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

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: June 30, 2005

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	**05-0420589**
(State or Other Jurisdiction of Incorporation or Organization)	**(IRS Employer Identification Number)**

50 Enterprise Center, Middletown, RI 02842
(Address of Principal Executive Offices)

(401) 847-3327
(Registrant's Telephone Number, Including Area Code)

Indicate by an (X) 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 (X) whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES ☒ 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
August 2, 2005	Common Stock, par value $0.01 per share	14,585,453

KVH INDUSTRIES, INC. AND SUBSIDIARY
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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

KVH INDUSTRIES, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts, unaudited)

	June 30, 2005	December 31, 2004
Current assets:		
Cash and cash equivalents	$ 13,181	$ 10,289
Marketable securities	33,886	35,438
Accounts receivable, net of allowance for doubtful accounts of $584 in 2005 and $677 in 2004	10,358	9,577
Costs and estimated earnings in excess of billings on uncompleted contracts	1,012	747
Inventories	8,021	7,251
Prepaid expenses and other deposits	813	487
Deferred income taxes	440	646
Total current assets	67,711	64,435
Property and equipment, net	8,114	8,218
Intangible assets, less accumulated amortization of $953 in 2005 and $890 in 2004	126	189
Other non-current assets	107	59
Deferred income taxes	3,013	3,013
Total assets	**$ 79,071**	**$ 75,914**
Current liabilities:		
Accounts payable	$ 2,886	$ 1,604
Accrued compensation and employee-related expenses	2,375	1,765
Accrued loss on TracVision A5 non-cancelable purchase commitments	328	997
Accrued professional fees and license and settlement costs	366	436
Accrued product warranty costs	474	440
Accrued other	963	435
Current portion of long-term debt	111	107
Total current liabilities	7,503	5,784
Long-term debt excluding current portion	2,340	2,397
Total liabilities	9,843	8,181
Stockholders' equity:		
Preferred stock, $0.01 par value. Authorized 1,000,000 shares; none issued.	—	—
Common stock, $.01 par value. Authorized 20,000,000 shares; issued and outstanding 14,565,560 as of June 30, 2005 and 14,487,841 as of December 31, 2004.	146	145
Additional paid-in capital	85,374	85,073
Accumulated deficit	(16,182)	(17,436)
Accumulated other comprehensive loss	(110)	(49)
Total stockholders' equity	**69,228**	**67,733**
Total liabilities and stockholders' equity	**$ 79,071**	**$ 75,914**

See accompanying Notes to Condensed Consolidated Financial Statements.

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ITEM 1. Financial Statements (continued)

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

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net sales	$18,807	$14,532	$36,700	$32,529
TracVision A5 revaluation charge	—	2,413	—	2,413
All other cost of sales	11,029	9,947	21,812	20,972
Total costs of sales	11,029	12,360	21,812	23,385
Gross profit	7,778	2,172	14,888	9,144
Operating expenses:				
Research & development	1,978	1,811	3,876	3,619
Sales & marketing	3,347	3,828	6,970	7,663
Administration	1,493	1,513	2,766	2,627
Income (loss) from operations	960	(4,980)	1,276	(4,765)
Other:				
Interest income	345	137	630	195
Interest expense	(51)	(49)	(100)	(91)
Other expense	(226)	(5)	(320)	(22)
Income (loss) before income taxes	1,028	(4,897)	1,486	(4,683)
Income tax expense	76	51	233	137
Net income (loss)	$ 952	$ (4,948)	$ 1,253	$ (4,820)
Per share information:				
Earnings (loss) per share				
Basic	$ 0.07	$ (0.34)	$ 0.09	$ (0.35)
Diluted	$ 0.06	$ (0.34)	$ 0.09	$ (0.35)
Number of shares used in per share calculation:				
Basic	14,549	14,420	14,535	13,751
Diluted	14,658	14,420	14,662	13,751

See accompanying Notes to Condensed Consolidated Financial Statements.

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ITEM 1. Financial Statements (continued)

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

	Six months ended June 30, 2005	Six months ended June 30, 2004
Operating activities:		
Net income (loss)	$ 1,253	$ (4,820)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	1,022	1,001
Deferred income taxes	233	137
Increase (decrease) in provision for doubtful accounts, net	(33)	101
Loss (gain) on disposal of equipment	(22)	105
TracVision A5 revaluation and related charges	—	2,466
Changes in operating assets and liabilities:		
Accounts receivable	(748)	1,924
Costs and estimated earnings in excess of billings on uncompleted contracts	(265)	(74)
Inventories	(770)	(5,552)
Prepaid expenses and other deposits	(326)	104
Accounts payable	1,282	100
Accrued expenses	405	1,226
Net cash provided by (used in) operating activities	**2,031**	**(3,282)**
Investing activities:		
Purchase of marketable securities	(507)	(35,096)
Redemption of marketable securities	2,000	—
Capital expenditures	(855)	(1,004)
Proceeds from sale of equipment	22	5
Other long term assets	(48)	—
Net cash provided by (used in) investing activities	**612**	**(36,095)**
Financing activities:		
Repayments of long term debt	(53)	(52)
Proceeds from sale of common stock, net	—	48,370
Stock option and stock benefit plan transactions	302	272
Net cash provided by financing activities	**249**	**48,590**
Net change in cash and cash equivalents	**2,892**	**9,213**
Cash and cash equivalents at beginning of period	**10,289**	**2,849**
Cash and cash equivalents at end of period	**$13,181**	**$ 12,062**
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 87	$ 90

See accompanying Notes to Condensed Consolidated Financial Statements.

ITEM 1. Financial Statements (continued)

KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited, all amounts in thousands except per share amounts)

(1) Basis of Presentation

The accompanying Condensed Consolidated Financial Statements of KVH Industries, Inc., and its wholly owned subsidiary, KVH Europe A/S (collectively, KVH or the Company), have been prepared in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Regulation S-X. All intercompany accounts and transactions have been eliminated in consolidation. The Condensed Consolidated Financial Statements have not been audited by our independent registered public accounting firm, but include all adjustments (consisting of only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial condition, results of operations, and cash flows for the periods presented. These Condensed Consolidated Financial Statements do not include all disclosures associated with annual financial statements and accordingly should be read in conjunction with the Company's Consolidated Financial Statements and related notes included in the Company's Annual Report on Form 10-K filed on March 16, 2005 with the Securities and Exchange Commission. Copies of the Company's Form 10-K are available upon request. The results for the three and six months ended June 30, 2005 are not necessarily indicative of operating results for the remainder of the year.

(2) Stock-based Compensation

The Company 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.

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Net income (loss) as reported	**$ 952**	**$ (4,948)**	**$1,253**	**$(4,820)**
Compensation expense under SFAS 123	(460)	(439)	(897)	(823)
Pro forma net income (loss)	**$ 492**	**$ (5,387)**	**$ 356**	**$(5,643)**
Income (loss) per share – basic				
As reported	$ 0.07	$ (0.34)	$ 0.09	$ (0.35)
Pro forma	$ 0.03	$ (0.37)	$ 0.02	$ (0.41)
Income (loss) per share – diluted				
As reported	$ 0.06	$ (0.34)	$ 0.09	$ (0.35)
Pro forma	$ 0.03	$ (0.37)	$ 0.02	$ (0.41)

(3) Income per Common Share

Basic net income per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined in accordance with the treasury-stock accounting method.

KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited, all amounts in thousands except per share amounts)

(3) Income per Common Share (continued)

A reconciliation of weighted average common shares outstanding to weighted average common shares outstanding assuming dilution is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net income (loss)	$ 952	$ (4,948)	$ 1,253	$ (4,820)
Weighted average common shares outstanding – basic	14,549	14,420	14,535	13,751
Incremental common shares issuable: stock options	109	—	127	—
Weighted average common shares outstanding assuming dilution	14,658	14,420	14,662	13,751
Income (loss) per share – Basic	$ 0.07	$ (0.34)	$ 0.09	$ (0.35)
Income (loss) per share – Diluted	$ 0.06	$ (0.34)	$ 0.09	$ (0.35)

For the three and six months ended June 30, 2005, options to purchase 719 and 637 shares, respectively, of KVH common stock were not included in the computation of diluted earnings per common share because the exercise prices for these options were greater than the average market price of KVH's common shares for the quarters then ended and, therefore, their inclusion would have been antidilutive. For the three and six months ended June 30, 2004, common stock equivalents equaled approximately 318 and 267, respectively, and were excluded from the calculation of weighted average number of diluted common shares, as their effect would be antidilutive. Total common stock options outstanding as of June 30, 2005 and 2004 equaled 1,314 and 1,132, respectively.

(4) Cash, Cash Equivalents and Marketable Securities

In accordance with KVH's investment policy, cash in excess of short-term operational needs is held in a separate marketable security account and invested in investment-grade corporate and U.S. government debt as well as certain auction rate note obligations and money market accounts. KVH determines the appropriate classification of marketable securities at each balance sheet date. Available-for-sale marketable securities are carried at their fair value with unrealized gains and losses included in accumulated other comprehensive income (loss) in the accompanying balance sheet. KVH considers all highly liquid investments with an original maturity of ninety days or less, as of the date of purchase, to be cash equivalents. As of June 30, 2005 and December 31, 2004, approximately $3.7 million and $2.3 million, respectively, of temporarily non-invested cash equivalents were included within the marketable securities balances.

KVH reviews investments in debt and equity securities for other than temporary impairment whenever the fair value of an investment is less than amortized cost and evidence indicates that an investment's carrying amount is not recoverable within a reasonable period of time. KVH has reviewed those securities with unrealized losses as of June 30, 2005 for other-than-temporary impairment, and has concluded that no other-than-temporary impairment existed.

(5) Derivative Instruments

KVH accounts for derivative instruments at fair value and as of each reporting period, records any changes in fair value within earnings. In June 2005, we entered into three foreign currency cash flow hedge contracts with notional value totaling €1.5 million to hedge a portion of anticipated Euro-denominated intercompany trade repayments against currency fluctuations. The three contracts have maturity dates ranging from July 28, 2005 through September 27, 2005. As of June 30, 2005, we recorded cumulative realized gains of $2 in other income for these contracts.

KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited, all amounts in thousands except per share amounts)

(6) Inventories

Inventories are stated at the lower of cost or market using the first-in first-out costing method. Inventories as of June 30, 2005 and December 31, 2004 include the costs of material, labor, and factory overhead. Inventories consist of the following:

	June 30, 2005	December 31, 2004
Raw materials	$4,425	$ 4,070
Work in process	641	778
Finished goods	2,955	2,403
	$8,021	$ 7,251

(7) Inventory Revaluation and other Special Charges

In July 2004, the Company initiated a new pricing initiative for the TracVision A5 mobile satellite antenna. As a result of the associated price reduction, and in accordance with Accounting Research Bulletin 43, KVH recognized $2.6 million in TracVision A5 inventory revaluation and other related pricing initiative losses or costs. Activity within the reserve account accrued loss on TracVision A5 non-cancelable purchase commitments for the six months ended June 30, 2005 is as follows:

Category	Balance as of December 31, 2004	Additions / Adjustment to the Provision	Current Utilization	Balance as of June 30, 2005
Non-cancelable inventory purchase commitments	$ 995	$ —	$ (667)	$ 328
Other TracVision A5 pricing initiative	2	4	(6)	—
Accrued loss on TracVision A5 non-cancelable purchase commitments	$ 997	$ 4	$ (673)	$ 328

(8) Comprehensive Income

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

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net income (loss)	$ 952	$ (4,948)	$1,253	$(4,820)
Unrealized loss on available-for-sale securities	(70)	(46)	(60)	(46)
Total comprehensive income (loss)	$ 882	$ (4,994)	$1,193	$(4,866)

(9) Segment Reporting

Under common operational management, KVH designs, develops, manufactures and markets its navigation, guidance and stabilization and mobile satellite communication sensor products for use in a wide variety of applications. Products are generally sold directly to third-party consumer electronic dealers and retailers, consumer product manufacturers, government contractors or directly to U.S. and other foreign government agencies. Primarily, sales originating in North America consist of sales within the United States and Canada and, to a lesser extent, Mexico, Asia/Pacific and some Latin and South American countries. North American sales also include all defense-related product sales throughout the world. Sales originating from 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 INDUSTRIES, INC. AND SUBSIDIARY
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(Unaudited, all amounts in thousands except per share amounts)

(9) Segment Reporting (continued)

KVH operates in two geographic segments, exclusively in the satellite communication, navigation and guidance sensor equipment industry, which it considers to be a single business activity. KVH has two primary product categories: (1) mobile satellite communication and (2) navigation, guidance and stabilization. Mobile satellite communication sales and services include 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 defense-related navigation, guidance and stabilization equipment based upon digital compass and fiber optic sensor technology, as well as sales of KVH fiber optic gyros for both military and commercial applications. Defense services also include development contract revenue. The following table provides, for the periods indicated, sales originating from the following geographic segments:

	Sales Originating From		
Three months ended June 30, 2005	North America	Europe	Total
Mobile satellite communication sales to the United States and Canada	$ 10,401	$ —	$10,401
Mobile satellite communication sales to Europe	—	2,764	2,764
Mobile satellite sales to other geographic areas	—	627	627
Defense sales to United States and Canada	3,528	—	3,528
Defense sales to Europe	1,336	—	1,336
Defense sales to other geographic areas	151	—	151
Intercompany sales	2,162	—	2,162
Subtotal	17,578	3,391	20,969
Eliminations	(2,162)	—	(2,162)
Net sales	$ 15,416	$3,391	$18,807
Segment net income (loss)	$ 777	$ 175	$ 952
Depreciation and amortization	$ 451	$ 8	$ 459
Total assets	$ 75,808	$3,263	$79,071
Three months ended June 30, 2004			
Mobile satellite communication sales to the United States and Canada	$ 9,692	$ —	$ 9,692
Mobile satellite communication sales to Europe	—	2,613	2,613
Mobile satellite sales to other geographic areas	—	190	190
Defense sales to United States and Canada	1,040	—	1,040
Defense sales to Europe	297	—	297
Defense sales to other geographic areas	700	—	700
Intercompany sales	1,996	2	1,998
Subtotal	13,725	2,805	16,530
Eliminations	(1,996)	(2)	(1,998)
Net sales	$ 11,729	$2,803	$14,532
Segment net income (loss)	$ (5,049)	$ 101	$ (4,948)
Depreciation and amortization	$ 502	$ 10	$ 512
Total assets	$ 76,999	$3,371	$80,370

KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited, all amounts in thousands except per share amounts)

(9) Segment Reporting (continued)

	Sales Originating From		
Six months ended June 30, 2005	**North America**	**Europe**	**Total**
Mobile satellite communication sales to the United States and Canada	$ 21,529	$ —	$21,529
Mobile satellite communication sales to Europe	—	5,528	5,528
Mobile satellite sales to other geographic areas	—	840	840
Defense sales to United States and Canada	6,813	—	6,813
Defense sales to Europe	1,781	—	1,781
Defense sales to other geographic areas	209	—	209
Intercompany sales	4,102	—	4,102
Subtotal	34,434	6,368	40,802
Eliminations	(4,102)	—	(4,102)
Net sales	$ 30,332	$6,368	$36,700
Segment net income (loss)	$ 710	$ 543	$ 1,253
Depreciation and amortization	$ 1,003	$ 19	$ 1,022
Total assets	$ 75,808	$3,263	$79,071
Six months ended June 30, 2004			
Mobile satellite communication sales to the United States and Canada	$ 21,543	$ —	$21,543
Mobile satellite communication sales to Europe	—	4,991	4,991
Mobile satellite sales to other geographic areas	—	278	278
Defense sales to United States and Canada	3,355	—	3,355
Defense sales to Europe	853	—	853
Defense sales to other geographic areas	1,509	—	1,509
Intercompany sales	3,591	55	3,646
Subtotal	30,851	5,324	36,175
Eliminations	(3,591)	(55)	(3,646)
Net sales	$ 27,260	$5,269	$32,529
Segment net income (loss)	$ (5,137)	$ 317	$ (4,820)
Depreciation and amortization	$ 981	$ 20	$ 1,001
Total assets	$ 76,999	$3,371	$80,370

