SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

# FORM 10-Q

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

For the quarterly period ended September 30, 2001

Commission file number: 0-28082

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

| | |
|---|---|
| Delaware | 05-0420589 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

50 Enterprise Center, Middletown, RI 02842
(Address of principal executive offices)

(401) - 847 - 3327
(Registrant's telephone number, including area code)

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

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

| Date | Class | Outstanding shares |
|---|---|---|
| October 19, 2001 | Common Stock, par value $0.01 per share | 10,924,216 |

KVH INDUSTRIES, INC. AND SUBSIDIARY
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Part I. Financial Information

Item 1. Financial Statements.

KVH INDUSTRIES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

| | September 30, 2001 (Unaudited) | December 31, 2000 (Audited) |
|---|---|---|
| Assets: | | |
| Current assets: | | |
| Cash and cash equivalents | $ 13,258,113 | 5,411,460 |
| Accounts receivable, net | 5,738,014 | 6,553,976 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 677,704 | 419,145 |
| Inventories | 3,569,368 | 3,600,660 |
| Prepaid expenses and other deposits | 761,956 | 346,518 |
| Deferred income taxes | 637,799 | 637,799 |
| Total current assets | 24,642,954 | 16,969,558 |
| Property and equipment, net | 7,134,534 | 6,580,375 |
| Other assets, less accumulated amortization | 607,005 | 706,473 |
| Deferred income taxes | 2,238,430 | 2,238,430 |
| Total assets | $ 34,622,923 | 26,494,836 |
| Liabilities and stockholders' equity: | | |
| Current liabilities: | | |
| Bank line of credit | $ -- | 598,865 |
| Current portion long-term debt | 81,111 | 81,111 |
| Accounts payable | 1,609,256 | 1,478,198 |
| Accrued expenses | 2,004,394 | 1,164,790 |
| Customer deposits | 1,124,914 | 1,195,091 |
| Total current liabilities | 4,819,675 | 4,518,055 |
| Long-term debt | 2,729,964 | 2,784,121 |
| Total liabilities | 7,549,639 | 7,302,176 |
| Stockholders' equity: | | |
| Common stock | 109,242 | 86,191 |
| Additional paid-in capital | 34,142,538 | 21,186,459 |
| Accumulated deficit | (7,178,496 ) | (2,079,990 ) |
| Total stockholders' equity | 27,073,284 | 19,192,660 |
| Total liabilities and stockholders' equity | $ 34,622,923 | 26,494,836 |

See accompanying Notes to Consolidated Financial Statements.

Item 1. Financial Statements (continued).

KVH INDUSTRIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three months ended September 30, 2001 | Three months ended September 30, 2000 | Nine months ended September 30, 2001 | Nine months ended September 30, 2000 |
|---|---|---|---|---|
| Net sales | $ 7,939,402 | 7,461,492 | 23,901,290 | 21,109,261 |
| Cost of sales | 5,126,719 | 4,454,136 | 15,143,165 | 13,323,446 |
| Gross profit | 2,812,683 | 3,007,356 | 8,758,125 | 7,785,815 |
| Operating expenses: | | | | |
| Research & development | 1,722,112 | 882,350 | 5,727,613 | 2,972,633 |
| Sales & marketing | 2,017,777 | 1,433,292 | 6,245,013 | 4,474,048 |
| Administration | 711,309 | 605,353 | 1,989,354 | 1,697,414 |
| (Loss) income from operations | (1,638,515 ) | 86,361 | (5,203,855 ) | (1,358,280 ) |
| Other income (expense): | | | | |
| Other income (expense), net | | (3,493 ) | (28,806 ) | (120,050 ) |
| | 7,950 | | | |
| Interest income (expense), net | 63,321 | (51,533 ) | 134,155 | (129,535 ) |
| (Loss) income before income tax expense (benefit) | (1,567,244 ) | 31,335 | (5,098,506 ) | (1,607,865 ) |
| Income tax expense (benefit) | -- | 13,097 | -- | (590,214 ) |
| Net (loss) income | $ (1,567,244 ) | 18,238 | (5,098,506 ) | (1,017,651 ) |
| Per share information: | | | | |
| (Loss) income per share | | | | |
| Basic | $ (0.14 ) | 0.00 | (0.51 ) | (0.13 ) |
| Diluted | $ (0.14 ) | 0.00 | (0.51 ) | (0.13 ) |
| Number of shares used in per share calculation: | | | | |
| Basic | 10,924,145 | 7,677,043 | 9,964,896 | 7,578,471 |
| Diluted | 10,924,145 | 8,127,286 | 9,964,896 | 7,578,471 |

See accompanying Notes to Consolidated Financial Statements.

