



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2003

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission File Number 0-28082

**KVH Industries, Inc.**

*(Exact Name of Registrant as Specified in its Charter)*

**Delaware**

*(State or Other Jurisdiction of Incorporation  
or Organization)*

**05-0420589**

*(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)*

**Securities registered pursuant to Section 12(b) of the Act: None.**

**Securities registered pursuant to Section 12(g) of the Act:**

**Common Stock, \$0.01 par value per share.**

*(Title of Class)*

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

Indicate by an  if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by an  whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). **Yes  No**

On June 30, 2003, the last day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the stock held by non-affiliates of the registrant was approximately \$252,320,000, based upon a total of 10,260,043 shares held by non-affiliates and the last sale price on that date of \$24.65. As of March 1, 2004, the number of shares outstanding of the registrant's common stock was 14,396,808.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement relating to the 2004 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K. The registrant anticipates that its definitive Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after December 31, 2003, the end of the registrant's fiscal year.

## **TABLE OF CONTENTS**

### **PART I**

[ITEM 1. Business](#)

[ITEM 2. Properties](#)

[ITEM 3. Legal Proceedings](#)

[ITEM 4. Submission of Matters to a Vote of Security Holders](#)

### **PART II**

[ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Repurchases of Equity Securities](#)

[ITEM 6. Selected Financial Data](#)

[ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS](#)

[ITEM 7a. Quantitative and Qualitative Disclosure About Market Risk](#)

[ITEM 8. Financial Statements and Supplementary Data](#)

[ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure](#)

[ITEM 9a. Controls and Procedures](#)

### **PART III**

[ITEM 10. Directors and Executive Officers of the Registrant](#)

[ITEM 11. Executive Compensation](#)

[ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters](#)

[ITEM 13. Certain Relationships and Related Transactions](#)

[ITEM 14. Principal Accountant Fees and Services](#)

### **PART IV**

[ITEM 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K](#)

### **SIGNATURES**

[INDEPENDENT AUDITORS' REPORT](#)

[CONSOLIDATED BALANCE SHEETS](#)

[CONSOLIDATED STATEMENTS OF OPERATIONS](#)

[CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY](#)

[CONSOLIDATED STATEMENTS OF CASH FLOWS](#)

[Notes to Consolidated Financial Statements](#)

[Ex-10.2 Amended and Restated 1995 ISOP](#)

[Ex-10.3 Amended and Restated 1996 Incentive & NSOP](#)

[Ex-10.4 Amended & Restated 1996 ESPP](#)

[Ex-10.5 2003 Incentive & Non-Qualified SOP](#)

[Ex-23.1 Consent of KPMG LLP](#)

[Ex-31.1 Section 302 CEO Certification](#)

[Ex-31.2 Section 302 CFO Certification](#)

[Ex-32.1 Section 906 CEO and CFO Certifications](#)

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**INDEX TO FORM 10-K**

		<b>Page</b>
<b>PART I</b>		
Item 1.	Business	3
Item 2.	Properties	10
Item 3.	Legal Proceedings	10
Item 4.	Submission of Matters to a Vote of Security Holders	10
<b>PART II</b>		
Item 5.	Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Repurchases of Equity Securities	11
Item 6.	Selected Financial Data	12
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	13
Item 7a.	Quantitative and Qualitative Disclosure About Market Risk	32
Item 8.	Financial Statements and Supplementary Data	32
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	32
Item 9a.	Controls and Procedures	32
<b>PART III</b>		
Item 10.	Directors and Executive Officers of the Registrant	33
Item 11.	Executive Compensation	33
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	33
Item 13.	Certain Relationships and Related Transactions	33
Item 14.	Principal Accountant Fees and Services	33
<b>PART IV</b>		
Item 15.	Exhibits, Financial Statement Schedule, and Reports on Form 8-K	34

## **PART I**

### **ITEM 1. Business**

#### **Forward-Looking Statements**

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

#### **Additional Information Available**

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

#### **Introduction**

We develop, manufacture and market mobile satellite communications products for the automotive, recreational vehicle and marine markets, and navigation, guidance and stabilization products for defense markets. Our expertise in mobile satellite antenna, digital compass and fiber optic gyroscope technologies has enabled us to lower the cost, decrease the size and improve the performance of our products. Our research and development, manufacturing and quality control capabilities have enabled us to meet the demanding standards of our military, consumer and commercial customers for performance and reliability. This combination of factors has allowed us to increase our penetration of existing markets and enter new markets.

We are a leading provider of mobile satellite communications products that enable customers to receive live digital television, telephone and Internet services in their automobiles, recreational vehicles and marine vessels while in motion. In September 2003, we introduced our TracVision A5, the first commercially available, low-profile satellite antenna to provide in-motion satellite TV reception in minivans, SUVs and other passenger vehicles. We sell our TracVision, Tracphone and TracNet mobile satellite communications products through an extensive international network of retailers, distributors and dealers.

Our defense products include tactical navigation systems that provide uninterrupted navigation and pointing information in a broad range of military vehicles, including Humvees and light armored vehicles. We also offer precision fiber optic gyro-based systems that help stabilize platforms such as gun turrets and radar units and also provide guidance for munitions. 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.

#### **Our Solutions**

We develop, manufacture and market mobile satellite communications products for the automotive, recreational vehicle and marine markets, and navigation, guidance and stabilization products for defense markets. Our expertise in mobile satellite antenna, digital compass and fiber optic gyroscope technologies has enabled us to lower the cost, decrease the size and improve the performance of our products. This has allowed us to increase our penetration of existing markets and enter new markets.

#### **Mobile Satellite Communications**

We have developed a comprehensive family of products using a range of technologies to address the unique needs of our satellite communications markets. Our TracVision, Tracphone and TracNet products enable customers to receive live satellite TV and to send and receive telephone, fax, and Internet information while on the move. Our

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## [Table of Contents](#)

products use sophisticated robotics, stabilization and control software, sensing technologies and advanced antenna designs to offer the following benefits:

*Consistent and reliable mobile satellite communications.* Our mobile satellite communications products can automatically search for, identify and point directly at the satellite, whether a vehicle or vessel is in motion or stationary. Our antennas use gyros and inclinometers to measure the pitch, roll and yaw of an antenna platform in relation to the earth. Microprocessors and our proprietary stabilization and control software use that data to compute the antenna movement necessary for the antenna's motors to point the antenna properly and maintain satellite contact. If an obstruction temporarily blocks the satellite signal, our products continue to track the satellite's location according to the movement of the antenna in order to carry out automatic, rapid reacquisition of the signal when a direct line of sight to the satellite is restored.

*Wide range of products for the mobile user.* We provide mobile satellite communications products for a variety of vehicles in the land mobile market, which includes luxury motor coaches, buses, recreational vehicles and trucks and a variety of vessels in the marine market, which includes commercial shipping vessels, commercial fishing vessels merchant ships and yachts.. We developed our earliest products for the luxury yacht market and have succeeded in reducing the size and cost of our products for introduction into our other markets, which now also includes the automotive market. We entered the automotive market in September 2003 with the introduction of our TracVision A5, a low-profile antenna that currently provides in-motion satellite television in the continental United States using the DIRECTV service. Our entry into the automotive market was facilitated by our new hybrid phased-array antenna technology, which integrates hundreds of small antenna elements across a flat surface, allowing a low-profile design.

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

### **Defense**

We offer a family of digital compass and fiber optic gyro-based systems that address the rigorous requirements of military customers for precision navigation, guidance and stabilization. Our systems offer:

*Reliable, continuously available navigation and guidance.* Our systems provide an unjammable source of reliable, easy-to-use and continuously available navigation and pointing data. For example, our TACNAV system can tell a vehicle driver in which direction to steer to reach a certain target, how far the vehicle has traveled, how much farther to the destination, and whether or not the vehicle is on course. Because our digital compass products measure the earth's magnetic field rather than satellite signals from the global positioning system, or GPS, they are not susceptible to GPS jamming devices. In addition, our new fiber optic gyro-based inertial measurement unit, or IMU, product enhances the accuracy of guided munitions.

*Compatibility with a wide range of vehicles and platforms.* We offer multiple variants of our TACNAV system using both our fiber optic gyros and digital compasses, providing low-cost, integrated tactical navigation solutions for military vehicles ranging from trucks and Humvees to light armored vehicles and main battle tanks. TACNAV systems address the varying operational requirements of different vehicles, such as turret pointing on a battle tank and vehicle navigation on a support vehicle. We also offer several fiber optic gyro-based products that support stabilization applications, such as stabilization of turrets, optical targeting systems, radar and communication antennas.

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

### **Our Products**

We offer a broad array of products to address the needs of a variety of customers in the markets for mobile satellite communications and defense navigation, guidance and stabilization.

**Mobile Satellite Communications Products**

Our mobile satellite communications products include our TracVision, Tracphone and TracNet products, which offer satellite television and voice, fax, data and Internet communications to customers in the automotive, land mobile and marine markets. We began to offer both our first KVH branded mobile satellite communications product, the Tracphone K2, and our first mobile satellite TV antenna, the TracVision, in 1996. Since that time, we have expanded our product offerings to include more than 15 different mobile satellite communications products. Our mobile satellite communications antennas are housed in impact-resistant domes to protect them from inclement weather or debris. All of our mobile satellite communications products require customers to pay fees in connection with the services they obtain with our products, such as monthly Internet access fees for TracNet and airtime charges for Tracphone telephone service. We collect these fees only in cases where the customer contracts for these services through us.

*Automotive.* In the automotive market, we offer the TracVision A5, which uses new hybrid phased-array antenna technology to provide in-motion reception of satellite TV in the continental United States using the DIRECTV service. We began shipping the TracVision A5 at the end of September 2003 following almost three years of research and development. Our TracVision A5 product includes a mobile satellite communications antenna and a receiver to convert the satellite signal into a video stream. The TracVision A5 stands approximately five inches high and mounts to a vehicle's roof rack, making it practical for use aboard minivans, SUVs and other passenger vehicles. The antenna's hybrid phased-array technology integrates 260 small antenna elements across a flat surface, mechanically rotates that surface horizontally and uses an electronic "lens" to bend the satellite signal so that the broadcast energy strikes each of the individual elements at closer to a perpendicular angle. The separate signals from each small antenna element are then recombined to create a single data stream.

*Land Mobile.* In the land mobile market, we offer several versions of our TracVision satellite TV product, including products intended for both stationary and in-motion use, and our TracNet product. Our TracVision L3 and S3 products offer automatic satellite switching and compatibility with both digital video broadcasting technology and our TracNet product. Our other land mobile TracVision products offer fewer features at lower price points. All of our land mobile TracVision products use an elliptical parabolic antenna to reduce the antenna's profile to address height restrictions on the road. Our stationary land mobile TracVision products can be upgraded to full in-motion satellite tracking at any time. We sell our TracVision LF and SF products exclusively to original equipment manufacturers for factory installation on new vehicles.

Our TracNet product uses one of our TracVision antennas to receive broadband downloads of Internet data and either a cellular or satellite modem as a return path. In the continental United States and Canada and nearby coastal waters, TracNet users with a TracVision antenna can surf the Internet at download speeds as fast as 400-512 Kbps, or kilobits per second, while the vehicle is in motion. Without a TracVision antenna, downloads and return path data rates can be as fast as 56 Kbps. TracNet includes both integrated Ethernet networking and 802.11b, known as Wi-Fi, wireless networking capabilities. We began initial TracNet shipments in the second quarter of 2002 and introduced TracNet 2.0 for European consumers in the second quarter of 2003.

*Marine.* In the marine market, we offer our complete range of mobile satellite communications products. Our marine TracVision products use round parabolic antennas to receive satellite TV services. Our newest marine satellite TV system is the TracVision G8, which includes a 32-inch carbon fiber antenna for greater range and efficiency and a KVH military-grade fiber optic gyro for precision tracking.

Our Tracphone products provide in-motion access to global satellite communications offered by Inmarsat, a satellite service provider that supports links for phone, fax and data communications as fast as 64 Kbps. Our Tracphone F77, F55 and F33 antennas use the new Inmarsat Fleet service to offer voice as well as high-speed Internet service, while our Tracphone 252 antenna offers lower-cost voice and low-speed data services via the Inmarsat mini-M service.

Our marine TracNet system is identical to our land mobile TracNet system.

## **Defense Products**

Our defense products include digital compasses for tactical navigation, fiber optic gyros for tactical navigation and stabilization, and our recently introduced inertial measurement unit for precision guidance of torpedoes, smart munitions and unmanned aerial vehicles. Our TACNAV digital compass products have been sold for use aboard U.S. Army, Marine Corps, and Navy vehicles as well as to many allied countries, including Australia, Britain, Canada, Germany, Italy, New Zealand, Saudi Arabia, Spain, Sweden and Taiwan. We believe that we are among the leading manufacturers of such systems. Our TACNAV products are generally designed to our customers' specifications. At customer request, we offer training and other services on a time-and-materials basis. We expect to provide certain inertial measurement unit products, such as those used in smart munitions applications, in partnership with other companies.

Our fiber optic gyro products use an all-fiber design without moving parts, which provides precision, accuracy and durability. Fiber optic gyros can be used for precision tactical navigation systems for military vehicles and image stabilization and synchronization for shoulder- or tripod-mounted weapon simulators.

*Tactical Navigation.* The TACNAV II Fiber Gyro Navigation system is a fiber optic gyro-based navigation and pointing system designed to support a variety of vehicle and weapons platforms. The system offers a compact design, continuous output of heading and pointing data, and a flexible architecture that allows it to function as either a stand-alone navigation module or as the central component of an expanded, multifunctional TACNAV system. We also offer an optional digital compass with TACNAV II.

TACNAV TLS is a digital compass-based tactical navigation and targeting system designed for turreted vehicles, including reconnaissance vehicles, armored personnel carriers and light armored vehicles. The system offers a range of capabilities, including GPS backup and enhancement, vehicle position, hull and turret azimuth, navigation displays, and target location. We also offer T•FOG, a fiber optic gyro upgrade to enhance the accuracy of the TACNAV TLS.

The M100 GMENS, formerly TACNAV Light, is a digital compass-based battlefield navigation system specifically designed for non-turreted vehicles, such as Humvees and trucks. In September 2003, the M100 GMENS was designated by the U.S. Special Operations Command as a standard product, and in November 2003 the German Army gave the M100 GMENS a similar designation. The M100 GMENS offers a range of capabilities, including GPS backup and enhancement, vehicle position, hull azimuth and navigation displays. We believe that customers purchase the M100 GMENS in part because of its low cost relative to its performance.

*Guidance and Stabilization.* Our TG-6000 Inertial Measurement Unit, or IMU, introduced in October 2003, is a guidance system that provides precise measurement of motion and acceleration in three dimensions. It uses a three-axis configuration of our high performance DSP-based fiber optic gyros integrated with three accelerometers. We believe that this configuration provides outstanding performance, high reliability, low maintenance and easy system integration. The TG-6000 IMU is suitable for use in applications that involve flight control, orientation, instrumentation and navigation, such as torpedoes, smart munitions and unmanned aerial vehicles.

Our open-loop DSP-5000 and DSP-3000 fiber optic gyros provide tactical-grade precision measurement of the rate and angle of a platform's turning motion for significantly less than competing closed-loop gyros. We introduced the DSP-5000 in April 2002 and the DSP-3000 in October 2003. Applications for these products include inertial measurement units, integrated navigation systems, attitude/heading/reference systems, and stabilization of antenna, radar and optical equipment. These products use digital signal processing, or DSP, technology to deliver performance superior to analog signal processing devices, which experience greater temperature-sensitive drift and rotation errors. The DSP-3000 is slightly larger than a deck of cards. High-performance 2-axis and 3-axis configurations can be realized by integrating multiple DSP-3000 units.

E•Core is the designation for our original line of fiber optic gyros. The E•Core 4000 series offers both single- and dual-axis fiber optic gyros specifically designed to provide the military with a low-cost, high-performance successor to mechanical gyros. E•Core 4000 series fiber optic gyros are available for highly dynamic environments, such as small-caliber gun and turret applications that experience high rates of fire and repeated shocks, as well as applications requiring long-term bias and/or scale factor stability, such as gun and turret stabilization gyros in main battle tanks. Our E•Core 2000 is a low-noise, high-performance fiber optic gyro available with either digital or analog output. The E•Core 2000 is suitable for demanding, non-tactical stabilization, navigation, positioning and instrumentation applications. We are in the process of gradually phasing out our E•Core products in favor of our higher precision, more durable DSP-based fiber optic gyros.



## [Table of Contents](#)

### **Legacy Products**

We also continue to offer a number of our older products, including Sailcomp and Azimuth 1000 digital marine compass systems and the DataScope hand-held compass and rangefinder product. We do not consider these products to be an integral part of our ongoing business and we expect that these products will experience a long-term decline as we focus our business on more strategic products and services.

### **Sales and Marketing**

We sell our mobile satellite communications products through an international network of independent retailers, chain stores and distributors, as well as to manufacturers of marine vessels and recreational vehicles. We currently market and sell the TracVision A5 in the continental United States through a large number of retailers specializing in automotive electronics and consumer electronic chain stores, as well as a variety of specialty distributors of automotive after-market products and auto dealership expeditors. We do not currently offer the TracVision A5 outside the United States. We intend to continue to expand our distribution network to include additional retailers and distributors in the continental United States. We also plan to pursue arrangements with automobile manufacturers to include our TracVision A5 product as optional or standard equipment on the vehicles they manufacture. Our European sales subsidiary located in Denmark, KVH Europe A/S, coordinates our sales and marketing efforts for our mobile satellite communications products in Europe, the Middle East and Africa.

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.

### **Backlog**

Our backlog was approximately \$4.6 million on December 31, 2003, \$5.6 million on December 31, 2002 and \$8.4 million on December 31, 2001.

Backlog consists of orders evidenced by written agreements and specified delivery dates for customers who are acceptable credit risks. Military orders included in backlog are generally subject to cancellation for the convenience of the customer. When orders are cancelled, we recover actual costs incurred through the date of cancellation and the costs resulting from termination. Individual orders for defense products are often in excess of one million dollars and may require procurement of specialized long-lead components and allocation of manufacturing resources. The complexity of planning and executing larger orders requires customers to order well in advance of the required delivery date, resulting in backlog.

Backlog is not a meaningful indicator for predicting revenue in future periods. Commercial resellers for our mobile satellite communications products and legacy products do not carry extensive inventories and rely on us to ship products quickly. Our generally rapid delivery of our commercial products results in negligible backlog for those products.

### **Intellectual Property**

Our ability to compete effectively depends to a significant extent on our ability to protect our proprietary information. We rely primarily on patents and trade secret laws, confidentiality procedures and licensing arrangements to protect our intellectual property rights. We own more than fifty U.S. and foreign patents and have numerous pending patent applications. Among these patents pending are applications relating to certain technological and design features incorporated into our TracVision A5 low-profile satellite TV antenna. In addition to patents, we register our trademarks in the United States and other key markets where we do business. Our patents and trademarks will expire at various dates between March 28, 2004 and July 13, 2021. We enter into confidentiality agreements with our consultants, key employees and sales representatives, and maintain controls over access to and distribution of our technology, software and other proprietary information. The steps we have taken to protect our technology may be inadequate to prevent others from using what we regard as our technology to compete with us.

We do not generally conduct exhaustive patent searches to determine whether the technology used in our products infringes patents held by third parties. In addition, product development is inherently uncertain in a rapidly

## Table of Contents

evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies.

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

### **Manufacturing**

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

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

### **Competition**

We encounter significant competition in all of our markets, and we expect this competition to intensify in the future.

In the market for mobile satellite communications products, we compete with a variety of companies. We believe the principal competitive factors in this market are product size and design, product performance and reliability, service offerings, price and customer support. In the land mobile market for satellite TV communications equipment, we compete directly with King Controls, MotoSAT, TracStar Systems, Inc., and Winegard Company. In the land mobile market for Internet communications equipment and services, we compete directly with Hughes Electronics Corporation's DIRECWAY service and indirectly with mobile telephone service providers, whose services are substantially cheaper than TracNet. In the marine market for satellite TV communications equipment, we compete with Navigator Technology, Orbit Satellite Television & Radio Network and Sea Tel. In the marine market for telephone, fax, data and Internet communications equipment and services, we compete with Furuno Electric Co., Ltd., Globalstar LP, Iridium Satellite LLC, Japan Radio Company and Nera ASA.

Our TracVision A5 is the first commercially available, low-profile mobile satellite TV antenna for use on minivans, SUVs and other passenger vehicles. In January 2004, Delphi Corp., a prominent supplier of automotive parts, demonstrated a prototype mobile satellite TV antenna that can be integrated into the roof of a luxury SUV. The product, which Delphi announced would be commercialized in coming years, includes antenna technology developed by Motia, Inc., a semiconductor company focused on enabling antennas for wireless systems providers. Motia expects to offer a separate product for the automotive after-market. MotoSAT has announced its intention to introduce a low-profile phased-array satellite antenna manufactured by Skygate in the second quarter of 2004. Winegard has also announced a low-profile in-motion satellite TV antenna compatible with DIRECTV. ERA Technology Ltd. has announced that it has developed a low-profile scanning antenna allowing direct broadcast satellite TV services. In addition, Delphi and SIRIUS Satellite Radio announced in January 2004 that they intend to introduce in 2005 a service offering several video channels through SIRIUS'

## [Table of Contents](#)

existing satellite radio system.

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

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

### **Research and Development**

Focused investments in research and development are critical to our future growth and competitive position in the marketplace. Our research and development efforts are directly related to timely development of new and enhanced products that are central to our core business strategy. The industries in which we compete are subject to rapid technological developments, evolving industry standards, changes in customer requirements, and new product introductions and enhancements. As a result, our success depends in part upon our ability, on a cost-effective and timely basis, to continue to enhance our existing products and to develop and introduce new products that improve performance and meet customers' operational and cost requirements. Our current research and development efforts include projects to achieve additional cost reductions in our products, the development of new products for our existing marine and land mobile markets using our TracVision A5 hybrid phased-array antenna technology and the introduction of a version of the TracVision A5 that is compatible with the DISH Network. We also plan to make future investments in the development of a smaller version of our TracNet Internet access product that is suitable for use in automobiles and to pursue the integration of satellite communications technology with our existing TACNAV systems to enable them to send and receive navigation data directly to and from digital battlefield management or similar systems.

Our research and development activities consist of projects funded by us, projects funded with the assistance of Small Business Innovative Research (SBIR) grants, and customer-funded contract research. SBIR projects are generally directed towards the discovery of specific information requested by the government research sponsor. Many of these grants have enhanced our technologies, resulting in new or improved product offerings. Our customer-funded research efforts are made up of contracts with defense and OEM customers, whose performance specifications are unique to their product applications. These specifications are different from "off-the-shelf" products and require original research to either modify an existing product or develop a new technology. Defense and OEM research often results in new product offerings. We strive to be the first company to bring a new product to market, and we use our own funds to accelerate new product development efforts. Our aggressive product development strategy has contributed to our operating losses in each of the last three fiscal years.

### **Government Regulation**

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

We are subject to compliance with the U.S. export administration regulations. Some of our products have military or strategic applications, and are on the Munitions List of the International Traffic in Arms Regulations. These products require an individual validated license to be exported to certain jurisdictions. The length of time involved in the licensing process varies and can result in delays of the shipping of the products.

### **Employees**

On December 31, 2003, we employed 308 full-time employees, up significantly from the 235 full-time employees we had on December 31, 2002. The increase resulted primarily from hiring for our manufacturing and production operations as we continued to expand both our sales volume and product lines.

## Table of Contents

We also employ temporary or contract personnel to provide short-term and/or specialized support for production and other functional projects.

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

### **ITEM 2. Properties**

The following table provides information about our current facilities.

<u>Location</u>	<u>Type</u>	<u>Principal Uses</u>	<u>Square Footage</u>	<u>Ownership</u>	<u>Lease Expiration</u>
Middletown, Rhode Island	Office, plant and warehouse	Corporate headquarters, research and development, sales and service, manufacturing (mobile satellite communications products), marketing and administration	75,000	Purchased with mortgage loan	—
Middletown, Rhode Island	Plant and warehouse	Manufacturing (mobile satellite communications products)	10,715	Leased	August 2005
Tinley Park, Illinois	Plant and warehouse	Manufacturing (defense products)	23,000	Leased	March 2005
Hoersholm, Denmark	Office and warehouse	European headquarters, sales and service, marketing and administration	11,840	Leased	Terminable upon three-months' notice

We anticipate that any substantial increase in demand for our products, including the TracVision A5, would require us to expand our production capacity. Although we can expand production by adding additional shifts to our operations, we may need to identify and acquire or lease additional manufacturing facilities. We believe that suitable additional or substitute facilities will be available as required.

### **ITEM 3. Legal Proceedings**

On June 20, 2002, Agility Robotics, Inc., and Ross-Hime Designs, Inc., which we refer to together as Agility, filed a complaint against us in the U.S. District Court for the District of Minnesota alleging that certain of our products infringe three U.S. patents held by Agility. On November 14, 2003, we entered into a license and settlement agreement with Agility, which released all pending claims against us, dismissed the lawsuit with prejudice, and licensed its rights under certain of its patents to us.

In the ordinary course of business, we may be a party to legal proceedings and claims. In addition, from time to time, we have had disagreements with customers concerning our products and services, which, we believe, will not have a material adverse effect on our operations or capital resources.

### **ITEM 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of our stockholders during the fourth quarter of fiscal 2003.

**PART II****ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Repurchases of Equity Securities**

*Market Information.* Our common stock has traded on the Nasdaq National Market under the symbol "KVHI" since our initial public offering in 1996. The following table provides, for the periods indicated, the high and low sale prices for our common stock as reported on the Nasdaq National Market.

	High	Low
Year Ended December 31, 2002:		
First quarter	\$ 8.60	\$ 5.90
Second quarter	8.59	6.20
Third quarter	7.75	5.75
Fourth quarter	9.51	5.90
Year Ended December 31, 2003:		
First quarter	13.25	8.62
Second quarter	26.45	11.64
Third quarter	32.70	16.55
Fourth quarter	34.73	21.95

*Stockholders.* On March 5, 2004, we had approximately 122 holders of record of our common stock. This number does not include stockholders for whom shares were held in a "nominee" or "street" name.

