TracVision-satellite television systems for vessels and vehicles

•TracPhone-two-way satellite communications systems

•mini-VSAT Broadband-broadband mobile satellite communications network

- CommBox-network management hardware and software for maritime communications
- TACNAV-tactical navigation systems for military vehicles
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Our FOGs and digital compass sensors use an alphanumeric model numbering sequence such as C-100, DSP-1750 IMU, DSP-3000, DSP-4000, CNS-5000, CG-5100, and TG-6000 IMU.

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We sell our mobile satellite communications products directly and through an international network of independent retailers, chain stores and distributors, as well as to manufacturers of vessels and vehicles.
We sell media content directly through our KVH Media Group, headquartered in Leeds.
Our European headquarters, which is located in Denmark, coordinates our sales, marketing and support efforts for our mobile satellite communications products in Europe, the Middle East, and Africa. Asian (excluding Japanese) and Australia/New Zealand sales are managed through our office located in Singapore. Japanese sales are managed through our office in Japan. All international offices are managed under the oversight of our North American sales and marketing office. Standalone CommBox sales are managed by our Norwegian subsidiary in cooperation with members of our satellite sales teams in all offices worldwide. See note 13 of the notes to our consolidated financial statements for information regarding our geographic segments.
We sell our guidance and stabilization products directly to U.S. and foreign governments and government contractors, as well as through an international network of authorized independent sales representatives. This same network also sells our FOG products to commercial/industrial entities.
In 2013, purchases of TACNAV products and services by the U.S. Army Program Office - Saudi Arabian National Guard (SANG) represented 12% of our total sales.

Backlog

Backlog is not a meaningful indicator for predicting revenue in future periods. Commercial resellers for our mobile satellite communications products and legacy products do not carry extensive inventories and rely on us to ship products quickly. Generally due to the rapid delivery of our commercial products, our backlog for those products is not significant.
Our backlog for all products and services was approximately \$20.5 million, \$35.0 million, and \$22.1 million on December 31, 2013, 2012, and 2011, respectively. As of December 31, 2013, our backlog was scheduled for fulfillment in 2014 except for \$5.0 million scheduled for fulfillment in 2015. The decrease in backlog of \$14.5 million from December 31, 2012 to December 31, 2013 was primarily a result of the fulfillment of the order for TACNAV products and services received in June 2012 from SANG and decreased orders for FOGs, partially offset by additional TACNAV orders. The increase in backlog of \$12.9 million from December 31, 2011 to December 31, 2012 was primarily a result of the order for TACNAV products and services received in June 2012 from SANG. This increase was partially offset by decreased orders for FOGs.
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 or media content service sales in our backlog even though many of our satellite connectivity and media content 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 December 31, 2013, our backlog included approximately \$12.2 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.

Intellectual Property

Our ability to compete effectively depends to a significant extent on our ability to protect our proprietary information. We rely primarily on patents and trade secret laws, confidentiality procedures and licensing arrangements to protect our intellectual property rights. We own approximately 28 U.S. and foreign patents and have additional patent applications that are currently pending. We also register our trademarks in the United States and other key markets where we do business. Our patents will expire at various dates between June 2014 and July 2028. We enter into confidentiality agreements with our consultants, key employees and sales representatives, and maintain controls over access to and distribution of our technology, software and other proprietary information. 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.

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.

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From time to time, we have faced claims by third parties that our products or technologies infringe their patents or other intellectual property rights, and we may face similar claims in the future. Any claim of infringement could cause us to incur substantial costs defending against the claim, even if the claim is invalid, and could distract the attention of our management. If any of our products is 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 seek to 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.

Manufacturing

Manufacturing operations for our mobile satellite communications and navigation products consist of light manufacture, final assembly and testing. Manufacturing operations for our FOG products are more complex. We produce specialized optical fiber, FOG components and sensing coils and combine them with components purchased from outside vendors for assembly into finished goods. We own optical fiber drawing towers with which we produce the specialized optical fiber that we use in all of our FOG products. Excluding the CommBox product, which we manufacture in Norway, we manufacture, warehouse and distribute our mobile satellite communications products at our headquarters in Middletown, Rhode Island. We manufacture our navigation and FOG products in our facility located in Tinley Park, Illinois.

We contract with third parties for fabrication and assembly of printed circuit boards, injection-molded plastic parts, machined metal components, connectors and housings. We believe there are a number of acceptable vendors for the components we purchase. We regularly evaluate both domestic and foreign suppliers for quality, dependability and cost effectiveness. In some instances we utilize sole-source suppliers to develop strategic relationships to enhance the quality of materials and save costs. Our manufacturing processes are controlled by an ISO 9001:2008-certified quality standards program.

Competition

We encounter significant competition in all of our markets, and we expect this competition to intensify in the future. Many of our primary competitors are well-established companies and some have substantially greater financial, managerial, technical, marketing, operational and other resources than we do.

In the marine market for satellite TV equipment, we compete 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 communications equipment, we compete 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 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 new announced Global Xpress service), MTN/SeaMobile, Speedcast, CapRock, and Airbus Defense & Space.

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

In the markets for media content, we compete with Swank Motion Pictures and NewspaperDirect.

In the markets for mobile satellite communications technology, the principal competitive factors are product size, features, design, performance, reliability and price. In the markets for media content, the principal competitive factors are license rights, distribution and price.

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. We believe the principal competitive factors in these markets are performance, size, reliability, durability and price.

Research and Development

Focused investments in research and development are critical to our future growth and competitive position in the marketplace. Our research and development efforts are directly related to timely development of new and enhanced products and services that are central to our core business strategy. The industries in which we compete are subject to rapid technological developments, evolving industry standards, changes in customer requirements, and new product and service introductions and enhancements. As a result, our success depends in part upon our ability, on a cost-effective and timely basis, to continue to enhance our existing products and to develop and introduce new products and services that improve performance and meet customers' operational and cost requirements. Our current research and development efforts include projects to achieve

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additional cost reductions in our products and the development of new products and services for our existing marine and land mobile communications markets, and navigation, guidance and stabilization application markets. For example:

- In June 2013, we introduced our new TracPhone V-IP Series Product line for the mini-VSAT Broadband network enabling easier integration along with network management tools and multicast reception;
- In October 2013, we introduced the new DSP-1760 single-axis and multi-axis FOG offerings with improved performance and ease of integration relative to the DSP-1750; and
- Later this year, we plan to offer new value-added services to our mini-VSAT Broadband customers using our IP-MobileCast software.

Our research and development activities consist of projects funded by us, and projects funded with the assistance of customer-funded contract research. Our customer-funded research efforts are made up of contracts with defense and OEM customers, whose performance specifications are unique to their product applications. Defense and OEM research often results in new product offerings. We strive to be the first company to bring a new product to market, and we use our own funds to accelerate new product development efforts.

Government Regulation

Our manufacturing operations are subject to various laws governing the protection of the environment and our employees. These laws and regulations are subject to change, and any such change may require us to improve our technologies, incur expenditures, or both, in order to comply with such laws and regulations.

We are subject to compliance with the U.S. Export Administration Regulations. Some of our products have military or strategic applications, and are on the Munitions List of the U.S. International Traffic in Arms Regulations. These products require an individual validated license to be exported to certain jurisdictions. The length of time involved in the licensing process varies and can result in delays of the shipping of the products. Sales of our products to either the U.S. government or its prime contractors are subject to the U.S. Federal Acquisition Regulations.

We are also subject to the laws and regulations of the U.S. and foreign jurisdictions in which we offer and sell our satellite communication products and services, including those of the European Union, Brazil, Norway, Singapore and Japan. These laws and regulations, as well as the interpretation and application of these laws and regulations, are subject to change and any such change may affect our ability to offer and sell existing and planned satellite communications products and services.

Employees

On December 31, 2013, we employed 471 full-time employees. We also employ part-time employees as well as temporary or contract personnel, when necessary, to provide short-term and/or specialized support for production and other functional projects.

We believe our future success will depend upon the continued service of our key technical and senior management personnel and upon our continued ability to attract and retain highly qualified technical and managerial personnel. None of our employees is represented by a labor union. We have never experienced a work stoppage and consider our relationship with our employees to be good.

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ITEM 1A. Risk Factors

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors in evaluating our business. If any of these risks, or other risks not presently known to us or that we currently believe are not significant, develops into an actual event, then our business, financial condition and results of operations could be adversely affected. If that happens, the market price of our common stock could decline.

Our revenues and results of operations have been and may continue to be adversely impacted by worldwide economic turmoil, credit tightening, high fuel prices and associated declines in consumer spending.

Worldwide economic conditions have experienced a significant downturn over the last several years, including slower economic activity, tightened credit markets, inflation and deflation concerns, increased fuel prices, decreased consumer confidence, reduced corporate profits, reduced or canceled capital spending, adverse business conditions and liquidity concerns. These conditions make it difficult for businesses, governments and consumers to accurately forecast and plan future activities. Many governments are experiencing significant deficits that 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 could continue to slow or suspend spending on our products and services. We may also incur increased credit losses and need to increase our allowance for doubtful accounts, which would have a negative impact on our earnings and financial condition. For example, our bad debt expense increased $0.5 million in 2013 from 2012, driven by bad debt expense associated with airtime sales for our mini-VSAT Broadband service.

We cannot predict the timing, duration or ultimate impact of the downturn in our markets. We expect our business to continue to be adversely impacted by this downturn.

Net sales of many of our mobile communications products are largely generated by discretionary consumer spending, and demand for these products may continue to decline as a result of continuing weak regional and global economic conditions. For example, sales of our mobile communications products decreased 2% from 2012 to 2013, and the declines were more extensive in certain areas such as Asia and Europe. Consumer spending tends to decline during recessionary periods and may decline at other times. Some consumers have chosen not to purchase our mobile communications products due to a perception that they are luxury items, and these trends could continue or accelerate. As global and regional economic conditions change, including uncertainty regarding federal budgetary pressures, overseas sovereign debt crisis, the general level of interest rates, fluctuating oil prices and demand for durable consumer products, demand for our products could continue to be materially and adversely affected.