Item 1. Financial Statements (continued).

KVH INDUSTRIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Nine months ended September 30, 2001 | 2000 |
|---|---|---|
| Cash flow from operations: | | |
| Net loss | $ (5,098,506 ) | (1,017,651 ) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 938,934 | 860,073 |
| Provision for deferred taxes | -- | (585,115 ) |
| Decrease (increase) in accounts and contract receivables, net | 815,962 | (1,948,267 ) |
| Increase in costs and estimated earnings in excess of billings on uncompleted contracts | (258,559 ) | (241,657 ) |
| Decrease in inventories | 31,292 | 39,056 |
| Increase in prepaid expenses and other deposits | (415,438 ) | (48,827 ) |
| Increase (decrease) in accounts payable | 131,058 | (330,823 ) |
| Increase in accrued expenses | 839,604 | 448,741 |
| Decrease in customer deposits | (70,177 ) | -- |
| Net cash used in operating activities | (3,085,830 ) | (2,824,470 ) |
| Cash flow from investing activities: | | |
| Capital expenditures | (1,393,625 ) | (338,497 ) |
| Cash flow from financing activities: | | |
| (Repayments) proceeds from bank line of credit | (598,865 ) | 1,354,647 |
| Repayments of long-term debt | (54,157 ) | (28,640 ) |
| Proceeds from sales of common stock and exercise of stock options | 12,979,130 | 630,318 |
| Net cash provided by financing activities | 12,326,108 | 1,956,325 |
| Net increase (decrease) in cash and cash equivalents | 7,846,653 | (1,206,642 ) |
| Cash and cash equivalents at beginning of period | 5,411,460 | 2,047,838 |
| Cash and cash equivalents at end of period | $ 13,258,113 | 841,196 |
| Supplement disclosure of cash flow information: | | |
| Cash paid during the period for interest | $ 142,866 | 111,918 |

See accompanying Notes to Consolidated Financial Statements.

Item 1. Financial Statements (continued).

KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements
September 30, 2001 and 2000
(Unaudited)

(1) The accompanying consolidated financial statements of KVH Industries, Inc. and subsidiary (the "Company") for the three- and nine-month periods ended September 30, 2001 and 2000 have been prepared in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The consolidated financial statements presented have not been audited by independent public accountants, but they include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition, results of operations, and cash flows for such periods. These consolidated financial statements do not include all disclosures associated with annual financial statements and accordingly should be read in conjunction with our consolidated financial statements and notes included in the Company's Annual Report on Form 10-K filed on February 8, 2001, with the Securities and Exchange Commission. Copies of our Form 10-K are available upon request. Our results for the three- and nine-months ended September 30, 2001 are not necessarily indicative of operating results for the remainder of the year.

(2) Inventories at September 30, 2001 and December 31, 2000 include the costs of material, labor, and factory overhead. Inventories are stated at the lower of cost (first-in, first-out) or market and consist of the following:

| | September 30, 2001 | December 31, 2000 |
|---|---|---|
| Raw materials | $ 2,732,613 | 3,039,310 |
| Work in process | 43,838 | 97,750 |
| Finished goods | 792,917 | 463,600 |
| | $ 3,569,368 | 3,600,660 |

Defense project inventories are included in the balance sheet caption "Costs and estimated earnings in excess of billings on uncompleted contracts." Defense project inventories amounted to $109,423 and $249,173 at September 30, 2001 and December 31, 2000, respectively. Monthly invoicing of defense contracts, using vouchers or progress billings, allows us to recover project costs as we incur them.

(3) On January 11, 1999, we entered into a mortgage loan in the amount of $3,000,000 with a life insurance company. The note term is 10 years, with a principal amortization of 20 years at a fixed interest rate of 7%. Land, building, and improvements secure the mortgage loan. The monthly mortgage obligation is $23,259, including interest and principal. Due to the difference in the term of the note and the amortization of the principal, a balloon payment of $2,014,716 is due on February 1, 2009. As of September 30, 2001, $2,811,075 remained outstanding.

On March 27, 2000, we entered into a $5,000,000 asset-based, three-year, revolving loan facility with interest at the prime bank lending rate plus 1%. Unused portions of the revolving credit facility accrue interest at an annual rate of 50 basis points. Funds are advanced based upon an asset availability formula that includes our eligible accounts receivable and inventory. The availability formula sets aside a fixed amount of qualified assets that may not be borrowed against. We may terminate the loan prior to the full term, however we would become liable for certain termination fees. As of September 30, 2001, no amounts were outstanding against the line of credit.