*Dividends.* We have never declared or paid cash dividends on our capital stock, and we do not plan to pay any cash dividends in the foreseeable future. We currently intend to retain any future earnings to finance our operations and future growth. In addition, the terms of our bank line of credit place restrictions on our ability to pay cash dividends on our common stock.

**ITEM 6. Selected Financial Data**

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

	Year Ended December 31,				
	2003	2002	2001	2000	1999
(in thousands, except per share data)					
<b>Consolidated Statement of Operations Data:</b>					
Net sales	\$56,672	\$47,694	\$32,707	\$29,954	\$22,822
Cost of goods sold	33,795	26,505	20,255	18,621	15,034
Gross profit	22,877	21,189	12,452	11,333	7,788
Operating expenses:					
Research and development	8,578	8,854	7,885	3,902	4,199
Sales and marketing	11,201	9,951	8,412	6,322	5,471
General and administrative	4,597	3,594	2,514	2,221	2,112
Operating loss	(1,499)	(1,210)	(6,359)	(1,112)	(3,994)
Other income (expense):					
Interest income (expense), net	(165)	(119)	140	(192)	(40)
Other income (expense)	(78)	(62)	(42)	(197)	83
Loss before income tax expense (benefit)	(1,742)	(1,391)	(6,261)	(1,501)	(3,951)
Income tax expense (benefit)	(272)	86	—	(560)	(1,254)
Net loss	\$ (1,470)	\$ (1,477)	\$ (6,261)	\$ (941)	\$ (2,697)
Per share information:					
Net loss per common share – basic and diluted	\$ (0.13)	\$ (0.13)	\$ (0.61)	\$ (0.12)	\$ (0.37)
Weighted average number of shares outstanding:					
Basic and diluted	11,403	11,040	10,217	7,628	7,235

	December 31,				
	2003	2002	2001	2000	1999
(in thousands)					
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 2,849	\$ 7,239	\$11,241	\$ 5,411	\$ 2,048
Working capital	16,561	17,971	18,700	12,452	7,729
Total assets	34,071	32,549	33,163	26,495	19,835
Long-term obligations, excluding current portion	2,504	2,604	2,697	2,784	2,865
Total stockholders’ equity	25,333	25,431	26,246	19,193	14,502

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

**Overview**

We develop, manufacture and market mobile satellite communications products for the automotive, recreational vehicle and marine markets, as well as navigation, guidance and stabilization products for defense markets. Our mobile satellite communications products enable customers to receive live digital television, telephone and Internet services in their automobiles, recreational vehicles and marine vessels while in motion. We sell our mobile satellite communications products through an extensive international network of independent retailers, chain stores and distributors, as well as to manufacturers of marine vessels and recreational vehicles. Our defense products include tactical navigation systems that provide uninterrupted navigation and pointing information in a broad range of military vehicles, including Humvees and light armored vehicles. We also offer precision fiber optic gyro-based systems that help stabilize platforms such as gun turrets and radar units and also provide guidance for munitions. 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 entered the market for mobile satellite antenna systems in 1993. Initially, we sold our antenna systems primarily to original equipment manufacturers. In 1996, we began to offer our mobile satellite communications products to customers under the KVH Tracphone brand. That year, we introduced our first KVH-branded satellite TV antenna for the marine market. In 1999, we introduced a more compact antenna for the recreational vehicle market. In September 2003, we introduced the TracVision A5, our first product for the automotive market using our low-profile satellite TV antenna technology.

In 1979, we invented the first digital compass for use in sailing vessels. Since then, we have further developed and refined this technology to produce reliable precision navigation systems in military and combat environments. In 1997, we acquired fiber optic gyro technology from Andrew Corporation to complement and enhance our existing navigation and inertial measurement systems. We continue to develop new products for the defense industry. In October 2003, we introduced our newest tactical-grade fiber optic gyro, the DSP-3000. Also in October 2003, we introduced the TG-6000, our first fiber optic gyro-based inertial measurement unit for use in aviation, guided munitions and precision navigation applications. We expect to provide certain inertial measurement unit products, such as those used in smart munitions applications, in partnership with other companies.

We generate revenue primarily from the sale of our mobile satellite communications and defense products. We also generate a portion of our revenue from the sale of our legacy recreational navigation systems. Our legacy navigation product line includes primarily digital compass-based navigation products for the marine market. The following table provides, for the periods indicated, our net sales by product line category.

	Year Ended December 31,		
	2003	2002	2001
		(in thousands)	
Mobile satellite communications	\$38,053	\$25,893	\$17,699
Defense	16,241	18,979	11,556
Legacy	2,378	2,822	3,452
Net sales	<u>\$56,672</u>	<u>\$47,694</u>	<u>\$32,707</u>

In addition to revenue from product sales, our mobile satellite communications revenue includes fees earned from product repairs, fees from satellite phone and Internet usage services, and certain DIRECTV account activation services provided in conjunction with the sale of our products. We provide, for a fee, third-party satellite phone and Internet airtime to our Tracphone and TracNet 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

## [Table of Contents](#)

DIRECTV for each customer who activates their DIRECTV service directly through us. Our defense revenue includes engineering services provided under long-term development contracts. To date, revenues earned from product repairs, satellite phone and Internet usage services, DIRECTV activations and earnings under long-term development contracts have not been a material portion of our revenue.

Our defense business is characterized by a small number of customers who place a small number of large dollar value orders. In the year ended December 31, 2003, our top four customers, including the U.S. military as a single customer, accounted for 71.1% of our net sales attributable to defense products and 20.4% of our total net sales. In the year ended December 31, 2002, our top four customers, including the U.S. military as a single customer, accounted for 53.5% of our net sales attributable to defense products and 21.3% of our total net sales. Direct sales to the U.S. military accounted for 11.3% of our total net sales in the year ended December 31, 2003 and 10.7% in the year ended December 31, 2002. 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 only a few orders. Each order can have a significant impact on our net sales, and because our defense products generally have higher margins than our mobile satellite communications products, each order can have an impact on our net income that is disproportionately large relative to the revenue generated by the order. Moreover, customers of our defense products are governments and government contractors who generally must adhere to lengthy procurement processes, which make the timing of individual orders difficult to predict and often result in long sales cycles. Government customers and their contractors can generally cancel orders for our products for convenience.

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

	Year Ended December 31,		
	2003	2002	2001
	(in thousands)		
Originating from North American locations:			
United States and Canada	\$47,221	\$38,627	\$25,706
Europe	3,140	4,390	2,258
Other	621	605	572
Total North America	50,982	43,622	28,536
Originating from European location:			
Europe	4,977	3,796	3,920
Other	713	276	251
Total Europe	5,690	4,072	4,171
Net sales	<u>\$56,672</u>	<u>\$47,694</u>	<u>\$32,707</u>

Since 2001, we have made significant investments in research and development. We completed a private placement of common stock in the first half of 2001 and used a substantial portion of the proceeds to develop new technologies, including a low-profile satellite TV antenna and a high-speed in-fiber modulator. We introduced our first product using our low-profile satellite TV antenna technology, the TracVision A5, in September 2003. A decline in the potential market for our in-fiber modulator led us to conclude in the second half of 2002 that we should defer further significant investments in this technology until market demand increases. During this period, we also continued to develop other products, and in October 2003, we introduced our DSP-3000 and TG-6000 fiber optic gyro-based products. As a result of the more advanced progress of these various research and development initiatives and the significant reduction in our investments in our in-fiber modulator technology, we expect that our research and development expense will constitute a smaller percentage of our net sales than we experienced during 2001, 2002 and 2003. We anticipate maintaining our efforts in the areas of identifying and evaluating new and innovative satellite and navigation products based on our platform technologies, refining products for commercial introduction and improving manufacturing and development processes.

In addition to our internally funded research and development efforts, we also conduct research and development activities that are funded by our customers. These activities relate primarily to the customization of our defense products to meet customer requirements. In accordance with accounting principles generally accepted in the United States of America, we account for customer-funded research as revenue, and we account for the associated research costs as cost of goods sold. As a result, in accordance with accounting principles generally accepted in the



## [Table of Contents](#)

United States of America, some of our expenditures for research and development activities are not included in the research and development expense that we calculate and present in our statement of operations. The following table presents our total annual research effort, representing the sum of research cost of goods sold and the operating expense of research and development as described in our statement of operations. Our management believes this information is useful because it provides a better understanding of our total expenditures on research and development activities.

	Year ended December 31,		
	2003	2002	2001
	(in thousands)		
Research and development expense presented on statement of operations	\$8,578	\$8,855	\$7,885
Cost of customer-funded research and development included in cost of goods sold	937	1,041	1,342
Total expenditures on research and development activities	<u>\$9,515</u>	<u>\$9,896</u>	<u>\$9,227</u>

As of December 31, 2003, we had approximately \$2.8 million in cash and cash equivalents and an accumulated deficit of approximately \$11.3 million.

### **Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure at the date of our financial statements. Our significant accounting policies are summarized in note 1 to our consolidated financial statements. The significant accounting policies that we believe are the most critical in understanding and evaluating our reported financial results include the following:

#### **Revenue Recognition**

*Revenue from Product Sales.* Revenue from product sales is recognized when requested goods are shipped, title has passed and collectibility is reasonably assured. We establish reserves for potential sales returns and allowances, and evaluate, on a monthly basis, the adequacy of those reserves based upon historical experience and our expectations for future returns.

*Contracted Service Revenue.* Engineering service revenue under long-term development contracts is recognized during the period in which we perform the development efforts in accordance with the performance criteria as established under the agreement. Performance is determined principally by comparing the accumulated costs incurred to date with management's estimate of total cost to complete the contracted work. Revisions to costs and income estimates are reflected in the period in which the facts that require revision become known. Any advance payments arising from such long-term development contracts are deferred and recognized as revenue when earned. If, in any period, estimated total costs under a contract indicate a loss, then such loss is provided for in that period. To date, contracted service revenue has not been a significant portion of our total revenue.

*Product Service Revenue.* Revenue from services other than under long-term development contracts is recognized when completed services are provided to the customer and collectibility is reasonably assured. To date, product service revenue has not been a significant portion of our total revenue.

*Satellite Activation and Usage Revenue.* Service activation revenue is recognized at the time of activation. Satellite connectivity and usage revenue is recognized when services are provided to subscribers. To date, satellite activation and usage revenue has not been a significant portion of our total revenue.

#### **Accounts Receivable**

Our estimate for allowance for doubtful accounts related to trade receivables is primarily based on specific, historical criteria. We evaluate specific accounts where we have information that the customer may have an inability to meet its financial obligations. We make judgments, based on facts and circumstances, regarding the need to

## [Table of Contents](#)

record a specific reserve for that customer against amounts owed to reduce the receivable to the amount that we expect to collect. We also provide for a general reserve based on an aging analysis of our accounts receivable. We evaluate these reserves on a monthly basis and adjust them as we receive additional information that impacts the amount reserved. If circumstances change, we could change our estimates of the recoverability of amounts owed to us by a material amount.

### ***Inventories***

Inventory is valued at the lower of cost or market. We regularly review current quantities on hand, actual and projected sales volumes and anticipated selling prices on products and write down slow-moving and/or obsolete inventory to its net realizable value. Generally, our inventory does not become obsolete because the materials we use are typically interchangeable among various product offerings. If we overestimate projected sales or anticipated selling prices, our inventory might be overvalued, and we would have to reduce our inventory valuation accordingly.

### ***Long-Lived Assets***

Long-lived assets are reviewed for indications of impairment when events and circumstances indicate that the assets might not be recoverable. We measure recoverability of a long-lived asset by comparing the asset's carrying value to the estimated future undiscounted cash flows associated with the utilization of the asset. If assets were considered impaired, we would measure the impairment by the amount by which the book value of the asset exceeds its fair value based on current market values for comparable assets and projected future discounted cash flows. The preparation of future cash flows requires significant judgments and estimates with respect to future revenues related to the asset and the future cash outlays related to those revenues. Actual revenues and related cash flows or changes in anticipated revenues and related cash flows could result in a change in this assessment and result in an impairment charge. The preparation of discounted cash flows also requires the selection of an appropriate discount rate. The use of different assumptions would increase or decrease estimated discounted cash flows and could increase or decrease the related impairment charge.

### ***Income Taxes and Deferred Income Tax Assets and Liabilities***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry forwards. On a quarterly basis, we assess the recoverability of our deferred tax assets by considering whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on the history of operating losses in our ongoing business, we determined that it was more likely than not that portions of the deferred tax assets were not recoverable and therefore a valuation allowance was established. We determined that the remaining deferred tax assets were recoverable based on certain tax planning strategies. The amount of the deferred tax assets considered realizable could be reduced in the future if there are changes in the feasibility of those tax planning strategies. Conversely, some portion or all of the previously reserved deferred tax assets could be realized in the future if we generate future earnings during the periods in which those temporary differences become deductible.

## Results of Operations

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

	Year Ended December 31,		
	2003	2002	2001
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	59.6	55.6	61.9
Gross profit	40.4	44.4	38.1
Operating expenses:			
Research and development	15.1	18.6	24.1
Sales and marketing	19.8	20.8	25.7
General and administrative	8.1	7.5	7.7
Operating loss	(2.6)	(2.5)	(19.4)
Other income (expense), net	(0.5)	(0.4)	0.3
Loss before income tax expense (benefit)	(3.1)	(2.9)	(19.1)
Income tax expense (benefit)	(0.5)	0.2	—
Net loss	(2.6)%	(3.1)%	(19.1)%

### Years Ended December 31, 2003 and 2002

#### Operating Summary

Net loss for 2003 was \$1.5 million, or \$0.13 per basic and diluted common share, and was approximately equal to the fiscal 2002 loss of \$1.5 million, or \$0.13 per basic and diluted common share. The 2003 results included an 18.8% increase in sales over 2002, offset by a 4.0 percentage point decline in gross margin and an 8.8% increase in operating expenses. The decline in gross margin from 44.4% in 2002 to 40.4% in 2003 was primarily due to a lower percentage of our higher margin military products and a high initial product cost of the TracVision A5. The increase in operating expenses was primarily the result of increased sales and marketing expenses associated with the strong growth in sales of satellite communication products together with the initial product launch expenses for our TracVision A5 satellite TV antenna. Additional professional fees and increased salary and salary-related expenses also contributed to the increase in operating expenses.

#### Net Sales

Net sales increased by \$9.0 million, or 18.8%, to \$56.7 million in 2003 from \$47.7 million in 2002. The increase was primarily attributable to a 47.0% increase in sales volume of mobile satellite communications products and services, including our recently introduced TracVision A5 automotive antenna. Growth in our marine and land mobile satellite communication products primarily reflects our focus on the continued development and expansion of sales to major distributors, large account retailers and original equipment manufacturers.

Defense sales decreased by \$2.7 million, or 14.4%, to \$16.2 million in 2003 from \$19.0 million in 2002. Sales of tactical navigation systems, including engineering services, were \$12.5 million, a decrease of \$2.9 million compared to 2002. The decrease in 2003 primarily reflects a reduction in demand compared to 2002 when the U.S. military was preparing for conflicts in Afghanistan and Iraq. Fiber optic component sales increased by \$122,000, or 3.4%, to \$3.8 million in 2003 from \$3.6 million in 2002.

Legacy marine and OEM sensor shipments declined by \$444,000, or 15.7%, to \$2.4 million in 2003 from \$2.8 million in 2002. The decline in our legacy product sales is consistent with the long-term trend line for these non-strategic products.

#### Cost of Goods Sold

Our cost of goods sold consists of direct labor, materials, manufacturing overhead expenses and engineering costs related to customer-funded research and development. Cost of goods sold increased by \$7.3 million, or 27.5%, to \$33.8 million in 2003 from \$26.5 million in 2002. The increase was primarily the result of increases in sales and unit volume as well as the high initial per unit cost of the TracVision A5. Customer-funded research and

## [Table of Contents](#)

development costs included in cost of goods sold during 2003 and 2002 were approximately \$937,000 and \$1.0 million, respectively. As cost of goods sold increased in relation to revenue, gross margin decreased to 40.4% in 2003 from 44.4% in 2002. The gross margin decline was primarily the result of decreased sales volumes of our higher-margin defense-related products coupled with the initial product cost of the TracVision A5 automotive antenna. Partially offsetting these factors were year-over-year improvements in product gross margin for our marine and land mobile satellite communications products. Manufacturing overhead, at 11% of revenue in 2003, was comparable with 2002.

### **Operating Expenses**

Research and development expense consists of direct labor, materials, associated overhead expenses, and other direct costs in support of our internally funded product development activities. All internal research and development costs are expensed in the period they are incurred. Research and development expense decreased by \$276,000, or 3.1%, to \$8.6 million in 2003 from \$8.9 million in 2002. As a percentage of net sales, research and development expense decreased to 15.1% in 2003 from 18.6% in 2002. The decrease was due primarily to reduced spending on our photonic fiber initiative. Both 2002 and 2003 spending levels reflect significant investment in our new low-profile TracVision A5 satellite antenna.

Sales and marketing expense consists primarily of salaries and related expenses for sales and marketing personnel, sales commissions for in-house and third-party sales representatives, travel expenses, sales literature, advertising and trade shows. Sales and marketing expense increased by \$1.2 million, or 12.6%, to \$11.2 million in 2003 from \$10.0 million in 2002. As a percentage of net sales, sales and marketing expense decreased modestly to 19.8% in 2003 from 20.9% in 2002. The dollar increase resulted primarily from the costs to support the strong growth of satellite communications sales and the initial TracVision A5 product launch and promotional activities. Also contributing to the increase were higher sales representative commissions that generally scale proportionately with sales volume, and expanded large account and trade show promotions within the marine and land-mobile markets.

General and administrative expense consists of costs attributable to our management, finance, accounting, management information systems, human resources, facility management, and outside professional services. General and administrative expense increased by \$1.0 million, or 27.9%, to \$4.6 million in 2003 from \$3.6 million in 2002. As a percentage of net sales, general and administrative expense increased to 8.1% in 2003 from 7.5% in 2002. License and litigation settlement costs, professional fees and salary and salary-related expenses accounted for the majority of our general and administrative cost increases.

### **Income Taxes**

In 2003, we recorded an income tax benefit of \$272,000 compared to income tax expense of \$86,000 in 2002. The income tax benefit recorded in 2003 consisted primarily of a one-time adjustment of approximately \$235,000 to reflect the recovery of prior U.S. taxes paid as well as a modest increase in a foreign deferred tax asset associated with our Denmark subsidiary. The one-time U.S. benefit resulted from the favorable outcome of an IRS audit of our income tax returns for the fiscal years 1996 through 1998. The loss for 2003 did not result in any additional U.S. income tax benefit because we accrued an equal and offsetting amount of tax valuation allowances. For a further discussion of income taxes, see note 7 to our consolidated financial statements included elsewhere in this annual report.

### **Years Ended December 31, 2002 and 2001**

#### **Net Sales**

Net sales increased by \$15.0 million, or 45.8%, to \$47.7 million in 2002 from \$32.7 million in 2001. Mobile satellite communications revenues made up over half of this growth, increasing by \$8.2 million, or 46.3%, to \$25.9 million in 2002 from \$17.7 million in 2001. Communications growth reflects the expansion of sales of land mobile products through large national distributors and significant original equipment manufacturer sales volumes resulting from new agreements with major recreational vehicle distributors and manufacturers.

Combined sales for our defense navigation, fiber optic gyro components, legacy marine and OEM products increased by \$6.8 million, or 45.3%, to \$21.8 million in 2002 from \$15.0 million in 2001.

Defense navigation sales increased by \$8.2 million, or 114.1%, to \$15.3 million in 2002 from \$7.2 million in 2001; fiber optic gyro components (excluding defense shipments) declined by

## [Table of Contents](#)

\$751,000, or 17.1%, to \$3.7 million in 2002 from \$4.4 million in 2001; and legacy marine and OEM sensor shipments declined by \$630,000, or 18.3%, to \$2.8 million in 2002 from \$3.5 million in 2001. The growth in defense revenues was due to the demand for tactical military navigation systems, such as our TACNAV Light system. In addition, an increased percentage of our defense systems sales included fiber optic components. The decline in fiber optic gyro component sales reflected the unevenness of non-recurring orders year-to-year, while the planned decline in marine legacy and OEM orders resulted from a marketing shift away from the consumer marine navigation market towards higher-volume sales opportunities in the mobile satellite communications and defense markets.

### **Cost of Goods Sold**

Cost of goods sold increased by \$6.2 million, or 30.9%, to \$26.5 million in 2002 from \$20.3 million in 2001. As cost of goods sold decreased in relation to revenue, gross margin increased to 44.4% in 2002 from 38.1% in 2001. Customer-funded research and development costs included in cost of goods sold were approximately \$1.0 million in 2002 and \$1.3 million in 2001. During 2002, we realized material and labor cost savings equal to 0.6% of sales. Cost improvements resulted from reduced component costs, outsourcing of sub-assemblies and improvements in our manufacturing methods. Our supply-chain and materials requirements planning systems continued to provide us with stronger control over our manufacturing inventories, resulting in favorable material purchase agreements, improved component pricing and increased inventory turns, which rose to 6.6 turns from 5.2 turns during the previous year. Manufacturing overhead spending decreased slightly from the prior year and overhead spending declined as a percentage of sales to 11.1% in 2002 from 16.4% in 2001. Improved manufacturing spending reflects favorable overhead spending and improved capacity utilization at our manufacturing facilities at our headquarters in Middletown, Rhode Island and in Tinley Park, Illinois. Our largest productivity gain occurred at our Rhode Island manufacturing facility, where overhead spending grew modestly, while production rose by 42.4% in 2002 from 2001 levels.

### **Operating Expenses**

Research and development expense increased by \$970,000, or 12.3%, to \$8.9 million in 2002 from \$7.9 million in 2001. As a percentage of net sales, research and development expense decreased to 18.6% in 2002 from 24.1% in the same period in 2001. Internally funded development costs associated with our low-profile antenna and active-fiber projects for each of 2002 and 2001 represented approximately 50% of total research and development spending in 2002 and 2001. We made significant progress in the development of our low-profile antenna in 2002 and announced the product in January 2003. Telecommunications market conditions forced us to dramatically slow our active fiber high-speed modulator project. Other research and development expense increased approximately \$900,000 as a result of decreased customer funding and new hires.

Sales and marketing expense increased by \$1.5 million, or 18.3%, to \$10.0 million in 2002 from \$8.4 million in 2001. As a percentage of net sales, sales and marketing expense decreased to 20.9% in 2002 from 25.7% in 2001. The majority of the 2002 cost increase was related to variable selling expenses such as third-party sales commissions, trade show costs, media, and the expense of new product introductions. We utilize a third-party distribution network, which augments our in-house resources. Third party distribution allows us to grow with fewer in-house sales personnel and enables us to take advantage of third-party sales resources and their geographic market presence. In 2002, we also entered into OEM agreements with leading recreational vehicle coach manufacturers that allowed us to leverage their sales volumes to increase our product sales. OEM customers provide significant sales volume potential and require a proportionately smaller investment in sales support costs per dollar of revenue than lower volume customers.

General and administrative expense increased by \$1.1 million, or 42.9%, to \$3.6 million in 2002 from \$2.5 million in 2001. As a percentage of net sales, general and administrative expense decreased slightly to 7.5% in 2002 from 7.7% in 2001. Cost increases reflect annual salary increases, key hires, rising professional fees resulting from compliance with new regulations contained in the Sarbanes-Oxley Act, and professional fees associated with general law support for patent filings, contracts and other legal matters.

Interest income reflected the interest earned by investing excess cash in fully insured, federal short-term obligations.

Interest expense was made up of interest charges related to our mortgage loan and the commitment fee associated with the unused portion of our asset-based line of credit.

## **Income Taxes**

In 2002, we had income tax expense of \$86,000 compared to no income tax expense in 2001. Income tax expense in 2002 represented both income tax on income generated by our foreign subsidiary and domestic income tax expense from further adjustment of cumulative domestic income tax benefit. The total income tax benefit resulting from domestic losses for 2002 and 2001 was allocated to income from continuing operations and stockholders' equity (e.g., from current year disqualifying dispositions of incentive stock options and exercise of non-qualified stock options), but was fully reserved with a valuation allowance.

## **Liquidity and Capital Resources**

We have historically funded our operations from product sales, net proceeds from public and private equity offerings, bank financings, equipment leases and, to a lesser extent, proceeds received from exercises of warrants and stock options. As of December 31, 2003, we had \$2.8 million in cash and cash equivalents and \$16.6 million in working capital. On February 13, 2004, we completed an underwritten public offering of 2,750,000 shares of our common stock at \$18.75 per share. We received net proceeds of approximately \$48.0 million after deducting all associated offering expenses. We intend to use these proceeds primarily for working capital and general corporate purposes.

For the year ended December 31, 2003, we used \$2.7 million in operating cash primarily to fund our sales, marketing, research and product development activities and to finance working capital requirements. Operating cash uses included \$2.4 million in inventory growth and \$1.7 million in accounts receivable growth. Both the inventory and accounts receivable growth were driven by the overall product sales growth and the TracVision A5 introduction. Directly related to the growth in our sales and inventory levels, was an offsetting \$1.3 million increase in our accounts payable balance.

Net cash used in investing activities was \$2.9 million for the year ended December 31, 2003, and primarily represents acquisitions of manufacturing equipment required to support sales and product line growth. Equipment purchases during 2003 included the acquisition and installation of our new TracVision A5 production capability as well as additional operational and computer equipment needed to support growth in our Rhode Island and Chicago facilities. We anticipate that the level of capital expenditures during 2004 and the first six months of 2005 will grow approximately proportional with sales.

Net cash provided by financing activities was \$1.3 million for the year ended December 31, 2003. We received \$1.4 million from common stock issuances under our stock option and stock purchase programs and recorded \$10,000 in equipment financing debt. This amount was partially offset by \$93,000 in principal payments on outstanding long-term debt obligations.