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

We have historically sold a substantial portion of our FOG systems to a U.S. government contractor for the U.S. Army's CROWS III program. A reduction in sales to the U.S. government, 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. We expect that the drawdown of troops from Afghanistan will continue to adversely affect sales of our FOG products to contractors to the U.S. government.

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

Appropriations can also be affected by legislation that addresses larger budgetary issues of the U.S. government. For example, 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, including spending for our FOG products for the U.S. Army's CROWS III program.

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

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

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

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

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

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.

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

Our mobile communications products and services historically have had lower product and service gross margins than our guidance and stabilization products. As a result of the completion of the product delivery portion of the SANG contract and other factors, we expect a shift in our sales mix towards mobile communications products and services, which would likely cause lower gross margins in the future. Moreover, our mobile communications services have lower gross margins than our overall average gross margins, and those services have been increasing as a percentage of net sales. If and to the extent that our mobile communications services continue to increase as a percentage of net sales, we expect to generate lower overall gross margins, although this trend may be somewhat offset if we continue to generate increased efficiencies of scale in the delivery of our mobile communications services.

We must generate a certain level of sales of the TracPhone V-series products and our mini-VSAT Broadband service in order to improve our service gross margins.

As a result of our mini-VSAT Broadband network infrastructure, our cost of service sales includes certain fixed costs that do not generally vary with the volume of service sales, and we have almost no ability to reduce these fixed costs in the short term. These fixed costs will increase if we further expand our network to accommodate additional subscriber demand and/or coverage area expansion. If sales of our TracPhone V-series products and the mini-VSAT

Broadband service do not generate the level of revenue that we expect or decline, our service gross margins may remain below historical levels or decline. The failure to improve our mini-VSAT Broadband service gross margins would have a material adverse effect on our overall profitability.

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

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

In the marine market for satellite TV equipment, we compete 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 communications equipment, we compete 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 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 new announced Global Xpress service), MTN/SeaMobile, Speedcast, CapRock, and Airbus Defense & Space.

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

In the markets for media content, we compete with Swank Motion Pictures and NewspaperDirect.

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;
- 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; 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 60-centimeter (cm) diameter TracPhone V7 and 37-cm diameter TracPhone V3 antennas along with our integrated Ku-band mini-VSAT Broadband service, or with our C/Ku-band mini-VSAT Broadband service and our TracPhone V11.

Our TracPhone V3 and V7 systems offer customers a range of benefits due to their integrated design, hardware costs that are lower than existing maritime Ku-band VSAT systems, and spread spectrum technology. We currently compete against companies that offer established maritime Ku-band VSAT service using, in some cases, antennas 1-meter in diameter or larger. While we are unaware of any company offering a 37-cm VSAT solution comparable to our TracPhone V3, we are encountering regional competition from companies offering 60-cm VSAT systems and services, which are comparable in size to our TracPhone V7. Likewise, our TracPhone V11, at 1.1-meter in diameter, is approximately 85% smaller and lighter than competing C-band maritime VSAT systems, which uses 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-series products, which could potentially reduce the appeal of our solution, increase price competition and adversely affect sales. For example, Inmarsat has announced a new global Ka-band mobile VSAT service called Global Xpress which they claim will be faster and have a lower price per megabit than existing Ku-band services that might adversely impact sales of KVH’s mini-VSAT Broadband service and related equipment. Moreover, consumers may choose other services such as FleetBroadband or Iridium OpenPort for their service coverage and potentially lower hardware costs despite higher service costs and slower data rates.

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

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

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.

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 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 from the Middle East;
- priorities for current battlefield operations;
- new military and operational doctrines that affect military equipment needs;
- sales cycles that are long and difficult to predict;
- shifting response time and/or delays in the approval process associated with the export licenses we must obtain prior to the international shipment of certain of our military products;
- delays in military procurement schedules; and
- delays in the testing and acceptance of our products, including delays resulting from changes in customer specifications.

These factors can cause substantial fluctuations in sales of our TACNAV and FOG products from period to period. For example, sales of our FOG products increased $0.7 million, or 3%, from 2011 to 2012 and increased $1.1 million, or 5%, from 2012 to 2013. However, sales of our FOG products decreased $3.0 million, or 39%, from the fourth quarter of 2012 to the fourth quarter of 2013. TACNAV product sales, increased $1.0 million, or 5% from 2011 to 2012 and decreased $0.6 million, or 3% from 2012 to 2013. TACNAV service sales increased $4.8 million, or 88% from 2012 to 2013. The increases in TACNAV product sales in 2012 and service sales in 2013 were due primarily to the $35.6 million SANG order received in June 2012, the largest TACNAV order in our history. The product shipments on the SANG order were completed in the second quarter of 2013. The remaining $1.3 million in contract value for the services portion of the SANG order as of December 31, 2013 is estimated for completion in the first quarter of 2014. We do not currently have in backlog another order of comparable

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size for 2014 or future years, and as a result we expect that our TACNAV service revenues will decline in 2014 from 2013 and our TACNAV product revenue may decline as well in 2014. The U.S. government may change defense spending priorities at any time. Moreover, government customers such as the U.S. Coast Guard and their contractors can generally cancel orders for our products for convenience or decline to exercise previously disclosed contract options. Even under firm orders with government customers, funding must often be appropriated in the budget process in order for the government to complete the contract. The cancellation of or failure to fund orders for our products could further reduce our net sales and results of operations.

Sales of our 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 one million dollars. For example, we received orders for TACNAV products and services of $7.2 million, $35.6 million and $2.8 million in January 2013, June 2012 and June 2012, respectively. Orders of this size are often unpredictable and difficult to replicate. As a result, the delay or cancellation of a single order could materially reduce our net sales and results of operations. We periodically experience repeated and unanticipated delays in defense orders, which make our revenues and operating results less predictable. Because our guidance and stabilization products typically have relatively higher product gross margins than our mobile communications products, the loss of an order for guidance and stabilization products could have a disproportionately adverse effect on our results of operations.

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

We derive a significant portion of our guidance and stabilization revenues from a small number of customers, many of whom are contractors for the U.S. government. For example, for the year ended December 31, 2013, SANG accounted for approximately 12% of our total sales, and product deliveries to this customer under our existing contract were completed in the second quarter. We do not currently have in backlog another order of comparable size for 2014 or future years. The loss of business from any of these customers could substantially reduce our net sales and results of operations and could seriously harm our business. Since we are often awarded a contract as a subcontractor to a major defense supplier that is engaged in a competitive bidding process as prime contractor for a major weapons procurement program, our revenues depend significantly on the success of the prime contractors with which we align ourselves.

Commercial sales of our guidance and stabilization products are unpredictable.

Increased 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 FOGs, 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. 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 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 to directly provide two-way satellite communications. We currently offer satellite television products compatible with the DIRECTV and DISH Network services in the United States, the Bell TV service in Canada, the Sky Mexico service and various other regional satellite TV services in other parts of the world.

SES, Eutelsat, Sky Perfect-JSAT, Telesat, EchoStar, Intelsat and Star One currently provide the satellite capacity to support the mini-VSAT Broadband service and our TracPhone V-series products. Intelsat also currently provides our C-Band satellite coverage. In addition, we have agreements with various teleports and Internet service providers around the globe to support the mini-VSAT Broadband service. We rely on Inmarsat for satellite communications

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

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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 60-cm diameter TracPhone V7 antenna, our 37-cm diameter TracPhone V3 antenna, and our 1.1-meter diameter TracPhone V11, and any disruption in the availability of this technology could adversely affect sales.

Our mini-VSAT Broadband service relies on spread spectrum technology developed with ViaSat, Inc., for use with satellite capacity controlled by SES, Eutelsat, Sky Perfect-JSAT, Telesat, Echostar, Intelsat and Star One. Our TracPhone two-way broadband satellite terminals 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-series products and our mini-VSAT Broadband service could be disrupted if we fail to receive approval from regulatory authorities to provide our spread spectrum service in the waters of various countries where our customers operate or if there are issues with the availability of the ArcLight maritime modems.

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

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

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

Although we have historically manufactured and sourced raw materials for the majority of our products domestically, in order for us to compete with lower priced competitive products while also improving our profitability, 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.

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

Excluding the CommBox product, which we manufacture in Norway, we currently manufacture all of our mobile communications products at our manufacturing facility in Middletown, Rhode Island, and the majority of our guidance and stabilization products at our facility in Tinley Park, Illinois. Some of our production processes are complex, and we may be unable to respond rapidly to the loss of the use of either production facility. For example, our production facilities use some specialized equipment that may take time to replace if they are damaged or become unusable for any reason. In that event, shipments would be delayed, which could result in customer or dealer dissatisfaction, loss of sales and damage to our reputation. Finally, we have only a limited capability to increase our manufacturing capacity in the short term. If short-term demand for our products exceeds our manufacturing capacity, our inability to fulfill orders in a timely manner could also lead to customer or dealer dissatisfaction, loss of sales and damage to our reputation.

We depend on sole or limited source suppliers, and any disruption in supply could impair our ability to deliver our products on time or at expected cost.

We obtain many key components for our products from third-party suppliers, and in some cases we use a single or a limited number of suppliers. Any interruption in supply could impair our ability to deliver our products until we identify and qualify a new source of supply, which could take several weeks, months or longer and could increase our costs significantly. Suppliers might change or discontinue key components, which could require us to modify our product designs. For example, in the past, we have experienced changes in the chemicals used to coat our optical fiber, which changed its characteristics and thereby necessitated design modifications. 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

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purchase components through purchase orders, which expose us to potential price increases and termination of supply without notice or recourse. It is generally not our practice to carry significant inventories of product components, and this could magnify the impact of the loss of a supplier. If we are required to use a new source of materials or components, it could also result in unexpected manufacturing difficulties and could affect product performance and reliability. In addition, from time to time, lead times for certain components can increase significantly due to imbalances in overall market supply and demand. This, in turn, could limit our ability to satisfy the demand for certain of our products on a timely basis, and could result in some customer orders being rescheduled or canceled.

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

We market and sell our mobile communications products and services through an international network of independent retailers, chain stores and distributors, as well as to manufacturers of marine vessels, 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 may sell products of other companies, including competing products, and are generally not required to purchase minimum quantities of our products.

