KVH INDUSTRIES INC \DE\
Form 10-Q
May 08, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: March 31, 2007

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)	**(IRS Employer Identification Number)**

50 Enterprise Center, Middletown, RI 02842

(Address of principal executive offices)

(401) 847-3327

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

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

Date	Class	Outstanding shares
May 7, 2007	Common Stock, par value $0.01 per share	14,996,261

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KVH INDUSTRIES, INC. AND SUBSIDIARY

Form 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

KVH INDUSTRIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts, unaudited)

	March 31, 2007	December 31, 2006
Current assets:		
Cash and cash equivalents	$ 14,366	$ 15,781
Marketable securities	39,471	38,958
Accounts receivable, net of allowance for doubtful accounts of $693 in 2007 and 2006	12,574	10,556
Inventories	8,937	9,043
Prepaid expenses and other assets	584	680
Costs and estimated earnings in excess of billings on uncompleted contracts	128	183
Deferred income taxes	165	165
Total current assets	76,225	75,366
Property and equipment, net	9,989	9,569
Other non-current assets	283	155
Deferred income taxes	3,334	3,334
Total assets	**$ 89,831**	**$ 88,424**
Current liabilities:		
Accounts payable	$ 3,452	$ 2,639
Accrued compensation and employee-related expenses	1,732	2,783
Accrued other	2,398	1,748
Accrued product warranty costs	604	539
Accrued professional fees	419	539
Current portion of long-term debt	125	123
Total current liabilities	8,730	8,371
Long-term debt excluding current portion	2,126	2,158
Deferred revenue	102	99
Total liabilities	**10,958**	**10,628**
Stockholders equity:		
Preferred stock, $0.01 par value. Authorized 1,000,000 shares; none issued.		
Common stock, $0.01 par value. Authorized 20,000,000 shares; issued and outstanding 14,986,198 as of March 31, 2007 and 14,866,212 as of December 31, 2006.	150	149
Additional paid-in capital	89,516	88,511
Accumulated deficit	(10,773)	(10,830)
Accumulated other comprehensive loss	(20)	(34)

Total stockholders equity	**78,873**	**77,796**
Total liabilities and stockholders equity	**$ 89,831**	**$ 88,424**

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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ITEM 1. Financial Statements (continued)

KVH INDUSTRIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share amounts, unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Net sales	$ 20,397	$ 20,289
Costs of sales	12,804	11,469
Gross profit	7,593	8,820
Operating expenses:		
Sales, marketing and support	4,012	3,845
Research and development	2,198	2,170
General and administrative	1,784	1,895
(Loss) income from operations	(401)	910
Other income (expense):		
Interest income, net	649	454
Other expense	(13)	(21)
Income before income taxes	235	1,343
Income tax expense	178	89
Net income	**$ 57**	**$ 1,254**
Per share information:		
Net income per share		
Basic	**$ 0.00**	**$ 0.09**
Diluted	**$ 0.00**	**$ 0.08**
Number of shares used in per share calculation:		
Basic	**14,908**	**14,685**
Diluted	**14,966**	**14,827**

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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ITEM 1. Financial Statements (continued)

KVH INDUSTRIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, unaudited)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Cash flows from operating activities:		
Net income	$ 57	$ 1,254
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	521	480
Deferred income tax		39
Compensation expense related to options and employee stock purchase plan	213	233
Loss (gain) on foreign currency forward exchange contracts	63	(15)
Provision (recovery) for doubtful accounts, net	13	(10)
Changes in operating assets and liabilities:		
Accounts receivable	(2,031)	601
Costs and estimated earnings in excess of billings on uncompleted contracts	55	91
Inventories	106	(1,039)
Prepaid expenses and other assets	96	245
Accounts payable	813	(928)
Accrued expenses	(936)	(621)
Deferred revenue	3	71
Net cash (used in) provided by operating activities	**(1,027)**	**401**
Cash flows from investing activities:		
Purchase of marketable securities	(17,713)	(9,159)
Maturities and sales of marketable securities	17,214	8,801
Capital expenditures	(540)	(974)
Other long-term assets	(128)	8
Net cash used in investing activities	**(1,167)**	**(1,324)**
Cash flows from financing activities:		
Repayments of long-term debt	(30)	(28)
Proceeds from stock option and employee stock purchase plan	809	761
Net cash provided by financing activities	**779**	**733**
Net decrease in cash and cash equivalents	**(1,415)**	**(190)**
Cash and cash equivalents at beginning of period	**15,781**	**14,160**
Cash and cash equivalents at end of period	**$ 14,366**	**$ 13,970**
Supplemental disclosure of noncash activity:		
Change in accrued expenses related to contracted building additions	$ 401	$
Employee stock purchase plan activity	$ 7	$

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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ITEM 1. Financial Statements (continued)

KVH INDUSTRIES, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

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

(1) Description of Business

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

KVH s mobile communications products enable customers to receive live digital television, telephone and Internet services in their automobiles, recreational vehicles and marine vessels while in motion via satellite and wireless services. KVH sells its mobile communications products through an extensive international network of retailers, distributors and dealers.

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

(2) Basis of Presentation

The accompanying condensed consolidated financial statements of KVH Industries, Inc. and its wholly owned subsidiary, KVH Europe A/S (collectively, KVH or the Company), have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission regarding interim financial reporting. Given that KVH Europe A/S operates as the Company s European and international distributor, all of its operating expenses are reflected within sales, marketing and support within the accompanying condensed consolidated statements of operations. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the current year presentation. The condensed consolidated financial statements have not been audited by our independent registered public accounting firm, but include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition, results of operations, and cash flows for the periods presented. These condensed consolidated financial statements do not include all disclosures associated with annual financial statements and accordingly should be read in conjunction with the Company s consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K filed on March 16, 2007 with the Securities and Exchange Commission. The results for the three months ended March 31, 2007 are not necessarily indicative of operating results for the remainder of the year.

(3) Significant Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions by management affect the Company s revenue recognition, valuation of accounts receivable, valuation of inventory, deferred tax assets, certain accrued expenses and accounting for contingencies.

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

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KVH INDUSTRIES, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

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

(4) Stock-Based Compensation

The Company recognizes stock-based compensation in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment . Stock-based compensation expense was $213 and $233 for the quarter ended March 31, 2007 and March 31, 2006, respectively. As of March 31, 2007, there was approximately $2.9 million of total unrecognized compensation expense related to stock-based compensation arrangements, which is expected to be recognized over a weighted-average period of 2.99 years.

The Company granted 225,200 stock options under the terms of the 2006 Stock Incentive Plan for the quarter ended March 31, 2007.

The weighted-average fair values per share for all options granted during the three months ended March 31, 2007 and 2006 was $4.36 per share and $5.11 per share, respectively. The fair value of stock options granted was estimated using the Black-Scholes option-pricing model. The weighted-average assumptions used to value options as of their grant date were as follows:

	Three months ended March 31,	
	2007	**2006**
Risk-free interest rate	4.46%	4.39%
Expected volatility	49.6%	54.1%
Expected life (in years)	4.13	4.42
Dividend yield	N/A	N/A

(5) Income Per Common Share

Basic net income per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined with the treasury-stock accounting method. For the three months ended March 31, 2007 and 2006 common stock equivalents related to options to purchase 1,530,073 and 1,150,760 shares of common stock, respectively, have been excluded from the fully diluted calculation of income per share, as inclusion would be anti-dilutive.