For the year ended December 31, 2002, cash used in operating activities decreased by \$1.6 million to \$3.1 million from \$4.7 million in 2001. The improvement included the impact of a decrease in the net loss of \$4.8 million and an increase in short-term liabilities, which was partially offset by a change from a decrease in accounts receivable of \$543,000 in 2001 to an increase in accounts receivable of \$3.8 million in 2002, a difference of \$4.3 million. A key success factor in preserving operating cash was our control of manufacturing inventory, which decreased by \$177,000, while sales grew by 45.8% over 2001 results. Capital spending declined by \$640,000 from 2001 to 2002, as we were selective in making capital acquisitions. Cash generated from financing activities declined by \$12.1 million from 2001 to 2002, reflecting the fact that a private offering occurred in 2001. Overall, in 2001 we experienced a net increase in cash and cash equivalents of \$5.8 million. Factoring out the \$13.0 million raised in our 2001 private offering, our cash flows from operating activities, investing activities and other financing activities in 2001 resulted in a net decrease in cash and cash equivalents of \$7.2 million. The net decrease in cash and cash equivalents of \$4.0 million that we experienced in 2002 represents an improvement in our cash flow by \$3.2 million over our 2001 results, calculated without the proceeds from the 2001 private offering. The largest factor contributing to the 2002 results was the decrease in our net loss.

Since March 27, 2000, we have had a revolving loan agreement with a bank. The agreement originally provided for a \$5.0 million asset-based, revolving loan facility. We amended and restated the loan agreement on July 17, 2003. The loan agreement currently provides for a maximum available credit of \$15.0 million and will expire on July 17, 2006. We pay interest on any outstanding amounts at a rate equal to, at our option, LIBOR plus 2.0%, or the greater of the Federal Funds Effective Rate plus 0.5% or the bank's prime interest rate. We pay fees at an annual rate of 0.25% on up to \$10.0 million of the unused portion of the loan facility. The loan facility advances funds using an

## [Table of Contents](#)

asset availability formula based upon our eligible accounts receivable and inventory balances, less a fixed reserve amount. We may terminate the loan agreement prior to its full term, provided we give 30 days written notice to the bank. As of December 31, 2003, no borrowings were outstanding under the facility.

On January 11, 1999, we entered into a mortgage loan in the amount of \$3.0 million. The note 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 note and amortization of the principal, a balloon payment of \$2.0 million is due on February 1, 2009. We paid principal of \$87,000 in 2002 and \$93,000 in 2003. As of December 31, 2003, \$2.6 million of loan principal remained outstanding.

We believe that the \$48.0 million net proceeds from our February 13, 2004 equity offering, together with our existing working capital, will be adequate to meet planned operating and capital requirements through at least the end of 2004. 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 acceptable terms.

### Recent Accounting Pronouncements

In November 2003, the Financial Accounting Standards Board, or FASB, issued a tentative decision to require companies to expense the fair value of all employee equity-based awards granted, modified or settled. The tentatively determined requirements would be effective for public companies beginning in the first quarter of 2005 and would require any options issued or vesting on or after January 1, 2005 to be recognized as compensation expense. The FASB has not yet determined the valuation model required to be adopted. We believe the adoption of this proposed statement could have a material effect upon our financial results beginning in the first quarter of 2005.

### Contractual Obligations and Other Commercial Commitments

As of December 31, 2003, our contractual commitments consisted of a mortgage note payable, facility leases and equipment leases. The principal repayment of the mortgage note is based on a 20-year amortization schedule, but the term is 10 years, requiring a balloon payment of \$2.0 million on February 1, 2009. There are no loan-to-value covenants in the loan that would require early pay-down of the mortgage if the market value of the property should decline. We are also obligated under multi-year facility leases that terminate in 2005. Our other operating leases represent vehicle and equipment operating leases.

The following table summarizes our obligations under these commitments at December 31, 2003:

Contractual Obligations	Payment Due by Period				
	Total	Less than 1 Year	1 - 3 Years	3-5 Years	More than 5 Years
			(in thousands)		
Mortgage and other loans	\$2,614	\$110	\$222	\$256	\$2,026
Facility lease obligations	336	248	88	—	—
Operating lease obligations	206	141	65	—	—
Total	<u>\$3,156</u>	<u>\$499</u>	<u>\$375</u>	<u>\$256</u>	<u>\$2,026</u>

We have not entered into any off-balance sheet commercial commitments, such as standby letters of credit, guarantees or standby repurchase obligations.

## RISK FACTORS

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

### **We may not be profitable in the future.**

We have a history of unprofitable operations. Although we generated net income during four of the last six fiscal quarters, we incurred net losses of \$1.5 million in both 2003 and 2002 and \$6.3 million in 2001. As of December 31, 2003, we had an accumulated deficit of \$11.3 million.

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

Our TracVision A5 is the first commercially available, low-profile mobile satellite TV antenna practical for use on minivans, SUVs and other passenger vehicles, and we began shipping the TracVision A5 in September 2003. Accordingly, the market for this product is new and emerging. Consumers may not respond favorably to live satellite TV in passenger vehicles, and the market may not accept the TracVision A5. The early stage of development of this market makes it difficult for us to predict customer demand accurately. For example, sales of the TracVision A5 in the fourth quarter of 2003 were below our expectations, due in part to production delays resulting from component supply issues in the quarter. Although we believe we have addressed those issues in our production process, similar issues or other latent defects in the TracVision A5 could adversely affect sales.

We believe the success of the TracVision A5 will depend upon consumers' assessment of whether or not it meets their expectations for performance, quality, price and design. For example, the TracVision A5 is designed only for use on open roads in the continental United States where there is a clear view of the transmitting satellite in the southern sky. Among the factors that could affect the success of the TracVision A5 are:

- the extent to which customers perceive mobile satellite TV services as a luxury or a necessary convenience;
- the extent to which customers prefer live TV over recorded media;
- the performance, price and availability of competing or alternative products relative to the TracVision A5;
- customers' willingness to pay monthly fees for satellite television service;
- the adoption of laws or regulations that restrict or ban live television or other video technology in vehicles;
- difficulties or inconveniences associated with scheduling installation at the point of sale;
- poor performance arising from improper installation or installation of damaged equipment; and
- our limited experience with marketing a product to the automotive market, which is substantially larger and more fragmented than our other markets.

### **We expect that others will introduce competing mobile satellite TV antennas for automobiles.**

Our TracVision A5 is the first commercially available, low-profile mobile satellite TV antenna for use on minivans, SUVs and other passenger vehicles. Any advantage we may have may erode as others enter this market. In January 2004, Delphi Corp., a prominent supplier of automotive parts, demonstrated a prototype mobile satellite TV antenna that can be integrated into the roof of a luxury SUV. The product, which Delphi announced would be commercialized in coming years, includes antenna technology developed by Motia, Inc., a semiconductor company focused on enabling antennas for wireless systems providers. Motia expects to offer a separate product for the automotive after-market. MotoSAT has announced its intention to introduce a low-profile phased-array satellite antenna manufactured by Skygate in the second quarter of 2004. Winegard has also announced a low-profile in-motion satellite TV antenna compatible with DIRECTV. ERA Technology Ltd. has announced that it has developed a low-profile scanning antenna allowing direct broadcast satellite TV services. These satellite antenna products may have a slightly lower profile than the TracVision A5's five-inch profile, and customers may prefer antennas integrated into the vehicle roof or antennas with a lower profile. In addition, Delphi and SIRIUS Satellite Radio announced in January 2004 that they intend to introduce in 2005 a service offering several video channels through SIRIUS' existing satellite radio system. Customers may delay purchasing the TracVision A5 in anticipation of the release of any of these products. Competition from any of these products could impair our ability to sell the TracVision A5 and may force us to reduce the price of the TracVision A5. Moreover, Delphi's long-term



relationships with automobile manufacturers may give it a significant advantage in selling mobile satellite TV antennas to those manufacturers.

**We must achieve significant cost reductions for the TracVision A5 to reach our targeted profit margins.**

Initial product profit margins for the TracVision A5 have been low. To reach our targeted profit margins, we must significantly reduce our manufacturing costs for the TracVision A5. We may be unable to achieve the cost reductions necessary to increase our overall profit margins. Although we have already commenced a cost reduction program that includes volume purchasing discounts 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 TracVision A5 is not attractive to a broad range of customers, we may be forced to lower the price, which would further impair our product profit margins unless we are able to achieve corresponding cost reductions.

**Customers for TACNAV and our other defense products include the U.S. military and foreign governments, whose purchasing schedules and priorities can be unpredictable.**

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

- new military and operational doctrines that affect military equipment needs;
- changes in tactical navigation requirements;
- changes in modernization plans for military equipment;
- priorities for current battlefield operations;
- delays in military procurement schedules;
- allocation of funding for military programs;
- delays in the testing and acceptance of our products; and
- sales cycles that are long and difficult to predict.

These factors can cause substantial fluctuations in sales of TACNAV and our other defense products from period to period. Moreover, TACNAV and most of our other defense products must meet military quality standards, and our products may not continue to meet existing 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. 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.

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

We derive a substantial portion of our defense revenues from a small number of customers. In the year ended December 31, 2003, our top four customers, including the U.S. military as a single customer, accounted for 71.1% of our net sales attributable to defense products and 20.4% of our total net sales. In the year ended December 31, 2002, our top four customers, including the U.S. military as a single customer, accounted for 53.5% of our net sales attributable to defense products and 21.3% of our total net sales. Direct sales to the U.S. military accounted for 11.3% of our total net sales in the year ended December 31, 2003 and 10.7% in the year ended December 31, 2002. The loss of any of these customers would substantially reduce our net sales and results of operations and could seriously harm our business.

## [Table of Contents](#)

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

Unlike our mobile satellite communications products, TACNAV and our other defense products are purchased through orders that typically range in size from several hundred thousand dollars to over 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 higher margins than our mobile satellite communications products, the loss of a large order for defense products could have a disproportionately adverse effect on our net sales and results of operations.

### **Shifts in our product mix toward our mobile satellite communications products may reduce our overall gross margins.**

Our mobile satellite communications products have historically had lower product margins than our defense products. In 2003, sales of our mobile satellite communications products grew while sales of defense products declined compared to 2002. If this change in the mix profile of satellite communications and defense products were to continue, it could result in lower gross margins in the future.

### **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. For example, we obtain plastic components for the TracVision A5 from a single supplier. 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 general, we do not have written long-term supply agreements with our suppliers but instead purchase components through purchase orders, which exposes us to potential price increases and termination of supply without notice or recourse. We do not carry significant inventories of product components, which 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 satellite communications products.**

We market and sell our mobile satellite 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.

### **We depend on others to provide programming for our TracVision products, Internet access for our TracNet products, and telephone, fax and data services for our Tracphone products.**

## [Table of Contents](#)

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 continental United States, the ExpressVu service in Canada and various other regional services in other parts of the world. Our initial TracVision A5 product is compatible only with the DIRECTV service in the continental United States. If customers become dissatisfied with the programming, pricing, service, availability or other aspects 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 that could impair the performance of our TracVision products.

Similarly, our Tracphone and TracNet products currently depend on satellite services provided by third parties. We rely on Inmarsat for satellite communications services for our Tracphone products. We rely on Bell ExpressVu for TracNet service in North America and Telemar for TracNet service in Europe. We also rely on Globalstar LP for the satellite return link for TracNet. In February 2002, Globalstar filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. In November 2003, the U.S. Bankruptcy Court in Delaware approved the acquisition of the Globalstar business by Thermo Capital Partners LLC. Globalstar announced that the transfer of some assets has already occurred and that it expects the entire process to be completed upon receipt of U.S. regulatory approval. There is no assurance that this acquisition will be completed or that the buyer will operate the Globalstar business in a manner that will allow us to continue to use Globalstar services as we currently do.

If Globalstar or any of our other vendors are unable to fulfill their obligations, we would need to seek alternate suppliers. 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 satellite 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 satellite 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 while in orbit. These risks include 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 you 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.

### **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 satellite communications products are largely generated by discretionary consumer spending, and demand for these products can demonstrate slower growth than we anticipated as a result of recent 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 satellite communications products due to a perception that they are luxury items. If global and regional economic conditions fail to improve or deteriorate, demand for our products could be adversely affected.

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

The markets for mobile satellite communications products and defense navigation, mobilization 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 recently announced their intentions to offer low-profile in-motion satellite antennas in the near future. These products will compete with our TracVision A5 and may offer more attractive performance, pricing and other features.

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

Recently, we have expanded our operations to pursue existing and potential market opportunities. This growth has placed, and is expected to continue to place, a strain on our personnel, management, financial and other resources. If we fail to manage our growth properly, we may incur unnecessary expenses and the efficiency of our operations may decline. In order to pursue successfully the opportunities presented by the emerging TracVision A5 market, we must continue to expand our operations. To manage our growth effectively, we must, among other things:

- upgrade and expand 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, 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 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.

**Competition may limit our ability to sell our recreational vehicle and marine satellite communications products and defense products.**

The mobile satellite 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

## Table of Contents

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.

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. In the land mobile market for Internet communications equipment, we compete directly with Hughes Electronics Corporation's DIRECWAY service and indirectly with cellular telephone service providers, whose services are substantially cheaper than TracNet. In the marine market for satellite TV communications equipment, we compete with Navigator Technology, Orbit Satellite Television & Radio Network and Sea Tel. In the marine market for telephone, fax, data and Internet communications equipment, we compete with Furuno Electric Co., Ltd., Globalstar LP, Iridium Satellite LLC, Japan Radio Company and Nera ASA. 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 have substantially greater financial, managerial, technical, marketing, personnel and other resources than we do;
- 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.

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

Sales to customers outside the United States and Canada accounted for approximately 16.7%, 19.0% and 22.4% of our net sales in the years ended December 31, 2003, 2002 and 2001, respectively. 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 satellite communication products to function with different satellite services and technology in use in various regions around the world, including multiple satellite services in Europe;
- 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;
- satisfaction of international regulatory requirements and procurement of any necessary licenses or permits;
- 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

## [Table of Contents](#)

- economic and political instability in some international markets.

### **If we are unable to obtain 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.

### **If we are required to account for stock options as a compensation expense, our reported net income and earnings per share will be significantly reduced.**

We currently expect that changes in accounting standards or regulations will require us to record the fair market value of stock options and other forms of equity compensation as a compensation expense in our financial statements. We currently grant all options with an exercise price equal to fair market value and do not record compensation expense in connection with the grants. Accordingly, if such a change occurs, our reported net income and earnings per share will be reduced.

### **Exports of our 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.

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

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

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

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

**We may require additional financing, which may be difficult to obtain.**

In the future we may require additional capital to fund our operations, carry out our business strategy, and sustain our business. For example, we may require funds to expand manufacturing operations to meet additional demand for our mobile satellite communications products, and we may need funds to promote our new TracVision A5 product. Our existing and anticipated sources of capital may be insufficient for our needs, and we may be unable to access additional capital when needed. Our future capital requirements will depend upon customer demand, competitive conditions, regulatory and technological developments, magnitude and variability of our revenue, and equipment costs and other costs associated with the development and manufacture of our products. We may be unable to obtain additional capital on terms that are favorable or even acceptable to us. Any failure to raise capital as we need it may require us to delay or abandon marketing, product development and other plans.

**We may fail to commercialize our photonic fiber development projects.**

Our significant investments in the development of photonic fiber technology have not resulted in the commercialization of any new products. A decline in the potential market for a high-speed in-fiber modulator led us to conclude in the second half of 2002 that we should defer further significant investments in this technology until market demand increases. We may never complete the technological development necessary to commercialize the product.

**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:

- demand for our mobile satellite communications products and defense products;
- the timing and size of individual orders from military customers;
- our ability to manufacture, test and deliver products in a timely and cost-effective manner;

## Table of Contents

- our success in winning competitions for orders;
- the timing of new product introductions by us or our competitors;
- the mix of products we sell;
- 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.

### **New corporate governance requirements are likely to increase our costs and make it more difficult to attract qualified directors.**

We face new corporate governance requirements under the Sarbanes-Oxley Act of 2002, as well as rules adopted by the SEC and the Nasdaq Stock Market. We expect that these laws, rules and regulations will increase our legal and financial compliance costs and make some activities more difficult, time consuming and costly. We also expect that these new requirements will make it more difficult and more expensive for us to obtain director and officer liability insurance. We may be required to accept reduced coverage or incur significantly higher costs to obtain coverage. These new requirements are also likely to make it more difficult for us to attract and retain qualified individuals to serve as members of our board of directors or committees of the board, particularly the audit committee.

### **The market price of our common stock may be volatile.**

Our stock price has been volatile. From January 1, 2003 to March 5, 2004, the trading price of our common stock ranged from \$8.62 to \$34.73. Many factors may cause the market price of our common stock to fluctuate, including:

- variations in our quarterly results of operations;
- the introduction of new products 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 accounting principles;
- future sales of shares of common stock in the public market; and
- market conditions in our industries and the economy as a whole.

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 class action litigation against that company. Any litigation against us could



## [Table of Contents](#)

cause us to incur substantial costs, divert the time and attention of our management and other resources or otherwise harm our business.

### **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 7a. Quantitative and Qualitative Disclosure 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 operations in Denmark are transacted in the Danish Krone or Euro and reported in the U.S. dollar, the functional currency. We have not engaged in material formal currency hedging activities, but do have a natural hedge in that both subsidiary revenues and expenses are denominated in the same currency. Any gains or losses from currency transactions have not been material.

The primary objective of our investment activities is to preserve principal and maintain liquidity, while at the same time maximize income. Some of the securities that we invest in may have market risk. To minimize this risk we have generally maintained our portfolio in cash and cash equivalents comprised primarily of U.S. government-backed treasury accounts in which the weighted average maturity is less than three months. 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 credit facility, we will be subject to interest rate risk. There were no borrowings outstanding at December 31, 2003.

**ITEM 8. Financial Statements and Supplementary Data**

Our consolidated financial statements and supplementary data, together with the report of KPMG LLP, independent auditors, are included in Part IV of this Report on Form 10-K.

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

Not applicable.

**ITEM 9a. Controls and Procedures**

**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 Vice President 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 Vice President 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 fourth quarter of fiscal 2003, 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.

**PART III**

We have omitted the information required in Part III of this annual report because we intend to include that information in our definitive proxy statement for our 2004 annual meeting of stockholders, which we expect to file before 120 days after the end of fiscal 2003. We incorporate that information in this annual report by reference to our 2004 proxy statement.

**ITEM 10. Directors and Executive Officers of the Registrant**

Information in our 2004 proxy statement under the captions “Directors and Executive Officers,” “Section 16(a) Beneficial Ownership Reporting Compliance” and “Code of Ethics” is incorporated by reference.

**ITEM 11. Executive Compensation**

Information in our 2004 proxy statement under the caption “Compensation of Directors and Executive Officers” is incorporated by reference.

**ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information in our 2004 proxy statement under the captions “Principal Stockholders” and “Equity Compensation Plans” is incorporated by reference.

**ITEM 13. Certain Relationships and Related Transactions**

None.

**ITEM 14. Principal Accountant Fees and Services**

Information in our 2004 proxy statement under the caption “Principal Accountant Fees and Services” is incorporated by reference.

**PART IV**

**ITEM 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K**

(a) Documents filed as part of this report:

	Page
1. Financial Statements	
Report of Independent Auditors	37
Consolidated Balance Sheets as of December 31, 2003 and 2002	38
Consolidated Statements of Operations for the years ended December 31, 2003, 2002 and 2001	39
Consolidated Statements of changes in Stockholders' Equity for the years ended December 31, 2003, 2002 and 2001	40
Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2002 and 2001	41
Notes to Consolidated Financial Statements	42
2. Financial Statement Schedule	
See "Schedule II – Valuation and Qualifying Accounts" and "Independent Auditors Report" included on pages 54 and 55.	
All other schedules have been omitted since the information is not required, or because the information required is included in our consolidated financial statements or notes.	

(b) Reports on Form 8-K:

On October 2, 2003, we furnished a current report on Form 8-K, which provided an update for our fiscal quarter ended September 30, 2003 under Item 12.

On October 16, 2003, we filed a current report on Form 8-K, which reported our financial results for our fiscal quarter ended September 30, 2003 under Item 5. On October 21, 2003, we amended that report to report those financial results under Item 12, rather than Item 5.

On November 14, 2003, we furnished a current report on Form 8-K, which reported the settlement of our litigation with Agility under Item 12.

On November 26, 2003, we filed a current report on Form 8-K/A, which amended our current report on Form 8-K filed on March 12, 2003 regarding the extension of the term of our line of credit with Fleet Capital Corporation under Items 5 and 7 to provide text inadvertently omitted from the original filing.

[Table of Contents](#)

(C) Exhibit Index

Exhibit No.	Description	Filed with this Form 10-K	Incorporated by Reference		Exhibit No.
			Form	Filing Date	
3.1	Amended and Restated Certificate of Incorporation		S-1	February 16, 1996	3.3
3.2	Certificate of Amendment of Certificate of Incorporation		S-3	November 26, 2003	4.2
3.3	Amended, Restated and Corrected By-Laws		8-K	January 23, 2004	3.1
4.1	Specimen certificate for the common stock		S-1/A	March 22, 1996	4.1
* 10.1	1986 Executive Incentive Stock Option Plan		S-1	February 9, 1996	10.1
* 10.2	Amended and Restated 1995 Incentive Stock Option Plan	X			
* 10.3	Amended and Restated 1996 Incentive and Nonqualified Stock Option Plan	X			
* 10.4	Amended and Restated 1996 Employee Stock Purchase Plan	X			
* 10.5	2003 Incentive and Nonqualified Stock Option Plan	X			
10.6	Open End Mortgage and Security Agreement dated January 11, 1999 with IDS Life Insurance Co. for 50 Enterprise Center, Middletown, RI		10-K	March 24, 1999	99.1
10.7	Commercial and Industrial Lease dated January 30, 1998 with Cole Taylor Bank for Tinley Park, IL		10-K	March 24, 1999	99.2
10.8	Lease Agreement dated August 18, 2003 with Tech Plaza 2, 3 & 4 LLC for Tech 4 office building, Middletown, RI		8-K	August 21, 2003	99.1
10.9	Loan and Security Agreement dated March 27, 2000 with Fleet Capital Corporation		10-K	March 30, 2000	10.38
10.10	First Amendment to Loan and Security Agreement dated March 7, 2003 with Fleet Capital Corporation		8-K/A	November 26, 2003	10.1
10.11	Second Amendment to Loan and Security Agreement dated as of June 25, 2003 with Fleet Capital Corporation		8-K	June 27, 2003	99.1
10.12	Amended and Restated Credit and Security Agreement dated July 17, 2003 with Fleet Capital Corporation		8-K	July 18, 2003	99.1
21.1	List of Subsidiaries		S-1	March 28, 1996	21.1
23.1	Consent of KPMG LLP	X			
31.1	Rule 13a-14(a)/15d-14(a) certification of principal executive officer	X			
31.2	Rule 13a-14(a)/15d-14(a) certification of principal financial officer	X			
32.1	Rule 1350 certification	X			

\* Management contract or compensatory plan.

**SIGNATURES**

Pursuant to the requirements of Section 13 or Section 15(d) 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.

KVH Industries, Inc.