(4) 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 is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. In accordance with the provisions of the Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes", management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the deferred tax asset



considered realizable, however, could be reduced in the near term if there are changes in the estimates of future taxable income during the carry-forward period or in the feasibility of certain tax planning strategies.

The Company has established a valuation allowance for deferred tax assets in the amount of $2,104,841 based upon an annual projected effective income tax rate of 39% and accumulated losses through September 30, 2001. The Company does not believe, based upon historical losses and its expectations for lack of profitability in the near term due to increased spending on research and development projects, that it is more likely than not that its operating income will be sufficient to fully utilize the net operating loss generated in the nine months ended September 30, 2001.

(5) On April 2, 2001 and April 17, 2001, we issued and sold an aggregate of 1,230,770 shares of our common stock, at a purchase price of $6.50 per share, to Special Situations Fund III, LP, Special Situations Cayman Fund, LP, Special Situations Private Equity Fund, LP, and Special Situations Technology Fund, LP, pursuant to a Common Stock Purchase Agreement dated March 30, 2001. On April 17, 2001, we also issued and sold an aggregate of 307,692 shares of our common stock, at a purchase price of $6.50 per share, to the State of Wisconsin Investment Board, pursuant to a Common Stock Purchase Agreement dated April 16, 2001. On May 1, 2001, we issued and sold 76,923 shares of our common stock, at a purchase price of $6.50 per share, to Mr. Austin Marxe. We concluded our private financing on May 25, 2001, after receiving approval from our shareholders to issue additional shares of common stock, with the issuance and sale of 615,384 shares of our common stock, at a purchase price of $6.50 per share, to the Massachusetts Mutual Life Insurance Company.

(6) Net (loss) income per common share. Common share equivalents to purchase 207,704 and 327,431 shares of common stock for the three and nine-month periods ended September 30, 2001 and 2000, have been excluded from the basic and fully diluted calculations of loss per share, as their inclusion would be anti-dilutive. The following is a reconciliation of the weighted-average number of shares outstanding used in the computation of the basic (loss) income per common share:

Data in thousands, except per share data

| | Three months ended September 30, 2001 | Three months ended September 30, 2000 | Nine months ended September 30, 2001 | Nine months ended September 30, 2000 |
|---|---|---|---|---|
| Calculation of (loss) income per share - basic | | | | |
| Net (loss) income | $ (1,567 ) | 18 | (5,099 ) | (1,018 ) |
| Shares: | | | | |
| Common shares outstanding | 10,924 | 7,677 | 9,965 | 7,578 |
| Net (loss) income per common share - basic | $ (0.14 ) | 0.00 | (0.51 ) | (0.13 ) |
| Calculation of (loss) income per share - diluted | | | | |
| Net (loss) income | $ (1,567 ) | 18 | (5,099 ) | (1,018 ) |
| Shares: | | | | |
| Common shares outstanding | 10,924 | 7,677 | 9,965 | 7,578 |
| Additional shares assuming conversion of stock options and warrants | -- | 450 | -- | -- |
| Average common and equivalent shares outstanding | 10,924 | 8,127 | 9,965 | 7,578 |
| Net (loss) income per common share - diluted | $ (0.14 ) | 0.00 | (0.51 ) | (0.13 ) |

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

"Safe Harbor" Statement Under the Private Securities Litigation Reform Act of 1995. With the exception of historical information, the matters discussed in this Quarterly Report on Form 10-Q include certain forward-looking statements that are subject to certain risks and uncertainties that could cause actual results to differ materially from those stated. These forward-looking statements reflect management's opinions only as of the date hereof, and KVH Industries, Inc. assumes no obligation to update this information. Risks and uncertainties include, but are not limited to; those discussed in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements - `Risk Factors.'" Shareholders of the Company are cautioned not to place undue reliance on forward-looking statements made in the Quarterly Report on Form 10-Q. This report should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K as filed on February 8, 2001. These reports are filed with the Securities and Exchange Commission and copies are available from the Company upon request or through the Company's web site at www.kvh.com.

### Company Overview

KVH Industries, Inc., is an international leader in developing and manufacturing innovative, mobile, high-bandwidth satellite communications systems, navigation products, and fiber optic sensors.