Our new media and entertainment business relies on licensing arrangements with content providers, and the loss of or changes in those arrangements could adversely affect 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 potential price increases. The loss of content could adversely affect the attractiveness of our media and entertainment offerings, which could adversely affect our revenues. Any increase in the cost of content could reduce the profitability of these offerings.

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

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

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

We have previously expanded our operations to pursue existing and potential market opportunities, and we are continuing to expand our international operations. For example, we recently opened a new sales office in Japan to service local customers, and we recently expanded our service offerings through the acquisition of Headland Media Limited (now known as the KVH Media Group). This growth placed a strain on our personnel, management, financial and other resources. If any portion of our business grows more rapidly than we anticipate and we fail to manage that growth properly, we may incur unnecessary expenses, and the efficiency of our operations may decline. If we are unable to adjust our operating expenses on a timely basis in response to changes in revenue cycles, our results of operations may be harmed. To manage changes in our rate of growth effectively, we must, among other things:

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

We identified a material weakness in our internal control over financial reporting as of December 31, 2012, and the occurrence of this or any other material weakness could have a material adverse effect on our ability to report accurate financial information in a timely manner.

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

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

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

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

Our success depends on the services of our executive officers.

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

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

Historically, sales to customers outside the United States and Canada have accounted for a significant portion of our net sales, and our acquisition of Headland Media Limited (now known as the KVH Media Group) in May 2013 increased our sales in new foreign markets. We have foreign sales offices in Denmark, the United Kingdom, Singapore, Japan, Norway and Cyprus, as well as a subsidiary in Brazil that manages local sales. We otherwise support our international sales from our operations in the United States. Our limited operations in foreign countries may impair our ability to compete successfully in international markets and to meet the service and support needs of our customers in countries where we have little to no infrastructure. We are subject to a number of risks associated with our international business activities, which may increase our costs and require significant management attention. These risks include:

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

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- protectionist laws and business practices that favor local competitors, which could slow our growth in international markets;
- potentially longer sales cycles, which could slow our revenue growth from international sales;
- potentially longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- losses arising from foreign currency exchange rate fluctuations; and
- economic and political instability in some international markets.

Exports of certain guidance and stabilization products are subject to the 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.

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

Our ability to compete depends significantly upon our patents, our source code and our other proprietary technology. The steps we have taken to protect our technology may be inadequate to prevent others from using what we regard as our technology to compete with us. Our patents could expire or be challenged, invalidated or circumvented, and the rights we have under our patents could provide no competitive advantages. Existing trade secrets, copyright and trademark laws offer only limited protection. In addition, the laws of some foreign countries do not protect our proprietary technology to the same extent as the laws of the United States, which could increase the likelihood of misappropriation. Furthermore, other companies could independently develop similar or superior technology without violating our intellectual property rights. Any misappropriation of our technology or the development of competing technology could seriously harm our competitive position, which could lead to a substantial reduction in net sales.

If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome, disruptive and expensive, distract the attention of management, and there can be no assurance that we would prevail.

Also, we have delivered certain technical data and information to the U.S. government under procurement contracts, and it may have unlimited rights to use that technical data and information. There can be no assurance that the U.S. government will not authorize others to use that data and information to compete with us.

Claims by others that we infringe their intellectual property rights could harm our business and financial condition.

Our industries are characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. We cannot be certain that our products do not and will not infringe issued patents, patents that may be issued in the future, or other intellectual property rights of others.

We do not generally conduct exhaustive patent searches to determine whether the technology used in our products infringes patents held by third parties. In addition, product development is inherently uncertain in a rapidly evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies.

From time to time we have faced claims by third parties that our products or technology infringe their patents or other intellectual property rights, and we may face similar claims in the future. Any claim of infringement could cause us to incur substantial costs defending against the claim, even if the claim is invalid, and could distract the attention of our management. If any of our products are found to violate third-party proprietary rights, we may be required to pay substantial damages. In addition, we may be required to re-engineer our products or obtain licenses from third parties to continue to offer our products. Any efforts to re-engineer our products or obtain licenses on commercially reasonable terms may not be successful, which would prevent us from selling our products, and, in any case, could substantially increase our costs and have a material adverse effect on our business, financial condition and results of operations.

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Cybersecurity breaches could expose us to liability, damage our reputation, require us to incur significant costs or otherwise adversely affect our financial results.

We retain sensitive data, including intellectual property, proprietary business information and personally identifiable information of our employees and customers on our computer networks. Although we take protective measures and endeavor to modify them as circumstances warrant, invasive technologies and techniques continue to evolve rapidly, and our computer systems, software and networks may be vulnerable to unauthorized access, misuse, computer viruses or other malicious code and other events that could have a security impact. Any security breach may compromise information stored on our networks and may result in significant data losses or theft of our, our customers', our business partners' or our employees' intellectual property, proprietary business information or personally identifiable information.

If any of these events were to occur, they could lead to the loss of sensitive information, cause us to lose existing customers and fail to attract new customers, as well as subject us to regulatory actions, litigation, fines or damage to our reputation, and could have a material adverse effect on our financial position, results of operations or cash flows.

Fluctuations in our quarterly net sales and results of operations could depress the market price of our common stock.

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

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

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

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

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

Deferred tax assets are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carry forwards. A valuation allowance reduces deferred tax assets to estimated realizable value, which assumes that it is more likely than not that we will be

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able to generate sufficient future taxable income to realize the net carrying value. We review our deferred tax assets and valuation allowance on a quarterly basis. As part of our review, we consider positive and negative evidence, including cumulative results in recent years.

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

The market price of our common stock may be volatile.

Our stock price has historically been volatile. During the period from January 1, 2012 to December 31, 2013, the trading price of our common stock ranged from $7.61 to $15.00. Many factors may cause the market price of our common stock to fluctuate, including:

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

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

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

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

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Acquisitions may disrupt our operations or adversely affect our results.

We evaluate strategic acquisition opportunities to acquire other businesses as they arise, such as our acquisition of Headland Media Limited (now known as the KVH Media Group) in May 2013. The expenses we incur evaluating and pursuing this and other such acquisitions could have a material adverse effect on our results of operations. For example, we incurred approximately $0.9 million in connection with the acquisition of the KVH Media Group. If we acquire a business, we may be unable to manage it profitably or successfully integrate its operations with our own. Moreover, we may be unable to realize the strategic, financial, operational and other benefits we anticipate from any acquisition. Competition for acquisition opportunities could increase the price we pay for businesses we acquire and could reduce the number of potential acquisition targets. Further, our approach to acquisitions may involve a number of special financial and business risks, such as:

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

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

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

- the ability of our Board of Directors to issue preferred stock, and determine its terms, without a stockholder vote;
- the classification of our Board of Directors, which effectively prevents stockholders from electing a majority of the directors at any one annual meeting of stockholders;
- the limitation that directors may be removed only for cause by the affirmative vote of the holders of two-thirds of our shares of capital stock entitled to vote;
- the prohibition against stockholder actions by written consent;
- the inability of stockholders to call a special meeting of stockholders; and
- advance notice requirements for stockholder proposals and director nominations.

ITEM 1B. Unresolved Staff Comments

None.

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ITEM 2. Properties

The following table provides information about our facilities as of December 31, 2013.

| Location | Type | Principal Uses | Approximate Square Footage | Ownership | Lease Expiration |
|---|---|---|---|---|---|
| Middletown, Rhode Island | Office | Corporate headquarters, research and development, sales and service, marketing and administration | 75,000 | Owned | — |
| Middletown, Rhode Island | Plant and warehouse | Manufacturing and warehousing (mobile communications products) | 75,300 | Owned | — |
| Tinley Park, Illinois | Plant and warehouse | Manufacturing, warehousing, research and development (guidance and stabilization products) | 101,000 | Owned | — |
| Kokkedal, Denmark | Office and warehouse | European headquarters, sales, marketing and support | 11,000 | Leased | May 2014 |
| Horten, Norway | Office | Research and development, sales, marketing and support | 4,400 | Leased | December 2018 |
| Singapore | Office | Asian headquarters, sales office | 2,000 | Leased | May 2014 |
| Japan | Office | Japanese, sales office | 600 | Leased | July 2016 |
| Leeds, UK | Office | Audio/video production, sales and support | 2,700 | Leased | April 2018 |
| Liverpool, UK | Office | Maritime sales, news production, marketing and support | 3,400 | Leased | June 2023 |
| Manila, Philippines | Office | News production | 1,000 | Leased | February 2014 |
| Limassol, Cyprus | Office | Sales | 600 | Leased | Month-to-Month |
| Walport, New Jersey | Office | Video distribution | 600 | Leased | Month-to-Month |

ITEM 3. 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 management’s opinion, is likely to materially harm our business, results of operations, financial condition or cash flows.

ITEM 4. Mine Safety Disclosures

Not applicable.

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PART II

ITEM 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information. Our common stock trades on the NASDAQ Global Market under the symbol “KVHI”. The following table provides, for the periods indicated, the high and low sale prices for our common stock as reported on the NASDAQ Global Market.

| | High | Low |
|---|---|---|
| Year Ended December 31, 2013: | | |
| First quarter | $15.00 | $11.98 |
| Second quarter | 13.89 | 12.11 |
| Third quarter | 14.62 | 12.66 |
| Fourth quarter | 14.27 | 12.71 |
| Year Ended December 31, 2012: | | |
| First quarter | $10.98 | $7.61 |
| Second quarter | 12.95 | 8.51 |
| Third quarter | 14.50 | 11.70 |
| Fourth quarter | 14.66 | 10.38 |

Stockholders. As of March 13, 2014, we had 89 holders of record of our common stock. This number does not include stockholders for whom shares were held in a nominee or “street” name.

Dividends. We have never declared or paid cash dividends on our capital stock, and we have no plan to pay any cash dividends in the foreseeable future. We currently intend to retain any future earnings to finance our operations and future growth. In addition, the terms of our bank line of credit place restrictions on our ability to pay cash dividends on our common stock.