Date: March 14, 2004

By: /s/ Martin A. Kits van Heyningen

Martin A. Kits van Heyningen  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Martin A. Kits van Heyningen</u>	President, Chief Executive Officer and Director (Principal Executive Officer)	March 14, 2004
<u>Martin A. Kits van Heyningen /s/ Patrick J. Spratt</u>	Chief Financial Officer (Principal Financial and Accounting Officer)	March 14, 2004
<u>Patrick J. Spratt /s/ Arent H. Kits van Heyningen</u>	Chairman of the Board	March 14, 2004
<u>Arent H. Kits van Heyningen /s/ Robert W.B. Kits van Heyningen</u>	Director	March 14, 2004
<u>Robert W.B. Kits van Heyningen /s/ Mark S. Ain</u>	Director	March 14, 2004
<u>Mark S. Ain /s/ Stanley K. Honey</u>	Director	March 14, 2004
<u>Stanley K. Honey /s/ Bruce J. Ryan</u>	Director	March 14, 2004
<u>Bruce J. Ryan</u>	Director	
<u>Charles R. Trimble</u>		

**INDEPENDENT AUDITORS' REPORT**

Board of Directors and Stockholders  
KVH Industries, Inc.:

We have audited the accompanying consolidated balance sheets of KVH Industries, Inc. and subsidiary as of December 31, 2003 and 2002, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of KVH Industries, Inc. and subsidiary at December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

/s/ KPMG LLP

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Providence, Rhode Island  
February 13, 2004

**KVH INDUSTRIES, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2003	2002
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,848,755	7,239,255
Accounts receivable, net of allowance for doubtful accounts of \$120,000 in 2003 and \$153,090 in 2002	11,353,175	9,716,292
Costs and estimated earnings in excess of billings on uncompleted contracts	415,415	377,058
Inventories	6,298,151	3,947,207
Prepaid expenses and other deposits	1,229,064	587,647
Deferred income taxes	650,157	616,877
Total current assets	<u>22,794,717</u>	<u>22,484,336</u>
Property and equipment, net	8,722,854	7,384,888
Other assets, less accumulated amortization of \$764,419 in 2003 and \$638,395 in 2002	315,201	441,225
Deferred income taxes	2,238,430	2,238,430
Total assets	<u>\$ 34,071,202</u>	<u>32,548,879</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Commitments and contingencies (notes 4, 5 and 14)		
Current liabilities:		
Accounts payable	\$ 3,590,494	2,321,104
Accrued compensation and employee-related expenses	1,646,776	1,441,029
Accrued professional fees and license and settlement costs	644,121	220,891
Accrued other	215,381	345,550
Current portion of long-term debt	109,954	93,262
Customer deposits	27,422	91,665
Total current liabilities	<u>6,234,148</u>	<u>4,513,501</u>
Long-term debt excluding current portion	2,503,881	2,603,885
Total liabilities	<u>8,738,029</u>	<u>7,117,386</u>
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 11,590,103 as of December 31, 2003 and 11,149,768 as of December 31, 2002	115,901	111,498
Additional paid-in capital	36,505,751	35,134,093
Accumulated deficit	(11,288,479)	(9,818,025)
Accumulated other comprehensive income	—	3,927
Total stockholders' equity	<u>25,333,173</u>	<u>25,431,493</u>
Total liabilities and stockholders' equity	<u>\$ 34,071,202</u>	<u>32,548,879</u>

*See accompanying Notes to Consolidated Financial Statements.*



**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31,		
	2003	2002	2001
Net sales	\$56,672,605	\$47,694,483	\$32,707,123
Cost of goods sold	33,795,341	26,504,831	20,255,238
Gross profit	22,877,264	21,189,652	12,451,885
Operating expenses:			
Research and development	8,578,628	8,854,946	7,885,374
Sales and marketing	11,200,733	9,950,784	8,411,910
General and administrative	4,596,799	3,593,827	2,514,178
Operating loss	(1,498,896)	(1,209,905)	(6,359,577)
Other income (expense):			
Interest income (expense), net	(165,459)	(118,696)	140,173
Other expense	(78,044)	(61,941)	(41,989)
Loss before income tax expense (benefit)	(1,742,399)	(1,390,542)	(6,261,393)
Income tax expense (benefit)	(271,945)	86,100	—
Net loss	\$ (1,470,454)	\$ (1,476,642)	\$ (6,261,393)
Per share information:			
Net loss per common share – basic and diluted	\$ (0.13)	\$ (0.13)	\$ (0.61)
Weighted average number of shares outstanding – basic and diluted	11,403,258	11,039,676	10,217,305

*See accompanying Notes to Consolidated Financial Statements.*

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Income	Total Stockholders' Equity
Balances at December 31, 2000	\$ 86,191	\$21,186,459	\$ (2,079,990)	\$ —	\$19,192,660
Net loss	—	—	(6,261,393)	—	(6,261,393)
Sale of common stock	22,138	12,211,539	—	—	12,233,677
Common stock issued under benefit plan	347	173,170	—	—	173,517
Issuance of warrants	—	777,770	—	—	777,770
Exercise of stock options	936	129,064	—	—	130,000
Balances at December 31, 2001	109,612	34,478,002	(8,341,383)	—	26,246,231
Net loss	—	—	(1,476,642)	—	(1,476,642)
Common stock issued under benefit plan	299	167,353	—	—	167,652
Exercise of stock options	1,587	488,738	—	—	490,325
Unrealized gain on foreign exchange contract	—	—	—	3,927	3,927
Balances at December 31, 2002	111,498	35,134,093	(9,818,025)	3,927	25,431,493
Net loss	—	—	(1,470,454)	—	(1,470,454)
Non-cash stock based compensation expense	—	12,057	—	—	12,057
Common stock issued under benefit plan	185	225,197	—	—	225,382
Exercise of warrants	1,090	(1,090)	—	—	—
Exercise of stock options	3,128	1,135,494	—	—	1,138,622
Unrealized loss on foreign exchange contract	—	—	—	(3,927)	(3,927)
Balances at December 31, 2003	<u>\$115,901</u>	<u>36,505,751</u>	<u>(11,288,479)</u>	<u>—</u>	<u>25,333,173</u>

*See accompanying Notes to Consolidated Financial Statements.*

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net loss	\$(1,470,454)	\$ (1,476,642)	\$ (6,261,393)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,723,748	1,623,211	1,366,392
Provision for doubtful accounts	52,812	85,053	(16,126)
Non-cash stock based compensation expense	12,057	—	—
(Benefit) provision for deferred income taxes	(33,280)	20,922	—
(Increase) decrease in accounts and contracts receivable	(1,689,695)	(3,774,656)	543,413
(Increase) decrease in costs and estimated earnings in excess of billings on uncompleted contracts	(38,357)	105,428	(63,341)
(Increase) decrease in inventories	(2,354,871)	176,996	(523,543)
Increase in prepaid expenses and other deposits	(641,417)	(176,854)	(60,348)
Increase in accounts payable	1,269,390	236,597	606,309
Increase (decrease) in accrued expenses	498,808	863,680	(21,000)
Decrease in customer deposits	(64,243)	(812,188)	(291,238)
Net cash used in operating activities	<u>(2,735,502)</u>	<u>(3,128,453)</u>	<u>(4,720,875)</u>
Cash flows from investing activities:			
Capital expenditures	(2,935,690)	(1,444,188)	(2,084,680)
Net cash used in investing activities	<u>(2,935,690)</u>	<u>(1,444,188)</u>	<u>(2,084,680)</u>
Cash flows from financing activities:			
Repayment of mortgage note	(83,312)	(86,974)	(81,111)
Repayment of bank line of credit	—	—	(598,865)
Proceeds from sale of common stock	—	—	13,011,447
Stock option and benefit plan transactions	1,364,004	657,977	303,517
Net cash provided by financing activities	<u>1,280,692</u>	<u>571,003</u>	<u>12,634,988</u>
Net (decrease) increase in cash and cash equivalents	(4,390,500)	(4,001,638)	5,829,433
Cash and cash equivalents at beginning of year	7,239,255	11,240,893	5,411,460
Cash and cash equivalents at end of year	<u>\$ 2,848,755</u>	<u>\$ 7,239,255</u>	<u>\$ 11,240,893</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	<u>\$ 209,688</u>	<u>\$ 219,707</u>	<u>\$ 224,039</u>

*See accompanying Notes to Consolidated Financial Statements.*

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(1) Summary of Significant Accounting Policies**

**(a) Description of Business**

KVH Industries, Inc. (KVH) develops, manufactures and markets mobile satellite communications products for the automotive, land mobile and marine markets, and navigation, guidance and stabilization products for defense markets.

KVH is among the leading providers of mobile satellite communications products that enable customers to receive live television, telephone and Internet services in their cars, recreational vehicles and marine vessels while on the move. In September 2003, KVH introduced its TracVision A5 low-profile antenna system, which provides in-motion satellite TV reception in minivans, SUVs and other passenger vehicles. KVH sells its TracVision, Tracphone and TracNet mobile satellite 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 information in a spectrum of military vehicles, including Humvees 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 U.S. and allied governments and government contractors, as well as through an international network of authorized independent sales representatives.

**(b) Principles of Consolidation**

The consolidated financial statements include the financial statements of KVH Industries, Inc. and its wholly owned subsidiary, KVH Europe A/S ("KVH Europe"). All significant inter-company accounts and transactions have been eliminated in consolidation.

**(c) Cash and Cash Equivalents**

KVH considers all highly liquid investments with maturity, at the purchase date, of three months or less to be cash equivalents.

**(d) Revenue Recognition**

*Product Sales.* Revenue from product sales is recognized when requested goods are shipped, title has passed and collectibility is reasonably assured. KVH establishes reserves for potential sales returns and allowances, and evaluates, on a monthly basis, the adequacy of those reserves based upon historical experience and its expectations for future returns.

*Contracted service revenue.* Engineering service revenue under long-term development contracts is recognized during the period in which KVH performs the development efforts in accordance with the performance criteria as established under the agreement. Performance is determined principally by comparing the accumulated costs incurred to date with management's estimate of total cost to complete the contracted work. Revisions to costs and income estimates are reflected in the period in which the facts that require revision become known. Any advance payments arising from such long-term development contracts are deferred and recognized as revenue when earned. If, in any period, estimated total costs under a contract indicate a loss, then such loss is provided for in that period. To date, contracted service revenue has not been a significant portion of KVH's total revenue.

*Product service revenue.* Revenue from services other than under long-term development contracts is recognized when completed services are provided to the customer and collectibility is reasonably assured. To date, product service revenue has not been a significant portion of KVH's total revenue.

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

Satellite *activation and usage revenue*. Service activation revenue is recognized at time of activation. Satellite connectivity and usage revenues are recognized when services are provided to subscribers. To date, satellite activation and usage revenue has not been a significant portion of KVH's total revenue.

**(e) Progress Payments**

Progress payments received on long-term development contracts are applied against the balance sheet item costs and estimated earnings in excess of billings on uncompleted contracts. Under certain contractual arrangements by which progress payments are received from the United States Government, the United States Government has a lien on the capitalized project costs identified with related contracts.

**(f) Inventories**

Inventories are stated at the lower of cost or market using the first-in first-out costing method.

**(g) Property and Equipment**

Property and equipment are stated at cost. Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the respective assets. The principal lives used in determining the depreciation rates of various assets are: buildings and improvements, 40 years; leasehold improvements, over term of lease; machinery and equipment, 5 years; office and computer equipment, 5-7 years; and motor vehicles, 4 years.

**(h) Other Assets**

Other assets consist of patents and other intangibles resulting from KVH's October 1997 acquisition. These costs are being amortized on a straight-line basis over periods ranging from 5-12 years. KVH continually reviews intangible assets to assess recoverability from estimated future results of operations and estimated future cash flows.

**(i) Research and Development**

Expenditures for research and development, including customer-funded research and development, are expensed as incurred. Revenue from customer-funded research and development is included in net sales, and the related product development costs are included in cost of goods sold. Revenue and related development costs from customer-funded research and development are as follows:

	Year ended December 31,		
	2003	2002	2001
Customer-funded revenues	\$1,196	\$1,472	\$1,715
Customer-funded costs	937	1,041	1,342

**(j) Foreign Currency Translation**

The financial statements of KVH's foreign subsidiary are maintained in the United States dollar functional currency for both reporting and consolidation purposes. Historical exchange rates in effect on the date of the transaction are used to translate and record monetary assets and liabilities. Revenue and other expense elements are translated at rates that approximate the rates in effect on the transaction dates. Realized foreign currency exchange gains and losses are recognized within operating expense in the consolidated statements of operations.

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(k) Stock-based Compensation**

KVH accounts for its various stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." The following pro forma information is based on provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure," issued in December 2002.

	Year ended December 31,		
	2003	2002	2001
Net loss as reported	\$(1,470)	\$(1,477)	\$(6,261)
Deduct: Compensation expense under SFAS 123, net of tax at expected tax rate for the period	1,330	703	1,420
Pro forma net loss	<u>\$(2,800)</u>	<u>\$(2,180)</u>	<u>\$(7,681)</u>
Loss per share – basic and diluted			
As reported	<u>\$ (0.13)</u>	<u>\$ (0.13)</u>	<u>\$ (0.61)</u>
Pro forma	<u>\$ (0.25)</u>	<u>\$ (0.20)</u>	<u>\$ (0.75)</u>

**(l) Income Taxes**

Income taxes are accounted for under the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

**(m) Use of Estimates**

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 as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(n) Long-lived Assets**

KVH's management reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

**(o) Loss per Common Share**

Basic net loss per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net loss per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined in accordance with the treasury-stock accounting method. Common stock equivalents to purchase approximately 516,000, 342,000 and 425,000 common stock shares for the twelve-month periods ended December 31, 2003, 2002, and 2001, respectively, have been excluded from the fully diluted calculation of loss per share, as inclusion would be anti-dilutive.

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(p) Fair Value of Financial Instruments**

The carrying amounts of accounts receivable, contracts receivable, costs and estimated earnings in excess of billings on uncompleted contracts, accounts payable and accrued expenses approximate fair value due to the short maturity of these instruments. The carrying amount of KVH's mortgage loan approximates fair value based on currently available quoted rates of similarly structured mortgage facilities.

**(2) Inventories**

Inventories as of December 31, 2003 and 2002 include the costs of material, labor, and factory overhead. Inventories consist of the following:

	December 31,	
	2003	2002
Raw materials	\$4,571	\$2,763
Work in process	49	108
Finished goods	1,678	1,076
	<u>\$6,298</u>	<u>\$3,947</u>

**(3) Property and Equipment**

Property and equipment, net, as of December 31, 2003 and 2002 consist of the following:

	December 31,	
	2003	2002
Land	\$ 807	\$ 807
Building and improvements	3,528	3,430
Leasehold improvements	1,375	1,283
Machinery and equipment	7,478	5,286
Office and computer equipment	4,710	4,243
Motor vehicles	227	107
	<u>18,125</u>	<u>15,156</u>
Less accumulated depreciation	<u>9,402</u>	<u>7,771</u>
	<u>\$ 8,723</u>	<u>\$ 7,385</u>

Depreciation for the years ended December 31, 2003, 2002 and 2001 amounted to approximately \$1.6 million, \$1.5 million and \$1.2 million, respectively.

**(4) Debt and Line of Credit**

On January 11, 1999, KVH entered into a mortgage loan in the amount of \$3.0 million. The note term is 10 years, with a principal amortization of 20 years at a fixed rate of interest of 7%. 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 note and amortization of the principal, a balloon payment of approximately \$2.0 million is due on February 1, 2009. The principal paid during the year ended December 31, 2003 totaled \$93,000. As of December 31, 2003, KVH's Denmark subsidiary, also has outstanding a \$10,000, 6% variable Copenhagen interbank offered rate-based note, payable monthly through September 2005 to a financial institution, in relation to the purchase of a commercial vehicle.

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(4) Debt and Line of Credit (continued)**

The following is a summary of future principal payments under the mortgage and equipment loans:

Years ending December 31,	Principal Payment
2004	\$ 110
2005	107
2006	115
2007	123
2008	132
After 2008	2,027
Total outstanding at December 31, 2003	<u>\$2,614</u>

Since March 27, 2000, KVH has had a revolving loan agreement with a bank. The agreement originally provided for a \$5.0 million asset-based, revolving loan facility. KVH amended and restated the loan agreement on July 17, 2003. The loan agreement currently provides for a maximum available credit of \$15.0 million and will expire on July 17, 2006. In the event of a draw down KVH would pay interest at a rate equal to, at its option, LIBOR plus 2%, or the greater of the Federal Funds Effective Rate plus 0.5% or the bank's prime interest rate. Fees are paid at an annual rate of 0.25% on up to \$10.0 million of the unused portion of the loan facility. The loan facility advances funds using an asset availability formula based upon KVH's eligible accounts receivable and inventory balances, less a fixed reserve amount. KVH may terminate the loan agreement prior to its full term, provided the bank is given 30 days' written notice. At December 31, 2003, no borrowings were outstanding under the facility.

**(5) Leases**

KVH has certain operating leases for facilities, automobiles, and various equipment. The following is a summary of future minimum payments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year at December 31, 2003:

Years ending December 31,	Operating Leases
2004	\$388
2005	122
2006	20
2007	11
Total minimum lease payments	<u>\$541</u>

Total rent expense incurred under facility operating leases for the years ended December 31, 2003, 2002 and 2001 amounted to \$210,000, \$165,000 and \$165,000, respectively.

**(6) Stockholders' Equity****(a) Employee Stock Options and Warrants**

KVH currently has a 1996 Incentive and Non-Qualified Stock Option Plan and a 2003 Incentive and Non-Qualified Stock Option Plan (the "Plans").

KVH has reserved 2,126,639 shares of its common stock for issuance upon exercise of options granted or to be granted under the Plans. These options generally vest in equal annual amounts over four years beginning on the date of the grant. The Plans provide that options be granted at exercise prices not less than market value on the date the option is granted and options are adjusted for such changes as stock splits and stock dividends. No options are exercisable for periods of more than 10 years after date of grant.



**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(6) Stockholders' Equity (continued)**

All stock option values were derived using the Black-Scholes option-pricing model. The per share weighted-average fair values of stock options granted during 2003, 2002 and 2001 were \$9.49, \$2.69 and \$3.68, respectively. All options were valued as of the date of grant using the following weighted-average assumptions:

	Year Ended December 31,		
	2003	2002	2001
Risk-free interest rate	2.7%	3.4%	3.4%
Expected volatility	93.9%	45.6%	68.5%
Expected life (years)	4.13	3.97	2.85

The changes in outstanding employee stock options for the three years ended December 31, 2003, 2002 and 2001 are as follows:

	Number of Shares	Weighted-average Exercise Price
Outstanding at December 31, 2000	907,360	\$ 4.08
Granted	386,134	6.32
Exercised	(76,627)	4.11
Expired or canceled	(185,609)	6.60
Outstanding at December 31, 2001	1,031,258	\$ 4.78
Granted	379,550	6.83
Exercised	(183,054)	3.80
Expired or canceled	(77,475)	5.47
Outstanding at December 31, 2002	1,150,279	\$ 5.56
Granted	314,425	13.97
Exercised	(350,815)	4.83
Expired or canceled	(88,698)	6.82
Outstanding at December 31, 2003	1,025,191	\$ 8.28

The following table summarizes information about employee stock options at December 31, 2003:

Range of Exercise Prices	Number Outstanding	Average Remaining Life in Years	Outstanding Weighted- Average Exercise Price	Number Exercisable	Exercisable Weighted- Average Exercise Price
\$ 1.06 – 2.00	44,375	0.17	\$ 1.15	44,375	\$ 1.15
2.01 – 4.00	62,398	0.86	2.76	53,883	2.63
4.01 – 6.00	147,089	1.92	5.47	85,920	5.39
6.01 – 9.00	470,391	2.94	6.88	148,308	6.92
9.01 – 13.50	183,363	4.17	11.25	950	13.00
13.51 – 20.02	117,575	4.59	18.40	21,250	19.97
	1,025,191	2.96	\$ 8.28	354,686	\$ 5.98

As of December 31, 2002 and 2001 the number of options exercisable was 468,229 and 424,771, respectively, and the weighted average exercise price of those options was \$4.62 and \$4.09, respectively.

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(6) Stockholders' Equity (continued)**

**(b) Employee Stock Purchase Plan**

The Employee Stock Purchase Plan (the "ESPP") covers substantially all KVH's employees in the United States and Denmark. The ESPP allows eligible employees the right to purchase common stock on a semi-annual basis at 85% of the market price. During 2003, 2002 and 2001, 18,516, 29,854 and 34,720 shares, respectively, were issued under this plan. As of December 31, 2003, 85,964 shares were reserved for future issuance under the plan.

**(7) Income Taxes**

Income tax (benefit) expense for the years ended December 31, 2003, 2002 and 2001 attributable to income (loss) from continuing operations is presented below.

		<u>Current</u>	<u>Deferred</u>	<u>Total</u>
Year ended December 31, 2003				
	Federal	\$(280)	\$—	\$(280)
	State	—	—	—
	Foreign	—	8	8
		<u>\$(280)</u>	<u>\$ 8</u>	<u>\$(272)</u>
Year ended December 31, 2002				
	Federal	\$ 65	\$—	\$ 65
	State	—	—	—
	Foreign	—	21	21
		<u>\$ 65</u>	<u>\$21</u>	<u>\$ 86</u>
Year ended December 31, 2001				
	Federal	\$ —	\$—	\$ —
	State	—	—	—
	Foreign	—	—	—
		<u>\$ —</u>	<u>\$—</u>	<u>\$ —</u>

The income tax benefits derived from non-qualified and disqualified dispositions of employee stock options amounting to \$1,364,000, \$194,000 and \$108,000 in the years ended December 31, 2003, 2002 and 2001, respectively, were not included in the statement of operations. These tax benefits have been fully reserved with a valuation allowance.

The actual income tax expense (benefit) differs from the "expected" income tax expense (benefit) computed by applying the United States Federal corporate income tax rate of 34% to income (loss) before taxes as follows:

	<u>Year Ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Computed "expected" tax benefit	\$(592)	\$(473)	\$(2,129)
Increase (decrease) in income taxes resulting from:			
State income tax expense (benefit), before valuation allowance, net of Federal benefit	23	(20)	(324)
Non-deductible expenses	18	17	17
Foreign tax rate and regulation differential	(14)	(3)	(15)
Adjustments to prior year deferred tax items and carry backs	—	17	(152)
Revaluation of tax credits	57	—	—
Change in tax reserves	(65)	—	—
Change in valuation allowance (federal and state)	301	548	2,603
Net income tax expense (benefit)	<u>\$(272)</u>	<u>\$ 86</u>	<u>\$ —</u>

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(7) Income Taxes (continued)**

The components of results of operations before income taxes, determined by tax jurisdiction, are as follows:

	Year Ended December 31,		
	2003	2002	2001
United States	\$(1,805)	\$(1,461)	\$(6,305)
Denmark	63	70	44
<b>Total</b>	<b>\$(1,742)</b>	<b>\$(1,391)</b>	<b>\$(6,261)</b>

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities for the period presented are as follows:

	December 31,	
	2003	2002
Deferred tax assets:		
Accounts receivable, due to allowance for doubtful accounts	\$ 47	\$ 53
Inventories, due to valuation reserve	64	108
Inventories, due to differences in costing for tax purposes	5	3
Inventories, due to unrealized gain	86	34
Operating loss carry forwards	8,412	5,764
Intangibles due to differences in amortization	112	106
Research and alternative minimum tax credit carry forwards	235	329
State tax credit carry forwards	69	69
Accrued warranty costs	193	41
Accrued vacation	105	24
Accrued legal	1	33
Gross deferred tax assets	9,329	6,564
Affiliated foreign subsidiary's operating loss carry forwards	210	177
Less valuation allowance	(5,793)	(3,436)
Net deferred tax assets	3,746	3,305
Deferred tax liability:		
Property and equipment, due to differences in depreciation	(857)	(450)
Net deferred tax asset	<u>\$ 2,889</u>	<u>\$ 2,855</u>

As of December 31, 2003, KVH had federal net operating loss carry forwards available to offset future taxable income of approximately \$19,548,000. KVH also had state net operating loss carry forwards available to offset future state taxable income of approximately \$10,287,000. The federal net operating loss carry forwards generated in years 1999 through 2003 expire in years 2019 through 2023, respectively, while the state net operating loss carry forwards will begin to expire in 2004. Furthermore, KVH had foreign operating loss carry forwards to offset future taxable income of approximately \$403,000. These foreign net operating loss carry forwards generated in 1999 and 2000 expire in years 2004 and 2005, respectively.

As of December 31, 2003, KVH had federal tax credit carry forwards available to reduce future tax expense of approximately \$235,000. Research and development tax credit carry forwards in the amount of \$224,000 relating to years 1989 through 1997 are due to expire in years ranging from 2004 through 2012. Alternative Minimum Tax credits of \$11,000 from 1995 have no expiration date. As of December 31, 2003, KVH also had state tax credit carry forwards available to reduce future state tax expense of approximately \$69,000. These state investment tax credit carry forwards relate to years 1998 through 2001 and are due to expire in years ranging from 2005 through 2008.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends upon the generation of future taxable income during the periods in which those temporary differences become deductible. KVH has recorded a valuation allowance against its deferred tax assets because management believes that, after considering all of the available objective evidence, including available tax

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(7) Income Taxes (continued)**

planning strategies, historical and prospective, with greater weight given to historical evidence, it is more likely than not that a portion of the asset will not be realized.

The total valuation allowance for deferred tax assets as of December 31, 2003 was \$5,793,000, of which \$4,144,000 was charged against income tax expense while \$1,649,000 was charged against stockholders' equity directly against current year compensation expense credited to stockholders' equity. The total valuation allowance increased by \$2,357,000 from December 31, 2002, as a result of an increase of temporary differences for certain carry forward items, including benefits from the exercise of certain employee stock options and 2003 net operating losses.

The Company's policy is that undistributed earnings of the Company's foreign subsidiaries are indefinitely reinvested and, accordingly, no related provision for U.S. federal and state income taxes has been provided. Upon distribution of those earnings in the form of dividends or otherwise, the Company will be subject to both U.S. income taxes (less foreign tax credits) and withholding taxes in the various foreign countries.

**(8) 401(k) Profit Sharing Plan**

KVH has a 401(k) Profit Sharing Plan (the Plan) for all eligible employees. All employees who have attained age 21 are eligible to participate. Participants can contribute up to 15% of total compensation, subject to the annual IRS dollar limitation. Company contributions to the Plan are discretionary. Company contributions vest over a four-year period from the date of enrollment in the Plan. KVH has not made a contribution to the Plan since its inception.

**(9) Business and Credit Concentrations**

Significant portions of KVH's net sales are as follows:

	Year ended December 31,		
	2003	2002	2001
Net sales to foreign customers outside of the U.S. and Canada	16.7%	19.0%	22.4%
Net sales to the United States Army Tank and Automotive Command	11.3%	10.7%	6.4%

**(10) Segment Reporting**

Under common operational management, KVH designs, develops, manufactures and markets its defense-related navigation, guidance and stabilization and mobile satellite communication products for use in a wide variety of applications. Products are generally sold directly to third-party consumer electronic dealers and retailers, or in the case of defense-related products, either to 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 KVH's Denmark office principally consist of sales into Western European countries, including the United Kingdom, France, Italy, and Spain, as well as a growing number of sales into Russia and certain Middle Eastern countries.

KVH operates in two geographic segments, exclusively in the satellite communication, navigation and guidance equipment industry, which it considers to be a single business activity. KVH has two primary product categories: mobile satellite communication and defense-related navigation, guidance and stabilization. Mobile satellite communication sales and services include automotive, marine and land mobile satellite 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.