### Mobile Broadband Satellite Communications

The Company's award-winning mobile satellite communications systems have established KVH as a market leader. Our TracVision(R) and Tracphone(R) product families connect people on the move to satellite television, telephone, and Internet data services. Platforms using our TracVision satellite television antennas include moving or stationary pleasure and commercial marine craft, as well as recreational and sport utility vehicles, motor coaches, vans, and long-haul trucks. Our Tracphone systems equip pleasure and commercial marine vessels with two-way voice, fax, and e-mail, with almost worldwide coverage via the mini-M satellite constellation operated by Inmarsat (the International Maritime Satellite Organization).

### Tactical Navigation

In addition to a line of digital marine compasses for the commercial and recreational markets, we supply tactical land navigation systems to U.S. and allied armed forces around the globe. Our TACNAV(TM) product family is the most widely fielded, GPS-assisted military navigation system in the world, providing a critical link to digital battlefield management systems for virtually every vehicle in the modern mobile military.

### Fiber Optic Products

Over the past three years, we have completed the development of an array of fiber optic sensors and successfully brought them to market. In addition to enhancing the precision and durability of our own systems, our proprietary fiber optic technology is now being used to meet the growing demand for precise, cost-effective sensors in robotics, high-voltage current sensors, and other OEM applications.

### New Technology in Mobile Broadband Communications and Fiber Optics

We are currently developing two new technologies that complement and expand our existing product lines. The first of these projects is the creation of photonic fiber and next-generation optical networking components. Our photonic fiber may enable us to build external modulators capable of speeds in excess of 100 GHz and could cost substantially less to manufacture than optical chip-based solutions. Our ActiveFiber(TM) technology may, if successful, also serve as the platform for a variety of other new optical networking components, such as amplifiers, tunable Bragg fiber gratings, and simple optical switches.

The second project is the development of ultra-low profile satellite antennas that will provide access to high-speed, two-way Internet services and satellite television signals aboard automobiles and other vehicles. While we intend to first build a low-profile antenna suitable for sport utility vehicles and mini-vans, our long-term objective is to develop a photonic phased-array antenna that will be suitable for automotive applications.

We have made substantial progress in the development of both new technologies. However, these technologies are complex and both projects carry a significant risk of failure.

## Results of Operations

Net (loss) income per share - Net losses and net income for the three- and nine-month periods ended September 30 were a loss of $1,567,244 or $0.14 per share and a loss of $5,098,506 or $0.51 per share in 2001 and income of $18,238 or $0.00 per share and a loss of $1,017,651 or $0.13 per share in 2000. The third quarter 2001 operating loss increased from the prior year primarily due to increased project R&D expenses of $1,722,112, while other operating costs increased $690,441, reflecting growth in selling and administrative expenses. R&D spending increases are driven by our photonic fiber and mobile broadband research initiatives. Year-to-date results reflect the same factors that influenced our third quarter's net loss.

Net sales - Net sales for this year's third quarter were $7,939,402, an increase of 6% over last year's third quarter sales of $7,461,492. Quarterly results reflect a doubling of fiber optic sales to $773,334 and a 15% gain in communication revenues, which rose to $4,099,431. These positive sales results offset a $440,479 or 20% decline in defense sales. Year-to-date revenues grew to $23,901,290 or 13% higher than last year's first nine months. Factors contributing to this year's growth were robust fiber optic and OEM sales that grew 116% and 124%, respectively, and communications sales grew by $1,448,835 or 12% above the prior year. The RV land-mobile market is beginning to rebound, and we are encouraged by the recent earnings release of Winnebago Industries, Inc, a leading RV manufacturer, which announced increased revenues of 8.1%. RV sales is a leading indicator for our land-mobile communication products, and growth in this market sector will strengthen our land-mobile satellite revenues. Our military order backlog closed at $10,007,358, of which $1,937,382 is scheduled to ship this year. In addition, we are actively responding to additional requests for quotations from the military that we believe could add substantially to our backlog by year-end. Clearly, today we are facing challenging economic circumstances and uncertainties. Given current circumstances, we believe our 2001 revenue growth will increase from 10% to 15% above 2000 results.

Gross profit - Gross profit is composed of revenues less the cost of materials, direct labor, manufacturing overheads, and warranty costs. Third quarter gross profit decreased 6% in 2001 to $2,812,683, down from $3,007,356 in 2000. Gross profit as a percentage of net sales decreased to 35% from 40% in the prior year. Factors that contributed to this decline included a lower mix of higher-margin military products, as well as costs associated with a manufacturing slow-down at our Tinley Park facility due to a component shortage. We have increased the number of suppliers for this component and believe that we will not experience similar events that may limit our production capacity in the future. Year-to-date gross profit increased to $8,758,125, or 37%, the same percentage of sales as the prior year. We project that gross profit will continue to increase gradually as revenue volumes increase and our sales mix begins to shift toward higher-margin military and fiber optic products in the fourth quarter.