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

	Three months ended March 31,	
	2007	**2006**
Weighted average common shares outstanding basic	14,907,649	14,684,528
Dilutive common shares issuable in connection with stock plans	58,394	142,921
Weighted average common shares outstanding - diluted	14,966,043	14,827,449

(6) Inventories

Inventories are stated at the lower of cost or market using the first-in first-out costing method. Inventories as of March 31, 2007 and December 31, 2006 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

	March 31, 2007	December 31, 2006
Raw materials	$ 6,248	$ 5,553
Finished goods	1,751	2,886
Work in process	938	604
	$ 8,937	$ 9,043

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KVH INDUSTRIES, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

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

(7) Comprehensive Income

Comprehensive income includes net income and other comprehensive income. Other comprehensive income includes certain changes in equity that are excluded from net income. Specifically, the effects of unrealized gains or losses on available-for-sale marketable securities are separately included in accumulated other comprehensive income within stockholders equity. The Company s comprehensive income for the periods presented is as follows:

	Three months ended March 31, 2007	2006
Net income	$ 57	$ 1,254
Unrealized gain on available-for-sale securities	14	1
Total comprehensive income	$ 71	$ 1,255

(8) Product Warranty

The Company s products carry limited warranties that range from one to two years and vary by product. The warranty period begins on the date of retail purchase by the original purchaser. The Company accrues estimated product warranty costs at the time of sale and any additional amounts are recorded when such costs are probable and can be reasonably estimated. Factors that affect the Company s warranty liability include the number of units sold, historical and anticipated rates of warranty repairs and the cost per repair. Warranty and related costs are reflected within sales, marketing and support in the accompanying statements of operations. As of March 31, 2007 and December 31, 2006, the Company had accrued product warranty costs of $604 and $539, respectively. The following table summarizes product warranty activity for the periods presented:

	Three months ended March 31, 2007	2006
Beginning balance	$ 539	$ 611
Charges to expense	430	151
Costs incurred	(365)	(212)
Ending balance	$ 604	$ 550

(9) Segment Reporting

Under common operational management, the Company designs, develops, manufactures and markets its navigation, guidance and stabilization and mobile communication products for use in a wide variety of applications. Products are generally sold directly to third-party consumer electronic dealers and retailers, consumer manufacturers, government contractors or directly to U.S. and other foreign government agencies. Primarily, sales originating in North America consist of sales within the United States and Canada and, to a lesser extent, Mexico, Asia/Pacific and some Latin and South American countries. North American sales also include all defense-related product sales throughout the world. Sales originating from the Company s Denmark subsidiary principally consist of sales into all European countries, both inside and outside the

European Union, as well as Africa, the Middle East, India and all countries in Asia.

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KVH INDUSTRIES, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

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

(9) Segment Reporting (Continued)

The Company operates in two geographic segments, exclusively in the mobile communications, navigation and guidance equipment industry, which it considers to be a single business activity. The Company has two primary product categories: mobile communication and navigation, guidance and stabilization. Mobile communication sales and services include automotive, marine and land mobile communication equipment, such as satellite-based telephone, television and broadband Internet connectivity services. Defense sales and services include sales of commercial marine and defense-related navigation, guidance and stabilization equipment based upon digital compass and fiber optic sensor technology. Defense services also include development contract revenue.

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

	Sales Originating From		
	North America	**Europe**	**Total**
Three months ended March 31, 2007			
Mobile communication sales to the United States and Canada	$ 11,369	$	$ 11,369
Mobile communication sales to Europe	80	3,747	3,827
Mobile communication sales to other geographic areas	120	739	859
Defense sales to the United States and Canada	3,986		3,986
Defense sales to Europe	226		226
Defense sales to other geographic areas	130		130
Intercompany sales	2,108		2,108
Subtotal	18,019	4,486	22,505
Eliminations	(2,108)		(2,108)
Net sales	$ 15,911	$ 4,486	$ 20,397
Segment net income (loss)	$ (388)	$ 445	$ 57
Depreciation and amortization	$ 511	$ 10	$ 521
Total assets	$ 85,740	$ 4,091	$ 89,831

	Sales Originating From		
	North America	**Europe**	**Total**
Three months ended March 31, 2006			
Mobile communication sales to the United States and Canada	$ 10,702	$	$ 10,702
Mobile communication sales to Europe		3,216	3,216
Mobile communication sales to other geographic areas	350	78	428
Defense sales to the United States and Canada	4,510		4,510
Defense sales to Europe	449		449
Defense sales to other geographic areas	984		984
Intercompany sales	1,901		1,901
Subtotal	18,896	3,294	22,190
Eliminations	(1,901)		(1,901)
Net sales	$ 16,995	$ 3,294	$ 20,289

Segment net income	$ 1,085	$ 169	$ 1,254
Depreciation and amortization	$ 471	$ 9	$ 480
Total assets	$ 79,308	$ 3,751	$ 83,059

KVH INDUSTRIES, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

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

(10) Legal Matters

The Company and certain of its officers are defendants in a class action lawsuit in the U.S. District Court for the District of Rhode Island. The suit asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 under that statute, as well as claims under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, on behalf of purchasers of our securities in the period October 1, 2003 to July 2, 2004 and seeks certain legal remedies, including compensatory damages. The Teamsters Affiliates Pension Plan has been appointed lead plaintiff. This matter consolidates into one action eight separate complaints filed between July 24, 2004 and September 15, 2004. On January 14, 2005, the defendants filed a motion to dismiss the consolidated complaint for failure to state a claim upon which relief can be granted. The court denied this motion in part and granted it in part.

On October 14, 2005, the defendants answered the consolidated complaint and denied liability and all allegations of wrongdoing. Subsequently, on December 13, 2005, plaintiffs filed a motion for class certification. The motion is pending.

On August 16, 2004, Hamid Mehrvar filed a shareholder s derivative action in the Rhode Island State Superior Court for Newport County against KVH and certain of its officers and directors. The amended complaint asserts state law claims on KVH s behalf arising between October 1, 2003 and the present in connection with the allegations set forth in the class action consolidated complaint in the U.S. District Court described above. On October 7, 2005, the court dismissed Mehrvar s amended complaint without prejudice. By letter dated October 14, 2005, Mehrvar delivered a demand that KVH commence litigation for the same acts alleged in his complaint against the directors and senior officers who served during the period October 1, 2003 to the present. On March 1, 2006, Mehrvar filed a shareholder s derivative action in the Rhode Island State Superior Court for Providence County against KVH and certain of its officers and directors. The complaint asserts state law claims on KVH s behalf arising between October 1, 2003 and the present in connection with the allegations set forth in the class action consolidated complaint in the U.S. District Court described above and seeks certain legal and equitable remedies, including restitution from KVH s directors and officers and corporate governance changes. On June 30, 2006, defendants moved to dismiss the complaint on the basis that plaintiff s complaint failed to adequately allege that demand was wrongfully refused. The motion to dismiss has been voluntarily withdrawn without prejudice to its refiling at a later date.

On June 20, 2005, Yemin Ji filed a shareholder s derivative action in the U.S. District Court for the District of Rhode Island against KVH and certain of its officers and directors, asserting certain federal and state law claims on KVH s behalf arising between October 1, 2003 and the present in connection with the same allegations set forth in the class action consolidated complaint in the U.S. District Court and the Mehrvar complaint described above and seeks certain legal and equitable remedies, including restitution from KVH s directors and officers and corporate governance changes. On August 23, 2005, KVH moved the Court to abstain from exercising jurisdiction and dismiss the action as duplicative of the Mehrvar case. The Court denied this motion. On January 5, 2006, defendants moved to dismiss the complaint on the same grounds on which the Rhode Island state court dismissed the derivative complaint in Mehrvar that was filed on August 16, 2004. The Court granted this motion and dismissed the complaint on August 29, 2006. In late September 2006, Ji filed an appeal of the dismissal with the U.S. Court of Appeals for the First Circuit. The appeal is pending.

In May 2005, Electronic Controlled Systems, Inc., d/b/a King Controls, filed a patent infringement suit against KVH in the U.S. District Court for the District of Minnesota. The three asserted patents relate generally to controlling a satellite dish to acquire a satellite signal. The complaint alleges that KVH willfully infringes the patents and seeks injunctive relief, enhanced damages and attorneys fees. KVH has denied the allegations and asserted counterclaims, including claims for false advertising. In January 2006, Electronic Controlled Systems, Inc., d/b/a/ King Controls, filed a second patent infringement suit against KVH in the U.S. District Court for the District of Minnesota. The second suit concerns one of the same three patents asserted in the original suit filed in May 2005, alleges that KVH willfully infringes the patent and seeks both preliminary and permanent injunctive relief, enhanced damages and attorneys fees. KVH has denied the allegations and asserted counterclaims. The court denied the plaintiff s motion for a preliminary injunction after a hearing on May 30, 2006. These two cases are now consolidated. An adverse ruling could result in an injunction preventing KVH from selling its TracVision products, other than those using phased-array antennas, and in significant monetary damages based, in part, on sales of those products since at least March 2005. Pursuant to a settlement agreement, the parties stipulated to the dismissal of the false advertising counterclaims. A trial is scheduled for June 2007.