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(10) Segment Reporting (continued)**

	<u>North American</u>	<u>European</u>	<u>Total</u>
<b><i>Year ended December 31, 2003</i></b>			
United States and Canada	\$47,221	\$ —	\$47,221
Europe	3,140	4,977	8,117
Other geographic areas	621	713	1,334
Intercompany sales	3,899	65	3,964
Subtotal	54,881	5,755	60,636
Eliminations	(3,899)	(65)	(3,964)
Net sales	<u>\$50,982</u>	<u>\$5,690</u>	<u>\$56,672</u>
Segment net income (loss)	\$ (1,526)	\$ 56	\$ (1,470)
Depreciation and amortization	\$ 1,695	\$ 28	\$ 1,723
Total assets	<u>\$32,093</u>	<u>\$1,978</u>	<u>\$34,071</u>
<b><i>Year ended December 31, 2002</i></b>			
United States and Canada	\$38,627	\$ —	\$38,627
Europe	4,390	3,796	8,186
Other geographic areas	605	276	881
Intercompany sales	2,501	—	2,501
Subtotal	46,123	4,072	50,195
Eliminations	(2,501)	—	(2,501)
Net sales	<u>\$43,622</u>	<u>\$4,072</u>	<u>\$47,694</u>
Segment net income (loss)	\$ (1,526)	\$ 49	\$ (1,477)
Depreciation and amortization	\$ 1,599	\$ 24	\$ 1,623
Total assets	<u>\$31,525</u>	<u>\$1,024</u>	<u>\$32,549</u>
<b><i>Year ended December 31, 2001</i></b>			
United States and Canada	\$25,706	\$ —	\$25,706
Europe	2,258	3,920	6,178
Other geographic areas	572	251	823
Intercompany sales	2,665	—	2,665
Subtotal	31,201	4,171	35,372
Eliminations	(2,665)	—	(2,665)
Net sales	<u>\$28,536</u>	<u>\$4,171</u>	<u>\$32,707</u>
Segment net income (loss)	\$ (6,305)	\$ 44	\$ (6,261)
Depreciation and amortization	\$ 1,334	\$ 32	\$ 1,366
Total assets	<u>\$31,919</u>	<u>\$1,244</u>	<u>\$33,163</u>

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(11) Selected Quarterly Financial Results (Unaudited)**

Financial information for interim periods was as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in thousands, except per share amounts)			
<b>2003</b>				
Net sales	\$ 13,119	\$ 14,384	\$ 13,515	\$ 15,654
Gross profit	5,958	6,576	5,803	4,540
Net (loss) income	\$ 183	\$ 438	\$ (466)	\$ (1,625)
(Loss) income per share (a):				
Basic and diluted	\$ 0.02	\$ 0.04	\$ (0.04)	\$ (0.14)
<b>2002</b>				
Net sales	\$ 9,642	\$ 12,641	\$ 12,435	\$ 12,976
Gross profit	4,284	5,320	5,598	5,987
Net (loss) income	\$ (1,147)	\$ (812)	\$ 150	\$ 332
(Loss) income per share (a):				
Basic and diluted	\$ (0.10)	\$ (0.07)	\$ 0.01	\$ 0.03
<b>2001</b>				
Net sales	\$ 8,133	\$ 7,829	\$ 7,939	\$ 8,806
Gross profit	3,123	2,822	2,813	3,694
Net loss	\$ (1,537)	\$ (1,994)	\$ (1,567)	\$ (1,163)
Loss per share (a):				
Basic and diluted	\$ (0.18)	\$ (0.19)	\$ (0.14)	\$ (0.11)

(a) Income (loss) per share is computed independently for each of the quarters. Therefore, the income (loss) per share for the four quarters may not equal the annual income (loss) per share data.

**(12) Common Stock Issuances**

On December 29, 2000 KVH issued and sold 800,000 shares of common stock to a single institutional investor at \$6.25 per share. In a series of transactions between April 2, 2001 and May 25, 2001, KVH issued and sold an aggregate of 2,230,767 shares of its common stock at a purchase price of \$6.50 per share. In total KVH realized net proceeds of \$17.5 million that has been used to fund operations and advanced research into photonics and mobile broadband satellite communications.

**(13) Derivative Instruments**

A portion of KVH's forecasted inventory purchases are exposed to foreign currency risk. KVH monitors its foreign currency exposures on an ongoing basis to maximize the overall effectiveness of its foreign currency hedge positions. During the second half of 2002, KVH used foreign currency forward contracts as a means of hedging limited amounts of exposure to foreign currency risks. KVH's foreign currency contracts were designated and qualified as cash flow hedges under the criteria of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 137 and 138. SFAS No. 133 requires that changes in fair value of derivatives that qualify as cash flow hedges be recognized in other comprehensive income until transacted, while the ineffective portion of the derivative's change in fair value be recognized immediately in earnings.

**KVH INDUSTRIES, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**  
**December 31, 2003, 2002 and 2001**  
**(all tabular amounts in thousands except per share amounts)**

**(13) Derivative Instruments (continued)**

KVH's cash flow hedges of the forecasted inventory purchases were held for non-trading purposes. At December 31, 2002, KVH entered into monthly contracts maturing from January to February 2003, purchasing a total of 322,000 Euros over that period, at pre-established rates. The fair value of foreign currency contracts, used for hedging purposes, was \$11,591, based upon a quotation from a currency broker. The net gain on these contracts, recorded in other comprehensive income during the quarter ended December 31, 2002, was \$3,927. KVH transferred the \$3,927 balance of the gain into the statement of operations in 2003, the period over which the inventory was sold.

**(14) Legal Matters**

On June 20, 2002, Agility Robotics, Inc., and Ross-Hime Designs, Inc. (collectively, "Agility") filed a complaint against KVH in the United States District Court for the District of Minnesota alleging that certain of its products infringe three United States patents held by Agility. On November 14, 2003, KVH and Agility entered into a license and settlement agreement, releasing all claims pending against KVH, dismissing the law suit with prejudice, and licensing Agility's rights under certain of its patents to KVH.

In the ordinary course of business, KVH is a party to legal proceedings and claims. In addition, from time to time, KVH has had disagreements with certain customers concerning KVH's products and services, which, KVH believes, will not have a material adverse effect on operations or capital resources.

**(15) Subsequent Event**

On February 13, 2004, KVH completed an underwritten public offering of 2,750,000 shares of its common stock at \$18.75 per share. Net proceeds to KVH, after deducting all associated financing expenses, were approximately \$48.0 million and will be used for working capital and general corporate purposes.

## Schedule II

## KVH INDUSTRIES, INC. AND SUBSIDIARY

## Valuation and Qualifying Accounts

Description	Balance at the Beginning of the Period	Additions Charged to Expense	Deductions from Reserve	Balance at the End of the Period
<b>(Deducted from accounts receivable as an allowance for doubtful accounts - in thousands)</b>				
Year ended December 31, 2003	\$153	53	(86)	120
Year ended December 31, 2002	\$ 68	129	(44)	153
Year ended December 31, 2001	\$ 84	25	(41)	68



**INDEPENDENT AUDITORS' REPORT**

Board of Directors and Stockholders  
KVH Industries, Inc.:

Under the date of February 13, 2004, we reported on the consolidated balance sheets of KVH Industries, Inc., and subsidiary as of December 31, 2003 and 2002 and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2003, as contained in the annual report on Form 10-K for the year 2003. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related financial statement schedule of Valuation and Qualifying Accounts in the Annual Report on Form 10-K. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion, such financial statement schedule when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG LLP

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Providence, Rhode Island  
February 13, 2004

KVH INDUSTRIES, INC.

AMENDED AND RESTATED 1995 INCENTIVE STOCK OPTION PLAN  
(AS AMENDED FEBRUARY 6, 1996, MARCH 14, 1996 AND MAY 23, 2001)

TABLE OF CONTENTS

1. Purpose of the Plan.....	1
2. Administration.....	1
(a) The Committee.....	1
(b) Powers of the Committee.....	2
3. Option Shares.....	3
4. Authority to Grant Options.....	4
5. Limitation on Amount of Options which may be Granted.....	4
6. Eligibility.....	4
7. Option Price.....	5
8. Duration of Options.....	5
9. Amount Exercisable; Right of First Refusal.....	5
10. Exercise of Options.....	6
11. Transferability of Options and Shares.....	7
12. Termination of Employment or Services or Death of Optionee.....	7
(a) Temporary Leave.....	8
(b) Death or Disability.....	8
(c) Retirement.....	8
13. Employment Relationship.....	8
14. Requirements of Law.....	9
15. No Rights as Stockholder.....	10
16. Employment Obligation.....	10
17. Changes in the Company's Capital Structure.....	10
(a) Rights of the Company.....	10
(b) Recapitalization, Stock Splits, and Dividends.....	10
(c) Merger of Company With No Change of Control.....	11
(d) Sale or Merger of Company With Change of Control.....	12
(e) Changes to Common Stock Subject to Options.....	13
18. Amendment or Termination of Plan.....	13
19. Written Agreement.....	13

20. Effective Date and Duration of Plan.....	13
21. "Lockup" Agreement.....	14

AMENDED AND RESTATED 1995 INCENTIVE STOCK OPTION PLAN

1. Purpose of the Plan.

This Amended and Restated 1995 Incentive Stock Option Plan (the "Plan") of KVH Industries, Inc., a Delaware corporation (the "Company"), is designed to provide additional incentive to present and future employees of the Company (which shall include its subsidiaries as defined in Section 424 of the Internal Revenue Code of 1986, (the "Code")). The Company intends that this purpose will be effected by the granting of incentive stock options (collectively, the "Options", and individually, an "Option") as defined in Section 422(b) of the Code under the Plan which afford key employees an opportunity to acquire or increase their proprietary interest in the Company through the acquisition of shares of its Common Stock (as hereinafter defined). By encouraging stock ownership by such employees the Company seeks to attract and retain on a continuing basis the services of persons of exceptional competence and seeks to furnish an added incentive for them to increase their efforts on behalf of the Company.

2. Administration.

(a) The Committee. The Plan shall be administered by a committee (the "Committee") consisting of the "Outside Directors," which Committee may be the Compensation Committee or another committee of the Company's Board of Directors (the "Board"). As used herein, the term "Outside Director" means any director who (i) is not an employee of the Company or of any "affiliated group," as such term is defined in Section 1504(a) of the Code, which includes the Company (an "Affiliate"), (ii) is not a former employee of the Company or any Affiliate who is receiving compensation for prior services (other than benefits under a tax-qualified retirement plan) during the Company's or any Affiliate's taxable

year, (iii) has not been an officer of the Company or any Affiliate and (iv) does not receive remuneration from the Company or any Affiliate, either directly or indirectly, in any capacity other than as a director. None of the members of the Committee shall have been granted any stock option under this Plan or any other stock option plan of the Company within one year prior to service on the Committee. It is the intention of the Company that the Plan shall be administered by "disinterested persons" within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934, but the authority and validity of any act taken or not taken by the Committee shall not be affected if any person administering the Plan is not a disinterested person. Except as specifically reserved to the Board under the terms of the Plan, the Committee shall have full and final authority to operate, manage and administer the Plan on behalf of the Company. Action by the Committee shall require the affirmative vote of a majority of all members thereof.

(b) Powers of the Committee. Subject to the terms and conditions of the Plan, the Committee shall have the power:

(i) To determine from time to time the persons eligible to receive Options and the Options to be granted to such persons under the Plan and to prescribe the terms, conditions, restrictions, if any, and provisions (which need not be identical) of each Option granted under the Plan to such persons;

(ii) To construe and interpret the Plan and Options granted thereunder and to establish, amend, and revoke rules and regulations for administration of the Plan. In this connection, the Committee may correct any defect or supply any omission, or reconcile any inconsistency in the Plan, or in any option agreement, in the manner and to the extent it shall deem necessary or expedient to make the Plan fully effective. All decisions and

determinations by the Committee in the exercise of this power shall be final and binding upon the Company and optionees;

(iii) To make, in its sole discretion, changes to any outstanding Option granted under the Plan, including: (x) to reduce the exercise price, (y) to accelerate the vesting schedule or (z) to extend the expiration date; and

(iv) Generally, to exercise such powers and to perform such acts as are deemed necessary or expedient to promote the best interests of the Company with respect to the Plan.

### 3. Option Shares.

The stock subject to the Options and other provisions of the Plan shall be shares of the Company's Common Stock, \$.01 par value per share (the "Common Stock"). The total amount of the Common Stock with respect to which Options may be granted shall not exceed in the aggregate 740,000 shares; provided, however, that the class and aggregate number of shares which may be subject to Options granted hereunder shall be subject to adjustment in accordance with the provisions of Paragraph 17 hereof. Such shares may be treasury shares or authorized but unissued shares.

In the event that any outstanding Option for any reason shall expire or terminate prior to exercise, the shares of Common Stock allocable to the unexercised portion of such Option may again be subject to an Option under the Plan.

In no event may any Plan participant be granted options with respect to more than 75,000 shares of Common Stock in any calendar year. The number of shares of Common Stock issuable pursuant to an option granted to a Plan participant in a calendar year that is subsequently forfeited, cancelled or otherwise terminated shall continue to count toward the foregoing

limitation in such calendar year. In addition, if the exercise price of an option is subsequently reduced, the transaction shall be deemed a cancellation of the original option and the grant of a new one so that both transactions shall count toward the maximum shares issuable in the calendar year of each respective transaction.

#### 4. Authority to Grant Options.

The Committee may grant Options from time to time to such eligible employees of the Company as it shall determine. Subject to any applicable limitations set forth in the Plan or established from time to time by the Committee, the number of shares of Common Stock to be covered by any Option shall be as determined by the Committee.

#### 5. Limitation on Amount of Options which may be Granted.

The aggregate fair market value (determined as of the date of grant of the Option) of the shares of Common Stock as to which any incentive stock option granted under the Plan shall first become exercisable (i.e., shall "vest") in any calendar year shall not exceed \$100,000. To the extent that the shares of Common Stock as to which any Option granted under the Plan shall vest in any calendar year shall have a fair market value (determined as of the date of grant of the Option) in excess of \$100,000, such Option shall be deemed to be a nonqualified option with respect to such excess.

#### 6. Eligibility.

Options may be granted only to officers and other employees of the Company or its subsidiaries, including members of the Board who are also employees of the Company or a subsidiary. No Option shall be granted to an individual who, at the time said Option is granted, owns (including ownership attributed pursuant to Section 424 of the Code) more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any subsidiary or parent (a "greater-than-ten-percent-stockholder") unless the purchase price per



share upon exercise of the Option shall be equal to or greater than one hundred and ten percent (110%) of the fair market value of the stock at the time such Option is granted, and further provided that no such Option shall be exercisable to any extent after the expiration of five (5) years from the date it is granted.

Except as otherwise provided, for all purposes of the Plan the term "subsidiary" shall mean any corporation of which 50% or more of its outstanding voting stock is at the time owned by the Company or by one or more subsidiaries or by the Company and one or more subsidiaries.

#### 7. Option Price.

The price at which shares may be purchased pursuant to Options shall be specified by the Committee at the time the Option is granted; provided, however, that the option price shall not be less than one hundred percent (100%) (one hundred and ten percent (110%) in the case of a greater-than-ten percent-stockholder) of the fair market value of the shares of Common Stock on the date such Option is granted, such fair market value to be determined in accordance with procedures to be established by the Committee. The Committee may not reduce the exercise price of any outstanding Option granted under any existing or future stock option plan. The provisions of this Section 7 may not be amended or repealed without the affirmative vote of the holders of a majority of the shares of Common Stock of the Company present and entitled to vote at a duly convened meeting of the Company's stockholders.

#### 8. Duration of Options.

The Committee in its discretion may provide that an Option shall be exercisable during any specified period of time from the date such Option is granted; provided, however, that no Option shall be exercisable after the expiration of ten (10) years (five years in the case of a greater-than ten percent stockholder) from the date such Option is granted.

#### 9. Amount Exercisable; Right of First Refusal.

Each Option may be exercised, so long as it is valid and outstanding, from time to time in part or as a whole, subject to any limitations with respect to the number of shares for which the Option may be exercised at a particular time and to such other conditions as the Committee in its discretion may specify upon granting the Option.

The Committee may also, or alternatively, specify upon granting an Option that prior to the effective date of a registration statement under the Securities Act of 1933 covering any shares of Common Stock, all or a portion of the shares purchasable upon exercise of such Option shall be subject to a right of first refusal in favor of the Company in the event that the optionee wishes to sell, assign, transfer, exchange, encumber or otherwise dispose of any of such shares issued pursuant to exercise of such Option or any interest in such shares. If such restriction is imposed, the Option shall contain appropriate provisions (or the optionee shall execute a separate agreement containing such terms), and the shares issued upon exercise shall bear an appropriate legend, disclosing the Company's right of first refusal.

#### 10. Exercise of Options.

Subject to the provisions of Paragraph 14 hereof, Options shall be exercised by the delivery of written notice to the Company setting forth the number of shares with respect to which the Option is to be exercised, together with (a) cash, certified check, bank draft or postal or express money order payable to the order of the Company for an amount equal to the option price of such shares, or (b) with the consent of the Company, shares of Common Stock of the Company having a fair market value equal to the option price of such shares, or (c) with the consent of the Company, a combination of (a) and (b), and specifying the address to which the certificates for such shares are to be mailed. For the purpose of the preceding sentence, the fair market value of the shares of Common Stock so delivered to the Company shall be determined in accordance with procedures adopted by the Committee. As promptly as practicable after receipt

of such written notification and payment, the Company shall deliver to the optionee certificates for the number of shares with respect to which such Option has been so exercised, issued in the optionee's name; provided, however, that such delivery shall be deemed effected for all purposes when the Company or a stock transfer agent of the Company shall have deposited such certificates in the United States mail, addressed to the optionee, at the address specified pursuant to this Paragraph 10.

11. Transferability of Options and Shares.

Options shall not be transferable by the optionee otherwise than by will or under the laws of descent and distribution or pursuant to a qualified domestic relations order as defined by the Code or Title I of the Employee Retirement Income Security Act, or the rules thereunder. Options shall be exercisable, during the optionee's lifetime, only by him.

The shares of stock issuable upon exercise of an Option by any executive officer, director or beneficial owner of more than ten percent of the Common Stock of the Company may not be sold or transferred (except that such shares may be issued upon exercise of such Option) by such officer, director or beneficial owner for a period of six months following the grant of such Option.

12. Termination of Employment or Services or Death of Optionee.

Except as may be otherwise expressly provided herein, or unless otherwise determined by the Committee, Options may not be exercised after the earlier of:

(i) the date of expiration thereof; or

(ii) the date of termination of the optionee's employment with or services to the Company if the termination is by the Company for cause (as determined by the Company), or if voluntarily by the optionee; or

(iii) thirty (30) days after termination of the optionee's employment with the Company, by the Company without cause. In each case described in this paragraph 12(iii), the Options shall be exercisable for the number of shares that had vested as of the date of such termination.

(a) Temporary Leave. Whether authorized temporary leave of absence, or absence on military or government service, shall constitute termination of the employment or consultant relationship between the Company and the optionee shall be determined by the Committee at the time thereof.

(b) Death or Disability. In the event the optionee's employment with or service to the Company is terminated while the optionee is an employee in good standing for reasons of permanent disability under the then established rules of the Company or in the event of the death and before the date of expiration of such Option, such Option may be exercised until the earlier of such date of expiration or one (1) year following the date of such termination for reason of permanent disability or death. In the event of such disability or death, the Option shall be exercisable for the number of shares that had vested as of the date of such disability or death. After the death of the optionee, his executors, administrators or any person or persons to whom his Option may be transferred by will or by the laws of descent and distribution, shall have the right to exercise the Option.

(c) Retirement. If, before the date of expiration of the Option, the optionee as an employee shall be retired in good standing from the employ of the Company for reasons of age under the then established rules of the Company, the Option may be exercised until the earlier of such date of expiration or thirty (30) days after the date of such retirement, to the extent to which the optionee was entitled to exercise such Option immediately prior to such retirement.

### 13. Employment Relationship.

An employment relationship between the Company and the optionee shall be deemed to exist during any period in which the optionee is employed by the Company.

#### 14. Requirements of Law.

The Company shall not be required to sell or issue any shares under any Option if the issuance of such shares shall constitute a violation by the optionee or by the Company of any provision of any law, regulation or order of any governmental authority. Without limiting the generality of the foregoing, upon exercise of any Option, the Company shall not be required to issue such shares unless the Committee has received evidence satisfactory to it to the effect that the holder of such Option will not transfer such shares except pursuant to a registration statement in effect under the Securities Act of 1933, as now in effect or hereafter amended (the "Act"), and under the applicable securities laws of any State, unless the Company has received an opinion of counsel satisfactory to the Company, in form and substance satisfactory to the Company, to the effect that such registration is not required. Any determination in this connection by the Committee shall be final, binding and conclusive. In the event the shares issuable on exercise of an Option are not registered under the Act, the Company may imprint the following legend or any other legend which counsel for the Company considers necessary or advisable to comply with the Act or other applicable laws:

"The shares of stock represented by this certificate have not been registered under the Securities Act of 1933 or under the securities laws of any State and may not be sold or transferred except upon such registration or upon receipt by the Corporation of an opinion of counsel satisfactory to the Corporation, in form and substance satisfactory to the Corporation, that registration is not required for such sale or transfer."

The Company may, but shall in no event be obligated to, register any securities covered hereby pursuant to the Act; and in the event any shares are so registered the Company may remove any legend on certificates representing such shares. The Company shall not be obligated

to take any other affirmative action in order to cause the exercise of an Option or the issuance of shares pursuant thereto to comply with any other law, regulation or order of any governmental authority.

15. No Rights as Stockholder.

No optionee shall have rights as a stockholder with respect to shares covered by his Option until the date of issuance of a stock certificate for such shares; and, except as otherwise provided in Paragraph 17 hereof, no adjustment for dividends, or otherwise, shall be made if the record date therefor is prior to the date of issuance of such certificate.

16. Employment Obligation.

The granting of any Option shall not impose upon the Company any obligation to employ or continue to employ any optionee; and the right of the Company to terminate the employment or services of any employee shall not be diminished or affected by reason of the fact that an Option has been granted to such employee.

17. Changes in the Company's Capital Structure.

(a) Rights of the Company.

The existence of outstanding Options shall not affect in any way the right or power of the Company or its stockholders to make or authorize any or all adjustments, recapitalizations, reorganizations or other changes in the Company's capital structure or its business, or any merger or consolidation of the Company, or any issue of bonds, debentures, preferred or prior preference stock ahead of or affecting the Common Stock or the rights thereof, or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, whether of a similar character or otherwise.

(b) Recapitalization, Stock Splits, and Dividends.

If the Company shall effect a subdivision or consolidation of shares or other capital readjustment, the payment of a stock dividend, or other increase or reduction of the number of shares of the Common Stock outstanding, without receiving compensation therefor in money, services or property, then (i) the number, class, and per share price of shares of stock subject to outstanding Options hereunder shall be appropriately adjusted in such a manner as to entitle an optionee to receive upon exercise of an Option, for the same aggregate cash consideration, the same total number and class of shares as he would have received as a result of the event requiring the adjustment had he exercised his Option in full immediately prior to such event; and (ii) the number and class of shares with respect to which Options may be granted under the Plan shall be adjusted by substituting for the total number of shares of Common Stock then reserved that number and class of shares of stock that would have been received by the owner of an equal number of outstanding shares of Common Stock as the result of the event requiring the adjustment.

(c) Merger of Company With No Change of Control.

After a merger of one or more corporations into the Company, or after a consolidation of the Company with one or more corporations in which (i) the Company shall be the surviving corporation and (ii) the stockholders of the Company prior to such merger or consolidation hold at least fifty percent (50%) of the voting shares of the Company after such merger or consolidation, each holder of an outstanding Option shall, at no additional cost, be entitled upon exercise of such Option to receive (subject to any required action by stockholders) in lieu of the number of shares as to which such Option shall then be so exercisable, the number and class of shares of stock or other securities to which such holder would have been entitled pursuant to the terms of the agreement of merger or consolidation if, immediately prior to such merger or

consolidation, such holder had been the holder of record of a number of shares of Common Stock equal to the number of shares as to which such Option shall be so exercised.

(d) Sale or Merger of Company With Change of Control.

If the Company is merged into or consolidated with another corporation under circumstances where the Company is not the surviving corporation, or if there is a merger or consolidation where the Company is the surviving corporation and the Stockholders of the Company prior to such merger or consolidation do not hold at least fifty percent (50%) of the voting shares of the Company after such merger or consolidation occurs, or if the Company is liquidated, or sells or otherwise disposes of substantially all its assets to another corporation while unexercised Options remain outstanding under the Plan, (i) subject to the provisions of clause (iii) below, after the effective date of such merger, consolidation or sale, as the case may be, each holder of an outstanding Option shall be entitled, upon exercise of such Option, to receive, in lieu of shares of Common Stock, shares of such stock or other securities, cash or property as the holders of shares of Common Stock received pursuant to the terms of the merger, consolidation or sale; (ii) the Committee may accelerate the time for exercise of all unexercised and unexpired Options to and after a date prior to the effective date of such merger, consolidation, liquidation or sale, as the case may be specified by the Committee; or (iii) all outstanding Options may be cancelled by the Committee as of the effective date of any such merger, consolidation, liquidation or sale provided that (x) notice of such cancellation shall be given to each holder of an Option and (y) each holder of an Option shall have the right to exercise such Option to the extent that the same is then exercisable or, if the Committee shall have accelerated the time for exercise of all unexercised and unexpired Options, in full during the 30-day period preceding the effective date of such merger, consolidation, liquidation, sale or acquisition.



(e) Changes to Common Stock Subject to Options.

Except as hereinbefore expressly provided, the issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, for cash or property, or for labor or services either upon direct sale or upon the exercise of rights or warrants to subscribe therefor, or upon conversion of shares or obligations of the Company convertible into such shares or other securities, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock then subject to outstanding Options.

18. Amendment or Termination of Plan.

The Board may modify, revise or terminate this Plan at any time and from time to time, except that the class of employees eligible to receive Options and the aggregate number of shares issuable pursuant to this Plan shall not be changed or increased, other than by operation of paragraph 17 hereof, without the consent of the stockholders of the Company, and except that, the provisions of Section 7 may not be amended or repealed without the affirmative vote of the holders of a majority of the shares of Common Stock of the Company present and entitled to vote at a duly convened meeting of the Company's stockholders.

19. Written Agreement.

Each Option granted hereunder shall be embodied in a written option agreement which shall be subject to the terms and conditions prescribed above and shall be signed by the President, any Vice President or the Treasurer of the Company for and in the name and on behalf of the Company. Such an option agreement shall contain such other provisions as the Committee in its discretion shall deem advisable.

20. Effective Date and Duration of Plan.

The Plan shall become effective upon its adoption by the Board, provided that the stockholders of the Company shall have approved the Plan within twelve (12) months prior to or following the adoption of the Plan by the Board. Options may not be granted under the Plan more than ten (10) years after said effective date. The Plan shall terminate (i) when the total amount of the Common Stock with respect to which Options may be granted shall have been issued upon the exercise of Options or (ii) by action of the Board pursuant to Paragraph 18 hereof, whichever shall first occur.

21. "Lockup" Agreement.

The Committee may in its discretion specify upon granting an Option that the Optionee shall agree for a period of time (not to exceed 180 days) from the effective date of any registration of securities of the Company (upon request of the Company or the underwriters managing any underwritten offering of the Company's securities), not to sell, make any short sale of, loan, grant any option for the purchase of, or otherwise dispose of any shares issued pursuant to the exercise of such Option, without the prior written consent of the Company or such underwriters, as the case may be.