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

During the year ended December 31, 2011, we repurchased 457,667 shares of our common stock in open market transactions at a cost of $3.7 million. We did not repurchase any shares of our common stock in open market transactions during the years ended December 31, 2013 and 2012.

During the year ended December 31, 2013, 60,699 vested restricted shares were surrendered in satisfaction of tax withholding obligations at an average price of $13.63 per share.

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STOCK PERFORMANCE GRAPH

The following graph compares the performance of our cumulative stockholder return with that of the NASDAQ Composite Index, a broad equity market index, and the NASDAQ Telecommunications Index, a published industry index. The cumulative stockholder returns for shares of our common stock and for the market indices are calculated assuming $100 was invested on December 31, 2008. We paid no cash dividends during the periods shown. The performance of the market indices is shown on a total return (dividends reinvested) basis. Measurement points are the last trading days of the years ended December 2008, 2009, 2010, 2011, 2012 and 2013.

| | Value of investments as of December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| KVH Industries, Inc. | $100 | $285 | $231 | $150 | $270 | $252 |
| NASDAQ Composite | 100 | 144 | 168 | 165 | 191 | 265 |
| NASDAQ Telecommunications | 100 | 148 | 154 | 135 | 137 | 170 |

ITEM 6. Selected Financial Data

We have derived the following selected financial data from our audited consolidated financial statements. You should read this data in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Item 8. Financial Statements and Supplementary Data.”

In September 2010, we acquired Virtek Communication for approximately $6.5 million. In May 2013, we acquired Headland Media Limited (now known as the KVH Media Group) for approximately $24.2 million. See note 1 to our consolidated financial statements for a summary of significant accounting policies and the effects on the year-to-year comparability of the selected financial data.

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| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| | (in thousands, except per share data) | | | | |
| Consolidated Statement of Operations Data: | | | | | |
| Sales: | | | | | |
| Product | $90,295 | $90,677 | $85,136 | $92,059 | $75,191 |
| Service | 71,993 | 46,435 | 27,400 | 20,184 | 13,869 |
| Net sales | 162,288 | 137,112 | 112,536 | 112,243 | 89,060 |
| Costs and expenses: | | | | | |
| Costs of product sales | 51,518 | 51,775 | 46,598 | 51,348 | 46,552 |
| Costs of service sales | 45,058 | 30,363 | 20,970 | 16,086 | 10,198 |
| Research and development | 12,987 | 12,147 | 11,548 | 10,715 | 8,805 |
| Sales, marketing and support | 28,792 | 24,069 | 23,473 | 18,469 | 16,316 |
| General and administrative | 17,764 | 12,188 | 10,555 | 10,084 | 7,832 |
| Total costs and expenses | 156,119 | 130,542 | 113,144 | 106,702 | 89,703 |
| Income (loss) from operations | 6,169 | 6,570 | (608) | 5,541 | (643) |
| Interest income | 657 | 510 | 297 | 301 | 358 |
| Interest expense | 637 | 323 | 223 | 204 | 89 |
| Other income (expense) | 494 | 86 | 910 | 23 | (20) |
| Income (loss) before income taxes | 6,683 | 6,843 | 376 | 5,661 | (394) |
| Income tax expense (benefit) | 2,150 | 3,263 | (484) | (2,612) | (261) |
| Net income (loss) | $4,533 | $3,580 | $860 | $8,273 | $(133) |
| Per share information: | | | | | |
| Net income (loss) per common share, basic | 0.30 | 0.24 | 0.06 | 0.57 | (0.01) |
| Net income (loss) per common share, diluted | 0.30 | 0.24 | 0.06 | 0.56 | (0.01) |
| Number of shares used in per share calculation: | | | | | |
| Basic | 15,144 | 14,777 | 14,768 | 14,420 | 13,996 |
| Diluted | 15,341 | 15,019 | 15,072 | 14,850 | 13,996 |

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| | (in thousands) | | | | |
| Consolidated Balance Sheet Data: | | | | | |
| Cash, cash equivalents and marketable securities | $55,744 | $38,285 | $30,570 | $37,307 | $41,304 |
| Working capital | 78,933 | 65,242 | 59,778 | 60,571 | 60,690 |
| Total assets | 183,849 | 137,568 | 128,556 | 115,198 | 97,746 |
| Line of credit | 30,000 | 7,000 | 9,000 | — | — |
| Long-term debt, excluding current portion | 7,094 | 3,414 | 3,553 | 3,684 | 3,807 |
| Other long-term obligations | 204 | 140 | 135 | 1,263 | 902 |
| Total stockholders' equity | 116,467 | 105,704 | 96,668 | 96,303 | 81,600 |

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ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the other financial information and consolidated financial statements and related notes appearing elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors, including those discussed under the heading "Item 1A. Risk Factors" and elsewhere in this annual report.

Overview

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

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

We offer precision fiber optic gyro (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.

Our mobile communications service sales include sales earned from satellite voice and Internet airtime services, engineering services provided under development contracts, sales from product repairs, and extended warranty sales. Our mobile communications services sales also include our distribution of commercially-licensed news, sports, music, movies and training video content to commercial and leisure customers in the maritime, hotel, and/or retail markets. 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 TracPhone customers who choose to activate their subscriptions with us. Our service sales have grown as a percentage of total revenue from 24% of our net sales in 2011 to 34% in 2012 to 44% in 2013.

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

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| | (in thousands) | | |
| Mobile communications | $108,151 | $87,685 | $70,202 |
| Guidance and stabilization | 54,137 | 49,427 | 42,334 |
| Net sales | $162,288 | $137,112 | $112,536 |

Net sales to SANG accounted for approximately 12% of our net sales for the year ended December 31, 2013, driven by a TACNAV related order received in 2012 for which the majority of the deliverables were completed in 2013. Net sales to General Dynamics Land Systems—Canada (General Dynamics) accounted for approximately 11% of our net sales for the year ended December 31, 2011, and less than 10% of our net sales for each of the years ended December 31, 2013 and 2012, respectively. The decrease in net sales to General Dynamics from 2011 to 2012 was primarily driven by the timing of deliverables in fulfillment of a large TACNAV related order. The terms and conditions of sales to SANG and General Dynamics are consistent with our standard terms and conditions of product sales as discussed in note 1 of our consolidated financial statements. The SANG receivable balance was current as of December 31, 2013 and the outstanding receivable

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balance as of that date has been paid as of the date of this report. No other customer accounted for more than 10% of our net sales for each of the years ended December 31, 2013, 2012 and 2011, respectively.

We have historically derived a substantial portion of our revenue from sales to customers located outside the United States and Canada. The following table provides, for the periods indicated, sales to specified geographic regions:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| | (in thousands) | | |
| Originating from the Americas locations | | | |
| United States | $86,621 | $71,489 | $62,748 |
| Canada | 14,272 | 11,513 | 17,518 |
| Europe | 7,876 | 12,210 | 8,315 |
| Other | 28,610 | 22,202 | 7,143 |
| Total Americas | 137,379 | 117,414 | 95,724 |
| Originating from European and Asian locations | | | |
| United States | 1,099 | — | — |
| Canada | 39 | — | — |
| Europe | 18,571 | 15,255 | 13,244 |
| Other | 5,200 | 4,443 | 3,568 |
| Total Europe and Asia | 24,909 | 19,698 | 16,812 |
| Net sales | $162,288 | $137,112 | $112,536 |

See note 13 to our consolidated financial statements for more information on our geographic segments.

In addition to our internally funded research and development efforts, we also conduct research and development activities that are funded by our customers. These activities relate primarily to engineering studies, surveys, prototype development, program management and standard product customization. In accordance with accounting principles generally accepted in the United States of America, we account for customer-funded research as service revenue, and we account for the associated research and development costs as costs of service and product sales. As a result, customer-funded research and development are not included in the research and development expense that we present in our statement of operations. The following table presents our total annual research and development effort, representing the sum of research costs of service and product sales and the operating expense of research and development as described in our statement of operations. Our management believes this information is useful because it provides a better understanding of our total expenditures on research and development activities.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| | (in thousands) | | |
| Research and development expense presented on the statement of operations | $12,987 | $12,147 | $11,548 |
| Costs of customer-funded research and development included in costs of service sales | 2,387 | 3,424 | 412 |
| Total consolidated statements of operations expenditures on research and development activities | $15,374 | $15,571 | $11,960 |

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Results of Operations

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| Sales: | | | |
| Product | 55.6 % | 66.1 % | 75.6 % |
| Service | 44.4 | 33.9 | 24.4 |
| Net sales | 100.0 | 100.0 | 100.0 |
| Costs and expenses: | | | |
| Costs of product sales | 31.7 | 37.8 | 41.4 |
| Costs of service sales | 27.8 | 22.1 | 18.6 |
| Research and development | 8.0 | 8.9 | 10.2 |
| Sales, marketing and support | 17.7 | 17.6 | 20.9 |
| General and administrative | 11.0 | 8.9 | 9.4 |
| Total costs and expenses | 96.2 | 95.3 | 100.5 |
| Income (loss) from operations | 3.8 | 4.7 | (0.5) |
| Interest income | 0.4 | 0.3 | 0.3 |
| Interest expense | 0.4 | 0.2 | 0.2 |
| Other income | 0.3 | 0.1 | 0.8 |
| Income before income taxes | 4.1 | 4.9 | 0.4 |
| Income tax expense (benefit) | 1.3 | 2.4 | (0.4) |
| Net income | 2.8 % | 2.5 % | 0.8 % |

Years ended December 31, 2013 and 2012

Net Sales

Product sales decreased in 2013 by $0.4 million, or less than 1%, to $90.3 million from $90.7 million in 2012. The primary reason for the decrease in 2013 was a decrease in sales of our mobile communications products to $47.0 million, or 2%. The decrease was primarily due to a $1.2 million, or 25%, decrease in sales of our land mobile products. The decrease in our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market. Sales of marine products in 2013 were consistent with 2012. Sales of our TracPhone V11 product, which was released in the fourth quarter of 2012, increased as did our TracPhone V7 sales in the Americas. Partially offsetting these increases in marine product sales was decreased sales of our TracPhone V7 product in Asia and Europe. We remain cautious about the prospects for our marine product sales, specifically in Europe and Asia, as a result of ongoing challenges in the global economy. However, we expect our mini-VSAT product sales will continue to grow year-over-year.