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KVH INDUSTRIES, INC. AND SUBSIDIARY

Notes to Condensed Consolidated Financial Statements

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

(11) Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN No. 48) was issued. FIN No. 48 applies to all tax positions accounted for under SFAS No. 109, Accounting for Income Taxes (SFAS No. 109) and is effective for fiscal years beginning after December 15, 2006. FIN No. 48 clarifies what criteria must be met prior to recognition of the financial benefit of a position taken in a tax return. FIN No. 48 requires companies to include additional qualitative and quantitative disclosures within their financial statements. The disclosures include potential tax benefits from positions taken for tax return purposes that have not been recognized for financial reporting purposes and a tabular presentation of significant changes during each period. The disclosures also include a discussion of the nature of uncertainties, factors which could cause a change, and an estimated range of reasonably possible changes in tax uncertainties. FIN No. 48 also requires a company to recognize a financial statement benefit for a position taken for tax return purposes when it will be more-likely-than-not that the position will be sustained.

The Company adopted the provisions of FIN No. 48 effective January 1, 2007. The adoption of FIN No. 48 did not have a material impact to the financial statements of the Company. Additionally, there have been no material changes in unrecognized tax benefits since January 1, 2007. When appropriate, the Company s policy is to recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense. The Company files tax returns in the United States Federal, state and in the Danish jurisdiction. In general the Company s United States Federal statue of limitation has expired for years prior to 2003 and the relevant state statutes vary. However, preceding years remain open to examination by United States Federal and state taxing authorities to the extent of future utilization of net operating losses and research and development tax credits generated in each preceding year. The Company generally is no longer subject to income tax examinations by the Danish tax authorities for years before 2003.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements, including the methods and assumptions used to measure fair value and the effect of fair value measures on earnings. This statement does not require any new fair value measures; rather, it applies to other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 will be applied prospectively and will be effective for fiscal years beginning after November 15, 2007. The Company does not expect that the adoption of this interpretation will have a material impact on the Company s financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 . SFAS No. 159 permits an entity to elect fair value as the initial and subsequent measurement attribute for many financial assets and liabilities. Entities electing the fair value option would be required to recognize changes in fair value in earnings. Entities electing the fair value option are required to distinguish, on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. SFAS No. 159 is effective for the Company in 2008; therefore, we anticipate adopting this standard as of January 1, 2008. The adjustment to reflect the difference between the fair value and the carrying amount would be accounted for as a cumulative-effect adjustment to retained earnings as of the date of initial adoption. The Company is currently evaluating the impact, if any, of SFAS No. 159 on its consolidated financial statements.

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

The statements included in this quarterly report on Form 10-Q, other than statements of historical fact, are forward-looking statements. Examples of forward-looking statements include statements regarding our future financial results, operating results, business strategies, projected costs, products, competitive positions and plans, customer preferences, consumer trends, anticipated product development, and objectives of management for future operations. In some cases, forward-looking statements can be identified by terminology such as may, will, should, would, expects, plans, anticipates, believes, estimates, predicts, potential, continue, or the negative of these terms or other comparable terminology. Any expectations based on these forward-looking statements are subject to risks and uncertainties and other important factors, including those discussed in the section entitled Risk Factors in Item 1A of Part II of this quarterly report. These and many other factors could affect our future financial and operating results, and could cause actual results to differ materially from expectations based on forward-looking statements made in this document or elsewhere by us or on our behalf. For example, our expectations regarding certain items as a percentage of revenue assume that we will achieve our anticipated revenue goals. The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this report.

Overview

We develop, manufacture and market mobile communications products for the land and marine markets, and navigation, guidance and stabilization products for both defense and commercial markets. Our mobile communications products enable customers to receive live digital television, telephone and Internet services in their automobiles, recreational vehicles and marine vessels while in motion via satellites and wireless services. We sell our mobile communications products through an extensive international network of independent retailers, distributors, and dealers. Our defense products include tactical navigation systems that provide uninterrupted access to navigation and pointing information in a spectrum of military vehicles, including tactical trucks (HMMWVs) and light armored vehicles. We also offer precision fiber optic gyro-based systems that enable stabilization and munitions guidance. We sell our defense products directly to U.S. and allied governments and government contractors, as well as through an international network of authorized independent sales representatives.

We generate revenue primarily from the sale of our mobile communications and defense products and services. The following table provides, for the periods indicated, our net sales by product line category.

	Three months ended March 31,	
	2007	2006
	(in thousands)	
Mobile communications	$ 16,055	$ 14,346
Defense	4,342	5,943
Net sales	$ 20,397	$ 20,289

In addition to revenue from product sales, our mobile communications revenue includes revenue earned from product repairs, revenue from satellite phone and Internet usage services, and certain DIRECTV account referral fees earned in conjunction with the sale of our products. We provide, for a fee, third-party satellite phone and Internet airtime to our TracPhone and Internet customers who choose to activate their subscriptions with us. Under current DIRECTV programs, we are eligible to receive a one-time, new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through us. Our defense revenue primarily includes product sales to both military and commercial markets and, to a lesser extent, revenue from product repairs and engineering services provided under development contracts. To date, our non-product revenue such as: revenues earned from product repairs, satellite phone, engineering services under development contracts, Internet usage services and DIRECTV activations have not been a material portion of our revenue individually. In the aggregate, such revenues represented approximately 9% and 7% of total net sales for the three months ended March 31, 2007 and 2006, respectively.

Our defense business is characterized by a small number of customers who place a small number of relatively large dollar value orders. Orders for our defense products typically range in size from several hundred thousand dollars to over one million dollars. Accordingly, our quarterly net sales of defense products usually consist of a relatively small number of orders. Each order can have a significant impact on our net sales, and because our defense products generally have higher direct margins than our mobile communications products, each order can have an impact on our net income that is disproportionately large relative to the revenue generated by the order.

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We have historically derived a substantial portion of our revenue from sales to customers located outside the United States and Canada. Note 9 of the notes to the condensed consolidated financial statements provides information regarding our sales to specific geographic regions.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our condensed 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 of the notes to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2006.

As described in our Form 10-K for the year ended December 31, 2006, our most critical accounting policies and estimates upon which our consolidated financial statements were prepared were those relating to revenue recognition, allowances for accounts receivable, inventories, income taxes and contingencies. We have reviewed our policies and determined that these remain our most critical accounting policies for the quarter ended March 31, 2007. Readers should refer to our 2006 Form 10-K for the detailed descriptions of these policies.

Results of Operations

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

	Three months ended March 31,	
	2007	**2006**
Net sales	100.0%	100.0%
Costs of sales	62.8	56.5
Gross profit	37.2	43.5
Operating expenses:		
Sales, marketing and support	19.7	19.0
Research and development	10.8	10.7
General and administrative	8.7	9.3
Total operating expenses	39.2	39.0
(Loss) income from operations	(2.0)	4.5
Other income, net	3.1	2.1
Income before income tax expense	1.1	6.6
Income tax expense	(0.9)	(0.4)
Net income	0.2%	6.2%

Three Months Ended March 31, 2007 and 2006

Operating Summary

Net income for the three months ended March 31, 2007 was $0.1 million, or $0.00 per diluted common share, as compared to net income of $1.3 million, or $0.08 per diluted common share for the three months ended March 31, 2006. The primary factor behind the decrease in net income was attributable to a $1.6 million, or 27% decrease in sales of our defense-related products, which included a $2.7 million, or 80%, decrease in our relatively higher margin military navigation product sales, driven largely by decreased sales volume related to our TACNAV products. The decrease in military navigation product sales significantly impacted an overall decrease in gross profit of $1.2 million, or 14% for the three months ended March 31, 2007, as compared to the three months ended March 31, 2006. The decrease in gross profit was also impacted by incremental new product start-up expenses, including a switch to new fiber optic components that were initially more costly than expected, but are anticipated to generate improved manufacturing yields. The decrease in gross profit was partially offset by an increase in sales of our mobile communications products of $1.7 million, or 12%, to $16.1 million.