### Operating expenses

Third quarter 2001 research and development expense rose to $1,722,112 or 95% from $882,350 in the third quarter of 2000. Increased R&D spending resulted from photonic fiber and low profile, mobile broadband antenna development projects that amounted to $1,073,423 for the quarter. Year-to-date R&D increased to $5,727,613 or 93% from the prior year of $2,972,633, driven by project spending of $3,311,096. A substantial portion of the R&D spending increase relates to outside professional design and research services that are scheduled to end when our research is completed. We are beginning to see a reduction in the use of outside professional services and we anticipate that R&D spending will decline gradually over the next three quarters as we reduce our reliance on outside professionals.

Quarterly sales and marketing expense rose to $2,017,777, or 41% above last year's third quarter spending of $1,433,292. Customer service accounts for almost half of the increase due to additional support staff. Customer service will increase proportionately with communication revenues as we begin to provide additional services to our customer base. The remainder of the quarterly cost increase resulted from increased sales commissions, trade shows, and advertising spending. Year-to-date selling expenses rose to $6,245,013, a 40% increase from the prior year's first nine months. The same cost elements that drove spending in the third quarter are responsible for year-to-date spending growth. We anticipate that marketing and sales expense will grow in proportion with sales volumes as we begin to promote our photonic fiber and mobile broadband technologies.

General and administrative third quarter expenses increased to $711,309, an 18% increase from last year's third quarter spending, which totaled $605,353. Year-to-date spending rose to $1,989,354 or 17% above the prior year. Spending growth was primarily due to increased outside professional fees and recruiting costs. We believe that administration expense will remain fairly constant in absolute terms but will decline as a percentage of sales.

Other income (expense) - Other income (expense) consists of interest income and expense, other income and expense, and foreign currency translation gains and losses.

Income tax (expense) benefit - Our quarterly and year-to-date income tax benefit was fully reserved and, accordingly, does not offset our operating loss. As a result, our quarterly and nine-month net loss increased by approximately $635,364 or $0.06 per share and $2,104,841 or $0.21 per share, respectively.

Utilizing the guidelines in the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," we weighed the operating risks that, should our new product initiatives fail, take longer to complete, or do not generate the anticipated sales volumes necessary to achieve profitability, we could continue to incur losses beyond the current year, resulting in our decision to reserve the current year's income tax benefit associated with our operating loss. In addition, the amount of the deferred tax asset appearing on the balance sheet that is considered realizable could be reduced in the near term if changes occur in the feasibility of certain tax planning strategies.

Liquidity and Capital Resources

Working Capital - Cash and cash equivalents were $13,258,113 and $5,411,460 at September 30, 2001, and December 31, 2000, respectively. Working capital increased by $7,371,776 at September 30, 2001 from December 31, 2000 as a consequence of our recent private sales of common stock. Looking ahead, we continue to forecast operating losses for the remainder of the year primarily due to the research costs of our new product initiatives. Year-to-date, we've expended $3,311,096 on our mobile broadband, low-profile antenna system and our photonic fiber technology. Our cash burn rate increased in the third quarter due to fiber optic capital expenditures related to the construction of a chemistry laboratory and clean room, which is required infrastructure for the manufacture of photonic fiber. With the completion of these capital expenditures and anticipated improvements in operating margins, our cash burn rate will slow substantially in the fourth quarter and continue to improve throughout 2002. We anticipate that existing cash balances, proceeds from the sale of common stock, and funds available under our bank line of credit will be sufficient to meet our anticipated working capital requirements for the foreseeable future.

Other Matters

Recent Accounting Pronouncements - In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations," SFAS No. 142, "Goodwill and Other Intangible Assets," and SFAS 143 "Accounting for Asset Retirement Obligations". Under SFAS No. 141, all business combinations initiated after June 30, 2001 must be accounted for using the purchase method. Under SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually for impairment (or more frequently if indicators of impairment arise). Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives (but with no maximum life). The amortization provisions of SFAS No. 142 apply to intangible assets acquired after June 30, 2001. With respect to intangible assets acquired prior to July 1, 2001, we are required to adopt SFAS No. 142 for financial statements issued for fiscal years beginning after December 15, 2001. We will evaluate intangible assets under the SFAS No. 142 transitional impairment test. Any transitional impairment loss will be recognized as a change in accounting principle on the date of adoption. If any impairment of goodwill is recognized prior to the date of adoption, the loss will be charged to operating expenses. Under SFAS No. 143, costs associated with retirement obligations of long-lived assets will be recognized, pro-rata over the life of the asset. The effective date for SFAS No. 143 is for financial statements issued for fiscal years beginning after June 15, 2002.