Mobile communications product sales originating from our European and Asian subsidiaries decreased $3.3 million, or 18%, in 2013 as compared to 2012. Mobile communications product sales originating from the Americas increased $2.1 million, or 7%, in 2013 as compared to 2012.

Offsetting the decrease in mobile communications product sales was an increase of $0.8 million, or 2%, in sales of guidance and stabilization products. Specifically, sales of our FOG products increased $1.1 million, or 5%, primarily due to increased demand for commercial applications. Partially offsetting the increase in FOG products was decreased sales from the U.S. Army's Common Remotely Operated Weapon Stations (CROWS) III Program. Sales of our TACNAV defense products decreased $0.6 million, or 3%, primarily as a result of decreased product sales related to our SANG contract, the largest contract in our history. The SANG contract contributed $9.8 million and $11.4 million to our product sales in 2013 and 2012, respectively, and we completed delivery of products under the SANG contract in the second quarter of 2013.

We expect that our TACNAV product sales will decrease year-over-year, primarily due to the completion of the SANG product order discussed above. Although we expect that TACNAV sales will continue to grow over the long term, sales on a quarter-to-quarter or year-to-year basis could continue to be very uneven. We also expect that our FOG sales will modestly

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increase year-over-year, primarily due to increased demand for new commercial applications, which is anticipated to be partially offset by reduced FOG demand for the U.S. Army's CROWS III program.
Service sales increased in 2013 by $25.6 million, or 55%, to $72.0 million from $46.4 million in 2012. The primary reason for the increase was a $12.2 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase were $8.8 million in new media services sales arising from our acquisition of Headland Media Limited (now known as the KVH Media Group) in May 2013, and a $4.8 million increase in contracted engineering services driven by construction and program management services provided in connection with the SANG contract. We expect that our mini-VSAT services sales will continue to grow year-over-year primarily from increased TracPhone V11 and V7 activations, an overall increase in our mini-VSAT Broadband customer base, and from the introduction of new value-added services to our mini-VSAT Broadband customers such as IP-MobileCast, which is expected to begin generating service revenue in 2014. We also expect that our contracted engineering services will significantly decrease year-over-year driven by the anticipated completion of the SANG project management services in the first quarter of 2014.
Costs of Sales
Our costs of product sales consist primarily of materials, manufacturing overhead and direct labor used to produce our products. Costs of product sales in 2013 decreased by $0.3 million, or less than 1%, to $51.5 million from $51.8 million in 2012, consistent with the decrease in product sales discussed above.
Our costs of service sales consist primarily of satellite service capacity, depreciation and service network overhead expense associated with our mini-VSAT Broadband network infrastructure, direct network service labor, engineering and related direct costs associated with customer-funded research and development, media materials and distribution costs, service repair material, Inmarsat service costs, as well as product installation costs. Costs of service sales increased by $14.7 million, or 48%, to $45.1 million in 2013 from $30.4 million in 2012. The primary reason for the increase was a $6.2 million increase in airtime costs of service sales for our mini-VSAT Broadband service. Also contributing to the increase was a $5.8 million increase in engineering services costs of sales due primarily to the services provided in connection with the SANG contract discussed above, and a $2.5 million increase in costs of service sales from media services arising from our new KVH Media Group business.
Gross margin from product sales remained consistent at 43% in 2013 and 2012. We anticipate that the gross margin from product sales in 2014 will be consistent with 2013.
Gross margin from service sales increased to 37% in 2013 from 35% in 2012. The increase in our gross margin from service sales was primarily attributable to the service gross margin contributed from our new KVH Media Group business. Also contributing to the gross margin increase was an increase in gross margin for mini-VSAT Broadband service sales to 35% from 31% in the year-ago period. Partially offsetting the increase in gross margin for mini-VSAT broadband service was a significant decrease in gross margin for contracted engineering services as a result of the facility construction, installation and project management services in Saudi Arabia, as these services had a gross margin of approximately 10%.
We anticipate that the gross margin percentage for contracted engineering services will continue to remain at the fourth quarter 2013 level in the first quarter of 2014 before returning closer to historical levels for the remainder of the year, as a result of the anticipated completion of the lower gross margin installation and program management services portion of the SANG contract in the first quarter of 2014.

Although we expect that mini-VSAT Broadband service revenue will continue to increase year-over-year, we do not anticipate the same year-over-year increase in gross margin percentage achieved in 2013. We anticipate that the favorable impact to our mini-VSAT Broadband service margin that we expect to achieve from increased TracPhone V11 and V7 activations, as well as an overall increase in our mini-VSAT Broadband customer base will be partially offset by the additional service costs of introducing new value-added services to our mini-VSAT Broadband customers such as IP-MobileCast in 2014.
Operating Expenses
Sales, marketing and support expense consists primarily of salaries and related expenses for sales and marketing personnel, commissions for both in-house and third-party representatives, other sales and marketing support costs

such as advertising, literature and promotional materials, product service personnel and support costs, warranty-related costs and bad debt expense. Sales, marketing and support expense also includes the entire operating expenses of our subsidiaries in Denmark, Singapore, Brazil and Japan. Sales, marketing and support expense in 2013 increased by $4.7 million, or 20%, to $28.8 million from $24.1 million in 2012. The primary reasons for the increase in 2013 were a $2.7 million increase in sales, marketing and support expense related to our new KVH Media Group business, and our Danish and Japanese subsidiaries, and a $1.0 million increase in warranty expense predominantly associated with our mini-VSAT products.

Also contributing to the increase was a $0.8 million increase in U.S.-based compensation for sales, marketing and support, a $0.5 million increase in bad debt expense mainly related to airtime sales for our mini-VSAT Broadband service , a $0.3 million increase in variable sales expense primarily as a result of the sales relating to the SANG contract and related facility construction, and a $0.2 million increase in demonstration equipment expense. Partially offsetting these increases was a $0.5 million insurance recovery related to misappropriated funds identified at our Danish subsidiary, and a $0.2 million decrease in sales, marketing and support expense related to our Norwegian subsidiary. As a percentage of net sales, sales, marketing and support expense was 18% in 2013, which was consistent with 2012.

We expect that our sales, marketing and support expenses will continue to increase year-over-year, driven by the additional expenses for our new KVH Media Group business and the introduction of new value-added services to our mini-VSAT Broadband customers such as IP-MobileCast.

Research and development expense consists of direct labor, materials, external consultants and related overhead costs that support our internally funded product development and product sustaining engineering activities. Research and development costs are generally expensed as incurred. Research and development expense in 2013 increased by $0.9 million, or 7%, to $13.0 million from $12.1 million in 2012. The primary reason for the increase in 2013 expense was a $0.6 million increase in U.S.-based compensation for research and development personnel driven by the development of our new IP-MobileCast content delivery service. As a percentage of net sales, research and development expense decreased to 8% in 2013 from 9% in 2012.

We expect research and development expense will continue to increase year-over-year due to the continued development efforts associated with the introduction of new value-added services to our mini-VSAT Broadband customers such as IP-MobileCast, as well as new FOG products.

General and administrative expense consists of costs attributable to management, finance and accounting, information technology, human resources, certain outside professional services and other administrative costs. General and administrative expense in 2013 increased by $5.6 million, or 46%, to $17.8 million from $12.2 million in 2012. The primary reason for the increase in 2013 was a $3.9 million increase in general and administrative expense relating to our new KVH Media Group business, and $0.9 million in transaction expenses related to that acquisition. Also contributing to the increase was a $0.5 million increase in U.S.-based employee compensation, and a $0.2 million increase in legal expense. As a percentage of net sales, general and administrative expense increased to 11% in 2013 from 9% in 2012.

We expect general and administrative expense to increase year-over-year, driven primarily by additional expenses for our new KVH Media Group business.

Income Tax Expense

Income tax expense decreased by $1.1 million to $2.2 million in 2013 from $3.3 million in 2012. The decrease in income tax expense is primarily due an income tax benefit from the American Taxpayer Relief Act of 2012, which extended the research and development tax credit for two years to December 31, 2013. As a result of the retroactive extension, a discrete income tax benefit of $0.4 million was recognized in 2013 for qualifying research and development amounts incurred in 2012, and an income tax benefit of $0.4 million was recognized for qualifying research and development amounts incurred in 2013. In 2012, we also recognized a discrete income tax expense of $0.2 million associated with tax shortfalls for non-qualified stock options expirations and shortfalls associated with restricted stock awards vesting. We estimate our effective tax rate for 2014 to be approximately 40%, subject to the effect of unforeseen discrete tax events such as stock option exercise activity and changes in forecasted expectations for pre-tax income.

Years ended December 31, 2012 and 2011

Net Sales

Product sales increased in 2012 by $5.5 million, or 7%, to $90.7 million from $85.1 million in 2011. The primary reason for the increase in 2012 was an increase in sales of our mobile communications products of $4.3 million, or 10%. The increase was primarily due to an increase in sales of our marine products of $5.7 million, or 15%, driven primarily by increased demand for our TracPhone V7 and TracPhone V3 products, as well as our new HD11 and TracPhone V11 products that were released in first quarter of 2012 and the fourth quarter of 2012, respectively. Also contributing to the marine products increase was increased sales of our HD7 product. Partially offsetting this increase was a decrease in land mobile products of $1.3 million, or

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20%. The decrease in our land mobile products was primarily a result of decreased sales to original equipment manufacturers in the recreational vehicle market.

Mobile communications product sales originating from the Americas increased $2.2 million, or 8%, in 2012 as compared to 2011. Mobile communications product sales originating from our European and Asian subsidiaries increased $2.1 million, or 13%, in 2012 as compared to 2011.

Also contributing to the increase in product sales was an increase of $1.3 million, or 3%, in sales of guidance and stabilization products. Specifically, sales of our TACNAV defense products increased $1.0 million, or 5%, primarily as a result of product sales related to the previously announced SANG contract. Also contributing to the increase in sales of our guidance and stabilization products was an increase in sales of our FOG products of $0.7 million, or 3%.