Net Sales

Net sales for the three months ended March 31, 2007 increased $0.1 million, or 1%, to $20.4 million from $20.3 million for the three months ended March 31, 2006. The primary reason for the improvement was an increase in sales of our mobile communications products of $1.7 million, or 12%, to $16.1 million. Specifically, for the three months ended March 31, 2007,

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sales of our marine products increased $1.0 million, or 10%, to $10.8 million. This increase was a result of demand for our new TracVision M3 DX satellite TV system that was launched in the first quarter of 2007. Also contributing to the improvement was an increase in sales of our land mobile communications products of $0.7 million, or 16%. The improvement in mobile communications sales was concentrated largely outside the United States and Canada. Sales of mobile communications products outside the United States and Canada increased by approximately $1.0 million, or 29%, while sales in the United States and Canada increased by approximately $0.7 million, or 6%.

Sales of our defense-related products decreased by $1.6 million, or 27%, to $5.9 million. Specifically, sales of our military navigation products decreased $2.7 million, or 80%, driven largely by decreased demand and sales volume related to our TACNAV products. Offsetting the decrease was an increase in sales of our fiber optic gyro products of $0.9 million, or 53%, driven primarily by increased sales in support of the U.S. Navy s MK54 torpedo program and the U.S. Army s remotely operated weapons station program. Also contributing to the improvement was an increase in contract engineering revenue, repair work and legacy navigation products of $0.2 million.

Cost of Sales

For the three months ended March 31, 2007, cost of sales increased by $1.3 million, or 12%, to $12.8 million. The primary reason for the increase, as discussed above, is due to a shift in sales mix toward our relatively lower margin mobile communications products during the three month period ended March 31, 2007.

Gross margin for the three months ended March 31, 2007 decreased to 37% from 44% for the three-month period ended March 31, 2006. The primary reason for the decrease in gross margin was the overall decrease in net sales of our relatively higher margin defense-related products during the quarter ended March 31, 2007. Given that we expect second quarter 2007 defense-related revenue to increase, we expect that gross margin percentage in the second quarter will improve from first quarter levels.

Operating Expenses

Sales, marketing and support expense for the three months ended March 31, 2007 increased by $0.2 million, or 4%, to $4.0 million from $3.8 million for the three months ended March 31, 2006. As a percentage of net sales, sales, marketing and support expense increased during the quarter ended March 31, 2007 to 20% from 19% for the quarter ended March 31, 2006. The primary reason for the increase in 2007 is a number of new product introductions in the quarter, both in the United States and internationally, coupled with an increase in warranty costs associated with mobile communications products. We anticipate that, for the second quarter of 2007, sales and marketing expense as a percentage of revenue will be below first quarter levels.

Research and development expense for the three months ended March 31, 2007 was $2.2 million, which was consistent with the expense incurred for the three months ended March 31, 2006. As a percentage of net sales, research and development expense remained fairly consistent on a quarter over quarter basis, representing 11% for both the three months ended March 31, 2007 and 2006. Our overall spending in 2007 continues to be focused on sustaining our existing product base and advancing new products. We anticipate that, for the second quarter of 2007, research and development expense as a percentage of revenue will remain at or slightly below first quarter levels.

General and administrative expense for the three months ended March 31, 2007 decreased by $0.1 million, or 6%, to $1.8 million from $1.9 million, for the three months ended March 31, 2006. As a percentage of net sales, general and administrative expense remained fairly consistent on a quarter over quarter basis, representing 9% for both the three months ended March 31, 2007 and 2006. We anticipate that, for the second quarter of 2007, general and administrative expense as a percentage of revenue will be well above first quarter levels, primarily due to increased legal expenses to be incurred related to our patent infringement lawsuit, which we expect may go to trial as early as June 2007 (see Part II, Item 1. Legal Proceedings). We anticipate the additional legal expenses related to this litigation will be in excess of $1.0 million in the second quarter.

Interest and Other Income, Net

Interest and other income, net for the three months ended March 31, 2007, increased by $0.2 million to $0.6 million from $0.4 million for the three months ended March 31, 2006. The primary reason for the increase is due to increased interest income in 2007 on cash and marketable securities of $0.2 million, resulting from improved interest rates, and a higher average amount of cash invested in marketable securities during the quarter ended March 31, 2007.

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Income Taxes

Income tax expense for the three months ended March 31, 2007 increased by $0.1 million to $0.2 million from $0.1 million for the three months ended March 31, 2006. Tax expense for the quarter ended March 31, 2007 relates to foreign income tax due based on pre-tax income generated from our wholly owned subsidiary in Denmark. The primary reason for the increase in 2007 was an increase of $0.4 million in pre-tax income from our Danish subsidiary. We expect that substantially all of our 2007 taxable income generated from our U.S. operations will be offset by both federal and state net operating losses generated by us in prior years. Accordingly, we expect that any tax expense generated by our U.S. operations in 2007 will made up primarily of federal alternative minimum tax and to a lesser extent certain state tax expense. Taxable income generated by our subsidiary in Denmark will be subject to taxation at the Danish statutory rates as we have no net operating loss carry-forwards or tax credits available to offset current or future taxable income in that jurisdiction.

Liquidity and Capital Resources

We have historically funded our operations primarily from product sales, net proceeds from public and private equity offerings, bank financings and proceeds received from exercises of stock options. As of March 31, 2007, we had $53.8 million in cash, cash equivalents and marketable securities and $67.4 million in working capital.

Net cash used in operations was $1.0 million for the three months ended March 31, 2007 as compared to net cash generated from operations of $0.4 million for the three months ended March 31, 2006. The decrease is primarily due to a $2.6 million decrease in cash inflows attributable to changes in accounts receivable, coupled with a $1.2 million decrease in net income. This decrease in cash generations was partially offset by a $1.7 million decrease in cash outflows related to increases in accounts payable and a $1.1 million decrease in cash outflows resulting from reduced inventory purchasing.

Net cash used in investing activities was $1.2 million for the three months ended March 31, 2007 as compared to net cash used in investing activities of $1.3 million for the three months ended March 31, 2006. The slight decrease is primarily due to a $0.4 million decrease in capital expenditures related predominately to manufacturing and other equipment, partially offset by a $0.1 million increase in our net investment in marketable securities, coupled with a $0.1 million increase in investments in non-current assets related to customer deposits.

Net cash provided by financing activities was $0.8 million for the three months ended March 31 2007 as compared to net cash provided by financing activities of $0.7 million for the three months ended March 31, 2006. The primary reason for the slight increase was an increase in proceeds received from the exercise of employee stock options.

On January 11, 1999, we entered into a mortgage loan in the amount of $3.0 million. The loan term is 10 years, with a principal amortization of 20 years at a fixed rate of interest of 7.0%. Land, building and improvements secure the mortgage loan. The monthly mortgage payment is $23,259, including interest and principal. Due to the difference in the term of the loan and amortization of the principal, a balloon payment of $2.0 million is due on February 1, 2009. Under the mortgage loan we may prepay our outstanding loan balance subject to certain early termination charges as defined in the mortgage loan agreement.

Currently, we have a revolving loan agreement with a bank that provides for a maximum available credit of $15.0 million that expires on December 31, 2008. We pay interest on any outstanding amounts at a rate equal to, at our option, LIBOR plus 1.5%, or the greater of either the Federal Funds Effective Rate plus 0.5% or the bank s prime interest rate. The line of credit contains two financial covenants, a Leverage Ratio and a Fixed Change Ratio, that apply in the event that our consolidated cash, cash equivalents and marketable securities balance falls below $25.0 million at any time. We may terminate the loan agreement prior to its full term without penalty, provided we give 30 days advance written notice to the bank. As of March 31, 2007, no borrowings were outstanding under the facility.

We are a defendant in a lawsuit brought by Electronic Controlled Systems, Inc., d/b/a King Controls, alleging infringement of three of its patents. A trial is scheduled for June 2007. An adverse ruling could result in an injunction preventing KVH from selling its TracVision products, other than those using phased-array antennas, and in significant monetary damages based, in part, on sales of those products since at least March 2005.