Inflation. The Company believes that inflation has not had a material effect on its results of operations.

Forward Looking Statements - "Risk Factors"

This "Management's Discussion and Analysis of Financial Condition and Results of Operations" contains forward-looking statements that are subject to a number of risks and uncertainties. There are important factors that could cause actual results to differ materially from those anticipated by our previous statements.

Increasing Operating Expenses, Acceleration of Research and Development Activities. We have recently increased our operating expenses to take advantage of anticipated revenue opportunities related to our photonic fiber and mobile broadband projects. Our decision to increase spending resulted from our desire to bring these products to market as quickly as possible in order to take advantage of strong market conditions. We are continuing to accelerate spending beyond current levels, and we expect operating losses and negative cash flows to continue for the remainder of the year.

Start-up Phase of Our Photonic Fiber Project. Our photonic fiber project is currently in the initial development stage. We may never complete the technological development necessary to realize the full commercial potential of this project. We are developing photonic fiber products to replace electro-optic components in order to create an active-fiber networking solution that would greatly enhance the speed and power of transmissions over fiber optic networks. Our current approach utilizes advanced polymers and our D-fiber technology. If we are delayed in the development of our photonic fiber technology and/or are not first to market this technology, we may be unable to achieve significant market share in the fiber optic networking market. Failure to complete development of our ActiveFiber technology will also prevent us from developing a phase shifter based on that technology, which may impair our ability to effectively provide mobile broadband communications services to automobiles.

Pricing of Mobile Satellite Communications Products. The success of our mobile broadband project depends upon our ability to develop a technologically advanced antenna at an acceptable price for the automotive marketplace. To date, phased array antennas have been developed at prices far in excess of what is practical in the automotive marketplace. There can be no assurance that we can engineer a phased array solution within the pricing and technical parameters necessary to be successful in the automotive marketplace.

Sole Source Component Purchases. We currently purchase a number of manufacturing components from single suppliers due to the design requirements of some of our products. In several instances, we have not yet developed a substitute technology for these components currently sole sourced from these vendors. If these vendors discontinue the supply of these components, or if these components should become unavailable for some other reason, we would be unable to ship the affected products on a timely basis and we would be required to redesign these products to allow for the substitution of a redesigned component.

Continuing Investment in Fiber Optics. A large portion of our product development strategy for the near future relies upon advanced fiber optic product concepts. Expenses for fiber optic operations will add significant costs to total corporate operations. As with any research and development project, there can be no assurance that we will succeed with our development concept and produce a product acceptable to consumers.

Impact of New Products on Sales Results. Our future sales growth will depend considerably upon the successful introduction of new mobile broadband satellite communications products for use in marine and land applications. Our success depends heavily upon the rapid completion of these new products, particularly for worldwide Internet and data applications, and depends upon other external variables that could adversely affect us:

- satellite launches and new technology are expensive and subject to failures; and - poor consumer confidence and/or economic conditions could depress product demand.

Dependence on Military Sales. We need to increase navigation sales over 2000 levels to achieve profitability. Issues that could affect our success include:

- funding for military programs may be postponed;
- we are introducing new technological solutions that must be proven and then accepted; and - sales cycles are long and difficult to predict in military markets.

Variability of Our Operating Results. Our quarterly operating results have varied in the past and may vary significantly in the future depending upon all the foregoing risk factors and how successful we are in improving our ratios of revenues to expenses.

Volatility of Our Share Price. The trading price of our Common Stock has been subject to wide fluctuations, and this could continue due to:

- variations in operating results;
- development delays of our proposed new products that could result in decreased sales; and
- stock market volatility caused by industry events.

Hiring and Retention of Skilled Personnel. Qualified personnel are in great demand throughout the photonics industry. Our success depends in large part upon our ability to attract, train, motivate, and retain highly skilled employees, particularly engineers and other senior personnel. A failure to attract and retain the highly trained technical personnel who are integral to our product development, sales, service, and support teams may limit the rate at which we can generate sales and develop new products or product enhancements. This could have a material adverse effect on our business, operating results, and financial condition.

Protection of Our Proprietary Technology, Potential Patent Litigation. Our success depends significantly upon the protection of our proprietary technology. The unauthorized reproduction or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it. This could have a material adverse effect on our business, operating results, and financial condition. If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could become burdensome and expensive and could involve a high degree of risk. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our intellectual property.