(10) Business and Credit Concentrations

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

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Net sales to foreign customers outside the U.S. and Canada	26%	26%	23%	23%
Net sales to Camping World, Inc.	7%	5%	8%	13%
Net sales to RiverPark, Inc.	6%	11%	8%	9%

(11) Legal Matters

KVH is a defendant in a class action lawsuit in the U.S. District Court for the District of Rhode Island in which KVH and certain of its officers are named as defendants. The suit asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 under that statute, as well as claims under Sections 11, 12(a)(2) and 15 under the Securities Act of 1933, on behalf of purchasers of KVH securities in the period

KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited, all amounts in thousands except per share amounts)

(11) Legal Matters (continued)

between October 1, 2003 and July 2, 2004. The Teamsters Affiliates Pension Plan has been appointed lead plaintiff. This matter consolidates into one action eight separate complaints filed between July 21, 2004 and September 15, 2004. On January 14, 2005, the defendants filed a motion to dismiss the consolidated complaint for failure to state a claim upon which relief can be granted. The court heard oral arguments on May 10, 2005 but has not acted on the defendants' motion.

On August 16, 2004, Hamid Mehrvar filed a shareholders' derivative action in the Rhode Island State Superior Court for Newport County against KVH and certain of its officers and directors. The complaint, as amended, asserts state law claims on KVH's behalf between October 1, 2003 and the present arising from the allegations set forth in the class action complaints in the U.S. District Court described above. On March 18, 2005 the defendants filed a motion to dismiss the amended complaint for failure to state a claim upon which relief can be granted. The court heard oral arguments on May 26, 2005 but has not acted on the defendants' motion.

On June 20, 2005, Yemin Ji filed a shareholders' derivative action in the U.S. District Court for the District of Rhode Island against KVH and certain of its officers and directors, asserting certain federal and state law claims on KVH's behalf between October 6, 2003 and the present arising from the same allegations set forth in the class action and Mehrvar complaints described above. The complaint has not been served on defendants.

In May 2005, Electronic Controlled Systems, Inc., d/b/a King Controls, filed a patent infringement suit against KVH in the U.S. District Court for the District of Minnesota. The three asserted patents relate generally to controlling a satellite dish to acquire a satellite signal. The complaint alleges that KVH willfully infringes the patents and seeks injunctive relief, enhanced damages and attorneys' fees. KVH has denied the allegations and asserted counterclaims, including claims for false advertising.

Additionally, in the ordinary course of business, KVH is a party to inquiries, legal proceedings and claims including, from time to time, disagreements with customers and vendors.

(12) Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" ("SFAS 123R"), which supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R requires companies to include compensation expense from stock options granted to employees in the consolidated statements of income.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, which provides interpretative guidance in applying the provisions of SFAS 123R.

In April 2005, the SEC adopted a rule that amended the compliance date of SFAS 123R whereby KVH will be required to adopt it no later than the first quarter of 2006. KVH expects to adopt the new requirements in the first quarter of 2006. KVH has not yet evaluated the impact of adoption of this pronouncement. However, as disclosed in note (2) above, KVH would have recorded approximately $0.5 million and $0.9 million of expense in the three-month and six-month periods ended June 30, 2005, respectively, if the provisions of SFAS 123R had been applied during fiscal 2005. KVH believes that the note (2) SFAS 123 disclosure of pro forma expense provides a reasonable approximation of the stock-based compensation expense that may be recorded in its consolidated statements of operations upon adoption of SFAS 123R.

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

Introduction

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

Overview

We develop, manufacture and market mobile satellite communications products for the land and marine markets, and navigation, guidance and stabilization products for defense and commercial 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 tactical trucks (HMMWVs) and combat vehicles. Our defense products also include precision fiber optic gyro-based systems that help stabilize platforms such as gun turrets and radar units, provide guidance for munitions and support a range of commercial and industrial applications. We sell our defense products directly to U.S. and allied governments and government contractors, as well as through an international network of authorized independent sales representatives.

We generate revenue primarily from the sale of our mobile satellite communications and defense products. The following table provides, for the periods indicated, our net sales by product line category. Amounts for 2004 have been adjusted to include amounts previously reported separately as legacy product revenue.

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
	(in thousands)		(in thousands)	
Mobile satellite communications	$13,792	$12,495	$27,897	$26,812
Defense	5,015	2,037	8,803	5,717
Net sales	$18,807	$14,532	$36,700	$32,529

In addition to revenue from product sales, our mobile satellite communications revenue includes fees earned from product repairs, fees from satellite telephone and Internet usage services, and certain DIRECTV account referral fees earned in conjunction with the sale of our products. We provide, for a fee, third-party satellite telephone and Internet airtime to our Tracphone and Internet customers who choose to activate their subscriptions with us. Under current DIRECTV programs, we are eligible to receive a one-time, new mobile account activation fee from DIRECTV for each customer who activates their DIRECTV service directly through us. Our defense revenue primarily includes product sales to both military and commercial markets and, to a lesser extent, engineering services provided under development contracts. To date, revenues earned from product repairs, satellite telephone and Internet usage services, DIRECTV activations and earnings under development contracts have not been a material portion of our revenue either individually or in the aggregate.

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

We have historically derived a substantial portion of our revenue from sales to customers located outside the United States and Canada. Note 9 of the Notes to the Condensed Consolidated Financial Statements provides information regarding our sales to specific geographic regions.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure at the date of our financial statements. Our significant accounting policies are summarized in Note 1 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2004. 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 is recognized when persuasive evidence of an arrangement exists, 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. Our standard sales terms require that:

- All sales are final;
- Terms are either Net 30 or Net 45;
- Shipments are tendered and shipped FOB (or as may be applicable, FCA, or EXW) from KVH’s plant or warehouse; and
- Title and risk of loss or damage passes to the dealer or distributor at the point of shipment when delivery is made to the possession of the carrier.

Under certain limited conditions, KVH, at its sole discretion, provides for the return of goods. No product is accepted for return and no credit is allowed on any returned product unless KVH has granted and confirmed prior written permission by means of appropriate authorization, and all products are returned in a pristine and re-sellable condition.

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 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. For example, as of June 30, 2005, included in our allowance for doubtful accounts is a specific reserve in the amount of approximately $492,000 to reserve for all outstanding balances of a European distributor that entered into a voluntary liquidation proceeding under local law during 2004 and commenced formal bankruptcy proceedings under local law during June 2005. At the time this reserve was established, our allowance for doubtful accounts substantially increased and our net accounts receivable were reduced accordingly.

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.