Service sales increased in 2012 by $19.0 million, or 69%, to $46.4 million from $27.4 million in 2011. The primary reason for the increase was a $12.6 million increase in airtime sales for our mini-VSAT Broadband service. Also contributing to the increase was a $4.4 million increase in contracted engineering services driven primarily by the SANG order and a separate TACNAV-related development effort, as well as contracted aviation antenna services, and a $1.9 million increase in service repair sales.

Costs of Sales

Costs of product sales in 2012 increased by $5.2 million, or 11%, to $51.8 million from $46.6 million in 2011. The primary reason for the increase in costs of product sales was the increase in sales of our mobile communications products discussed above.

Costs of service sales increased by $9.4 million, or 45%, to $30.4 million in 2012 from $21.0 million in 2011. The primary reason for the increase was a $5.3 million increase in airtime costs of sales for our mini-VSAT Broadband service. Also contributing to the increase was a $3.0 million increase in engineering services costs of sales due primarily to the services provided in connection with the SANG contract as well as a $0.9 million increase in cost of service repair sales.

Gross margin from product sales decreased in 2012 to 43% from 45% in 2011. The decrease in our gross margin from product sales was primarily due to the increase in mobile communications product sales discussed above, which generally have lower margins than our TACNAV defense products.

Gross margin from service sales increased in 2012 to 35% from 23% in 2011. The increase in our gross margin from service sales was primarily due to the increase in gross margin for mini-VSAT Broadband service sales, which increased in 2012 to 31% from 15% in 2011. Partially offsetting the increase in gross margin for the mini-VSAT Broadband service sales was a decrease in gross margin for contracted engineering services as a result of facility construction services and project management services in Saudi Arabia, as these services under the SANG contract had a gross margin of approximately 10%. The contract value for the services portion of the SANG TACNAV order remaining to be performed as of January 1, 2013 is approximately $11.0 million.

Operating Expenses

Sales, marketing and support expense in 2012 increased by $0.6 million, or 3%, to $24.1 million from $23.5 million in 2011. The primary reasons for the increase in 2012 were a $0.8 million increase in sales, marketing and support expense related to our Danish and Singaporean subsidiaries driven by the international expansion of our sales channel presence for the mini-VSAT Broadband satellite communication service, and a $0.4 million increase in variable sales expense primarily as a result of the sales related to the SANG TACNAV order and related facility construction that commenced in the third quarter of 2012. Also contributing to the increase was a $0.2 million increase in bad debt expense, a $0.2 million increase in trade show expenses, and a $0.2 million increase in demonstration equipment. Partially offsetting these increases was a $0.4 million decrease in U.S.-based compensation for sales, marketing and support, a $0.4 million decrease in warranty expense, a $0.2 million total decrease in marketing literature and cooperative advertising, and a $0.2 million decrease in Norwegian-based compensation for sales, marketing and support. As a percentage of net sales, sales, marketing and support expense decreased in 2012 to 18% from 21% in 2011.

Research and development expense in 2012 increased by $0.6 million, or 5%, to $12.1 million from $11.5 million in 2011. The primary reason for the increase in 2012 was a $0.5 million increase in U.S.-based employee compensation. Also contributing to the increase was a $0.2 million increase in research and development expense related to our

Norwegian subsidiary. As a percentage of net sales, research and development expense decreased in 2012 to 9% from 10% in 2011.

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General and administrative expense in 2012 increased by $1.6 million, or 15%, to $12.2 million from $10.6 million in 2011. The primary reason for the increase in 2012 was a $0.9 million increase in U.S.-based employee compensation. Also contributing to the increase was a $0.8 million increase in facility expenditures, a $0.2 million increase in equipment lease expense and software maintenance expense, and a $0.1 million increase in recruiting expense. Partially offsetting these increases was a $0.5 million decrease in legal expense. As a percentage of net sales, general and administrative expense was 9% in 2012, which was consistent with 2011.

Interest and Other Income, Net

Interest and other income, net decreased by $0.7 million to $0.3 million in 2012 from $1.0 million in 2011. The primary reason for the decrease was a $0.8 million net benefit in other income in September 2011 resulting from reaching agreement with LiveTV regarding the termination of our original antenna development and production agreement.

Income Tax Expense (Benefit)

Income tax expense increased by $3.7 million to $3.3 million as compared to an income tax benefit of $0.5 million in 2011. The increase in income tax expense is primarily due to a $6.5 million increase in pre-tax income. Also, in 2011 we completed the construction of our new Rhode Island production facility, and as a result we had fewer Rhode Island state investment tax credits in 2012. Further, Congress did not pass the 2012 federal research and development tax credit until January 2013, which reduced our federal research and development tax credits for 2012. Instead, these credits were treated as a discrete tax event that was accounted for in the first quarter of 2013. Partially offsetting this tax expense was a reduction in income tax expense associated with windfalls for non-qualified stock option exercises and restricted stock award vesting.

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, revenues and expenses, and related disclosure at the date of our financial statements. Our significant accounting policies are summarized in note 1 to our consolidated financial statements. The significant accounting policies that we believe are the most critical in understanding and evaluating our reported financial results include the following:

Revenue Recognition

Product sales. Product sales are recognized when persuasive evidence of an arrangement exists, goods are shipped, title has passed and collectability is reasonably assured. Our standard sales terms require that:

- All sales are final;
- Terms are generally Net 30;
- Shipments are tendered and shipped FOB (or as may be applicable, FCA or EXW) our plant or warehouse; and
- Title and risk of loss or damage passes to the dealer or distributor at the point of shipment when delivery is made to the possession of the carrier.

For certain guidance and stabilization product sales, customer acceptance or inspection may be required before title and risk of loss transfers to the customer. For those sales, revenue is recognized after transfer of title and risk of loss and after notification of customer acceptance.

Under certain limited conditions, we, at our sole discretion, provide for the return of goods. No product is accepted for return and no credit is allowed on any returned product unless we have granted and confirmed prior written permission by means of appropriate authorization. We establish reserves for potential sales returns, credits and allowances, and evaluate, on a monthly basis, the adequacy of those reserves based upon historical experience and our expectations for the future.

Multiple-element revenue arrangements. Some of our sales involve multiple-element arrangements that include both hardware-related products and contracted service, or satellite connectivity. We analyze revenue arrangements with multiple deliverables to determine if the deliverables should be divided into more than one unit of accounting. For contracts with more than one unit of accounting, we allocate the consideration we receive among the separate units of accounting based on a selling price hierarchy for determining the selling price of each deliverable, which includes: (1)

vendor-specific objective evidence (VSOE) if available; (2) third-party evidence (TPE) if VSOE is not available; and (3) best estimated selling price (BESP), if neither VSOE nor TPE is available. Best estimate selling price is determined based on prices of the deliverables if sold on a stand-alone basis, or if not sold on a stand-alone basis, the prices we would charge if sold on a stand-alone basis. We recognize revenue for each deliverable based on the revenue recognition policies described in this section. We have accounted for our $35.6 million contract received in June 2012 from SANG to purchase TACNAV defense products and services as a multiple-element arrangement. The total contract value associated with TACNAV defense products is $21.2 million, for which the final shipments were completed in the second quarter of 2013. The total contract value associated with all services is $14.4 million, which are estimated to continue into the first quarter of 2014. The contract value for the services portion of the SANG TACNAV order remaining to be performed as of December 31, 2013 is approximately $1.3 million. The revenue for these services is recognized using the percentage of completion accounting method. Total revenue recognized on the SANG contract in 2013 was approximately $19.6 million.

Contracted service sales. We also have contracts for development, production and services activities that are recognized primarily under the percentage of completion method of revenue recognition. The use of contract accounting requires significant judgment relative to estimating total contract revenues and costs, including assumptions relative to the length of time to complete the contract, the nature and complexity of the work to be performed, and prices for subcontractor services and materials. Our estimates are based upon the professional knowledge and experience of our engineers, program managers and other personnel, who review each long-term contract monthly to assess the contract's schedule, performance, technical matters and estimated cost at completion. A cancellation, schedule delay, or modification of a fixed-price contract which is accounted for using the percentage of completion method may adversely affect our gross margins for the period in which the contract is modified. Changes in estimates are applied when adjustments in estimated contract costs are identified, such revisions may result in current period adjustments to earnings applicable to performance in prior periods.

Satellite connectivity and media content sales. Directly sold and re-sold satellite connectivity service for voice, data and Internet is recognized monthly based upon minutes or megabytes of traffic processed or contracted fixed fee schedules. Typically, all subscribers enter into a contracted one-year minimum service agreement. We record all satellite connectivity service sales to subscribers as gross sales, as we are the primary obligor in the contracted service arrangement. All associated regulatory service fees and costs are recorded net in our consolidated financial statements. Media content sales include our distribution of premium licensed news, sports, movies and music content for commercial and leisure customers in the maritime, hotel, and retail markets as well as training videos to the merchant marine market that are typically based on a contracted fixed fee schedule. We typically recognize revenue from media content sales ratably over the period of the service contract. The accounting estimates related to the recognition of satellite connectivity and media content service sales in our results of operations require us to make assumptions about future billing adjustments for disputes with subscribers as well as unauthorized usage.

Accounts Receivable Allowance

Our estimate of allowance for doubtful accounts related to trade receivables is primarily based on specific and historical criteria. We evaluate specific accounts where we have information that the customer may have an inability to meet its financial obligations. We make judgments, based on facts and circumstances, regarding the need to record a specific reserve for that customer against amounts owed to reduce the receivable to the amount that we expect to collect. We also provide for a reserve based on an aging analysis of our accounts receivable. We evaluate these reserves on a monthly basis and adjust them as we receive additional information that impacts the amount reserved. If circumstances change, we could change our estimates of the recoverability of amounts owed to us by a material amount. For example, our bad debt expense increased $0.5 million in 2013 from 2012, driven by bad debt expense associated with airtime sales for our mini-VSAT Broadband service.