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## KVH INDUSTRIES, INC.

AMENDED AND RESTATED  
1996 INCENTIVE AND NONQUALIFIED STOCK OPTION PLAN  
(AS AMENDED ON MAY 26, 1999 AND MAY 23, 2001)

## SECTION 1. PURPOSE

This Amended and Restated 1996 Incentive and Nonqualified Stock Option Plan (the "Plan") of KVH Industries, Inc., a Delaware corporation (the "Company"), is designed to provide additional incentive to executives and other key employees of the Company and its subsidiaries and for certain other individuals providing services to or acting as directors of the Company and its subsidiaries. The Company intends that this purpose will be effected by the granting of incentive stock options ("Incentive Stock Options") as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), and nonqualified stock options ("Nonqualified Options") under the Plan which afford such executives, key employees, directors and other eligible individuals an opportunity to acquire or increase their proprietary interest in the Company through the acquisition of shares of its Common Stock. The Company intends that Incentive Stock Options issued under the Plan will qualify as "incentive stock options" as defined in Section 422 of the Code and the terms of the Plan shall be interpreted in accordance with this intention. The term "subsidiary" shall have the meaning set forth in Section 424 of the Code.

## SECTION 2. ADMINISTRATION

2.1 THE COMMITTEE. The Plan shall be administered by a Committee (the "Committee") consisting of at least two (2) "Outside Directors" who may also be members of the Compensation Committee. As used herein, the term "Outside Director" means any director who (i) is not an employee of the Company or of any "affiliated group," as such term is defined in Section 1504(a) of the Code, which includes the Company (an "Affiliate"), (ii) is not a former

employee of the Company or any Affiliate who is receiving compensation for prior services (other than benefits under a tax-qualified retirement plan) during the Company's or any Affiliate's taxable year, (iii) has not been an officer of the Company or any Affiliate and (iv) does not receive remuneration from the Company or any Affiliate, either directly or indirectly, in any capacity other than as a director. None of the members of the Committee shall have been granted any incentive stock option or nonqualified option under this Plan (other than pursuant to Section 4.4) or any other stock option plan of the Company within one year prior to service on the Committee. It is the intention of the Company that the Plan shall be administered by "disinterested persons" within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934 (the "Exchange Act"), but the authority and validity of any act taken or not taken by the Committee shall not be affected if any person administering the Plan is not a disinterested person. Except as specifically reserved to the Company's Board of Directors (the "Board") under the terms of the Plan, the Committee shall have full and final authority to operate, manage and administer the Plan on behalf of the Company. Action by the Committee shall require the affirmative vote of a majority of all members thereof.

2.2 POWERS OF THE COMMITTEE. Subject to the terms and conditions of the Plan, the Committee shall have the power:

(a) To determine from time to time the persons eligible to receive options and the options to be granted to such persons under the Plan and to prescribe the terms, conditions, restrictions, if any, and provisions (which need not be identical) of each option granted under the Plan to such persons;

(b) To construe and interpret the Plan and options granted thereunder and to establish, amend, and revoke rules and regulations for administration of the Plan. In this connection, the Committee may correct any defect or supply any omission, or reconcile any inconsistency in the Plan, or in any option agreement, in the manner and to the extent it shall deem necessary or expedient to make the Plan fully effective. All decisions and determinations by the Committee in the exercise of this power shall be final and binding upon the Company and optionees;

(c) To make, in its sole discretion, changes to any outstanding option granted under the Plan, including: (i) to reduce the exercise price, (ii) to accelerate the vesting schedule or (iii) to extend the expiration date; and

(d) Generally, to exercise such powers and to perform such acts as are deemed necessary or expedient to promote the best interests of the Company with respect to the Plan.

### SECTION 3. STOCK

3.1 STOCK TO BE ISSUED. The stock subject to the options granted under the Plan shall be shares of the Company's authorized but unissued Class A Common Stock, \$.01 par value (the "Common Stock"), or shares of the Company's Class A Common Stock held in treasury. The total number of shares that may be issued pursuant to options granted under the Plan shall not exceed an aggregate of 1,915,000 shares of Common Stock; provided, however, that the class and aggregate number of shares which may be subject to options granted under the Plan shall be subject to adjustment as provided in Section 8 hereof.

3.2 EXPIRATION, CANCELLATION OR TERMINATION OF OPTION. Whenever any outstanding option under the Plan expires, is cancelled or is otherwise terminated (other than by exercise), the shares of Common Stock allocable to the unexercised portion of such option may again be the subject of options under the Plan.

3.3 LIMITATION ON GRANTS. In no event may any Plan participant be granted options with respect to more than 120,000 shares of Common Stock in any calendar year. The number of shares of Common Stock issuable pursuant to an option granted to a Plan participant in a calendar year that is subsequently forfeited, cancelled or otherwise terminated shall continue to count toward the foregoing limitation in such calendar year. In addition, if the exercise price of an option is subsequently reduced, the transaction shall be deemed a cancellation of the original option and the grant of a new one so that both transactions shall count toward the maximum shares issuable in the calendar year of each respective transaction.

#### SECTION 4. ELIGIBILITY

4.1 PERSONS ELIGIBLE. Incentive Stock Options under the Plan may be granted only to officers and other employees of the Company or its subsidiaries. Nonqualified Options may be granted to officers or other employees of the Company or its subsidiaries, and to members of the Board and consultants or other persons who render services to the Company (regardless of whether they are also employees), provided, however, that no such option may be granted to a person who is a member of the Committee at the time of grant other than pursuant to Section 4.4.

4.2 GREATER-THAN-TEN-PERCENT STOCKHOLDERS. Except as may otherwise be permitted by the Code or other applicable law or regulation, no Incentive Stock Option shall be granted to an individual who, at the time the option is granted, owns (including ownership attributed pursuant to Section 424 of the Code) more than ten percent of the total combined voting power of all classes of stock of the Company or any subsidiary (a "greater-than-ten-percent stockholder"), unless such Incentive Stock Option provides that (i) the purchase price per share shall not be less than one hundred ten percent of the fair market value of the Common Stock at the time such option is granted, and (ii) that such option shall not be exercisable to any extent after the expiration of five years from the date it is granted.

4.3 MAXIMUM AGGREGATE FAIR MARKET VALUE. The aggregate fair market value (determined at the time the option is granted) of the Common Stock with respect to which

Incentive Stock Options are exercisable for the first time by any optionee during any calendar year (under the Plan and any other plans of the Company or its subsidiary for the issuance of incentive stock options) shall not exceed \$100,000 (or such greater amount as may from time to time be permitted with respect to incentive stock options by the Code or any other applicable law or regulation).

4.4 OPTION GRANTS TO NON-EMPLOYEE DIRECTORS. As compensation for services to the Company, each director of the Company who is not an employee of the Company or any subsidiary of the Company (a "Non-Employee Director") in office on the date of the closing of the initial public offering of the Common Stock of the Company, and each other Non-Employee Director upon his or her initial election to the Board subsequent to said closing of the initial public offering, shall be automatically granted a Nonqualified Option to purchase 10,000 shares of Common Stock of the Company (the "Initial Option Grant"). In addition, any director of the Company who is elected to the Board but who is not a Non-Employee Director at the time of his or her initial election and later becomes a Non-Employee Director shall automatically receive an Initial Option Grant to purchase 10,000 shares of Common Stock of the Company upon his or her first election to the Board as a Non-Employee Director. Each Initial Option Grant shall vest with respect to 2,500 shares on each three-month anniversary of the date of grant, provided that the optionee is a director of the Company on each such three-month anniversary, and shall expire on the fifth annual anniversary of the date of grant. At the first meeting of the Board of Directors following each annual meeting of stockholders, commencing with the first meeting of the Board of Directors following the Company's annual meeting of stockholders in 1997, each Non-Employee Director (other than any Non-Employee Director who has received an Initial Option Grant as a result of election to the Board at such meeting) shall be automatically granted an additional Nonqualified Option to purchase 5,000 shares of Common Stock of the Company (the "Subsequent Option Grant"). Each Subsequent Option Grant shall be exercisable in its entirety on the date of grant and shall expire on the fifth annual anniversary of the date of grant. The exercise price per share of Common Stock of each Nonqualified Option granted pursuant to this

Section 4.4 shall be equal to the fair market value of the Common Stock on the date the Nonqualified Option is granted, such fair market value to be determined in accordance with the provisions of Section 6.3.

No Nonqualified Option granted under this Section 4.4 shall be transferable by the optionee otherwise than by will or by the laws of descent and distribution, and such Options shall be exercisable during the optionee's lifetime only by the optionee. Any Nonqualified Option granted to a Non-Employee Director and outstanding on the date of his or her death may be exercised by the legal representative or legatee of the optionee until the expiration of the stated term of the option.

Nonqualified Options granted under this Section 4.4 may be exercised only by written notice to the Company specifying the number of shares to be purchased. Payment of the full purchase may be made by one or more of the methods specified in Section 7.2. An optionee shall have the rights of a stockholder only as to shares acquired upon the exercise of an option and not as to unexercised options.

The provisions of this Section 4.4 shall apply only to options granted or to be granted to Non-Employee Directors, and shall not be deemed to modify, limit or otherwise apply to any other provision of this Plan or to any option issued under this Plan to a participant who is not a Non-Employee Director of the Company. To the extent inconsistent with the provisions of any other Section of this Plan, the provisions of this Section 4.4 shall govern the rights and obligations of the Company and Non-Employee Directors respecting options granted or to be granted to Non-Employee Directors.

#### SECTION 5. TERMINATION OF EMPLOYMENT OR DEATH OF OPTIONEE

5.1 TERMINATION OF EMPLOYMENT. Except as may be otherwise expressly provided herein, options shall terminate on the earlier of:

- (a) the date of expiration thereof,



(b) the date of termination of the optionee's employment with or services to the Company by it for cause (as determined by the Company), or voluntarily by the optionee; or

(c) thirty days after the date of termination of the optionee's employment with or services to the Company by it without cause;

PROVIDED THAT Nonqualified Options granted to persons who are not employees of the Company need not, unless the Committee determines otherwise, be subject to the provisions set forth in clauses (b) and (c) above.

An employment relationship between the Company and the optionee shall be deemed to exist during any period in which the optionee is employed by the Company or any subsidiary. Whether authorized leave of absence, or absence on military or government service, shall constitute termination of the employment relationship between the Company and the optionee shall be determined by the Committee at the time thereof.

As used herein, "cause" shall mean (x) any material breach by the optionee of any agreement to which the optionee and the Company are both parties, (y) any act or omission to act by the optionee which may have a material and adverse effect on the Company's business or on the optionee's ability to perform services for the Company, including, without limitation, the commission of any crime (other than ordinary traffic violations), or (z) any material misconduct or material neglect of duties by the optionee in connection with the business or affairs of the Company or any affiliate of the Company.

5.2 DEATH OR PERMANENT DISABILITY OF OPTIONEE. In the event of the death or permanent and total disability of the holder of an option prior to termination of the optionee's employment with or services to the Company and before the date of expiration of such option, such option shall terminate on the earlier of such date of expiration or one year following the date of such death or disability. After the death of the optionee, his/her executors, administrators or any person or persons to whom his/her option may be transferred by will or by the laws of descent and distribution, shall have the right, at any time prior to such termination, to exercise

the option to the extent the optionee was entitled to exercise such option immediately prior to his/her death. An optionee is permanently and totally disabled if he/she is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to last for a continuous period of not less than twelve months; permanent and total disability shall be determined in accordance with Section 22(e)(3) of the Code and the regulations issued thereunder.

#### SECTION 6. TERMS OF THE OPTION AGREEMENTS

Each option agreement shall be in writing and shall contain such terms, conditions, restrictions, if any, and provisions as the Committee shall from time to time deem appropriate. Such provisions or conditions may include without limitation restrictions on transfer, repurchase rights, or such other provisions as shall be determined by the Committee; PROVIDED THAT such additional provisions shall not be inconsistent with any other term or condition of the Plan and such additional provisions shall not cause any Incentive Stock Option granted under the Plan to fail to qualify as an incentive option within the meaning of Section 422 of the Code. Option agreements need not be identical, but each option agreement by appropriate language shall include the substance of all of the following provisions:

6.1 EXPIRATION OF OPTION. Subject to Section 4.4 hereof, notwithstanding any other provision of the Plan or of any option agreement, each option shall expire on the date specified in the option agreement, which date shall not, in the case of an Incentive Stock Option, be later than the tenth anniversary (fifth anniversary in the case of a greater-than-ten-percent stockholder) of the date on which the option was granted, or as specified in Section 5 hereof.

6.2 EXERCISE. Subject to Sections 4.4 and 7.3 hereof, each option may be exercised, so long as it is valid and outstanding, from time to time in part or as a whole, subject to any limitations with respect to the number of shares for which the option may be exercised at a particular time and to such other conditions as the Committee in its discretion may specify upon granting the option.

6.3 PURCHASE PRICE. Subject to Section 4.4 hereof, the purchase price per share under each option shall be determined by the Committee at the time the option is granted; provided, however, (i) that the option price of any Incentive Stock Option shall not, unless otherwise permitted by the Code or other applicable law or regulation, be less than the fair market value of the Common Stock on the date the option is granted (110% of the fair market value in the case of a greater-than-ten-percent stockholder), and (ii) that, unless approved by the holders of a majority of the shares present and entitled to vote at a duly convened meeting of the Company's stockholders, the option price of any stock option shall not be less than the fair market value of the Common Stock on the date the option is granted and the exercise price of any outstanding stock option grant under any existing or future stock option plan may not be reduced. Subsection 6.3(ii) hereof may not be amended or repealed without the affirmative vote of the holders of a majority of the shares of the Company present and entitled to vote at a duly convened meeting of the Company's stockholders. For the purpose of the Plan the fair market value of the Common Stock shall be the closing price per share on the date of grant of the option as reported by a nationally recognized stock exchange, or, if the Common Stock is not listed on such an exchange, as reported by the National Association of Securities Dealers Automated Quotation System, Inc. ("NASDAQ"), or, if the Common Stock is not quoted on NASDAQ, the fair market value as determined by the Committee.

6.4 TRANSFERABILITY OF OPTIONS. Options shall not be transferable by the optionee otherwise than by will or under the laws of descent and distribution, and shall be exercisable, during his or her lifetime, only by him or her.

6.5 RIGHTS OF OPTIONEES. No optionee shall be deemed for any purpose to be the owner of any shares of Common Stock subject to any option unless and until the option shall have been exercised pursuant to the terms thereof, and the Company shall have issued and delivered the shares to the optionee.

6.6 REPURCHASE RIGHT. The Committee may in its discretion provide upon the grant of any option hereunder that the Company shall have an option to repurchase upon such terms

and conditions as determined by the Committee all or any number of shares purchased upon exercise of such option. The repurchase price per share payable by the Company shall be such amount or be determined by such formula as is fixed by the Committee at the time the option for the shares subject to repurchase is granted. In the event the Committee shall grant options subject to the Company's repurchase option, the certificates representing the shares purchased pursuant to such option shall carry a legend satisfactory to counsel for the Company referring to the Company's repurchase option.

6.7 "LOCKUP" AGREEMENT. The Committee may in its discretion specify upon granting an option that the optionee shall agree for a period of time (not to exceed 180 days) from the effective date of any registration of securities of the Company (upon request of the Company or the underwriters managing any underwritten offering of the Company's securities), not to sell, make any short sale of, loan, grant any option for the purchase of, or otherwise dispose of any shares issued pursuant to the exercise of such option, without the prior written consent of the Company or such underwriters, as the case may be.

#### SECTION 7. METHOD OF EXERCISE; PAYMENT OF PURCHASE PRICE

7.1 METHOD OF EXERCISE. Any option granted under the Plan may be exercised by the optionee by delivering to the Company on any business day a written notice specifying the number of shares of Common Stock the optionee then desires to purchase and specifying the address to which the certificates for such shares are to be mailed (the "Notice"), accompanied by payment for such shares.

7.2 PAYMENT OF PURCHASE PRICE. Payment for the shares of Common Stock purchased pursuant to the exercise of an option shall be made by:

(a) cash in an amount, or a check, bank draft or postal or express money order payable in an amount, equal to the aggregate exercise price for the number of shares specified in the Notice;

(b) with the consent of the Committee, shares of Common Stock of the Company having a fair market value (as defined for purposes of Section 6.3 hereof) equal to such aggregate exercise price;

(c) with the consent of the Committee, a personal recourse note issued by the optionee to the Company in a principal amount equal to such aggregate exercise price and with such other terms, including interest rate and maturity, as the Committee may determine in its discretion; PROVIDED THAT the interest rate borne by such note shall not be less than the lowest applicable federal rate, as defined in Section 1274(d) of the Code;

(d) with the consent of the Committee, such other consideration that is acceptable to the Committee and that has a fair market value, as determined by the Committee, equal to such aggregate exercise price, including any broker-directed cashless exercise/resale procedure adopted by the Committee; or

(e) with the consent of the Committee, any combination of the foregoing.

As promptly as practicable after receipt of the Notice and accompanying payment, the Company shall deliver to the optionee certificates for the number of shares with respect to which such option has been so exercised, issued in the optionee's name; provided, however, that such delivery shall be deemed effected for all purposes when the Company or a stock transfer agent of the Company shall have deposited such certificates in the United States mail, addressed to the optionee, at the address specified in the Notice.

7.3 SPECIAL LIMITS AFFECTING SECTION 16(B) OPTION HOLDERS. Shares issuable upon exercise of options granted to a person who in the opinion of the Committee may be deemed to be a director or officer of the Company within the meaning of Section 16(b) of the Exchange Act and the rules and regulations thereunder shall not be sold or disposed of until after the expiration of six months following the date of grant.

#### SECTION 8. CHANGES IN COMPANY'S CAPITAL STRUCTURE

8.1 RIGHTS OF COMPANY. The existence of outstanding options shall not affect in any way the right or power of the Company or its stockholders to make or authorize, without limitation, any or all adjustments, recapitalizations, reorganizations or other changes in the Company's capital structure or its business, or any merger or consolidation of the Company, or any issue of Common Stock, or any issue of bonds, debentures, preferred or prior preference stock or other capital stock ahead of or affecting the Common Stock or the rights thereof, or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, whether of a similar character or otherwise.

8.2 RECAPITALIZATION, STOCK SPLITS AND DIVIDENDS. If the Company shall effect a subdivision or consolidation of shares or other capital readjustment, the payment of a stock dividend, or other increase or reduction of the number of shares of the Common Stock outstanding, in any such case without receiving compensation therefor in money, services or property, then (i) the number, class, and price per share of shares of stock subject to outstanding options hereunder shall be appropriately adjusted in such a manner as to entitle an optionee to receive upon exercise of an option, for the same aggregate cash consideration, the same total number and class of shares as he or she would have received as a result of the event requiring the adjustment had he or she exercised his or her option in full immediately prior to such event; (ii) the number and class of shares with respect to which options may be granted under the Plan; and (iii) the number and class of shares set forth in Sections 3.3 and 4.4 shall be adjusted by substituting for the total number of shares of Common Stock then reserved for issuance under the Plan that number and class of shares of stock that the owner of an equal number of outstanding shares of Common Stock would own as the result of the event requiring the adjustment.

8.3 MERGER WITHOUT CHANGE OF CONTROL. After a merger of one or more corporations into the Company, or after a consolidation of the Company and one or more corporations in which (i) the Company shall be the surviving corporation, and (ii) the stockholders of the Company immediately prior to such merger or consolidation own after such merger or consolidation shares representing at least fifty percent of the voting power of the Company, each

holder of an outstanding option shall, at no additional cost, be entitled upon exercise of such option to receive in lieu of the number of shares as to which such option shall then be so exercisable, the number and class of shares of stock or other securities to which such holder would have been entitled pursuant to the terms of the agreement of merger or consolidation if, immediately prior to such merger or consolidation, such holder had been the holder of record of a number of shares of Common Stock equal to the number of shares for which such option was exercisable.

8.4 SALE OR MERGER WITH CHANGE OF CONTROL. If the Company is merged into or consolidated with another corporation under circumstances where the Company is not the surviving corporation, or if there is a merger or consolidation where the Company is the surviving corporation but the stockholders of the Company immediately prior to such merger or consolidation do not own after such merger or consolidation shares representing at least fifty percent of the voting power of the Company, or if the Company is liquidated, or sells or otherwise disposes of substantially all of its assets to another corporation while unexercised options remain outstanding under the Plan, (i) subject to the provisions of clause (iii) below, after the effective date of such merger, consolidation, liquidation, sale or disposition, as the case may be, each holder of an outstanding option shall be entitled, upon exercise of such option, to receive, in lieu of shares of Common Stock, shares of such stock or other securities, cash or property as the holders of shares of Common Stock received pursuant to the terms of the merger, consolidation, liquidation, sale or disposition; (ii) the Committee may accelerate the time for exercise of all unexercised and unexpired options to and after a date prior to the effective date of such merger, consolidation, liquidation, sale or disposition, as the case may be, specified by the Committee; or (iii) all outstanding options may be cancelled by the Committee as of the effective date of any such merger, consolidation, liquidation, sale or disposition provided that (x) notice of such cancellation shall be given to each holder of an option and (y) each holder of an option shall have the right to exercise such option to the extent that the same is then exercisable or, if the Committee shall have accelerated the time for exercise of all unexercised and unexpired options,

in full during the 30-day period preceding the effective date of such merger, consolidation, liquidation, sale or disposition.

8.5 ADJUSTMENTS TO COMMON STOCK SUBJECT TO OPTIONS. Except as hereinbefore expressly provided, the issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, for cash or property, or for labor or services, either upon direct sale or upon the exercise of rights or warrants to subscribe therefor, or upon conversion of shares or obligations of the Company convertible into such shares or other securities, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock then subject to outstanding options.

8.6 MISCELLANEOUS. Adjustments under this Section 8 shall be determined by the Committee, and such determinations shall be conclusive. No fractional shares of Common Stock shall be issued under the Plan on account of any adjustment specified above.

#### SECTION 9. GENERAL RESTRICTIONS

9.1 INVESTMENT REPRESENTATIONS. The Company may require any person to whom an option is granted, as a condition of exercising such option, to give written assurances in substance and form satisfactory to the Company to the effect that such person is acquiring the Common Stock subject to the option for his or her own account for investment and not with any present intention of selling or otherwise distributing the same, and to such other effects as the Company deems necessary or appropriate in order to comply with federal and applicable state securities laws.

9.2 COMPLIANCE WITH SECURITIES LAWS. The Company shall not be required to sell or issue any shares under any option if the issuance of such shares shall constitute a violation by the optionee or by the Company of any provisions of any law or regulation of any governmental authority. In addition, in connection with the Securities Act of 1933, as now in effect or hereafter amended (the "Act"), upon exercise of any option, the Company shall not be required to issue such shares unless the Committee has received evidence satisfactory to it to the effect that



the holder of such option will not transfer such shares except pursuant to a registration statement in effect under such Act or unless an opinion of counsel satisfactory to the Company has been received by the Company to the effect that such registration is not required. Any determination in this connection by the Committee shall be final, binding and conclusive. In the event the shares issuable on exercise of an option are not registered under the Act, the Company may imprint upon any certificate representing shares so issued the following legend or any other legend which counsel for the Company considers necessary or advisable to comply with the Act and with applicable state securities laws:

The shares of stock represented by this certificate have not been registered under the Securities Act of 1933 or under the securities laws of any State and may not be sold or transferred except upon such registration or upon receipt by the Corporation of an opinion of counsel satisfactory to the Corporation, in form and substance satisfactory to the Corporation, that registration is not required for such sale or transfer.

The Company may, but shall in no event be obligated to, register any securities covered hereby pursuant to the Act; and in the event any shares are so registered the Company may remove any legend on certificates representing such shares. The Company shall not be obligated to take any other affirmative action in order to cause the exercise of an option or the issuance of shares pursuant thereto to comply with any law or regulation of any governmental authority.

9.3 EMPLOYMENT OBLIGATION. The granting of any option shall not impose upon the Company any obligation to employ or continue to employ any optionee; and the right of the Company to terminate the employment of any officer or other employee shall not be diminished or affected by reason of the fact that an option has been granted to him or her.

#### SECTION 10. WITHHOLDING TAXES

10.1 RIGHTS OF COMPANY. The Company may require an employee exercising a Nonqualified Option, or disposing of shares of Common Stock acquired pursuant to the exercise of an Incentive Option in a disqualifying disposition (as defined in Section 421(b) of the Code),

to reimburse the Company for any taxes required by any government to be withheld or otherwise deducted and paid by the Company in respect of the issuance or disposition of such shares. In lieu thereof, the Company shall have the right to withhold the amount of such taxes from any other sums due or to become due from the Company to the employee upon such terms and conditions as the Company may prescribe. The Company may, in its discretion, hold the stock certificate to which such employee is otherwise entitled upon the exercise of an Option as security for the payment of any such withholding tax liability, until cash sufficient to pay that liability has been received or accumulated.

10.2 PAYMENT IN SHARES. An employee may elect to have such tax withholding obligation satisfied, in whole or in part, by (i) authorizing the Company to withhold from shares of Common Stock to be issued pursuant to the exercise of a Nonqualified Option a number of shares with an aggregate fair market value (as defined in Section 6.3 hereof determined as of the date the withholding is effected) that would satisfy the withholding amount due with respect to such exercise, or (ii) transferring to the Company shares of Common Stock owned by the employee with an aggregate fair market value (as defined in Section 6.3 hereof determined as of the date the withholding is effected) that would satisfy the withholding amount due. With respect to any employee who is subject to Section 16 of the Exchange Act, the following additional restrictions shall apply:

(a) the election to satisfy tax withholding obligations relating to an option exercise in the manner permitted by this Section 10.2 shall be made either (1) during the period beginning on the third business day following the date of release of quarterly or annual summary statements of sales and earnings of the Company and ending on the twelfth business day following such date, or (2) at least six (6) months prior to the date of exercise of the option;

(b) such election shall be irrevocable;

(c) such election shall be subject to the consent or approval of the Committee; and

(d) the Common Stock withheld to satisfy tax withholding, if granted at the discretion of the Committee, must pertain to an option which has been held by the employee for at least six (6) months from the date of grant of the option.