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 basis 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 are not recoverable and therefore a valuation allowance has been established and maintained. We determined that the remaining deferred tax assets are recoverable based on a tax planning strategy derived from our ability to sell our headquarters property located in Middletown, Rhode Island for the express purpose of generating taxable income to utilize operating loss carryforwards before they expire. This tax strategy is not an action that we ordinarily would take but would take, if necessary, to realize tax benefits prior to expiration. The amount of the deferred tax assets considered realizable could change in the future if there are changes in the feasibility of our tax planning strategy or a movement in the estimated unrealized gains associated with our Middletown property. In addition to our tax planning strategy, 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:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net sales	100.0%	100.0%	100.0%	100.0%
TracVison A5 revaluation charge	—	16.6	—	7.4
Other cost of goods sold	58.6	68.5	59.4	64.5
Total cost of goods sold	58.6	85.1	59.4	71.9
Gross profit	41.4	14.9	40.6	28.1
Operating expenses:				
Research and development	10.5	12.5	10.6	11.1
Sales and marketing	17.8	26.3	19.0	23.6
General and administrative	8.0	10.4	7.5	8.1
Total operating expenses	36.3	49.2	37.1	42.8
Operating income (loss)	5.1	(34.3)	3.5	(14.7)
Other income (expense), net	0.4	0.6	0.6	0.3
Income (loss) before income tax expense	5.5	(33.7)	4.1	(14.4)
Income tax expense	(0.4)	(0.3)	(0.7)	(0.4)
Net income (loss)	5.1%	(34.0)%	3.4%	(14.8)%

Three Months Ended June 30, 2005 and 2004

Operating Summary

Net income for the three months ended June 30, 2005 was $1.0 million, or $0.07 per basic and $0.06 per diluted common share, representing a significant improvement from the net loss of ($4.9 million), or ($0.34) per basic and diluted common share, in the three months ended June 30, 2004. The operational improvement was primarily the result of the following changes in 2005:

- a 29% increase in net sales, primarily within our defense product lines;
- leveraging of increased sales against fixed manufacturing and overhead costs;
- exclusion of the 2004 second-quarter $2.4 million, or 17% of revenue, TracVision A5 lower of cost or market inventory and non-cancelable future purchase commitment revaluation adjustment;

- a 10 percentage points of revenue decrease in other costs of goods sold; and
- a 13 percentage points of revenue decrease in operating expenses, primarily within sales and marketing.

Gross profit improved from 15% in the second quarter of 2004 to 41% in the second quarter of 2005, primarily as a result of the above-mentioned 2004 TracVision A5 revaluation charge, a significant increase in sales of our higher-margin defense products and the effects of continued manufacturing cost containment initiatives.

Operating expenses as a percentage of revenue improved as a result of increased sales in relation to general fixed cost structure, reduced product launch expenses within sales and marketing functions and controlled spending in both our research and development functions and our general and administrative functions.

Net Sales

Net sales increased by $4.3 million, or 29%, to $18.8 million in the second quarter of 2005 from $14.5 million in the second quarter of 2004. Sales of our mobile satellite communications products, which include our TracVision family of satellite antenna systems, increased 10% to $13.8 million in the 2005 period from $12.5 million in the 2004 period. This increase was primarily attributable to year-over-year unit volume increases throughout almost all of our marine and land mobile satellite communications product lines. Except for declines in our recreational vehicle, or RV-specific product offerings, total satellite communication sales reflect increased market penetration of our newer products, including the TracVision A5, our general expansion within the marine satellite communication markets, and increased sales to large account retailers and marine manufacturers. Sales decreases within our RV product lines are consistent with a general decrease in end-user demand in both the new U.S. luxury coach markets and the U.S. RV accessory aftermarkets.

Sales of our defense products increased by $3.0 million, or 146%, to $5.0 million in the second quarter of 2005 from $2.0 million in the second quarter of 2004. Increases within our TACNAV navigational system product lines were the largest contributor to the overall defense sales growth and came as a result of a combination of sales to new customers as well as replenishment and expansion orders from existing customers. Continued sales growth in our fiber optic gyro products, or FOGs, also represented a significant portion of the total increase in defense sales. FOG sales improvements were a result of the continued market penetration of our newer product offerings, including the DSP-3000 and the DSP-4000 fiber optic gyros and the TG-6000, our fiber optic gyro-based inertial measurement unit. To a lesser extent, sales of our compass and sensor sales for OEM applications and additional contracted project engineering service revenue also showed aggregate year-over-year growth.

Cost of Goods Sold

Cost of goods sold consists of direct labor, materials, manufacturing overhead expenses and engineering costs related to customer-funded research and development efforts. During the second quarter of 2004, and as a result of a new pricing initiative on the TracVision A5, we recorded a $2.4 million lower of cost or market inventory and non-cancelable future purchase commitment revaluation adjustment. Other cost of goods sold increased by $1.1 million, or 11%, to $11.0 million in the three months ended June 30, 2005 from $9.9 million in the same period in 2004. The net increase in other costs of goods sold was primarily the result of the 29% increase in total sales offset by the following:

- leveraging of sales increases on fixed manufacturing and overhead costs;
- shift in product sales mix towards the higher margin TACNAV and FOG product lines;
- lower actual indirect and fixed manufacturing costs, resulting from improved manufacturing efficiencies, reduced headcount and various cost reduction initiatives; and
- continued purchase price reductions for product components in both the satellite communication product lines and the defense product lines.

Customer-funded research and development costs included in cost of goods sold were approximately $0.3 million and $0.2 million, respectively, in the three months ended June 30, 2005 and 2004.

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. Total research and development expense increased modestly by $0.2 million, or 9%, to $2.0 million in the second quarter of 2005 from $1.8 million in the same period in 2004. As a percentage of net sales, research and development expense decreased to 11% in the second quarter of 2005 from 13% in the same period in 2004. The aggregate dollar change reflects increases in consulting services and engineering staff, primarily to support the development of new products in both our satellite communications and defense product line families. On a percentage of revenue basis, future research and development expenses are anticipated to remain at or near current levels.

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, sales related travel, literature, advertising trade shows and provisions for doubtful accounts. Sales and marketing expense decreased by $0.5 million, or 13%, to $3.3 million in the second quarter of 2005 from $3.8 million in the same period in 2004. As a percentage of net sales, sales and marketing expense decreased to 18% in the second quarter of 2005 from 26% in the same period in 2004. The dollar decrease was primarily a result of reduced national and direct marketing promotions associated with our land mobile satellite communications products. Scaled-back large account and trade show promotions within the marine and land-mobile markets also contributed to improvement in sales and marketing expenditures. Reduced bad debt expense associated with certain small volume dealers also contributed to the overall decrease in sales and marketing expense.

General and administrative expense consists of costs attributable to our general management, finance, accounting, legal, information systems, human resources, and outside professional services. General and administrative expense remained consistent at $1.5 million in both second quarters of 2005 and 2004, as increased accounting and compliance costs associated with the Sarbanes-Oxley Act of 2002 were offset by other professional fee reductions. As a percentage of net sales, general and administrative expense decreased from 10% in the three-month period in 2004 to 8% in the same period in 2005.

Interest and Other Income

Interest income increased to $0.3 million in the second quarter of 2005 from $0.1 million in the same period of 2004. The improvement was the result of higher investment yields stemming from rising interest rates as compared with the same period in 2004. Other expense increased to $0.2 million in the second quarter of 2005 from approximately $0 in the same period of 2004. The increase in other expense is completely due to increased foreign currency losses on certain subsidiary Euro-denominated sales invoices and supplier payables associated with a strengthening of the U.S. Dollar relative to the Euro for the periods presented.

Income Taxes

In both of the second quarters of 2005 and 2004, we recorded income tax expense of approximately $0.1 million. Income tax expense recorded during the periods was entirely attributable to profitable statutory results in our Denmark operations. We recognized no U.S. net income tax expense because the resultant U.S. provision for tax expense was offset by the utilization of NOL carryforwards for which deferred tax asset valuation allowances were recorded in prior years. As a result of our significant deferred tax asset valuation reserve recognized in prior years, we do not foresee the recognition of any significant tax expense in relation to our U.S. operations for the foreseeable future.