In the first quarter of 2007, we commenced a construction project to have significant renovations performed on our corporate headquarters in Middletown, Rhode Island. Currently, we estimate the total construction costs to the building will be approximately $2.0 million, of which approximately $0.1 million of these construction costs have been paid and $0.4 million have been accrued as of March 31, 2007. We anticipate the remaining construction expenditures will be incurred in the second and third quarters of 2007 and will be paid with available cash on hand.

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We believe that the $53.8 million we hold in cash, cash equivalents and marketable securities, together with our other existing working capital, will be adequate to meet planned operating and capital requirements through the foreseeable future. However, as the need or opportunity arises, we may seek to raise additional capital through public or private sales of securities or through additional debt financing. There are no assurances that we will be able to obtain any additional funding or that such funding will be available on terms acceptable to us.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary market risk exposure is in the area of foreign currency exchange risk. We are exposed to currency exchange rate fluctuations related to our subsidiary operations in Denmark. Certain functions in Denmark are transacted in the Danish Krone or Euro, yet reported in the U.S. dollar, the functional currency. For foreign currency exposures existing at March 31, 2007, a 10% unfavorable movement in the foreign exchange rates for our subsidiary location would not expose us to material losses in earnings or cash flows.

From time to time, we purchase foreign currency forward exchange contracts generally having durations of no more than four months. These forward exchange contracts are intended to offset the impact of exchange rate fluctuations on cash flows of our foreign subsidiary. Forward 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. For the quarter ended March 31, 2007 we recorded a loss of $63,000 related to these contracts. Such loss is reflected within other expense in our 2006 condensed consolidated statement of operations for the three months ended March 31, 2007. As of March 31, 2007, we had two Euro to U.S. dollar forward currency exchange contracts outstanding with a total fair value loss of $35,000.

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, including commercial paper, investment grade asset-backed corporate securities, money market funds and government agency and non-government debt securities. As of March 31, 2007, a hypothetical 100 basis-point increase in interest rates would result in an approximate $39,000 decrease in the fair value of our investments that have maturities of greater than one year. Due to the conservative nature of our investments, the relatively short duration of their maturities, our ability to either convert some or all of our long-term investments to less interest rate-sensitive holdings or hold most securities until maturity, we believe interest rate risk is mitigated. As of March 31, 2007, approximately 85% of the $39.4 million classified as available-for-sale marketable securities will mature or reset within one year. We do not invest in any financial instruments denominated in foreign currencies. Accordingly, interest rate risk is not considered material.

To the extent that we borrow against our variable-rate credit facility, we will be subject to interest rate risk. There were no borrowings outstanding at March 31, 2007.

ITEM 4. CONTROLS AND P ROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our president and chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, our president and chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that we record, process, summarize and report the information we must disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, within the time periods specified in the SEC s rules and forms.

The effectiveness of a system of disclosure controls and procedures is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of internal controls, and the risk of fraud. Because of these limitations, there can be no assurance that any system of disclosure controls and procedures will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management.

Changes in Internal Control over Financial Reporting

During the three months ended March 31, 2007, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are a defendant in a class action lawsuit in the U.S. District Court for the District of Rhode Island in which we and certain of our officers are named as defendants. The suit asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 under that statute, as well as claims under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, on behalf of purchasers of our securities in the period from October 1, 2003 to July 2, 2004 and seeks certain legal remedies, including compensatory damages. The Teamsters Affiliates Pension Plan has been appointed lead plaintiff. This matter consolidates into one action eight separate complaints filed between July 24, 2004 and September 15, 2004. On January 14, 2005, the defendants filed a motion to dismiss the consolidated complaint for failure to state a claim upon which relief can be granted. The court denied this motion in part and granted it in part.

On October 14, 2005, the defendants answered the consolidated complaint and denied liability and all allegations of wrongdoing. Subsequently, on December 13, 2005, plaintiffs filed a motion for class certification. The motion is pending.

On August 16, 2004, Hamid Mehrvar filed a shareholder s derivative action in the Rhode Island State Superior Court for Newport County against us and certain of our officers and directors. The amended complaint asserts state law claims on our behalf arising between October 1, 2003 and the present in connection with the allegations set forth in the class action consolidated complaint in the U.S. District Court described above. On October 7, 2005, the court dismissed Mehrvar s amended complaint without prejudice. By letter dated October 14, 2005, Mehrvar delivered a demand that we commence litigation for the same acts alleged in his complaint against the directors and senior officers who served during the period from October 1, 2003 to the present. On March 1, 2006, Mehrvar filed a shareholder s derivative action in the Rhode Island State Superior Court for Providence County against us and certain of our officers and directors. The complaint asserts state law claims on our behalf arising between October 1, 2003 and the present in connection with the allegations set forth in the class action consolidated complaint in the U.S. District Court described above and seeks certain legal and equitable remedies, including restitution from our directors and officers and corporate governance changes. On June 30, 2006, the defendants moved to dismiss the complaint on the basis that the plaintiff s complaint failed to adequately allege that demand was wrongfully refused. The motion to dismiss has been voluntarily withdrawn without prejudice to its refiling at a later date.

On June 20, 2005, Yemin Ji filed a shareholder s derivative action in the U.S. District Court for the District of Rhode Island against us and certain of our officers and directors, asserting certain federal and state law claims on our behalf arising between October 1, 2003 and the present in connection with the same allegations set forth in the class action consolidated complaint in the U.S. District Court and the Mehrvar complaint described above and seeks certain legal and equitable remedies, including restitution from our directors and officers and corporate governance changes. On August 23, 2005, we moved the Court to abstain from exercising jurisdiction and dismiss the action as duplicative of the Mehrvar case. The Court denied this motion. On January 5, 2006, the defendants moved to dismiss the complaint on the same grounds on which the Rhode Island state court dismissed the derivative complaint in Mehrvar that was filed on August 16, 2004. The Court granted this motion and dismissed the complaint on August 29, 2006. In late September 2006, Ji filed an appeal of the dismissal with the U.S. Court of Appeals for the First Circuit. The appeal is pending.

In May 2005, Electronic Controlled Systems, Inc., d/b/a King Controls, filed a patent infringement suit against us in the U.S. District Court for the District of Minnesota. The three asserted patents relate generally to controlling a satellite dish to acquire a satellite signal. The complaint alleges that we willfully infringe the patents and seeks injunctive relief, enhanced damages and attorneys fees. We have denied the allegations and asserted counterclaims, including claims for false advertising. In January 2006, Electronic Controlled Systems, Inc., d/b/a/ King Controls, filed a second patent infringement suit against us in the U.S. District Court for the District of Minnesota. The second suit concerns one of the same three patents asserted in the original suit filed in May 2005, alleges that we willfully infringe the patent and seeks both preliminary and permanent injunctive relief, enhanced damages and attorneys fees. We have denied the allegations and asserted counterclaims. The court denied the plaintiff s motion for a preliminary injunction after a hearing on May 30, 2006. These two cases are now consolidated. An adverse ruling could result in an injunction preventing us from selling our TracVision products, other than those using phased-array antennas, and in significant monetary damages based, in part, on sales of those products since at least March 2005. Pursuant to a settlement agreement, the parties stipulated to the dismissal of the false advertising counterclaims. A trial is scheduled for June 2007.

Additionally, 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.

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ITEM 1A. R ISK 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.

We have a history of variable operating results and may not be profitable in the future.

Although we generated net income during 2005 and 2006, and in thirteen of the last seventeen fiscal quarters, we incurred net losses of $6.1 million in 2004 and at times our profitability has fluctuated significantly on both a sequential and comparable quarter-to-quarter basis during 2005, 2006, and in the first quarter of 2007. As of March 31, 2007, we had an accumulated deficit of $10.8 million.