10.3 NOTICE OF DISQUALIFYING DISPOSITION. Each holder of an Incentive Option shall agree to notify the Company in writing immediately after making a disqualifying disposition (as defined in Section 421(b) of the Code) of any Common Stock purchased upon exercise of the Incentive Option.

#### SECTION 11. AMENDMENT OR TERMINATION OF PLAN

11.1 AMENDMENT. The Board may terminate the Plan and may amend the Plan at any time, and from time to time, subject to the limitation that, except as provided in Section hereof, no amendment shall be effective unless approved by the stockholders of the Company in accordance with applicable law and regulations, at an annual or special meeting held within 12 months before or after the date of adoption of such amendment, in any instance in which such amendment would: (i) increase the number of shares of Common Stock that may be issued under, or as to which Options may be granted pursuant to, the Plan; or (ii) change in substance the provisions of Section hereof relating to eligibility to participate in the Plan. In addition, the provisions of Section 4.4 shall not be amended more than once every six months, other than to comport with changes in the Code, the Employee Retirement Income Security Act, or the rules thereunder. In addition, the provisions of Subsection 6.3(ii) may not be amended or repealed without the affirmative vote of the holders of a majority of the shares of Common Stock present and entitled to vote at a duly convened meeting of the Company's stockholders. Without limiting the generality of the foregoing, the Board is expressly authorized to amend the Plan, at any time and from time to time, to conform it to the provisions of Rule 16b-3 under the Exchange Act, as that Rule may be amended from time to time.

Except as provided in Section hereof, the rights and obligations under any option granted before amendment of this Plan or any unexercised portion of such option shall not be adversely

affected by amendment of this Plan or such option without the consent of the holder of such option.

11.2 TERMINATION. This Plan shall terminate as of the tenth anniversary of its effective date. The Board may terminate this Plan at any earlier time for any or no reason. No Option may be granted after the Plan has been terminated. No Option granted while this Plan is in effect shall be altered or impaired by termination of this Plan, except upon the consent of the holder of such Option. The power of the Committee to construe and interpret this Plan and the Options granted prior to the termination of this Plan shall continue after such termination.

#### SECTION 12. NONEXCLUSIVITY OF PLAN

Neither the adoption of this Plan by the Board of Directors nor the submission of this Plan to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including the granting of stock options otherwise than under this Plan, and such arrangements may be either applicable generally or only in specific cases.

#### SECTION 13. EFFECTIVE DATE AND DURATION OF PLAN

This Plan shall become effective upon its adoption by the Board, PROVIDED that the stockholders of the Company shall have approved this Plan within twelve months prior to or following the adoption of this Plan by the Board. Subject to the foregoing, options may be granted under the Plan at any time subsequent to its effective date; PROVIDED, HOWEVER, that (a) no such option shall be exercised or exercisable unless the stockholders of the Company shall have approved the Plan within twelve months prior to or following the adoption of this Plan by the Board, and (b) all options issued prior to the date of such stockholders' approval shall contain a reference to such condition. No option may be granted under the Plan after the tenth anniversary of the effective date. The Plan shall terminate (i) when the total amount of the Common Stock with respect to which options may be granted shall have been issued upon the

exercise of options or (ii) by action of the Board of Directors pursuant to Section 11 hereof, whichever shall first occur.

SECTION 14. PROVISIONS OF GENERAL APPLICATION

14.1 SEVERABILITY. The invalidity or unenforceability of any provision of this Plan shall not affect the validity or enforceability of any other provision of this Plan, each of which shall remain in full force and effect.

14.2 CONSTRUCTION. The headings in this Plan are included for convenience only and shall not in any way effect the meaning or interpretation of this Plan. Any term defined in the singular shall include the plural, and vice versa. The words "herein," "hereof" and "hereunder" refer to this Plan as a whole and not to any particular part of this Plan. The word "including" as used herein shall not be construed so as to exclude any other thing not referred to or described.

14.3 FURTHER ASSURANCES. The Company and any holder of an option shall from time to time execute and deliver any and all further instruments, documents and agreements and do such other and further acts and things as may be required or useful to carry out the intent and purpose of this Plan and such option and to assure to the Company and such option holder the benefits contemplated by this Plan; PROVIDED, HOWEVER, that neither the Company nor any option holder shall in any event be required to take any action inconsistent with the provisions of this Plan.

14.4 GOVERNING LAW. This Plan and each Option shall be governed by the laws of the State of Delaware.

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## KVH INDUSTRIES, INC.

AMENDED AND RESTATED  
1996 EMPLOYEE STOCK PURCHASE PLAN  
(AS AMENDED FEBRUARY 6, 1996, MAY 26, 1999 AND MAY 23, 2001)

## 1. PURPOSE.

The KVH Industries, Inc. Amended and Restated 1996 Employee Stock Purchase Plan (the "Plan") is intended to provide a method whereby employees of KVH Industries, Inc. (the "Company") will have an opportunity to acquire an ownership interest (or increase an existing ownership interest) in the Company through the purchase of shares of the Common Stock of the Company. It is the intention of the Company that the Plan qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1986, as amended (the "Code"). The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

## 2. DEFINITIONS.

(a) "Board" means the Board of Directors of the Company.

(b) "Code" shall have the meaning set forth in Paragraph 1.

(c) "Committee" means the Compensation Committee of the Board.

(d) "Common Stock" means the common stock, \$.01 par value per share, of the Company.

(e) "Company" shall also include any subsidiary of KVH Industries, Inc. designated as a participant in the Plan by the Board, unless the context otherwise requires.

(f) "Compensation" means, for the purpose of any Offering pursuant to this Plan, base pay in effect as of the Offering Commencement Date (as hereinafter defined). Compensation shall not include any deferred compensation other than contributions by an individual through a salary reduction agreement to a cash or deferred plan pursuant to Section 401(k) of the Code or to a cafeteria plan pursuant to Section 125 of the Code.

(g) "Employee" means any person who is customarily employed at least 20 hours per week and more than five months in a calendar year by (i) the Company or (ii) any subsidiary corporation.

(h) "Investment Accounts" shall have the meaning set forth in Paragraph 9.

(i) "Offering" shall have the meaning set forth in Paragraph 4.

(j) "Offering Commencement Date" shall have the meaning set forth in Paragraph 4.

(k) "Offering Termination Date" shall have the meaning set forth in Paragraph 4.

(l) "Plan" shall have the meaning set forth in Paragraph 1.

(m) "Subsidiary corporation" shall mean any present or future corporation which is or would constitute a "subsidiary corporation" as that term is defined in Section 425 of the Code.

### 3. ELIGIBILITY.

(a) Participation in the Plan is completely voluntary. Participation in any one or more of the offerings under the Plan shall neither limit, nor require, participation in any other offering.

(b) Each employee of the Company shall be eligible to participate in the Plan on the first Offering Commencement Date, as hereafter defined, following the completion of twelve months of continuous service with the Company and/or its subsidiary corporations. Notwithstanding the foregoing, no employee shall be granted an option under the Plan:

(i) if, immediately after the grant, such employee would own stock, and/or hold outstanding options to purchase stock, possessing 5% or more of the total combined voting power or value of all classes of stock of the Company or any subsidiary corporation; for purposes of this Paragraph the rules of Section 425(d) of the Code shall apply in determining stock ownership of any employee; or

(ii) which permits his rights to purchase stock under all Section 423 employee stock purchase plans of the Company and its subsidiary corporations to exceed \$25,000 of the fair market value of the stock (determined at the time such option is granted) for each calendar year in which such option is outstanding; for purposes of this Paragraph, the rules of Section 423(b)(8) of the Code shall apply.

### 4. OFFERING DATES.

The right to purchase stock hereunder shall be made available by a series of six-month offerings (the "Offering" or "Offerings") to employees eligible in accordance with Paragraph 3 hereof. The Committee will, in its discretion, determine the applicable date of commencement ("Offering Commencement Date") and termination date ("Offering Termination Date") for each Offering. Participation in any one or more of the Offerings under the Plan shall neither limit, nor require, participation in any other Offering.

### 5. PARTICIPATION.

Any eligible employee may become a participant by completing a payroll deduction authorization form provided by the Company and filing it with the office of the Company's Treasurer 20 days prior to each applicable Offering Commencement Date, as determined by the Committee pursuant to Paragraph 4.

### 6. PAYROLL DEDUCTIONS.

(a) At the time a participant files his authorization for a payroll deduction, he shall elect to have deductions made from his pay on each payday during any Offering in which he is a participant at a specified percentage of his Compensation as determined on the applicable Offering Commencement Date; said percentage shall be in increments of one percent up to a maximum percentage of six percent.

(b) Payroll deductions for a participant shall commence on the applicable Offering Commencement Date when his authorization for a payroll deduction becomes effective and shall end on the Offering Termination Date of the Offering to which such authorization is applicable unless sooner terminated by the participant as provided in Paragraph 10.

(c) All payroll deductions made for a participant shall be credited to his account under the Plan. A participant may not make any separate cash payment into such account.

(d) A participant may withdraw from the Plan at any time during the applicable Offering period; provided, however, that a participant who is an officer or director of the Company and who withdraws from the Plan during any Offering period will not be eligible for the grant of any subsequent option under the Plan for a period of six months.

#### 7. GRANTING OF OPTION.

(a) Except as set forth in Paragraph 7(c) hereof, on the Offering Commencement Date of each Offering, a participating employee shall be deemed to have been granted an option to purchase a maximum number of shares of the Common Stock equal to an amount determined as follows: 85% of the market value per share of the Common Stock on the applicable Offering Commencement Date shall be divided into an amount equal to the sum of (i) the percentage of the employee's Compensation which he has elected to have withheld (but no more than 6%) multiplied by the employee's Compensation over the Offering period plus (ii) any amounts in the employee's account on the Offering Commencement Date that have been carried forward from prior Offerings. Such market value per share of the Common Stock shall be determined as provided in clause (i) of Paragraph 7(b).

(b) The option price of the Common Stock purchased with payroll deductions made during each such Offering for a participant therein shall be the lower of:

(i) 85% of the average of the bid and the asked prices as reported by the Nasdaq Stock Market in the Wall Street Journal, or, if the Common Stock is designated as a national market security by the National Association of Securities Dealers, Inc. ("NASD") the last trading price of the Common Stock as reported by the Nasdaq National Market System in the Wall Street Journal, or, if the Common Stock is listed on an exchange the closing price of the Common Stock on the exchange on the Offering Commencement Date applicable to such Offering (or on the next regular business date on which shares of the Common Stock shall be traded in the event that no shares of the Common Stock have been traded on the Offering Commencement Date); or if the Common Stock is not quoted on Nasdaq, not designated as a Nasdaq national market security and not listed on an exchange, 85% of the fair market value on the Offering Commencement Date as determined by the Committee; and



(ii) 85% of the average of the bid and the asked prices as reported by Nasdaq in the Wall Street Journal, or, if the Common Stock is designated as a national market security by the NASD the last trading price of the Common Stock as reported by the Nasdaq National Market System in the Wall Street Journal, or, if the Common Stock is listed on an exchange the closing price of the Common Stock on the exchange on the Offering Termination Date applicable to such Offering (or on the next regular business date on which shares of the Common Stock shall be traded in the event that no shares of the Common Stock shall have been traded on the Offering Termination Date); or if the Common Stock is not quoted on Nasdaq, not designated as a Nasdaq national market security and not listed on an exchange, 85% of the fair market value on the Offering Termination Date as determined by the Committee.

(c) A participant who is an officer or director of the Company and who elects pursuant to Paragraph 8(a) with respect to any Offering not to exercise an option deemed to have been granted pursuant to this Paragraph 7, shall not be eligible for the grant of an option hereunder for a period of six months.

#### 8. EXERCISE OF OPTION.

(a) Unless a participant gives written notice to the Treasurer of the Company as hereinafter provided, his option for the purchase of Common Stock with payroll deductions made during any Offering will be deemed to have been exercised automatically on the Offering Termination Date applicable to such Offering for the purchase of the number of full shares of Common Stock which the accumulated payroll deductions in his account at that time will purchase at the applicable option price (but not in excess of the number of shares for which options have been granted the employee pursuant to Paragraph 7(a)), and any excess in his account at that time will be automatically carried forward to the next Offering unless the participant elects, by written notice to the Treasurer of the Company, to have the excess returned to him.

(b) Fractional shares will not be issued under the Plan and any accumulated payroll deductions which would have been used to purchase fractional shares shall be automatically carried forward to the next Offering unless the participant elects, by written notice to the Treasurer of the Company, to have the excess cash returned to him.

#### 9. INVESTMENT ACCOUNTS.

All shares of Common Stock purchased pursuant to Paragraph 8 shall be held in separate investment accounts ("Investment Accounts") maintained by such brokerage house, investment banking firm, commercial bank or other such similar institution as may be selected by the Board for the participants. Each Investment Account shall be in the name of the participating employee. All dividends, if any, paid with respect to shares of Common Stock in a participant's Investment Account shall be credited to his or her Investment Account. Each participant shall have all of the rights and privileges of a stockholder of the Company with respect to those shares purchased under the Plan and held in his or her Investment Account.

#### 10. WITHDRAWAL AND TERMINATION.

(a) Prior to the Offering Termination Date for an Offering, any participant may withdraw the payroll deductions credited to his account under the Plan for such Offering by giving written notice to the Treasurer of the Company. All of the participant's payroll deductions credited to such account will be paid to him promptly after receipt of notice of withdrawal, without interest, and no future payroll deductions will be made from his pay during such offering. The Company will treat any attempt to borrow by a participant on the security of accumulated payroll deductions as an election to withdraw such deductions.

(b) Except as set forth in Paragraphs 6(d) and 7(c), a participant's election not to participate in, or withdrawal from, any Offering will not have any effect upon his eligibility to participate in any succeeding Offering or in any similar plan which may hereafter be adopted by the Company.

(c) Upon termination of the participant's employment for any reason, including retirement but excluding death, the payroll deductions credited to his account will be returned to him, or, in the case of his death, to the person or persons entitled thereto under Paragraph 14.

(d) Upon termination of the participant's employment because of death, his beneficiary (as defined in Paragraph 14) shall have the right to elect, by written notice given to the Company's Treasurer prior to the expiration of a period of 90 days commencing with the date of the death of the participant, either:

(i) to withdraw all of the payroll deductions credited to the participant's account under the Plan; or

(ii) to exercise the participant's option for the purchase of stock on the Offering Termination Date next following the date of the participant's death for the purchase of the number of full shares which the accumulated payroll deductions in the participant's account at the date of the participant's death will purchase at the applicable option price (subject to the limitation contained in Paragraph 7(a)), and any excess in such account will be returned to said beneficiary. In the event that no such written notice of election shall be duly received by the office of the Company's Treasurer, the beneficiary shall automatically be deemed to have elected to withdraw the payroll deductions credited to the participant's account at the date of the participant's death and the same will be paid promptly to said beneficiary.

#### 11. INTEREST.

No interest will be paid or allowed on any money paid into the Plan or credited to the account of any participating employee.

#### 12. STOCK.

(a) The maximum number of shares of Common Stock available for issuance and purchase by employees under the Plan, subject to adjustment upon changes in capitalization of the Company as provided in Paragraph 17, shall be 400,000 shares of Common Stock, \$.01 par value per share, of the Company. The maximum number of shares of Common Stock available for issuance and purchase by employees under the Plan in any Offering shall be one percent of the shares of Common Stock outstanding. If the total number of shares for which options are

exercised on any Offering Termination Date in accordance with Paragraph 8 exceeds the maximum number of shares for the applicable Offering, the Company shall make a pro rata allocation of the shares available for delivery and distribution in an equitable manner, with the balances of payroll deductions credited to the account of each participant under the Plan carried forward to the next Offering or returned to the participant if he so chooses, by giving written notice to the Treasurer to this effect.

(b) The participant will have no interest in stock covered by his option until such option has been exercised.

(c) The shares of stock purchased by a participant who is an officer or director of the Company, or a beneficiary of a participant who was an officer or director of the Company pursuant to Paragraph 14 hereof, at each Offering Termination Date may not be sold or transferred by such participant or beneficiary for a period of six months following such Offering Termination Date. Certificates representing said shares of stock issued pursuant to this Plan may bear legends to that effect.

#### 13. ADMINISTRATION.

The Plan shall be administered by the Committee. The interpretation and construction of any provision of the Plan and adoption of rules and regulations for administering the Plan shall be made by the Committee. Determinations made by the Committee with respect to any matter or provision contained in the Plan shall be final, conclusive and binding upon the Company and upon all participants, their heirs or legal representatives. Any rule or regulation adopted by the Committee shall remain in full force and effect unless and until altered, amended, or repealed by the Committee.

#### 14. DESIGNATION OF BENEFICIARY.

A participant shall file with the Treasurer of the Company a written designation of a beneficiary who is to receive any Common Stock and/or cash under the Plan. Such designation of beneficiary may be changed by the participant at any time by written notice. Upon the death of a participant and upon receipt by the Company of proof of the identity and existence at the participant's death of a beneficiary validly designated by him under the Plan, the Company shall deliver such Common Stock and/or cash to such beneficiary. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such Common Stock and/or cash to the executor or administrator of the estate of the participant. No beneficiary shall prior to the death of the participant by whom he has been designated, acquire any interest in the Common Stock and/or cash credited to the participant under the Plan.

#### 15. TRANSFERABILITY.

Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive Common Stock under the Plan may be assigned, transferred, pledged, or otherwise disposed of in any way by the participant other than by will or the laws of descent and distribution. Any such attempted assignment, transfer, pledge, or other

disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds in accordance with Paragraph 8(b).

16. USE OF FUNDS.

All payroll deductions received or held by the Company under this Plan may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such payroll deductions.

17. EFFECT OF CHANGES OF COMMON STOCK.

If the Company shall subdivide or reclassify the Common Stock which has been or may be optioned under this Plan, or shall declare thereon any dividend payable in shares of such Common Stock, or shall take any other action of a similar nature affecting such Common Stock, then the number and class of shares of Common Stock which may thereafter be optioned (in the aggregate and to any participant) shall be adjusted accordingly and in the case of each option outstanding at the time of any such action, the number and class of shares which may thereafter be purchased pursuant to such option and the option price per share shall be adjusted to such extent as may be determined by the Committee, with the approval of independent public accountants and counsel, to be necessary to preserve the rights of the holder of such option.

18. AMENDMENT OR TERMINATION.

The Board may at any time terminate or amend the Plan. No such termination shall affect options previously granted, nor may an amendment make any change in any option theretofore granted which would adversely affect the rights of any participant holding options under the Plan.

19. NOTICES.

All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received by the Treasurer of the Company.

20. MERGER OR CONSOLIDATION.

If the Company shall at any time merge into or consolidate with another corporation, the holder of each option then outstanding will thereafter be entitled to receive at the next Offering Termination Date upon the exercise of such option for each share as to which such option shall be exercised, the securities or property which a holder of one share of the Common Stock was entitled to upon and at the time of such merger or consolidation. In accordance with this Paragraph and Paragraph 17, the Committee shall determine the kind and amount of such securities or property which such holder of an option shall be entitled to receive. A sale of all or substantially all of the assets of the Company shall be deemed a merger or consolidation for the foregoing purposes.

21. APPROVAL OF STOCKHOLDERS.

The Plan is subject to the approval of the stockholders of the Company by written consent or at their next annual meeting or at any special meeting of the stockholders for which one of the purposes of such a special meeting shall be to act upon the Plan.

22. GOVERNMENTAL AND OTHER REGULATIONS.

The Plan, and the grant and exercise of the rights to purchase shares hereunder, and the Company's obligation to sell and deliver shares upon the exercise of rights to purchase shares, shall be subject to all applicable federal, state and foreign laws, rules and regulations, and to such approvals by any regulatory or governmental agency as may, in the opinion of counsel for the Company, be required. The Plan shall be governed by, and construed and enforced in accordance with, the provisions of Sections 421, 423 and 424 of the Code and the substantive laws of the Commonwealth of Massachusetts. In the event of any inconsistency between such provisions of the Code and any such laws, said provisions of the Code shall govern to the extent necessary to preserve favorable federal income tax treatment afforded employee stock purchase plans under Section 423 of the Code.

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KVH INDUSTRIES, INC.  
2003 INCENTIVE AND NONQUALIFIED  
STOCK OPTION PLAN

## SECTION 1. PURPOSE

This 2003 Incentive and Nonqualified Stock Option Plan (the "Plan") of KVH Industries, Inc., a Delaware corporation (the "Company"), is designed to provide additional incentive to executives and other key employees of the Company and its subsidiaries and for certain other individuals providing services to or acting as directors of the Company and its subsidiaries. The Company intends that this purpose will be effected by the granting of incentive stock options ("Incentive Stock Options") as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), and nonqualified stock options ("Nonqualified Options") under the Plan which afford such executives, key employees, directors and other eligible individuals an opportunity to acquire or increase their proprietary interest in the Company through the acquisition of shares of its Common Stock. The Company intends that Incentive Stock Options issued under the Plan will qualify as "incentive stock options" as defined in Section 422 of the Code and the terms of the Plan shall be interpreted in accordance with this intention. The term "subsidiary" shall have the meaning set forth in Section 424 of the Code.

## SECTION 2. ADMINISTRATION

2.1 THE COMMITTEE. The Plan shall be administered by the Compensation Committee of the Board of Directors of the Company, so long as each member of such committee shall qualify as an Outside Director, as defined below. In the event the Compensation Committee shall include any director who is not an Outside Director, the Outside Directors then serving as members of the Compensation Committee shall constitute the Stock Option Committee of the Board of Directors to administer the Plan (the Compensation Committee or Stock Option Committee, if appointed, being referred to herein as the "Committee"). The

Committee shall have at least two members at all times. As used herein, the term "Outside Director" means any director who (i) is not an employee of the Company or of any "affiliated group," as such term is defined in Section 1504(a) of the Code, which includes the Company (an "Affiliate"), (ii) is not a former employee of the Company or any Affiliate who is receiving compensation for prior services (other than benefits under a tax-qualified retirement plan) during the Company's or any Affiliate's taxable year, (iii) has not been an officer of the Company or any Affiliate and (iv) does not receive remuneration from the Company or any Affiliate, either directly or indirectly, in any capacity other than as a director. None of the members of the Committee shall have been granted any incentive stock option or nonqualified option under this Plan (other than pursuant to Section 4.4) or any other stock option plan of the Company within one year prior to service on the Committee. It is the intention of the Company that the Plan shall be administered by "disinterested persons" within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934 (the "Exchange Act"), but the authority and validity of any act taken or not taken by the Committee shall not be affected if any person administering the Plan is not a disinterested person. Except as specifically reserved to the Company's Board of Directors under the terms of the Plan, the Committee shall have full and final authority to operate, manage and administer the Plan on behalf of the Company. Action by the Committee shall require the affirmative vote of a majority of all members thereof.

2.2 POWERS OF THE COMMITTEE. Subject to the terms and conditions of the Plan, the Committee shall have the power:

(a) To determine from time to time the persons eligible to receive options and the options to be granted to such persons under the Plan and to prescribe the terms, conditions, restrictions, if any, and provisions (which need not be identical) of each option granted under the Plan to such persons;

(b) To construe and interpret the Plan and options granted thereunder and to establish, amend, and revoke rules and regulations for administration of the Plan. In this connection, the Committee may correct any defect or supply any omission, or reconcile any inconsistency in the

Plan, or in any option agreement, in the manner and to the extent it shall deem necessary or expedient to make the Plan fully effective. All decisions and determinations by the Committee in the exercise of this power shall be final and binding upon the Company and optionees;

(c) Except as provided in Section 6.3 hereof, to make, in its sole discretion, changes to any outstanding option granted under the Plan, including: (i) to accelerate the vesting schedule or (ii) to extend the expiration date; and

(d) Generally, to exercise such powers and to perform such acts as are deemed necessary or expedient to promote the best interests of the Company with respect to the Plan.

### SECTION 3. STOCK

3.1 STOCK TO BE ISSUED. The stock subject to the options granted under the Plan shall be shares of the Company's authorized but unissued Common Stock, \$.01 par value (the "Common Stock"), or shares of the Company's Common Stock held in treasury. The total number of shares that may be issued pursuant to options granted under the Plan shall not exceed an aggregate of 1,000,000 shares of Common Stock; provided, however, that the class and aggregate number of shares which may be subject to options granted under the Plan shall be subject to adjustment as provided in Section 8 hereof.

3.2 EXPIRATION, CANCELLATION OR TERMINATION OF OPTION. Whenever any outstanding option under the Plan expires, is cancelled or is otherwise terminated (other than by exercise), the shares of Common Stock allocable to the unexercised portion of such option may again be the subject of options under the Plan.

3.3 LIMITATION ON GRANTS. In no event may any Plan participant be granted options with respect to more than 120,000 shares of Common Stock in any calendar year. The number of shares of Common Stock issuable pursuant to an option granted to a Plan participant in a calendar year that is subsequently forfeited, cancelled or otherwise terminated shall continue to count toward the foregoing limitation in such calendar year. In addition, if the exercise price of an option is subsequently reduced, the transaction shall be deemed a cancellation of the original



option and the grant of a new one so that both transactions shall count toward the maximum shares issuable in the calendar year of each respective transaction.

#### SECTION 4. ELIGIBILITY

4.1 PERSONS ELIGIBLE. Incentive Stock Options under the Plan may be granted only to officers and other employees of the Company or its subsidiaries. Nonqualified Options may be granted to officers or other employees of the Company or its subsidiaries, and to members of the Board and consultants or other persons who render services to the Company (regardless of whether they are also employees), provided, however, that no such option may be granted to a person who is a member of the Committee at the time of grant other than pursuant to Section 4.4.

4.2 GREATER-THAN-TEN-PERCENT STOCKHOLDERS. Except as may otherwise be permitted by the Code or other applicable law or regulation, no Incentive Stock Option shall be granted to an individual who, at the time the option is granted, owns (including ownership attributed pursuant to Section 424 of the Code) more than ten percent of the total combined voting power of all classes of stock of the Company or any subsidiary (a "greater-than-ten-percent stockholder"), unless such Incentive Stock Option provides that (i) the purchase price per share shall not be less than one hundred ten percent of the fair market value of the Common Stock at the time such option is granted, and (ii) that such option shall not be exercisable to any extent after the expiration of five years from the date it is granted.