Six Months Ended June 30, 2005 and 2004

Operating Summary

Net income for the six months ended June 30, 2005, was $1.3 million, or $0.09 per basic and diluted common share, and was significantly above the loss of ($4.8 million), or ($0.35) per basic and diluted common share, in the six months ended June 30, 2004. The operational improvement was primarily the result of the following changes in 2005:

- a 13% increase in net sales, primarily within our defense product lines;
- leveraging of increased sales on fixed manufacturing and overhead costs;
- exclusion of the 2004, second-quarter, $2.4 million, or 7.4 percentage points of revenue, TracVision A5 lower of cost or market inventory and non-cancelable future purchase commitment revaluation adjustment;
- a 5 percentage points of revenue decrease in costs of goods sold; and
- a 6 percentage points of revenue decrease in operating expenses primarily associated with sales and marketing activities.

Consistent with results described for the second quarters ended June 30, 2005 and 2004, gross profit improved from 28% for the first six months of 2004 to 41% in the same period of 2005, primarily as a result of the TracVision A5 revaluation charge recorded in 2004, an increase in sales of our higher-margin defense products and the effects of continued manufacturing cost containment initiatives.

Year-to-date total operating expenses decreased by $0.3 million or 2%, from $13.9 million in 2004 to $13.6 million in 2005 due mostly to decreased new product sales and marketing expenses offset partially by increased new product research and development expenses and general and administrative professional fees. As a percentage of sales, the total operating expenses decreased from 43% of revenue in 2004 to 37% in 2005. The decrease in costs as a percentage of revenue was due primarily to the leveraging of fixed cost structure against increased sales.

Net Sales

Six-month period net sales increased by $4.2 million, or 13%, to $36.7 million in 2005 from $32.5 million in 2004. Sales of our mobile satellite communications products, particularly in our marine product lines, continued to show growth, increasing 4% to $27.9 million in the six months ended June 30, 2005 from $26.8 million in the same period in 2004. This increase was primarily attributable to year-over-year unit volume increases throughout most of our marine and land mobile satellite communications product lines. Except for some declines in our RV-specific product offerings, total satellite communications sales reflect increased market penetration of our newer products, including the TracVision A5, our general expansion within the global marine satellite communications markets, and increased sales to large account retailers and marine manufacturers. Sales decreases within our RV product lines are consistent with a general decrease in end-user demand in both the new U.S. luxury coach markets as well as the U.S. RV accessory aftermarkets.

Sales of our defense products increased by $3.1 million, or 54%, to $8.8 million in the six-month ended June 30, 2005 from $5.7 million in the same six-month period of 2004. Increases within our TACNAV navigational system product lines were the largest contributor to the overall defense sales growth and came as a result of a combination of sales to new customers as well as replenishment and expansion orders from existing customers. The continued market acceptance our new DSP-3000 and the DSP-4000 fiber optic gyros and the TG-6000, our fiber optic gyro-based inertial measurement unit along with additional contracted project engineering service revenue, also helped to produce the year-over-year growth.

Cost of Goods Sold

Cost of goods sold for the six months ended June 30, 2005 decreased by $1.6 million, or 7%, to $21.8 million from $23.4 million in the same period in 2004. Excluding the $2.4 million TracVision A5 lower of cost or market inventory and non-cancelable future purchase commitment revaluation adjustment recorded during 2004, other cost of goods sold for the six months increased $0.8 million, or 4%, to $21.8 million from $21.0 million. Increases in the other costs of goods sold were consistent with those described in the three-month period ended June 30, 2005 and 2004 and generally resulted from the 13% increase in sales offset by the following:

- leveraging of sales increases on fixed manufacturing and overhead costs;
- shift in product mix to the higher-margin defense-related products;
- lower actual indirect and fixed manufacturing costs, resulting from improved manufacturing efficiencies, reduced headcount and various cost reduction initiatives; and
- continued purchase price reductions for product components in both the satellite communication product lines and the defense product lines.

Customer-funded research and development costs included in cost of goods sold were approximately $0.6 million and $0.4 million, respectively, in the six months ended June 30, 2005 and 2004.

Operating Expenses

Total research and development expense increased by $0.3 million or 7%, to $3.9 million in the first half of 2005 from $3.6 million in the same period in 2004. As a percentage of net sales, year-to-date research and development expense remained steady at approximately 11% in both 2005 and 2004.

Sales and marketing expense decreased by $0.7 million, or 9%, to $7.0 million in 2005 from $7.7 million in the same period in 2004. As a percentage of net sales, sales and marketing expense decreased to 19% in 2005 from 24% in the same period in 2004. The expense decrease was primarily a result of reduced national and direct marketing promotions associated with our land mobile satellite communications products, including the TracVision A5, and reduced large account and trade show promotions within the marine and land-mobile markets. Reduced bad debt expense associated with certain small volume dealers also contributed to the overall decrease in sales and marketing expense.

General and administrative expense increased by more than $0.1 million, or 5%, to $2.8 million in 2005 from $2.6 million in the same period in 2004. As a percentage of net sales, general and administrative expense remained steady at approximately 8% in both 2005 and 2004. Accounting compliance expenses made up the majority of our general and administrative cost increases. Additional salary and salary-related costs also contributed to this increase. Partially offsetting the total increase was a reduction in other professional fees.

Income Taxes

In the six months ended June 30, 2005 and 2004, we recorded foreign income tax provisions of approximately $0.2 million and $0.1 million, respectively. The increase was entirely related to the increase in profitability of our foreign subsidiary. No tax provision was recorded in our U.S. operations for the six month period ended June 30, 2005 and 2004 for the same reasons as described in the three months ended June 30, 2005 and 2004.

Liquidity and Capital Resources

We have historically funded our operations from product sales, net proceeds from public and private equity offerings, bank financings, proceeds received from exercises of warrants and stock options, and to a lesser extent, equipment leasing and financing arrangements. On February 13, 2004, we completed an underwritten public offering of 2.75 million 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 incurred. As of June 30, 2005, we had $47.1 million in cash, cash equivalents and marketable securities, and $60.2 million in working capital.

For the six months ended June 30, 2005, cash flow from our operations approximated $2.0 million. Cash flow provided by operations, as reconciled from our net income of $1.3 million for the six months ended June 30, 2005 included non-cash positive adjustments of $1.0 million for depreciation and amortization and $0.2 million for income taxes. Net cash provided by operating activities during the first six months of 2005 also included the following:

- a $1.7 million addition to cash resulting from an increase in accounts payable and accrued expense balances primarily due to the timing of payments;
- a $1.0 million decrease in cash resulting from increases in accounts receivables and costs in excess of billings on uncompleted contracts receivables, primarily due to increased sales in the second quarter of 2005 as compared with the fourth quarter of 2004; and
- a $0.8 million decrease in cash resulting from increases in inventory due to the continued expansion of our product offerings as well as additions to stocking levels in anticipation of future sales growth.

Net cash provided by investing activities was $0.6 million for the six months ended June 30, 2005, and primarily represents the transfer of $2.0 million from longer-term marketable security holdings into cash equivalent securities as we align our investment portfolio in response to operating requirements. Offsetting the $2.0 million cash transfer from marketable securities was the following;

- $0.9 million in purchases of manufacturing and other capital equipment, primarily to replace obsolete equipment and support our sales growth and development activities within both the satellite communications and defense product lines; and
- reinvestment of $0.5 million of interest income into marketable securities.

Net cash provided by financing activities was $0.2 million for the six months ended June 30, 2005 and primarily resulted from cash received upon the purchase of our common stock through our employee stock option program. The stock option proceeds were partially offset by principal payments on outstanding long-term debt obligations.

Currently, we have a revolving loan agreement with a bank that provides for a maximum available credit of $15.0 million and expires 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 either the Federal Funds Effective Rate plus 0.5% or the bank’s prime interest rate. We pay monthly fees at an annual rate of 0.25% on the first $10.0 million of the unused portion of the loan facility. The loan facility advances funds using an 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 without penalty, provided we give 30 days advance written notice to the bank. As of June 30, 2005, 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. Under the mortgage loan we may prepay our outstanding loan balance subject to certain early termination charges as defined in the mortgage loan agreement.