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

Our mobile communications products historically have had lower product gross margins than our defense products. During the year ended December 31, 2006, and the first quarter of 2007, sales of our defense products either declined or grew at a substantially lower rate than our overall sales growth, resulting in a small decline in our overall gross margin compared with the prior period. Although sales of defense products in each of 2006 and 2005 were slightly higher than the prior year, during 2004, sales of our defense products declined in the first quarter of 2007 compared to the first quarter of 2006. A continuing shift in our product sales mix toward mobile communications products would likely cause lower gross margins in the future.

Pending patent litigation will cause us to incur substantial expenses to defend ourselves and could lead to a substantial judgment against us and/or an injunction preventing us from selling certain of our products.

We are a defendant in a lawsuit brought by Electronic Controlled Systems, Inc., d/b/a King Controls, alleging infringement of three of its patents by certain of our TracVision mobile satellite communications products. A trial is scheduled for June 2007. We are defending ourselves vigorously against these claims, and we expect that we will incur substantial expenses during the second quarter of 2007 and, depending on the length of the trial and its outcome, in subsequent quarters. There can be no assurance that the trial will not be postponed, that we will not have to pay significant damages or amounts in settlement, that we will not be enjoined from selling certain of our mobile satellite communications products, or that the suit will not otherwise have a materially adverse effect on our operations or financial performance

Competition may limit our ability to sell our mobile communications products and defense 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. To remain competitive, we must enhance our existing products and develop new products, and we may have to reduce the prices of our products. Moreover, new competitors may emerge, and entire product lines may be threatened by new technologies or market trends that reduce the value of those product lines. For example, improvements in less expensive wireless and cellular technologies may limit demand for land-based satellite telephone and Internet services. Likewise, emerging services like BGAN and maritime VSAT may be disruptive to existing marine Internet, data, and communication services that we currently support.

In the defense navigation, guidance and stabilization markets, we compete primarily with Honeywell International Inc., Kearfott Guidance & Navigation Corporation, Leica Microsystems AG, Northrop Grumman Corporation and Smiths Group plc.

In the market for mobile satellite communications products, we compete with a variety of companies. In the land mobile market for satellite TV communications equipment, we compete directly with King Controls, MotoSAT, TracStar Systems, Inc., and Winegard Company. There is also potential competition for sales of satellite TV to the automotive market from RaySat, Audiovox, Sirius Satellite Radio, Winegard, and Delphi.

In the marine market for satellite TV communications equipment, we compete with NaviSystem Marine Electronic Systems Srl, King Controls, Sea Tel, Inc., and Raymarine. In the marine market for telephone, fax, data and Internet communications equipment, we compete with Furuno Electric Co., Ltd., Globalstar LP, Iridium Satellite LLC, and Japan Radio Company.

In the mobile Internet market, we may compete with such products as single-user EVDO cards for use with individual laptops; EVDO/WiFi hubs such as those manufactured by Kyocera and Top Global; proposed WiMAX services in urban areas; and Internet-via-satellite systems proposed by companies such as RaySat. Moreover, new competitors may surface in the future. Among the factors that may affect our ability to compete in our markets are the following:

many of our primary competitors are well-established companies that could have substantially greater financial, managerial, technical, marketing, personnel and other resources than we do;

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- product improvements or price reductions by competitors may weaken customer acceptance of our products; and
- our competitors may have lower production costs than we do, which may enable them to compete more aggressively in offering discounts and other promotions.

Customers for TACNAV and our other defense products include the U.S. military and foreign governments, whose purchasing and delivery schedules and priorities are often unpredictable.

We sell TACNAV and our other defense products to the U.S. military and foreign military and government customers. These customers have unique purchasing and delivery requirements, which often make sales to these customers unpredictable. Factors that affect their purchasing and delivery decisions include:

- changes in modernization plans for military equipment;
- changes in tactical navigation requirements;
- priorities for current battlefield operations;
- allocation of funding for military programs;
- 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.

These factors can cause substantial fluctuations in sales of TACNAV and our other defense products from period to period. For example, sales of our TACNAV products declined in the third and fourth quarter of 2006 and in the first quarter of 2007, compared with sales in the comparable periods of 2005 and 2006. Moreover, TACNAV and most of our other defense products must meet military quality standards, and our products may not continue to meet existing standards or more rigorous standards adopted in the future. Any failure to meet military contract specifications may produce delays as we attempt to improve our design, development, manufacturing or quality control processes. Furthermore, government customers 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 usually 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 substantially reduce our net sales and results of operations.

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

Unlike our mobile communications products, TACNAV and our other defense products are purchased through orders that can generally range in size from several hundred thousand dollars to more than one million dollars. As a result, the delay or cancellation of a single order could materially reduce our net sales and results of operations. Because our defense products typically have relatively higher product gross margins than our mobile communications products, the loss of an order for defense products could have a disproportionately adverse effect on our results of operations.

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

We derive a significant portion of our defense revenues from a small number of customers, including the U.S. Government. 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.

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The market for our mobile TV products for minivans, SUVs and other passenger vehicles is still emerging, and our business may not grow as we expect.

The market for our low profile automotive TracVision product is still in the early stage of development, which continues to make it difficult for us to predict customer demand accurately. For example, although sales of the TracVision grew between 2004 and the first quarter of 2007, the sales trend has been below our original expectations.

We believe the success of our low profile TracVision systems will depend upon consumers assessment of whether these products meet their expectations for performance, quality, price and design. For example, the TracVision A7 is designed for use on open roads in the continental United States where there is a clear view of the transmitting satellite in the southern sky, and it may not perform satisfactorily under other conditions. Among the factors that could affect the success of the low profile TracVision systems are:

- the performance, price and availability of competing or alternative products and technology relative to the automotive TracVision;
- the extent to which customers prefer live TV over recorded media;
- the extent to which customers perceive mobile satellite TV services as a luxury or a preferred convenience;
- the extent to which TracVision gains the acceptance of the automotive OEMs;
- the extent to which high fuel prices and environmental concerns may negatively affect consumer demand for SUVs and other large passenger vehicles;
- difficulties or inconveniences associated with scheduling installation at the point of sale;
- customers willingness to pay monthly fees for satellite television service in automobiles;
- the adoption of laws or regulations that restrict or ban television or other video technology in vehicles;
- poor performance arising from improper installation or installation of damaged equipment; and
- our limited experience with marketing products to the automotive market, which is substantially larger and more fragmented than our other markets.

The market for mobile Internet services in vehicles and vessels may fail to develop or may be satisfied by alternative technological approaches.

Mobile Internet access is a market that is currently focused primarily on cell phones and Internet-enabled PDAs. We serve as a distributor of the MSN TV service to the marine, automotive, and RV markets and offer what we believe is a unique mobile Internet solution. Competing products based around high-speed cellular services are available for single users and in integrated EVDO/WiFi hubs. Other technologies, such as proposed WiMAX networks and Internet-via-satellite options, such as BGAN and maritime VSAT services, may also displace competing wireless services with regard to range and cost, preventing us from successfully marketing and selling mobile Internet systems in the mobile marketplace.

We depend on others to provide programming for our TracVision products, and the loss of programming could substantially reduce our sales.

Our TracVision products include only the equipment necessary to receive satellite television services; we do not broadcast satellite television programming. Instead, customers must obtain programming from another source. We currently offer marine and land mobile TracVision products compatible with the DIRECTV and DISH Network services in the United States, the ExpressVu service in Canada, Sky Mexico and various other regional services in other parts of the world. Our low profile automotive TracVision products currently offer access to only the DIRECTV service in the continental United States. Although DIRECTV is offering its Total Choice Mobile programming package at a price that we think should be attractive to consumers, DIRECTV has no obligation to continue to offer that package at the current price or at all. If customers become dissatisfied with the programming, pricing, service, availability or other aspects of any of these satellite television 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 TracVision products. The companies that operate these services have no obligation to inform us of technological or other changes, including discontinuation of the service, which could impair the performance of our TracVision products.

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Our TracPhone and TracNet 3.0 products currently depend on satellite services provided by third parties, and any disruption in those services could adversely affect sales.

We rely on Inmarsat for satellite communications services for our TracPhone products. We rely on Telemar for TracNet 3.0 service in Europe.