4.3 MAXIMUM AGGREGATE FAIR MARKET VALUE. The aggregate fair market value (determined at the time the option is granted) of the Common Stock with respect to which Incentive Stock Options are exercisable for the first time by any optionee during any calendar year (under the Plan and any other plans of the Company or its subsidiary for the issuance of incentive stock options) shall not exceed \$100,000 (or such greater amount as may from time to time be permitted with respect to incentive stock options by the Code or any other applicable law or regulation).

4.4 OPTION GRANTS TO NON-EMPLOYEE DIRECTORS. (a) As compensation for services to the Company, each director of the Company who is not an employee of the Company or any subsidiary of the Company (a "Non-Employee Director") upon his or her initial election to the Board shall be automatically granted a Nonqualified Option to purchase 10,000 shares of Common Stock of the Company (the "Initial Option Grant"). In addition, any director of the Company who is elected to the Board but who is not a Non-Employee Director at the time of his or her initial election and later becomes a Non-Employee Director shall automatically receive an Initial Option Grant to purchase 10,000 shares of Common Stock of the Company upon his or her first election to the Board as a Non-Employee Director. Each Initial Option Grant shall vest with respect to 2,500 shares on each three-month anniversary of the date of grant, provided that the optionee is a director of the Company on each such three-month anniversary, and shall expire on the fifth annual anniversary of the date of grant. At the first meeting of the Board of Directors following each annual meeting of stockholders, each Non-Employee Director (other than any Non-Employee Director who has received an Initial Option Grant as a result of election to the Board at such meeting) shall be automatically granted an additional Nonqualified Option to purchase 5,000 shares of Common Stock of the Company (the "Subsequent Option Grant"). Each Subsequent Option Grant shall be exercisable in its entirety on the date of grant and shall expire on the fifth annual anniversary of the date of grant;

(b) Each Non-Employee Director appointed to serve on the Audit Committee of the Board of Directors shall automatically receive an Option Grant to purchase 5,000 shares of Common Stock upon his or her appointment to the Audit Committee and an additional Option Grant of 5,000 shares of Common Stock on each anniversary of such appointment, so long as such Director shall serve on the Audit Committee. Each such Option shall vest with respect to 1,250 shares on each three-month anniversary of the date of Grant, provided that such optionee is a Director and member of the Audit Committee on each three-month anniversary, and shall expire on the fifth anniversary of the date of Grant;

(c) The exercise price per share of Common Stock of each Nonqualified Option granted pursuant to this Section 4.4 shall be equal to the fair market value of the Common Stock on the date the Nonqualified Option is granted, such fair market value to be determined in accordance with the provisions of Section 6.3;

(d) No Nonqualified Option granted under this Section 4.4 shall be transferable by the optionee otherwise than by will or by the laws of descent and distribution, and such Options shall be exercisable during the optionee's lifetime only by the optionee. Any Nonqualified Option granted to a Non-Employee Director and outstanding on the date of his or her death may be exercised by the legal representative or legatee of the optionee until the expiration of the stated term of the option;

Nonqualified Options granted under this Section 4.4 may be exercised only by written notice to the Company specifying the number of shares to be purchased. Payment of the full purchase may be made by one or more of the methods specified in Section 7.2. An optionee shall have the rights of a stockholder only as to shares acquired upon the exercise of an option and not as to unexercised options.

(e) The provisions of this Section 4.4 shall apply only to options granted or to be granted to Non-Employee Directors, and shall not be deemed to modify, limit or otherwise apply to any other provision of this Plan or to any option issued under this Plan to a participant who is not a Non-Employee Director of the Company. To the extent inconsistent with the provisions of any other Section of this Plan, the provisions of this Section 4.4 shall govern the rights and obligations of the Company and Non-Employee Directors respecting options granted or to be granted to Non-Employee Directors.

#### SECTION 5. TERMINATION OF EMPLOYMENT OR DEATH OF OPTIONEE

5.1 TERMINATION OF EMPLOYMENT. Except as may be otherwise expressly provided herein, options shall terminate on the earlier of:

(a) the date of expiration thereof;

(b) the date of termination of the optionee's employment with or services to the Company by it for cause (as determined by the Company), or voluntarily by the optionee; or

(c) thirty days after the date of termination of the optionee's employment with or services to the Company by it without cause;

provided, that Nonqualified Options granted to persons who are not employees of the Company need not, unless the Committee determines otherwise, be subject to the provisions set forth in clauses (b) and (c) above.

An employment relationship between the Company and the optionee shall be deemed to exist during any period in which the optionee is employed by the Company or any subsidiary. Whether authorized leave of absence, or absence on military or government service, shall constitute termination of the employment relationship between the Company and the optionee shall be determined by the Committee at the time thereof.

As used herein, "cause" shall mean (x) any material breach by the optionee of any agreement to which the optionee and the Company are both parties, (y) any act or omission to act by the optionee which may have a material and adverse effect on the Company's business or on the optionee's ability to perform services for the Company, including, without limitation, the commission of any crime (other than ordinary traffic violations), or (z) any material misconduct or material neglect of duties by the optionee in connection with the business or affairs of the Company or any affiliate of the Company.

5.2 DEATH OR PERMANENT DISABILITY OF OPTIONEE. In the event of the death or permanent and total disability of the holder of an option prior to termination of the optionee's employment with or services to the Company and before the date of expiration of such option, such option shall terminate on the earlier of such date of expiration or one year following the date of such death or disability. After the death of the optionee, his/her executors, administrators or any person or persons to whom his/her option may be transferred by will or by the laws of descent and distribution, shall have the right, at any time prior to such termination, to exercise

the option to the extent the optionee was entitled to exercise such option immediately prior to his/her death. An optionee is permanently and totally disabled if he/she is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to last for a continuous period of not less than twelve months; permanent and total disability shall be determined in accordance with Section 22(e)(3) of the Code and the regulations issued thereunder.

#### SECTION 6. TERMS OF THE OPTION AGREEMENTS

Each option agreement shall be in writing and shall contain such terms, conditions, restrictions, if any, and provisions as the Committee shall from time to time deem appropriate. Such provisions or conditions may include without limitation restrictions on transfer, repurchase rights, or such other provisions as shall be determined by the Committee; provided, that such additional provisions shall not be inconsistent with any other term or condition of the Plan and such additional provisions shall not cause any Incentive Stock Option granted under the Plan to fail to qualify as an incentive option within the meaning of Section 422 of the Code. Option agreements need not be identical, but each option agreement by appropriate language shall include the substance of all of the following provisions:

6.1 EXPIRATION OF OPTION. Subject to Section 4.4 hereof, notwithstanding any other provision of the Plan or of any option agreement, each option shall expire on the date specified in the option agreement, which date shall not, in the case of an Incentive Stock Option, be later than the tenth anniversary (fifth anniversary in the case of a greater-than-ten-percent stockholder) of the date on which the option was granted, or as specified in Section 5 hereof.

6.2 EXERCISE. Subject to Sections 4.4 and 7.3 hereof, each option may be exercised, so long as it is valid and outstanding, from time to time in part or as a whole, subject to any limitations with respect to the number of shares for which the option may be exercised at a particular time and to such other conditions as the Committee in its discretion may specify upon granting the option.

6.3 PURCHASE PRICE. Subject to Section 4.4 hereof, the purchase price per share under each option shall be determined by the Committee at the time the option is granted; provided, however, (i) that the option price of any Incentive Stock Option shall not, unless otherwise permitted by the Code or other applicable law or regulation, be less than the fair market value of the Common Stock on the date the option is granted (110% of the fair market value in the case of a greater-than-ten-percent stockholder), and (ii) that, unless approved by the holders of a majority of the shares present and entitled to vote at a duly convened meeting of the Company's stockholders, the option price of any stock option shall not be less than the fair market value of the Common Stock on the date the option is granted and the exercise price of any outstanding stock option grant under any existing or future stock option plan may not be reduced. Subsection 6.3(ii) hereof may not be amended or repealed without the affirmative vote of the holders of a majority of the shares of the Company present and entitled to vote at a duly convened meeting of the Company's stockholders. For the purpose of the Plan the fair market value of the Common Stock shall be the closing price per share on the date of grant of the option as reported by a nationally recognized stock exchange, or, if the Common Stock is not listed on such an exchange, as reported by the National Association of Securities Dealers Automated Quotation System, Inc. ("NASDAQ"), or, if the Common Stock is not quoted on NASDAQ, the fair market value as determined by the Committee.

6.4 TRANSFERABILITY OF OPTIONS. Options shall not be transferable by the optionee otherwise than by will or under the laws of descent and distribution, and shall be exercisable, during his or her lifetime, only by him or her.

6.5 RIGHTS OF OPTIONEES. No optionee shall be deemed for any purpose to be the owner of any shares of Common Stock subject to any option unless and until the option shall have been exercised pursuant to the terms thereof, and the Company shall have issued and delivered the shares to the optionee.

6.6 REPURCHASE RIGHT. The Committee may in its discretion provide upon the grant of any option hereunder that the Company shall have an option to repurchase upon such terms and conditions as determined by the Committee all or any number of shares purchased upon exercise of such option. The repurchase price per share payable by the Company shall be such amount or be determined by such formula as is fixed by the Committee at the time the option for the shares subject to repurchase is granted. In the event the Committee shall grant options subject to the Company's repurchase option, the certificates representing the shares purchased pursuant to such option shall carry a legend satisfactory to counsel for the Company referring to the Company's repurchase option.

6.7 "LOCKUP" AGREEMENT. The Committee may in its discretion specify upon granting an option that the optionee shall agree for a period of time (not to exceed 180 days) from the effective date of any registration of securities of the Company (upon request of the Company or the underwriters managing any underwritten offering of the Company's securities), not to sell, make any short sale of, loan, grant any option for the purchase of, or otherwise dispose of any shares issued pursuant to the exercise of such option, without the prior written consent of the Company or such underwriters, as the case may be.

#### SECTION 7. METHOD OF EXERCISE; PAYMENT OF PURCHASE PRICE

7.1 METHOD OF EXERCISE. Any option granted under the Plan may be exercised by the optionee by delivering to the Company on any business day a written notice specifying the number of shares of Common Stock the optionee then desires to purchase and specifying the address to which the certificates for such shares are to be mailed (the "Notice"), accompanied by payment for such shares.

7.2 PAYMENT OF PURCHASE PRICE. Payment for the shares of Common Stock purchased pursuant to the exercise of an option shall be made by:

(a) cash in an amount, or a check, bank draft or postal or express money order payable in an amount, equal to the aggregate exercise price for the number of shares specified in the Notice;

(b) with the consent of the Committee, shares of Common Stock of the Company having a fair market value (as defined for purposes of Section 6.3 hereof) equal to such aggregate exercise price;

(c) with the consent of the Committee, such other consideration that is acceptable to the Committee and that has a fair market value, as determined by the Committee, equal to such aggregate exercise price, including any broker-directed cashless exercise/resale procedure adopted by the Committee; or

(d) with the consent of the Committee, any combination of the foregoing.

As promptly as practicable after receipt of the Notice and accompanying payment, the Company shall deliver to the optionee certificates for the number of shares with respect to which such option has been so exercised, issued in the optionee's name; provided, however, that such delivery shall be deemed effected for all purposes when the Company or a stock transfer agent of the Company shall have deposited such certificates in the United States mail, addressed to the optionee, at the address specified in the Notice.

7.3 SPECIAL LIMITS AFFECTING SECTION 16(B) OPTION HOLDERS. Shares issuable upon exercise of options granted to a person who in the opinion of the Committee may be deemed to be a director or officer of the Company within the meaning of Section 16(b) of the Exchange Act and the rules and regulations thereunder shall not be sold or disposed of until after the expiration of six months following the date of grant.

#### SECTION 8. CHANGES IN COMPANY'S CAPITAL STRUCTURE

8.1 RIGHTS OF COMPANY. The existence of outstanding options shall not affect in any way the right or power of the Company or its stockholders to make or authorize, without limitation, any or all adjustments, recapitalizations, reorganizations or other changes in the Company's capital structure or its business, or any merger or consolidation of the Company, or any issue of Common Stock, or any issue of bonds, debentures, preferred or prior preference stock or other



capital stock ahead of or affecting the Common Stock or the rights thereof, or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, whether of a similar character or otherwise.

8.2 RECAPITALIZATION, STOCK SPLITS AND DIVIDENDS. If the Company shall effect a subdivision or consolidation of shares or other capital readjustment, the payment of a stock dividend, or other increase or reduction of the number of shares of the Common Stock outstanding, in any such case without receiving compensation therefor in money, services or property, then (i) the number, class, and price per share of shares of stock subject to outstanding options hereunder shall be appropriately adjusted in such a manner as to entitle an optionee to receive upon exercise of an option, for the same aggregate cash consideration, the same total number and class of shares as he or she would have received as a result of the event requiring the adjustment had he or she exercised his or her option in full immediately prior to such event; (ii) the number and class of shares with respect to which options may be granted under the Plan; and (iii) the number and class of shares set forth in Sections 3.3 and 4.4 shall be adjusted by substituting for the total number of shares of Common Stock then reserved for issuance under the Plan that number and class of shares of stock that the owner of an equal number of outstanding shares of Common Stock would own as the result of the event requiring the adjustment.

8.3 MERGER WITHOUT CHANGE OF CONTROL. After a merger of one or more corporations into the Company, or after a consolidation of the Company and one or more corporations in which (i) the Company shall be the surviving corporation, and (ii) the stockholders of the Company immediately prior to such merger or consolidation own after such merger or consolidation shares representing at least fifty percent of the voting power of the Company, each holder of an outstanding option shall, at no additional cost, be entitled upon exercise of such option to receive in lieu of the number of shares as to which such option shall then be so exercisable, the number and class of shares of stock or other securities to which such holder would have been entitled pursuant to the terms of the agreement of merger or consolidation if,

immediately prior to such merger or consolidation, such holder had been the holder of record of a number of shares of Common Stock equal to the number of shares for which such option was exercisable.

8.4 SALE OR MERGER WITH CHANGE OF CONTROL. If the Company is merged into or consolidated with another corporation under circumstances where the Company is not the surviving corporation, or if there is a merger or consolidation where the Company is the surviving corporation but the stockholders of the Company immediately prior to such merger or consolidation do not own after such merger or consolidation shares representing at least fifty percent of the voting power of the Company, or if the Company is liquidated, or sells or otherwise disposes of substantially all of its assets to another corporation while unexercised options remain outstanding under the Plan, (i) subject to the provisions of clause (iii) below, after the effective date of such merger, consolidation, liquidation, sale or disposition, as the case may be, each holder of an outstanding option shall be entitled, upon exercise of such option, to receive, in lieu of shares of Common Stock, shares of such stock or other securities, cash or property as the holders of shares of Common Stock received pursuant to the terms of the merger, consolidation, liquidation, sale or disposition; (ii) the Committee may accelerate the time for exercise of all unexercised and unexpired options to and after a date prior to the effective date of such merger, consolidation, liquidation, sale or disposition, as the case may be, specified by the Committee; or (iii) all outstanding options may be cancelled by the Committee as of the effective date of any such merger, consolidation, liquidation, sale or disposition provided that (x) notice of such cancellation shall be given to each holder of an option and (y) each holder of an option shall have the right to exercise such option to the extent that the same is then exercisable or, if the Committee shall have accelerated the time for exercise of all unexercised and unexpired options, in full during the 30-day period preceding the effective date of such merger, consolidation, liquidation, sale or disposition.

8.5 ADJUSTMENTS TO COMMON STOCK SUBJECT TO OPTIONS. Except as hereinbefore expressly provided, the issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, for cash or property, or for labor or services, either upon direct sale or upon the exercise of rights or warrants to subscribe therefor, or upon conversion of shares or obligations of the Company convertible into such shares or other securities, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock then subject to outstanding options.

8.6 MISCELLANEOUS. Adjustments under this Section 8 shall be determined by the Committee, and such determinations shall be conclusive. No fractional shares of Common Stock shall be issued under the Plan on account of any adjustment specified above.

#### SECTION 9. GENERAL RESTRICTIONS

9.1 INVESTMENT REPRESENTATIONS. The Company may require any person to whom an option is granted, as a condition of exercising such option, to give written assurances in substance and form satisfactory to the Company to the effect that such person is acquiring the Common Stock subject to the option for his or her own account for investment and not with any present intention of selling or otherwise distributing the same, and to such other effects as the Company deems necessary or appropriate in order to comply with federal and applicable state securities laws.

9.2 COMPLIANCE WITH SECURITIES LAWS. The Company shall not be required to sell or issue any shares under any option if the issuance of such shares shall constitute a violation by the optionee or by the Company of any provisions of any law or regulation of any governmental authority. In addition, in connection with the Securities Act of 1933, as now in effect or hereafter amended (the "Act"), upon exercise of any option, the Company shall not be required to issue such shares unless the Committee has received evidence satisfactory to it to the effect that the holder of such option will not transfer such shares except pursuant to a registration statement in effect under such Act or unless an opinion of counsel satisfactory to the Company has been received by the Company to the effect that such registration is not required. Any determination

in this connection by the Committee shall be final, binding and conclusive. In the event the shares issuable on exercise of an option are not registered under the Act, the Company may imprint upon any certificate representing shares so issued the following legend or any other legend which counsel for the Company considers necessary or advisable to comply with the Act and with applicable state securities laws:

The shares of stock represented by this certificate have not been registered under the Securities Act of 1933 or under the securities laws of any State and may not be sold or transferred except upon such registration or upon receipt by the Corporation of an opinion of counsel satisfactory to the Corporation, in form and substance satisfactory to the Corporation, that registration is not required for such sale or transfer.

The Company may, but shall in no event be obligated to, register any securities covered hereby pursuant to the Act; and in the event any shares are so registered the Company may remove any legend on certificates representing such shares. The Company shall not be obligated to take any other affirmative action in order to cause the exercise of an option or the issuance of shares pursuant thereto to comply with any law or regulation of any governmental authority.

9.3 EMPLOYMENT OBLIGATION. The granting of any option shall not impose upon the Company any obligation to employ or continue to employ any optionee; and the right of the Company to terminate the employment of any officer or other employee shall not be diminished or affected by reason of the fact that an option has been granted to him or her.

#### SECTION 10. WITHHOLDING TAXES

10.1 RIGHTS OF COMPANY. The Company may require an employee exercising a Nonqualified Option, or disposing of shares of Common Stock acquired pursuant to the exercise of an Incentive Option in a disqualifying disposition (as defined in Section 421(b) of the Code), to reimburse the Company for any taxes required by any government to be withheld or otherwise deducted and paid by the Company in respect of the issuance or disposition of such shares. In lieu thereof, the Company shall have the right to withhold the amount of such taxes from any other sums due or to become due from the Company to the employee upon such terms and

conditions as the Company may prescribe. The Company may, in its discretion, hold the stock certificate to which such employee is otherwise entitled upon the exercise of an Option as security for the payment of any such withholding tax liability, until cash sufficient to pay that liability has been received or accumulated.

10.2 PAYMENT IN SHARES. An employee may elect to have such tax withholding obligation satisfied, in whole or in part, by (i) authorizing the Company to withhold from shares of Common Stock to be issued pursuant to the exercise of a Nonqualified Option a number of shares with an aggregate fair market value (as defined in Section 6.3 hereof determined as of the date the withholding is effected) that would satisfy the withholding amount due with respect to such exercise, or (ii) transferring to the Company shares of Common Stock owned by the employee with an aggregate fair market value (as defined in Section 6.3 hereof determined as of the date the withholding is effected) that would satisfy the withholding amount due. With respect to any employee who is subject to Section 16 of the Exchange Act, the following additional restrictions shall apply:

(a) the election to satisfy tax withholding obligations relating to an option exercise in the manner permitted by this Section 10.2 shall be made either (1) during the period beginning on the third business day following the date of release of quarterly or annual summary statements of sales and earnings of the Company and ending on the twelfth business day following such date, or (2) at least six (6) months prior to the date of exercise of the option;

(b) such election shall be irrevocable;

(c) such election shall be subject to the consent or approval of the Committee; and

(d) the Common Stock withheld to satisfy tax withholding, if granted at the discretion of the Committee, must pertain to an option which has been held by the employee for at least six (6) months from the date of grant of the option.

10.3 NOTICE OF DISQUALIFYING DISPOSITION. Each holder of an Incentive Option shall agree to notify the Company in writing immediately after making a disqualifying disposition (as defined in Section 421(b) of the Code) of any Common Stock purchased upon exercise of the Incentive Option.

#### SECTION 11. AMENDMENT OR TERMINATION OF PLAN

11.1 AMENDMENT. The Board may terminate the Plan and may amend the Plan at any time, and from time to time, subject to the limitation that, except as otherwise provided herein, no amendment shall be effective unless approved by the stockholders of the Company in accordance with applicable law and regulations, at an annual or special meeting held within 12 months before or after the date of adoption of such amendment, in any instance in which such amendment would: (i) increase the number of shares of Common Stock that may be issued under, or as to which Options may be granted pursuant to, the Plan; or (ii) change in substance the provisions of Section 4 hereof relating to eligibility to participate in the Plan. In addition, the provisions of Section 4.4 shall not be amended more than once every six months, other than to comport with changes in the Code, the Employee Retirement Income Security Act, or the rules thereunder. In addition, the provisions of Subsection 6.3(ii) may not be amended or repealed without the affirmative vote of the holders of a majority of the shares of Common Stock present and entitled to vote at a duly convened meeting of the Company's stockholders. Without limiting the generality of the foregoing, the Board is expressly authorized to amend the Plan, at any time and from time to time, to conform it to the provisions of Rule 16b-3 under the Exchange Act, as that Rule may be amended from time to time.

Except as otherwise provided herein, the rights and obligations under any option granted before amendment of this Plan or any unexercised portion of such option shall not be adversely affected by amendment of this Plan or such option without the consent of the holder of such option.

11.2 TERMINATION. This Plan shall terminate as of the tenth anniversary of its effective date. The Board may terminate this Plan at any earlier time for any or no reason. No Option may be granted after the Plan has been terminated. No Option granted while this Plan is in effect shall be altered or impaired by termination of this Plan, except upon the consent of the holder of such Option. The power of the Committee to construe and interpret this Plan and the Options granted prior to the termination of this Plan shall continue after such termination.

#### SECTION 12. NONEXCLUSIVITY OF PLAN

Neither the adoption of this Plan by the Board of Directors nor the submission of this Plan to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including the granting of stock options otherwise than under this Plan, and such arrangements may be either applicable generally or only in specific cases.

#### SECTION 13. EFFECTIVE DATE AND DURATION OF PLAN

This Plan shall become effective upon its adoption by the Board, provided, that the stockholders of the Company shall have approved this Plan within twelve months prior to or following the adoption of this Plan by the Board. Subject to the foregoing, options may be granted under the Plan at any time subsequent to its effective date; provided, however, that (a) no such option shall be exercised or exercisable unless the stockholders of the Company shall have approved the Plan within twelve months prior to or following the adoption of this Plan by the Board, and (b) all options issued prior to the date of such stockholders' approval shall contain a reference to such condition. No option may be granted under the Plan after the tenth anniversary of the effective date. The Plan shall terminate (i) when the total amount of the Common Stock with respect to which options may be granted shall have been issued upon the exercise of options or (ii) by action of the Board of Directors pursuant to Section 11 hereof, whichever shall first occur.

SECTION 14. PROVISIONS OF GENERAL APPLICATION

14.1 SEVERABILITY. The invalidity or unenforceability of any provision of this Plan shall not affect the validity or enforceability of any other provision of this Plan, each of which shall remain in full force and effect.

14.2 CONSTRUCTION. The headings in this Plan are included for convenience only and shall not in any way effect the meaning or interpretation of this Plan. Any term defined in the singular shall include the plural, and vice versa. The words "herein," "hereof" and "hereunder" refer to this Plan as a whole and not to any particular part of this Plan. The word "including" as used herein shall not be construed so as to exclude any other thing not referred to or described.

14.3 FURTHER ASSURANCES. The Company and any holder of an option shall from time to time execute and deliver any and all further instruments, documents and agreements and do such other and further acts and things as may be required or useful to carry out the intent and purpose of this Plan and such option and to assure to the Company and such option holder the benefits contemplated by this Plan; PROVIDED, HOWEVER, that neither the Company nor any option holder shall in any event be required to take any action inconsistent with the provisions of this Plan.

14.4 GOVERNING LAW. This Plan and each Option shall be governed by the laws of the State of Delaware.

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**INDEPENDENT AUDITORS' CONSENT**

The Board of Directors  
KVH Industries, Inc.:

We consent to the incorporation by reference in the Registration Statement Nos. 333-112341, 333-08491 and 333-67556 on Form S-8 of our reports dated February 13, 2004, with respect to the consolidated balance sheets of KVH Industries, Inc. and Subsidiary as of December 31, 2003 and 2002 and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2003, and all related financial statement schedules, which reports appear on the consolidated financial statements and on the related schedule are included in the December 31, 2003 Annual Report on Form 10-K of KVH Industries Inc. and Subsidiary.

/s/ KPMG LLP

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Providence, Rhode Island  
March 12, 2004

**Certification**

I, Martin A. Kits van Heyningen, President and Chief Executive Officer of KVH Industries, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of KVH Industries, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [omitted]

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2004

/s/ Martin A. Kits van Heyningen

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Martin A. Kits van Heyningen  
President and Chief Executive Officer

**Certification**

I, Patrick J. Spratt, Chief Financial Officer of KVH Industries, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of KVH Industries, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [omitted]

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 14, 2004

/s/ Patrick J. Spratt

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Patrick J. Spratt  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of KVH Industries, Inc. (the "Company") for the year ended December 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned chief executive officer and chief financial officer of the Company, certifies, to the best knowledge and belief of the signatory, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Martin A. Kits van Heyningen

/s/ Patrick J. Spratt

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Martin A. Kits van Heyningen  
President and Chief Executive Officer  
Date: March 14, 2004

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Patrick J. Spratt  
Chief Financial Officer  
Date: March 14, 2004