We wrote off approximately $0.5 million, $0.2 million and $0.2 million of our accounts receivable in 2013, 2012 and 2011, respectively. These write-offs were driven largely by the financial deterioration of several airtime and lease customers as well as several mobile communications product distributors. The current economic downturn could continue to adversely impact the financial condition of our customers, which could result in additional write-offs and increases in our allowance for doubtful accounts and have a negative impact on our results of operations.

Inventories

Inventory is valued at the lower of cost or market. We generally must order components for our products and build inventory in advance of product shipments. We regularly review current quantities on hand, actual and projected sales volumes and anticipated selling prices on products and write down, as appropriate, slow-moving and/or obsolete inventory to its net realizable value. In 2013, 2012 and 2011, we wrote off approximately $0.1 million, $0.2 million and $0.2 million, respectively, of fully reserved inventory. However, if we overestimate projected sales or anticipated selling prices, our inventory might be overstocked or overvalued, and we would have to reduce our inventory valuation accordingly.

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Accounting for Income Taxes

As part of the process of preparing our financial statements, we are required to estimate our provision for income taxes in each of the jurisdictions in which we operate. This involves estimating our actual current tax exposure, including assessing the risks associated with tax audits, together with assessing temporary differences resulting from the different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We assess the likelihood that our deferred tax assets will be recovered from future taxable income and record a valuation allowance to reduce the deferred tax assets to an amount that, in our judgment, is more likely than not to be recovered.

Management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our deferred tax assets. The valuation allowance is based on our estimates of future taxable income and the period over which we expect the deferred tax assets to be recovered. Our assessment of future taxable income is based on historical experience and current and anticipated market and economic conditions and trends. In the event that actual results differ from these estimates or we adjust our estimates in the future, we may need to adjust our valuation allowance, which could materially impact our consolidated financial position and results of operations. At December 31, 2013, we had valuation allowances of $2.7 million to offset gross deferred tax assets of $10.8 million.

Warranty Provision

We typically offer a one to two year warranty for all of our base products. We provide for the estimated cost of product warranties at the time product revenue is recognized. Factors that affect our warranty reserves include the number of units sold, historical and anticipated rates of warranty repairs and the cost per repair. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers, our estimated warranty obligation is affected by ongoing product failure rates, specific product class failures outside our baseline experience, material usage and service delivery costs incurred in correcting a product failure. If actual product failure rates, material usage or service delivery costs differ from our estimates, revisions to the estimated warranty liability would be required. For example, our warranty expense increased $1.0 million in 2013 from 2012, driven primarily by warranty expense associated with our mini-VSAT products. Assumptions and historical warranty experience are evaluated to determine the appropriateness of such assumptions. We assess the adequacy of the warranty provision on a quarterly basis and we adjust this provision when necessary.

Stock-Based Compensation

Our stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is generally the vesting period.

We use the Black-Scholes valuation model for estimating the fair value on the date of grant of compensatory stock options. Determining the fair value of stock option awards at the grant date requires judgment regarding certain valuation assumptions, including the volatility of our stock price, expected term of the option, risk-free interest rate and expected dividends. Changes in these assumptions and estimates could result in different fair values and could therefore impact our earnings. These changes would not impact our cash flows. The fair value of restricted stock awards is based upon our stock price on the grant date.

The amount of stock-based compensation expense recorded in any period for unvested awards requires estimates of the amount of stock-based awards that are expected to be forfeited prior to vesting.

Compensation costs for awards subject only to service conditions that vest ratably are recognized on a straight-line basis over the requisite service period for the entire award.

Goodwill and Intangible Assets

Goodwill is tested at least annually for impairment. If an event occurs or circumstances change that indicate that the carrying value may not be recoverable, the Company will perform an interim test at that time. The impairment test begins by allocating goodwill to its reporting unit. Goodwill is then tested using a two step process that begins with an estimation of the fair value of the reporting unit using an income approach, which looks to the present value of expected future cash flows. The impairment test is performed through the application of a two-step process. The first step is a screen for potential impairment by comparing the carrying value of the Company’s reporting units to their estimated fair values as of the test date. The estimated cash flows are calculated using an income approach. If fair value is less than carrying value, a second step is performed to quantify the amount of the impairment, if any.

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Intangible assets with estimated lives and other long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of intangible assets with estimated lives and other long-lived assets is measured by comparing the carrying amount of the asset to future net undiscounted cash flows expected to be generated by the asset. If these comparisons indicate that an asset is not recoverable, we will recognize an impairment loss for the amount by which the carrying value of the asset exceeds the related estimated fair value. Estimated fair value is based on either discounted future operating cash flows or appraised values, depending on the nature of the asset.

Considerable judgment is required to estimate discounted future operating cash flows. Judgment is also required in determining whether an event has occurred that may impair the value of goodwill or identifiable intangible or other long-lived assets. Factors that could indicate an impairment may exist include significant underperformance relative to plan or long-term projections, changes in business strategy, significant negative industry or economic trends, a significant change in circumstances relative to a large customer, a significant decline in our stock price for a sustained period and a decline in our market capitalization to below net book value. We must make assumptions about future cash flows, future operating plans, discount rates and other factors in our models and valuation reports. To the extent these future projections and estimates change, the estimated amounts of impairment could differ from current estimates. Our annual testing for impairment of goodwill is completed as of August 31 of each year. As of August 31, 2013, the Company performed its annual impairment test for goodwill at the reporting unit level and, after conducting the first step, determined that it was not necessary to conduct the second step as it concluded that the fair value of its reporting units substantially exceeded their carrying value. Accordingly, the Company determined no adjustment to goodwill was necessary. There were no indicators of potential goodwill, intangible asset, or other long-lived asset impairment noted as of December 31, 2013. As of December 31, 2013, the Company has goodwill of $18.3 million and intangible assets of $15.0 million, which are associated with the purchase of Virtek Communication in September 2010 and Headland Media Limited (now known as the KVH Media Group) in May 2013.

Contingencies

We are subject to ongoing business risks arising in the ordinary course of business. An estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to determine whether such amounts should be adjusted and record changes in estimates in the period they become known. We reserve for legal contingencies and legal fees when the amounts are probable and reasonably estimable. At December 31, 2013, we have not recorded any material loss contingencies.

Liquidity and Capital Resources

We have historically funded our operations primarily from cash flows from operations, net proceeds from public and private equity offerings, bank financings and proceeds received from exercises of stock options. As of December 31, 2013, we had $55.7 million in cash, cash equivalents and marketable securities, of which $4.3 million in cash equivalents were held in a local currency by our foreign subsidiaries. There were no marketable securities held by our foreign subsidiaries as of December 31, 2013. As of December 31, 2013, we had $78.9 million in working capital.

Operating Activities

Net cash provided by operations for 2013 was $16.3 million as compared to net cash provided by operations of $15.1 million for 2012. The $1.2 million increase is primarily due to an increase in cash inflows attributable to accounts receivable of $3.5 million, a $1.3 million decrease in prepaid and other assets, a $1.0 million increase in net income, a $0.7 million increase in cash inflows related to deferred revenue. Partially offsetting the increase in cash inflows are a $4.4 million increase in cash outflows as a result of increased inventory levels, and a $0.3 million increase in cash outflows related to accrued expenses and accounts payable.

Net cash provided by operations for 2012 was $15.1 million as compared to net cash provided by operations of $1.9 million for 2011. The increase is primarily due to a $6.3 million decrease in cash outflows as a result of decreased inventory levels, a $5.2 million increase in cash inflows attributable to accounts receivable, as well as a $2.7 million increase in net income, which reflected a $2.8 million reduction in non-cash benefits related to deferred income taxes . Also contributing to the increase was a decrease in cash outflows of approximately $1.7 million related to accrued expenses and a $1.1 million decrease in cash outflows related to other long-term liabilities. Partially offsetting the increase in cash inflows is an increase in cash outflows of $2.6 million related to other non-current assets and a $2.5 million decrease in cash inflows related to deferred revenue. In addition, there was an increase in cash outflows of $1.3 million related to accounts payables and a $0.9 million increase in cash outflows related to prepaid expenses and other current assets.

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Investing Activities

Net cash used in investing activities for 2013 was $44.7 million as compared to net cash used in investing activities of $12.3 million for 2012. The $32.4 million increase in cash outflows is primarily due to the net cash paid for the acquisition of Headland Media Limited (now known as the KVH Media Group) of $22.9 million, and a $11.3 million increase in our net investment in marketable securities. Partially offsetting the increase in cash outflows is a decrease in capital expenditures of approximately $1.8 million.

Net cash used in investing activities for 2012 was $12.3 million as compared to net cash used in investing activities of $7.6 million for 2011. The increase in cash outflows is due to a $12.3 million increase in our net investment in marketable securities. Partially offsetting the increase in cash outflows is a decrease in capital expenditures of approximately $7.6 million, which in 2011 included expenditures relating to the construction of our new manufacturing facility in Middletown, Rhode Island.

Financing Activities

Net cash provided by financing activities for 2013 was $29.3 million as compared to net cash used in financing activities of $0.9 million for 2012. The $30.2 million increase in cash provided by financing activities is primarily due to $23.0 million in borrowings from our line of credit used to finance the majority of the acquisition cost of Headland Media Limited (now known as the KVH Media Group) in May 2013, and $5.8 million in borrowings on long-term debt associated with the equipment security notes that we entered into in January and December 2013. Also contributing to the increase was a $2.0 million reduction in payments on our line of credit and a $0.8 million increase in proceeds from exercises of stock options and purchases under our employee stock purchase plan. Partially offsetting this increase was a $1.0 million increase in repayments of long-term debt, as well as a $0.5 million increase in payments related to employee restricted stock withholdings.

Net cash used in financing activities for 2012 was $0.9 million as compared to net cash provided by financing activities of $5.5 million for 2011. The decrease in cash provided by financing activities is primarily the result of repayments on our line of credit of $2.0 million in 2012, in comparison to $9.0 million in borrowings under our line of credit in 2011, which were used to finance the construction of our new manufacturing facility in Middletown, Rhode Island. Partially offsetting this decrease was a $3.7 million decrease in common stock repurchases, a $0.6 million increase in proceeds from exercises of stock options and purchases of shares under our employee stock purchase plan, as well as a $0.3 million decrease in payments related to employee restricted stock withholdings.