Our TracNet 100 mobile Internet system uses high-speed EVDO cellular services offered by Verizon Wireless as well as Microsoft s MSN TV service. Should EVDO networks become unavailable, our TracNet 100 would be hampered in its ability to provide two-way Internet access. Likewise, if the status of MSN TV were to change, customers would no longer be able to access the Internet via the TV screens in their boats, RVs, and cars, a feature that offers KVH a competitive advantage over other mobile Internet solutions.

If any of our vendors were unable to fulfill their obligations, we would need to seek alternate suppliers or solutions. In that case, we may be required to retrofit or upgrade hardware and software as necessary to ensure the continued operation of the affected products. We may incur significant delays and expenses in our efforts to make the necessary changes, and those efforts may be unsuccessful. Moreover, we may not be successful in identifying and entering into appropriate agreements with replacement suppliers on commercially reasonable terms, which would impair our ability to offer the affected products. Similarly, we may lose the goodwill of existing customers if any currently installed products cease to work for any extended period. Any such outcome could lead to a substantial reduction in sales.

Our mobile communications products depend on the availability of third-party satellites, which face significant operational risks and could fail earlier than their expected useful lives.

Our mobile communications products depend on the availability of programming and services broadcast through satellites owned by third parties. 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. These satellites face significant operational risks during launch and while in orbit. These risks include launch failures, malfunctions that can occur as a result of satellite manufacturing errors, problems with power or control systems and general failures resulting from the harsh space environment. Moreover, each satellite has a limited useful life, and the satellite providers make no guarantees that the planned backup systems and capacity will be sufficient to support these satellite services in the event of a loss or reduction of service. We cannot assure that satellite services compatible with our products will continue to be available or that such services will continue to be offered at reasonable rates. The accuracy or availability of satellite signals may also be limited by ionospheric or other atmospheric conditions, intentional or inadvertent signal interference or intentional limitations on signal availability imposed by the satellite provider. A reduction in the number of operating satellites on any system, the inoperability of any key satellite or the failure of any key satellite or satellites to provide an accurate or available signal could impair the utility of our products or the growth of current and additional market opportunities.

High fuel prices and environmental concerns may adversely affect sales of our mobile communications products.

Fuel prices have been high and may remain high or increase in the foreseeable future. High fuel prices and environmental concerns tend to have a disproportionate impact on the larger vehicles and vessels for which our mobile communications products are designed, such as marine vessels, recreational vehicles and SUVs, because they consume relatively large quantities of fuel. We believe that the increased cost of operating these vehicles and vessels and environmental concerns have likely had an adverse effect on and may continue to adversely affect, demand for our mobile communications products.

Our effort to enter the automotive OEM market for embedded and factory-installed mobile satellite TV products may not be successful.

During 2005, we announced that we intend to support factory installation of an embedded version of our low profile TracVision mobile satellite TV antenna for automobiles. In addition, it has been our intent to develop an automotive satellite TV system designed to be integrated within the roof of a vehicle during the OEM manufacturing process. The timetable for potential OEM acceptance of an embedded or factory-installed system is uncertain, however, and our efforts to enter this market may not be successful. In particular, we must take into account roof and headliner designs, space and weight constraints, environmental requirements, performance standards, and OEM price requirements, and we may encounter unanticipated difficulties in designing antennas that will satisfy all of the unique requirements of various vehicle configurations. Because different vehicles may require different designs, our manufacturing efficiency for these embedded or factory-installed antennas may be lower and we may generate lower margins than for the aftermarket version of the low profile TracVision. In addition, our success in entering this market will depend in part on the close cooperation of vehicle manufacturers, and we cannot be certain that we will obtain the necessary cooperation. The expenses we expect to incur in pursuing this market may have an adverse effect on our results of operations.

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We expect that others will introduce competing mobile satellite TV antennas and technologies for automobiles.

When we began shipping our original low profile TracVision A5 in September 2003, it was the only commercially available, mobile satellite TV antenna for use on minivans, SUVs and other passenger vehicles. Any advantage we may have had by being the first to market such a product may erode as others enter this market. We are aware of announcements made by other companies of their intent to offer competing satellite TV or recorded video content to automobiles, but to date we have no knowledge of any such products in production and available for retail sale. Competing satellite antenna products may have a slightly lower profile, and customers may delay purchasing our low profile TracVision in anticipation of the release of any of these products. Competition from any of these products could impair our ability to sell the new low profile TracVision A7 and may force us to reduce the price of the product. The availability of pre-recorded video content via personal devices such as the iPod or embedded digital hard drives with downloadable content may also limit demand for live content in vehicles.

We must achieve additional significant cost reductions for our low profile TracVision to reach our targeted profit margins.

Our product profit margins for our low profile TracVision automotive system have been low since its introduction. Although we have had success in improving profit margins since the introduction of the low profile TracVision in September 2003, we may be unable to achieve the additional cost reductions necessary to achieve our overall target profit margins. Although our cost reduction programs include obtaining volume purchasing discounts, sourcing of components from off-shore suppliers and redesigning certain components using lower cost materials and processes, technological or other challenges may prevent us from achieving all of the necessary cost reductions. Moreover, if the price of the low profile automotive TracVision is not attractive to a broad range of customers, we may be forced to further lower the price, which would further impair our product profit margins unless we are able to achieve corresponding cost reductions.

We may fail to continue to increase the sale of our fiber optic products for commercial uses.

Our fiber optic products have numerous commercial applications where mobile communication, navigation, stabilization and precision pointing are required. For example, our fiber optic gyros have been used in commercial applications such as train location control and track geometry measurement systems, industrial robotics, and autonomous or remotely operated vehicles. We may not be successful in further developing and marketing our fiber optic products for commercial uses, which might limit the overall net sales of these products and limit our profitability accordingly.

We may continue to increase the international scope of our operations, which could disrupt our business.

Although we have historically manufactured and sourced raw materials for the majority of our products in the U.S., in order for us to improve our operating margin performance and overall profitability, we have found it desirable to increase the international scope of our operations. This includes the increased sourcing of raw materials and manufactured components from foreign countries such as China. We have only limited experience in foreign manufacturing, and we might not be successful in implementing or integrating an extended program. In addition, our increased reliance on foreign manufacturing and/or raw material supply has lengthened our supply chain and increased the risk that a disruption in that supply chain will have a material adverse affect on our operations and financial performance.

We depend on single manufacturing lines for our products, and any significant disruption in production could impair our ability to deliver our products.

We currently manufacture and assemble our products using individual production lines for each product category. We have experienced manufacturing difficulties in the past, and any significant disruption to one of these production lines will require time either to reconfigure and equip an alternative production line or to restore the original line to full capacity. Some of our production processes are complex, and we may be unable to respond rapidly to the loss of the use of any production line. For example, our production process uses some specialized equipment and custom molds that may take time to replace if they malfunction. 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. In

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general, we do not have written long-term supply agreements with our suppliers but instead purchase components through purchase orders, which expose us to potential price increases and termination of supply without notice or recourse. We do not generally 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.

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

We market and sell our mobile communications products through an international network of independent retailers, chain stores and distributors, as well as to manufacturers of marine vessels and recreational vehicles. If we are unable to maintain or increase the number of our distribution relationships, it could significantly reduce or limit our net sales. In addition, our distribution partners may sell products of other companies, including competing products, and are not required to purchase minimum quantities of our products. Moreover, our distributors may operate on low product margins and could give higher priority to products with higher margins than ours.

Our net sales and operating results could decline due to general economic trends or declines in consumer spending.

Our operating performance depends significantly on general economic conditions. Net sales of our mobile communications products are largely generated by discretionary consumer spending, and demand for these products could demonstrate slower growth than we anticipate as a result of regional and global economic conditions. Consumer spending tends to decline during recessionary periods and may decline at other times. Consumers may choose not to purchase our mobile communications products due to a perception that they are luxury items. As global and regional economic conditions change, including the general level of interest rates, fluctuating oil prices and demand for durable consumer products, demand for our products could be adversely affected.

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

The markets for mobile communications products and defense navigation, 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 certain 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. For example, other companies have either announced their intentions or have begun to offer low-profile in-motion satellite antennas or alternative means for providing mobile entertainment. These products will compete with our low profile TracVision and may offer more attractive performance, pricing and other features.