We believe that the $47.1 million we hold in cash, cash equivalents and marketable securities, together with our other existing working capital, will be adequate to meet planned operating and capital requirements through the foreseeable future. However, as the need or opportunity arises, we may seek to raise additional capital through public or private sales of securities or through additional debt financing. There are no assurances that we will be able to obtain any additional funding or that such funding will be available on terms acceptable to us.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123R, “Share-Based Payment” (“SFAS 123R”), which supersedes Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” and its related implementation guidance. SFAS 123R requires companies to include compensation expense from stock options granted to employees in the consolidated statements of income.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, which provides interpretative guidance in applying the provisions of SFAS 123R.

In April 2005, the SEC amended the compliance date for SFAS 123R, which we are required to adopt no later than the first quarter of 2006. We expect to adopt the new requirements in the first quarter of 2006. We have not yet evaluated the impact of adoption of this pronouncement. However, as disclosed in note 2 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, we would have recorded approximately $0.5 million and $0.9 million of expense in the three-month and six-month periods ended June 30, 2005, respectively, if the provisions of SFAS 123R had been applied to the second quarter of 2005. We believe the pro forma expense disclosure provides a reasonable approximation of the stock-based compensation expense that may be recorded in our consolidated statements of income for the periods presented upon adoption of SFAS 123R.

FORWARD LOOKING STATEMENTS – TRENDS, RISKS AND UNCERTAINTIES

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 $6.1 million in 2004 and $1.5 million in both of 2003 and 2002. As of June 30, 2005, we had an accumulated deficit of $16.2 million.

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

We began shipping the TracVision A5 in September 2003. It was the first commercially available, low-profile mobile satellite TV antenna practical for use on minivans, SUVs and other passenger vehicles. Accordingly, the market for this product remains 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 stages of development of this market make it difficult for us to predict customer demand accurately. For example, although sales of the TracVision A5 grew quarter-to-quarter throughout 2004, sales were still below our original expectations for the year. We have, at times, previously experienced temporary issues related to our production process and availability of adequate component supply. Although we believe we have successfully addressed the issues that have arisen, 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 increasing fuel prices may negatively affect consumer demand for SUVs;
- the extent to which TracVision A5 gains the acceptance of the automotive OEMs;
- the extent to which customers perceive mobile satellite TV services as a luxury or a necessary convenience;

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

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

When we began shipping our TracVision A5 in September 2003, it was the only commercially available, low-profile mobile satellite TV antenna for use on minivans, SUVs and other passenger vehicles. Any advantage we may have had by being the first to market such a product may erode as others enter this market. For example, RaySat has announced its intention to offer a phased-array satellite antenna for automobiles. Audiovox has indicated that it also expects to offer the RaySat antenna as an Audiovox-branded product. Winegard has also announced its intention to offer an in-motion automotive satellite TV antenna. In addition, SIRIUS Satellite Radio announced in January 2005 that it intends to introduce in 2006 a service offering several streaming video channels through SIRIUS' existing satellite radio system. In January 2005, Delphi Corp., a prominent supplier of automotive parts, announced a new agreement with Comcast Corporation to work together to develop ways to allow users to select video content and transfer it to an in-vehicle entertainment system. No details were provided as to the time frame for a possible product. These competing satellite antenna products may have a slightly lower profile and 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 additional significant cost reductions for the TracVision A5 to reach our targeted profit margins.

Our product profit margins for the TracVision A5 have been low since its introduction. To reach our targeted profit margins, we must continue to 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 cost reduction programs in place that include 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 further lower the price, which would further impair our product profit margins unless we are able to achieve corresponding cost reductions.

High fuel prices may adversely affect sales of our mobile satellite communications products.

Fuel prices have been high and may remain high or increase in the foreseeable future. High fuel prices tend to have a disproportionate impact on the larger vehicles and vessels for which our mobile satellite communications products are designed, such as marine vessels, recreational vehicles and SUVs, because they consume relatively large quantities of fuel. The increased cost of operating these vehicles and vessels may adversely affect demand for our mobile satellite communications products if consumers reduce purchases of these vehicles or if they spend discretionary funds on operating costs rather than our products.

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:

- priorities for current battlefield operations;

- changes in modernization plans for military equipment;
- allocation of funding for military programs;
- new military and operational doctrines that affect military equipment needs;
- changes in tactical navigation requirements;
- sales cycles that are long and difficult to predict;
- shifting response time and / or delays in the approval process associated with the export licenses we must obtain prior to the international shipment of certain of our military products;
- delays in military procurement schedules; and
- delays in the testing and acceptance of our products.

These factors can cause substantial fluctuations in sales of TACNAV and our other defense products from period to period. Moreover, TACNAV and most of our other defense products must meet military quality standards, and our products may not continue to meet existing standards or more rigorous standards adopted in the future. Any failure to meet military contract specifications may produce delays as we attempt to improve our design, development, manufacturing or quality control processes. Furthermore, government customers and their contractors can generally cancel orders for our products for convenience. 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 significant portion of our revenues from a small number of customers, including the U.S. Government. The loss of business from any of these customers could substantially reduce our net sales and results of operations and could seriously harm our business.

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

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

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

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. Through the first six months of 2005, sales of our defense products have grown at a higher rate than our overall sales growth. However, during 2004, sales of our defense products declined compared to 2003. If the current shift in the product sales mix of satellite communications and defense products were to reverse, we could return to lower gross margins in the future.

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.

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 TracVision A5 currently offers access to only the DIRECTV service in the continental United States. Although DIRECTV is offerings its TOTAL CHOICE Mobile programming package at a price that we think should be attractive to consumers, DIRECTV has no obligation to continue to offer that package at the current price or at all. If customers become dissatisfied with the programming, pricing, service, availability or other aspects of these satellite television services product or if any one or more of these services becomes unavailable for any reason, we could suffer a substantial decline in sales of our TracVision products. The companies that operate these services have no obligation to inform us of technological or other changes, including discontinuation of the service, which could impair the performance of our TracVision products.

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 Telemar for TracNet service in Europe. We currently rely on Bell ExpressVu for TracNet service in North America. We have been informed, however that ExpressVu has elected to discontinue its broadband service as of August 31, 2005. We have therefore decided to withdraw the TracNet product from the U.S. market and provide a terrestrial-based alternative service for TracNet systems already in use.

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

Our mobile 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 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.

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

We currently manufacture and assemble our products using individual production lines for each product category. We have experienced manufacturing difficulties in the past, and any significant disruption to one of these production lines will require time either to reconfigure and equip an alternative production line or to restore the original line to full capacity. Some of our production processes are complex, and we may be unable to respond rapidly to the loss of the use of any production line. For example, our production process uses some specialized equipment and custom molds that may take time to replace if they malfunction. In that event, shipments would be delayed, which could result in customer or dealer dissatisfaction, loss of sales and damage to our reputation. Finally, we have only a limited capability to increase our manufacturing capacity in the short term. If short-term demand for our products exceeds our manufacturing capacity, our inability to fulfill orders in a timely manner could also lead to customer or dealer dissatisfaction, loss of sales and damage to our reputation.

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

We obtain many key components for our products from third-party suppliers, and in some cases we use a single or a limited number of suppliers. Any interruption in supply could impair our ability to deliver our products until we identify and qualify a new source of supply, which could take several weeks, months or longer and could increase our costs significantly. In 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 generally carry significant inventories of product components, and this could magnify the impact of the loss of a supplier. If we are required to use a new source of materials or components, it could also result in unexpected manufacturing difficulties and could affect product performance and reliability.