Borrowing Arrangements

On April 6, 2009, we entered into a mortgage loan in the amount of $4.0 million related to our headquarters facility in Middletown, Rhode Island. The loan term is 10 years, with a principal amortization of 20 years, and the interest rate will be a rate per year adjusted periodically based on a defined interest period equal to the BBA LIBOR Rate plus 2.25 percentage points. On June 9, 2011, we entered into an amendment to the mortgage loan, providing for an adjustment of the interest rate from the BBA LIBOR Rate plus 2.25 percentage points to the BBA LIBOR Rate plus 2.00 points. Land, building and improvements with an approximate carrying value of approximately $5.0 million as of December 31, 2013 secure the mortgage loan. The monthly mortgage payment is approximately $11,000, 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 throughout 2013, the Fixed Charge Coverage Ratio did not apply. Under the mortgage loan we may prepay our outstanding loan balance subject to certain early termination charges as defined in the mortgage loan agreement. If we were to default on our mortgage loan, the land, building and improvements would be used as collateral. As discussed in note 16 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.

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

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days' advance written notice to the bank. Effective December 31, 2013, we further amended our revolving loan agreement with the bank to extend the maturity date from December 31, 2014 to December 31, 2015.

On May 11, 2013, we acquired Headland Media Limited (now known as the KVH Media Group) for an aggregate purchase price of approximately £15.5 million ($24.0 million at the exchange rate of £1.00: $1.5517 on May 11, 2013). The purchase price was subject to a potential post-closing adjustment based on the value of the net assets delivered at the closing. In July 2013, the Company paid approximately $0.2 million related to the post-closing purchase price adjustments.

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

As of December 31, 2013, we had $30.0 million outstanding under the revolving loan agreement, all of which we must repay on or before December 31, 2015. The monthly interest payments are presently approximately $36,000, subject to adjustment in accordance with the terms of the loan agreement.

Other Matters

It is our intent to continue to invest in the mini-VSAT Broadband network on a global basis in cooperation with ViaSat under the terms of a 10-year agreement announced in July 2008. As part of the future potential capacity expansion, we would plan to seek to acquire additional satellite capacity from satellite operators, expend funds to seek regulatory approvals and permits, develop product enhancements in anticipation of the expansion, and hire additional personnel. In addition, in December 2011, we entered into a five-year agreement to lease C-band satellite capacity from a satellite operator, effective February 1, 2012, and in 2012 we also purchased three satellite hubs to support this C-band service. The total cost of the five-year satellite capacity agreement, the satellite hubs, and teleport services is approximately $12.2 million, of which approximately $2.7 million related to the total cost of the three hubs. On January 30, 2013, we borrowed $4.7 million from a bank and pledged as collateral six satellite hubs and related equipment, including the three hubs purchased in 2012. The term of the equipment loan is five years, and the loan bears interest at a fixed 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.

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

We believe that the $55.7 million we hold in cash, cash equivalents and marketable securities, together with our other existing working capital and cash flows from operations, will be adequate to meet planned operating and capital requirements through at least the next twelve months. However, as the need or opportunity arises, we may seek to raise additional capital through public or private sales of securities or through additional debt financing. There are no assurances that we will be able to obtain any additional funding or that such funding will be available on terms acceptable to us.

Contractual Obligations and Other Commercial Commitments

As of December 31, 2013, our contractual commitments consisted of satellite service capacity, near-term purchase commitments, line of credit borrowings, a mortgage note payable, equipment notes payable, and equipment and facility leases. Our purchase commitments include unconditional purchase orders for inventory, manufacturing materials and fixed assets extending out over various periods throughout 2014. We are also obligated under satellite service capacity leases and multi-year facility leases that terminate at various times between 2014 and 2018.

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The following table summarizes our obligations under these commitments, excluding interest, at December 31, 2013:

| Contractual Obligations | Payment Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
| | (in thousands) | | | | |
| Satellite service capacity and equipment lease obligations | $23,162 | $10,685 | $9,364 | $3,113 | $— |
| Inventory and fixed asset purchase commitments | 16,094 | 16,094 | — | — | — |
| Line of credit borrowings | 30,000 | — | 30,000 | — | — |
| Mortgage note payable | 3,414 | 146 | 317 | 354 | 2,597 |
| Equipment note payable | 4,952 | 1,126 | 2,351 | 1,475 | — |
| Facility lease obligations | 1,252 | 241 | 359 | 311 | 341 |
| Total | $78,874 | $28,292 | $42,391 | $5,253 | $2,938 |

We did not have any off-balance sheet commitments, guarantees or standby repurchase obligations as of December 31, 2013.

Recently Issued Accounting Pronouncements

See note 1 of our accompanying audited consolidated financial statements for a description of recently issued accounting pronouncements including the dates of adoption and effects on our results of operations, financial position and disclosures.

ITEM 7A. Quantitative and Qualitative Disclosure 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 have $30.0 million in borrowings outstanding under our variable-rate credit facility at December 31, 2013, at an interest rate equal to the BBA LIBOR Daily Floating Rate plus 1.25%.

As discussed in note 16 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 Denmark, the United Kingdom, Norway, Brazil, Singapore, Belgium, the Netherlands, Cyprus, and Japan. Certain transactions in these locations are made in the local currency, yet are reported in the U.S. dollar, the functional currency. For foreign currency exposures existing at December 31, 2013, a 10% unfavorable movement in the foreign exchange rates for our subsidiary locations would not expose us to material losses in earnings or cash flows.

From time to time, we purchase foreign currency forward contracts generally having durations of no more than five months. These forward contracts are intended to offset the impact of exchange rate fluctuations on cash flows of our foreign subsidiaries. Foreign exchange contracts are accounted for as cash flow hedges and are recorded on the balance sheet at fair value until executed. Changes in the fair value are recognized in earnings. We did not enter into any such contracts during 2012 or 2013. However, we did inherit cash flow hedges from our acquisition of Headland Media Limited (now known as the KVH Media Group) in May 2013. We do not currently anticipate that we will enter into similar agreements once the existing agreements expire by the end of 2014.

The primary objective of our investment activities is to preserve principal and maintain liquidity, while at the same time maximize income. We have not entered into any instruments for trading purposes. Some of the securities that we invest in may have market risk. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities that can include government agency bonds, money market mutual funds, corporate notes, and certificates of deposit. As of December 31, 2013, a hypothetical 100 basis-point increase in interest rates would result in an immaterial decrease in the fair value of our investments that have maturities of greater than one year. Due to the conservative nature of our

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investments and the relatively short duration of their maturities, we believe interest rate risk is substantially mitigated. As of December 31, 2013, 67% of the $46.4 million classified as available-for-sale marketable securities will mature or reset within one year. Accordingly, long-term interest rate risk is not considered material. We did not invest in any financial instruments denominated in foreign currencies as of December 31, 2013.

ITEM 8. Financial Statements and Supplementary Data

Our consolidated financial statements and supplementary data, together with the report of KPMG LLP, our independent registered public accounting firm, are included in Part IV of this annual report.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

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## ITEM 9A. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, which are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our President, Chief Executive Officer and Chairman of the Board, or CEO, and Chief Financial and Accounting Officer, or CFO, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our CEO and CFO, our management has evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2013, the end of the period covered by this annual report. Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of December 31, 2013.

### Background

In March 2013, our management identified that the most senior member of our accounting staff at our Danish subsidiary had engaged in a fraudulent scheme to misappropriate assets from us over a period of at least three years. The scheme included fraudulent wire transfers to a personal bank account, fraudulent documentation, forged signatures and use of a corporate credit card for personal expenses. For the three years ended December 31, 2013, the aggregate amount of misappropriated funds in any year ranged from approximately $118,000 to $250,000. We recovered these losses in 2013 through our insurance policies.

In March 2013, management's assessment of our internal control over financial reporting identified the following control deficiencies at our Danish subsidiary as of December 31, 2012:

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

Management concluded that these control deficiencies constituted a material weakness in our internal control over financial reporting as of December 31, 2012, which meant that there was a reasonable possibility that a material misstatement of our annual or interim financial statements would not be prevented or detected in a timely manner.

Following the identification of the material weakness, management implemented a remediation plan that included the following steps:

- termination of the employment of the individual involved and reassignment of his duties to a controller for our Danish subsidiary;
- implementation of a new corporate-level control to review manual journal entries of foreign subsidiaries;
- implementation of new controls regarding the physical safekeeping of banking security devices and personal identification numbers, which are designed to prevent one person from gaining access to two devices and personal identification numbers required to execute wire transfers;
- reviewing the design and operation of our process level and transaction level controls at our foreign subsidiaries in relation to cash management and manual journal entry review and approvals; and
- conducting training sessions at our Danish subsidiary to reinforce control consciousness.

These steps were completed and successfully tested as of December 31, 2013. On that basis, management concluded that the control deficiencies had been remediated as of December 31, 2013.

### Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is the process designed by and under the supervision of our CEO and

CFO to provide

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reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements for external reporting in accordance with accounting principles generally accepted in the United States of America. Management has evaluated the effectiveness of our internal control over financial reporting based on the framework and criteria established in Internal Control – Integrated Framework (1992), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Under the supervision and with the participation of our CEO and CFO, our management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2013 and concluded that it is effective.

Management excluded from its assessment of internal control over financial reporting Headland Media Limited and its subsidiaries (now known as the KVH Media Group) which were acquired in May 2013. The aggregated total assets and revenues of the KVH Media Group represent 19% (including approximately 15% of total assets related to goodwill and intangible assets that were included within the scope of its assessment) and 5%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2013.

Our independent registered public accounting firm, KPMG LLP, has issued a report on the effectiveness of our internal control over financial reporting as of December 31, 2013, and that report is included in Part IV of this annual report.

Evaluation of Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of our CEO and CFO, our management has evaluated changes in our internal control over financial reporting that occurred during the fourth quarter of 2013. Based on that evaluation, other than the remediation of the material weakness discussed above, our CEO and CFO did not identify any other changes in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Important Considerations