Potential Claims by Other Companies That We Infringe Their Copyrights or Patents. If any of our products violate third-party proprietary rights, we may be required to reengineer our products or seek licenses from third parties to continue offering our products. Any efforts to reengineer our products or obtain licenses on commercially reasonable terms may not be successful and, in any case, would substantially increase our costs and have a material adverse effect on our business, operating results, and financial condition. We do not conduct comprehensive patent searches to determine whether the technology used in our products infringes on patents held by third parties. In addition, product development is inherently uncertain in a rapidly evolving technological environment in which numerous patent applications regarding similar technologies may be pending, many of which are confidential when filed.

Although we are generally indemnified against claims that the third-party technology we license infringes the proprietary rights of others, this indemnification is not always available for all types of intellectual property rights (for example, patents may be excluded), and, in some cases, the scope of such indemnification is limited. Even if we receive broad indemnification, third-party indemnitors are not always well capitalized and may not be able to indemnify us in the event of infringement, resulting in substantial exposure to us. There can be no assurance that infringement or invalidity claims arising from the incorporation of third-party technology in our products and claims for indemnification from our customers resulting from these claims will not be asserted or prosecuted against us. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources, in addition to potential product redevelopment costs and delays, all of which could materially affect our business, operating results, and financial condition.

In addition, any claim of infringement could cause us to incur substantial costs in defending ourselves against the claim, even if the claim is invalid. A party making a claim also could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling our products. Any of these events could have a material adverse effect on our business, operating results, and financial condition.

Services of Our CEO Martin Kits van Heyningen. Our future success depends significantly upon the skills, experience, and efforts of Martin Kits van Heyningen. The loss of Mr. Kits van Heyningen's services could have a material adverse effect on our business, operating results, and financial condition. We also depend upon the ability of our executive officers and other members of senior management to work effectively as a team. We do not have employment agreements with any of our executive officers.

## Part II. Other Information

### Item 1. Legal Proceedings.

In the ordinary course of business, we are party to legal proceedings and claims. In addition, from time to time, the Company has had contractual disagreements with certain customers concerning the Company's products and services, which will not have a material affect on operations or capital resources.

### Item 2. Changes in Securities and Use of Proceeds.

On April 2, 2001, and April 17, 2001, we issued and sold an aggregate of 1,230,770 shares of our common stock, at a purchase price of $6.50 per share, to Special Situations Fund III, LP, Special Situations Cayman Fund, LP, Special Situations Private Equity Fund, LP, and Special Situations Technology Fund, LP, pursuant to a Common Stock Purchase Agreement dated March 30, 2001. On April 17, 2001, we also issued and sold an aggregate of 307,692 shares of our common stock, at a purchase price of $6.50 per share, to the State of Wisconsin Investment Board, pursuant to a Common Stock Purchase Agreement dated April 16, 2001. On May 1, 2001 we issued and sold 76,923 shares of our common stock, at a purchase price of $6.50 per share, to Mr. Austin Marxe. We concluded our private financing on May 25, 2001, after receiving approval from our shareholders to issue additional shares of common stock, with the issuance and sale of 615,384 shares of our common stock, at a purchase price of $6.50 per share, to the Massachusetts Mutual Life Insurance Company. The gross proceeds amounted to an aggregate of $14,999,986. Needham & Company acted as our placement agent for the sale of our common stock. In connection with their services as placement agent we issued Needham & Company warrants to purchase an aggregate of 111,538 shares of our common stock at a per-share exercise price of $6.50. We relied on one or more exceptions from registration under the Securities Act of 1933, as amended, including the Section 4(2) exemption, for the sales of common stock and the issuance of warrants to purchase shares of common stock.

### Item 4. Submission of Matters to a Vote of Shareholders

There were no matters submitted to a vote of our shareholders during the period reported upon.

### Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

| Number | Description |
|---|---|
| 3.1 | Restated Certificate of Incorporation of the Company (1) |
| 3.5 | Amended and Restated By-laws of the Company |
| 10.1 | 1986 Executive Incentive Stock Option Plan (1) |
| 10.2 | Amended and Restated 1995 Incentive Stock Option Plan of the Company (1) |
| 10.3 | 1996 Employee Stock Purchase Plan (1) |
| 10.5 | Credit Agreement dated September 8, 1993 between the Company and Fleet National Bank (1) |
| 10.6 | $500,000 Revolving Credit Note dated September 8, 1993 between the Company and Fleet National Bank (1) |
| 10.7 | Security Agreement dated September 8, 1993 between the Company and Fleet National Bank (1) 10.8 Modification to Security Agreement dated May 30, 1994 between the Company and Fleet National Bank (1) |
| 10.9 | Second Modification to Credit Agreement and Revolving Credit Note dated May 30, 1994 between the Company and Fleet National Bank (1) |
| 10.10 | Second Modification to Security Agreement dated March 17, 1995 between the Company and Fleet National Bank (1) |
| 10.11 | Third Modification to Credit Agreement and Revolving Credit Note dated March 17, 1995 between the Company and Fleet National Bank (1) |
| 10.12 | Third Modification to Security Agreement dated December 12, 1995 between the Company and Fleet National Bank (1) |
| 10.13 | Fourth Modification to Credit Agreement and Revolving Credit Note dated December 12, 1995 between the Company and Fleet National Bank (1) |
| 10.14 | Lease dated February 27, 1989 between the Company and Middletown Technology Associates IV (1) |
| 10.17 | Registration Rights Agreement dated May 20, 1986 by and among the Company and certain stockholders of the Company (1) |
| 10.18 | Amendment to Registration Rights Agreement dated January 25, 1988, by and among the Company, Fleet Venture Resources, Inc., and Fleet Venture Partners I and certain stockholders of the Company (1) |

10.19 Amendment to Registration Rights Agreement dated October 25, 1988 by and among the Company and certain stockholders of the Company (1)
10.20 Amendment to Registration Rights Agreement dated July 21, 1989 by and among the Company and certain stockholders of the Company (1)
10.21 Third Amendment to Registration Rights Agreement dated November 3, 1989 by and among the Company and certain stockholders of the Company (1)
10.28 Technology License Agreement dated December 22, 1992 between the Company and Etak, Inc.(1)
10.29 Agreement dated September 28, 1995 between the Company and Thomson Consumer Electronics, Inc. (1)
10.31 Agreement regarding Technology Affiliates Program between Jet Propulsion Laboratory and the Company (1)
10.32 Purchase and Sale Agreement dated March 18, 1996, 50 Enterprise Center, Middletown, Rhode Island between the Company and SKW Real Estate Limited Partnership (2)
10.33 Fifth Modification to Credit Agreement and Revolving Note dated August 8, 1996 between the Company and Fleet National Bank
10.34 Andrew Corporation Asset Purchase and Warrant Agreement (3)
10.35 Sixth Modification to Credit Agreement and Revolving Note dated September 29, 1998 between the Company and Fleet National Bank
10.36 Seventh Modification to Credit Agreement and Revolving Note dated July 30, 1999 between the Company and Fleet National Bank
10.37 Eighth Modification to Credit Agreement and Revolving Note dated October 29, 1999 between the Company and Fleet National Bank
10.38 Loan and Security Agreement dated March 27, 2000 between the Company and Fleet Capital Corporation (5)
10.39 Common Stock Purchase Agreement between KVH Industries, Inc. and Special Situations Fund, III, L.P., Special Situations Cayman Fund, L.P., Special Situations Private Equity Fund, L.P. and Special Situations Technology Fund, L.P. dated March 30, 2001. (7)
10.40 Common Stock Purchase Agreement between KVH Industries, Inc. and the State of Wisconsin Investment Board pursuant to a Common Stock Purchase Agreement dated April 16, 2001. (7)
10.41 Common Stock Purchase Agreement between KVH Industries, Inc. and the Massachusetts Mutual Life Insurance Company dated May 25, 2001. (7)
99.1 Open End Mortgage, and Security Agreement (6)
99.2 Tinley Park, Illinois, lease (6)
99.3 Private Placement Share Purchase Agreement (4)

(1) Incorporated by Reference to Exhibit Index on Form S-1 filed with the Securities and Exchange Commission dated March 28, 1996, Registration No. 333-01258.
(2) Filed by paper with the Securities and Exchange Commission.
(3) Incorporated by reference to Exhibits 1 & 2 on Form 8-K filed with the Securities and Exchange Commission dated November 14, 1997.
(4) Incorporated by reference to Exhibit 10.39 on Form 8-K filed with the Securities and Exchange Commission dated January 5, 2001.
(5) Incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.
(6) Incorporated by reference to Exhibits 99.1 and 99.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998.
(7) Incorporated by reference to Exhibits 10.39 through 10.42 to the Company's Current Reports on Form 8-K filed with the Securities and Exchange Commission on April 19, 2001 and June 11, 2001.

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the period reported upon.

SIGNATURE

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

Date: October 25, 2001

KVH Industries, Inc.

By: /s/ Richard C. Forsyth
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Richard C. Forsyth
(Duly Authorized Officer and
Chief Financial and Accounting Officer)