If we cannot effectively manage our growth, our business may suffer.

We have previously expanded our operations to pursue existing and potential market opportunities. This growth placed a strain on our personnel, management, financial and other resources. If we fail to manage our future growth properly, we may incur unnecessary expenses, and the efficiency of our operations may decline. To manage our growth effectively, we must, among other things:

- upgrade, expand or re-size our manufacturing facilities and capacity in a timely manner;
- successfully attract, train, motivate and manage a larger number of employees for manufacturing, sales and customer support activities;
- control higher inventory and working capital requirements; and

improve the efficiencies within our operating, administrative, financial and accounting systems, and our procedures and controls.

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

To meet our growth objectives, we must attract and retain highly skilled technical, operational, managerial and sales and marketing personnel. If we fail to attract and retain the necessary personnel, we may be unable to achieve our business objectives and may lose our competitive position, which could lead to a significant decline in net sales. We face significant

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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 and key employees.

Our future success depends to a significant degree on the skills and efforts of Martin Kits van Heyningen, our co-founder, president and chief executive officer. 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 and members of senior management to work effectively as a team. None of our senior management or other key personnel is bound by an employment agreement. The loss of one or more of our executive officers or senior management members could impair our ability to manage our business effectively.

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

Historically, sales to customers outside the United States and Canada have accounted for a significant portion of our net sales. We have only one foreign sales office, which is located in Denmark, and 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 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 communication products to function with different satellite services and technology in use in various regions around the world, including multiple satellite services in Europe;
- satisfaction of international regulatory requirements and procurement of any necessary licenses or permits;
- restrictions on the sale of certain defense products to foreign military and government customers;
- additional costs and delays associated with obtaining approvals and licenses under applicable export regulations;
- increased costs of providing customer support in multiple languages;
- more limited protection of our intellectual property;
- potentially adverse tax consequences, including restrictions on the repatriation of earnings;
- protectionist laws and business practices that favor local competitors, which could slow our growth in international markets;
- potentially longer sales cycles, which could slow our revenue growth from international sales;
- potentially longer accounts receivable payment cycles and difficulties in collecting accounts receivable;

losses arising from foreign currency exchange rate fluctuations; and

economic and political instability in some international markets.

If we are unable to maintain adequate product liability insurance, we may have to pay significant monetary damages in a successful product liability claim against us.

The development and sale of mobile satellite communication products and defense products entail an inherent risk of product liability. For example, consumers may ignore laws or warnings not to watch satellite television while driving and, as a result, may become involved in serious accidents, for which they may seek to hold us responsible. Product liability insurance is generally expensive for companies such as ours. Accordingly, we maintain only limited product liability insurance coverage for our products. Our current levels of insurance or any insurance we may subsequently obtain may not provide us with adequate coverage against potential claims, such as claims by those involved in accidents caused by drivers watching television. In addition, we may be unable to renew our policies on commercially reasonable terms or obtain additional product liability insurance on acceptable terms, if at all. If we are exposed to product liability claims for which we have insufficient insurance, we may be required to pay significant damages, which could seriously harm our financial condition and results of operations.

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

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

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

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

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

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

Pending securities class action lawsuits could have a material adverse effect on our financial condition and results of operations.

We and certain of our officers are defendants in a class action lawsuit in the U.S. District Court for the District of Rhode Island. The suit asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, as well as claims under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, on behalf of purchasers of our securities between October 1, 2003 and July 2, 2004. We and certain of our directors and officers are also defendants in a shareholder s derivative action in the Rhode Island State Superior Court for Providence County. This suit asserts state law claims on our behalf between October 1, 2003 and the present arising from the allegations set forth in the class action complaint in the U.S. District Court described above. We and certain of our directors and officers are also appellees in an appeal of a dismissal of a shareholder s derivative action by the U.S. District Court for the District of Rhode Island. This suit asserted federal and state claims on our behalf between October 1, 2003 and the present arising from the same allegations set forth in the class action complaint described above. We intend to vigorously defend ourselves against these claims. There can be no assurance, however, that we will not have to pay significant damages or amounts in settlement. An unfavorable outcome or prolonged litigation could materially harm our business. Litigation of this nature is expensive and time-consuming and diverts the time and attention of our management.

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.

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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.

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

We have 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 defense products;
- 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;
- our success in winning competitions for orders;
- the timing of new product introductions by us or our competitors;
- expense incurred in pursuing acquisitions, such as during the third quarter of 2006;
- 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 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.

Our tax planning strategy involves assumptions that may cause our annual provision for income tax expense or benefit to fluctuate materially. Moreover, our tax planning strategy is based upon our ability to sell our manufacturing and corporate headquarters facility located in Middletown, Rhode Island, as may be necessary.

We utilize a tax planning strategy as provided for under accounting principles generally accepted in the United States as a means of supporting the realizability of certain of our deferred tax assets. The strategy involves our ability to sell our Middletown, Rhode Island headquarters facility in order to generate taxable income for the sole purpose of utilizing our U.S. net operating tax loss carryforwards before they expire. The determination of taxable income, and therefore supportable deferred tax asset value, is based upon the difference between the property s estimated fair market value and our book basis. Accordingly, the estimated net realizable value of our deferred tax asset is highly correlated to property values in and around the Middletown, Rhode Island area and therefore subject to changes in property value and or assumptions used in the valuation process. This fair market value subjectivity may cause us to record significant increases or decreases to our deferred tax assets during the year.

The strategy represents an action that we ordinarily would not take, but would take, if necessary, to realize an estimated $3.3 million in U.S. deferred tax assets based on approximately $8.5 million in estimated taxable gain from the sale of the building as of March 31, 2007.

The market price of our common stock may be volatile.

Our stock price has historically been volatile. From January 1, 2004 to March 31, 2007, the trading price of our common stock ranged from $27.75 to $6.61. Many factors may cause the market price of our common stock to fluctuate, including:

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- variations in our quarterly results of operations;
- the introduction of new products 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;
- changes in, or adoptions of, accounting principles;
- market conditions in our industries; and
- the global macroeconomic and geopolitical environment.

In addition, the stock market can experience extreme price and volume fluctuations. 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. We are now defending derivative and class action lawsuits. This pending litigation has caused us to incur substantial costs and is diverting the time and attention of our management. These adverse consequences may continue until this action is finally resolved. Any similar litigation in the future could have similar consequences.

Acquisitions may disrupt our operations or adversely affect our results.

We evaluate strategic acquisition opportunities to acquire other businesses as they arise. The expenses we incur evaluating and pursuing acquisitions, such as during the third quarter of 2006, could have a material adverse effect on our results of operations. If we acquire a business, we may be unable to manage it profitably or successfully integrate its operations with our own. Moreover, we may be unable to realize the financial, operational and other benefits we anticipate from any acquisition. Competition for acquisition opportunities could increase the price we pay for businesses we acquire and could reduce the number of potential acquisition targets. Further, our approach to acquisitions may involve a number of special financial and business risks, such as:

- charges related to any potential acquisition from which we may withdraw;
- diversion of our management s time, attention, and resources;
- loss of key acquired personnel;

- increased costs to improve or coordinate managerial, operational, financial, and administrative systems including compliance with the Sarbanes-Oxley Act of 2002;

- dilutive issuances of equity securities;

- the assumption of legal liabilities; and

- amortization of acquired 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 6. EXHI BITS

Exhibits:

10.1 Second Amendment and Note Modification Agreement, dated December 28, 2006 by and among KVH Industries, Inc. (the Borrower), and Bank of America, N.A. (the Bank) (incorporated by reference to Exhibit 10.1 to our current report on Form 8-K filed with the SEC on January 3, 2007)

31.1 Rule 13a-14(a)/15d-14(a) certification of principal executive officer

31.2 Rule 13a-14(a)/15d-14(a) certification of principal financial officer

32.1 Section 1350 certification of principal executive officer

32.2 Section 1350 certification of principal financial officer

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SIGNATURE

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

Date: May 8, 2007

KVH Industries, Inc.

By: /s/ Patrick J. Spratt
Patrick J. Spratt
(Duly Authorized Officer and
Chief Financial and Accounting Officer)

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Exhibit Index

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