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

We currently manufacture all of our products in the U.S. However, in order for us to improve our margin performance and overall profitability, we may find it necessary to evaluate the need to further increase the international scope of our operations. This could include offshore manufacturing and/or the increased sourcing of raw materials from foreign countries. We have only limited experience in foreign manufacturing and we might not be successful in implementing or integrating an extended program. In addition, an increased reliance on foreign manufacturing and/or raw material supply would lengthen our supply chain and increase the risk that a disruption in that supply chain would have a material adverse affect on our operations and financial performance.

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.

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 could demonstrate slower growth than we anticipate as a result of regional and global economic conditions. Consumer spending tends to decline during recessionary periods and may decline at other times. Consumers may choose not to purchase our mobile satellite communications products due to a perception that they are luxury items. As global and regional economic conditions change, including in the general level of interest rates, rising oil prices and end demand for durable consumer products, 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, guidance and stabilization products are each characterized by rapid technological change, frequent new product innovations, changes in customer requirements and expectations and evolving industry standards. If we fail to make innovations in our existing products and reduce the costs of our products, our market share may decline. Products using new technologies, or emerging industry standards, could render our products obsolete. If our competitors successfully introduce new or enhanced products that eliminate technological advantages our products may have in a certain market or otherwise outperform our products, or are perceived by consumers as doing so, we may be unable to compete successfully in the markets affected by these changes. For example, other companies have either announced their intentions or have begun to offer low-profile in-motion satellite antennas. 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.

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

- upgrade, expand or re-size our manufacturing facilities and capacity in a timely manner;
- successfully attract, train, motivate and manage a larger number of employees for manufacturing, sales and customer support activities;
- control higher inventory and working capital requirements; and
- improve the efficiencies within our operating, administrative, financial and accounting systems, and our procedures and controls.

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

To meet our growth objectives, we must attract and retain highly skilled technical, operational, managerial, and sales and marketing personnel. If we fail to attract and retain the necessary personnel, we may be unable to achieve our business objectives and may lose our competitive position, which could lead to a significant decline in net sales. We face significant 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 mobile 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 may have to reduce the prices of our products. Moreover, new competitors may emerge, and entire product lines may be threatened by new technologies or market trends that reduce the value of those product lines. For example, improvements in less expensive wireless and cellular technologies may limit demand for land-based satellite telephone and Internet services.

In the defense navigation, guidance and stabilization markets, we compete primarily with Honeywell International Inc., Kearfott Guidance & Navigation Corporation, Leica Microsystems AG, Northrop Grumman Corporation and Smiths Group PLC. In the market for mobile satellite communications products, we compete with a variety of companies. In the land mobile market for satellite TV communications equipment, we compete directly with King Controls, MotoSAT, TracStar Systems, Inc., and Winegard Company. There is also potential competition for sales of satellite TV to the automotive market from RaySat, Audiovox, Winegard, and Delphi. In the marine market for satellite TV communications equipment, we compete with NaviSystem Marine Electronic Systems Srl, Orbit Satellite Television & Radio Network and Sea Tel, Inc. 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. Moreover, new competitors may surface in the future. Among the factors that may affect our ability to compete in our markets are the following:

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

Historically, sales to customers outside the United States and Canada have accounted for a significant portion of our net sales. We have only one foreign sales office, which is located in Denmark, and we otherwise support our international sales from our operations in the United States. Our limited operations in foreign countries may impair our ability to compete successfully in international markets and to meet the service and support needs of our customers in countries where we have no infrastructure. We are subject to a number of risks associated with our international business activities, which may increase our costs and require significant management attention. These risks include:

- technical challenges we may face in adapting our mobile 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;
- satisfaction of international regulatory requirements and procurement of any necessary licenses or permits;
- restrictions on the sale of certain defense products to foreign military and government customers;
- additional costs and delays associated with obtaining approvals and licenses under applicable export regulations;
- increased costs of providing customer support in multiple languages;
- more limited protection of our intellectual property;
- potentially adverse tax consequences, including restrictions on the repatriation of earnings;
- protectionist laws and business practices that favor local competitors, which could slow our growth in international markets;
- potentially longer sales cycles, which could slow our revenue growth from international sales;
- potentially longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- losses arising from foreign currency exchange rate fluctuations; and
- economic and political instability in some international markets.

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

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

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

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

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

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

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

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

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

We and certain of our officers are defendants in a class action lawsuit in the U. S. District Court for the District of Rhode Island. The suit asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, as well as claims under Sections 11, 12(a)(2) and 15 under the Securities Act of 1933, on behalf of purchasers of our securities between October 1, 2003 and July 2, 2004. We and certain of our directors and officers are also defendants in a shareholders’ derivative action in the Rhode Island State Superior Court for Newport County. This suit asserts state law claims on our behalf between October 1, 2003 and the present arising from the allegations set forth in the class action complaint in the U.S. District Court described above. We and certain of our directors and officers are also defendants in a shareholders’ derivative action in the U.S. District Court for the District of Rhode Island. This suit asserts federal and state claims on our behalf between October 6, 2003 and the present arising from the same allegations set forth in the class action and Mehrvar complaints described above. We intend to vigorously defend ourselves against these claims. There can be no assurance, however, that we will not have to pay significant damages or amounts in settlement. An unfavorable outcome or prolonged litigation could materially harm our business. Litigation of this nature is expensive and time-consuming and diverts the time and attention of our management.

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

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

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

From time to time we have faced claims by third parties that our products or technology infringe their patents or other intellectual property rights, and we may face similar claims in the future. Any claim of infringement could cause us to incur substantial costs defending against the claim, even if the claim is invalid, and could distract the attention of our management. 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 are presently a defendant in a lawsuit brought by Electronic Controlled Systems, Inc., d/b/a King Controls, alleging infringement of three of its patents. We are defending ourselves vigorously against these claims, but there can be no assurances that we will not have to pay significant damages or amounts in settlement or that the suit will not otherwise materially affect our operations or financial performance.

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 changes 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;
- our success in winning competitions for orders;
- the timing of new product introductions by us or our competitors;
- the mix of products we sell;
- market and competitive pricing pressures;
- general economic climate; and
- seasonality of pleasure boat and recreational vehicle usage.

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

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

We utilize a tax planning strategy as provided for under accounting principles generally accepted in the United States as a means of supporting the realizable nature of our deferred tax assets. The strategy involves our ability to sell our Middletown, Rhode Island headquarters facility in order to generate taxable income for the sole purpose of utilizing our capitalized tax loss carryforwards before they expire. The determination of taxable income, and therefore supportable deferred tax asset value, is based upon the difference between the property’s estimated fair market value and our tax basis, less an adjustment for strategy implementation costs. Accordingly, the estimated net realizable value of our deferred tax asset is highly correlated to property values in and around the Middletown, Rhode Island area and therefore subject to changes in property value. This fair market value subjectivity may cause us to record significant increases or decreases to our deferred tax assets during the fourth quarter of each year, since we have historically evaluated our deferred tax asset during that period.

The strategy represents an action that we ordinarily would not take, but could take, if necessary, to realize an estimated $3.4 million in U.S. deferred tax assets or the equivalent of approximately $8.9 million in estimated net taxable income as of June 30, 2005.

Changes in the securities laws and regulations are likely to increase our costs.

As a result of the Sarbanes-Oxley Act of 2002, the SEC and the Nasdaq have promulgated a variety of new rules and listing standards. Compliance with these new rules and listing standards has significantly increased our legal, financial and accounting costs, and we expect these increased costs to continue. These developments may make it more difficult and more expensive for us to obtain director and officer liability insurance. Likewise, these developments may make it more difficult for us to attract and retain qualified members of our board of directors, particularly independent directors, or qualified executive officers.

The market price of our common stock may be volatile.

Our stock price has been volatile. From January 1, 2004 to June 30, 2005, the trading price of our common stock ranged from $6.61 to $27.75. 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, or adoptions of, accounting principles;
- market conditions in our industries; and
- the global macroeconomic and geopolitical environment.

In addition, the stock market can experience extreme price and volume fluctuations. These fluctuations are often unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of our common stock. When the market price of a company's stock drops significantly, stockholders often institute securities class action litigation against that company. We are now defending a securities class action lawsuit. This pending litigation is causing us to incur substantial costs and is diverting the time and attention of our management. These adverse consequences may continue until this action is finally resolved. Any similar litigation in the future could have similar consequences.

Acquisitions may disrupt our operations or adversely affect our results.

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

- charges related to any potential acquisition from which we may withdraw;
- diversion of our management's time, attention, and resources;
- loss of key acquired personnel;
- increased costs to improve or coordinate managerial, operational, financial, and administrative systems including compliance with the Sarbanes-Oxley Act of 2002;
- dilutive issuances of equity securities;
- the assumption of legal liabilities;
- amortization of acquired intangible assets; and

- potential write-offs related to the impairment of goodwill.

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 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary market risk exposure is in the area of foreign currency exchange risk. We are exposed to currency exchange rate fluctuations related to our subsidiary operations in Denmark. Certain functions in Denmark are transacted in the Danish Krone or Euro, yet reported in the U.S. Dollar, the functional currency. For foreign currency exposures existing at June 30, 2005, a 10% unfavorable movement in the foreign exchange rates for our subsidiary location would not expose us to material losses in earnings or cash flows.

From time to time, we purchase foreign currency forward exchange contracts generally having durations of no more than 4 months. These forward exchange contracts are intended to offset the impact of exchange rate fluctuations on intercompany payments due from our foreign subsidiary. Forward exchange contracts are accounted for as cash flow hedges and are recorded on the balance sheet at fair value until executed. Changes in the fair value are recognized in earnings. As of June 30, 2005, there were three outstanding forward contracts to purchase approximately $1.85 million at an average Euro to U.S. Dollar conversion rate of 1.21. Total gain recognized on the derivative instruments for the quarter ended June 30, 2005 was approximately $2,000.

The primary objective of our investment activities is to preserve principal and maintain liquidity, while at the same time maximize income. We have not entered into any instruments for trading purposes. Some of the securities that we invest in may have market risk. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, investment grade asset-backed corporate securities, money market funds and government, government agency and non-government debt securities. A hypothetical 100 basis-point increase in interest rates would result in an approximate $51,000 decrease in the fair value of our investments as of June 30, 2005. However, due to the conservative nature of our investments, the relatively short duration of their maturities, our ability to either convert some or all of our long-term investments to less interest rate-sensitive holdings or hold most securities until maturity, we believe interest rate risk is mitigated. As of June 30, 2005, approximately 30% of the $33.9 million classified as available-for-sale marketable securities will mature or reset within one year. We do not invest in any financial instruments denominated in foreign currencies. Accordingly, interest rate risk is not considered material.

To the extent that we borrow against our variable-rate credit facility, we will be subject to interest rate risk. There were no borrowings outstanding at June 30, 2005.

ITEM 4. 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 chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, our president and chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that we record, process, summarize and report the information we must disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, within the time periods specified in the SEC’s rules and forms.

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

Changes in Internal Control over Financial Reporting

During the three and six months ended June 30, 2005, 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 II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are a defendant in a class action lawsuit in the U.S. District Court for the District of Rhode Island in which we and certain of our officers are named as defendants. The suit asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 under that statute, as well as claims under Sections 11, 12(a)(2) and 15 under the Securities Act of 1933, on behalf of purchasers of our securities in the period October 1, 2003 and July 2, 2004. The Teamsters Affiliates Pension Plan has been appointed lead plaintiff. This matter consolidates into one action eight separate complaints filed between July 24, 2004 and September 15, 2004. On January 14, 2005 the defendants filed a motion to dismiss the consolidated complaint for failure to state a claim upon which relief can be granted. The court heard oral arguments on May 10, 2005, but has not acted on the defendants' motion.

On August 16, 2004, Hamid Mehrvar filed a shareholder's derivative action in the Rhode Island State Superior Court for Newport County against us and certain of our officers and directors. The amended complaint asserts state law claims on our behalf arising between October 1, 2003 and the present in connection with the allegations set forth in the class action complaints in the U.S. District Court described above. On March 18, 2005, the defendants filed a motion to dismiss the amended complaint for failure to state a claim upon which relief can be granted. The court heard oral arguments on May 26, 2005, but has not acted on the defendants' motion.

On June 20, 2005 Yemin Ji filed a shareholder's derivative action in the U.S. District Court for the District of Rhode Island against us and certain of our officers and directors, asserting certain federal and state law claims on our behalf arising between October 6, 2003 and the present in connection with the same allegations set forth in the class action and Mehrvar complaints described above. The complaint has not been served on defendants.

In May 2005, Electronic Controlled Systems, Inc., d/b/a King Controls, filed a patent infringement suit against KVH in the U.S. District Court for the District of Minnesota. The three asserted patents relate generally to controlling a satellite dish to acquire a satellite signal. The complaint alleges that KVH willfully infringes the patents and seeks injunctive relief, enhanced damages and attorneys' fees. KVH has denied the allegations and asserted counterclaims, including claims for false advertising.

Additionally, in the ordinary course of business, we are party to inquiries, legal proceedings and claims including, from time to time, disagreements with customers and vendors.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On May 25, 2005, we held our annual meeting of stockholders. Our stockholders elected Martin A. Kits van Heyningen, Robert W.B. Kits van Heyningen and Bruce J. Ryan to serve as Class III directors for three-year terms. In addition, the terms of office of our other directors, Arent H. Kits van Heyningen, Mark S. Ain, Stanley K. Honey, and Charles R. Trimble continued after our annual meeting of stockholders.

The votes cast to elect the directors were:

	Votes In Favor	Abstentions
Martin A. Kits van Heyningen	11,793,964	714,926
Robert W.B. Kits van Heyningen	11,793,456	715,434
Bruce J. Ryan	11,853,307	655,583

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ITEM 6. EXHIBITS

Exhibits:

31.1	Rule 13a-14(a)/15d-14(a) certification of principal executive officer
31.2	Rule 13a-14(a)/15d-14(a) certification of principal financial officer
32.1	Section 1350 certification of principal executive officer
32.2	Section 1350 certification of principal financial officer

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: August 9, 2005

KVH Industries, Inc.

By: /s/ Patrick J. Spratt

Patrick J. Spratt
(Duly Authorized Officer and
Chief Financial and Accounting Officer)

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31.1	Rule 13a-14(a)/15d-14(a) certification of principal executive officer
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32.1	Section 1350 certification of principal executive officer
32.2	Section 1350 certification of principal financial officer

Certification of Principal Executive Officer
Pursuant to Rule 13a-14 or 15d-14 under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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

1. I have reviewed this quarterly report on Form 10-Q 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(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: August 9, 2005

By: /s/ Martin A. Kits van Heyningen

Martin A. Kits van Heyningen
Chief Executive Officer

Certification of Principal Financial Officer
Pursuant to Rule 13a-14 or 15d-14 under the Securities Exchange Act of 1934 as Adopted Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002

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

1. I have reviewed this quarterly report on Form 10-Q 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(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: August 9, 2005

By: /s/ Patrick J. Spratt

Patrick J. Spratt
Chief Financial and Accounting Officer

EXHIBIT – 32.1

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 Quarterly Report on Form 10-Q of KVH Industries, Inc. (the "Company") for the quarter ended June 30, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned president and chief executive officer certifies, to his best knowledge and belief, 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 Exchange 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.

Date: August 9, 2005

/s/ Martin A. Kits van Heyningen

President & Chief Executive 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 Quarterly Report on Form 10-Q of KVH Industries, Inc. (the "Company") for the quarter ended June 30, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned chief financial officer of the Company, certifies, to his best knowledge and belief, 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 Exchange 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.

Date: August 9, 2005

/s/ Patrick J. Spratt

Chief Accounting & Financial Officer