

KVH INDUSTRIES INC \DE\
Form 10-Q
August 06, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: June 30, 2010

OR

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

For the transition period from _____ to _____

Commission File Number 0-28082

KVH Industries, Inc.

(Exact Name of Registrant as Specified in its Charter)

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

Delaware
(State or Other Jurisdiction of

05-0420589
(I.R.S. Employer

Incorporation or Organization)

Identification Number)

50 Enterprise Center, Middletown, RI 02842

(Address of Principal Executive Offices) (Zip Code)

(401) 847-3327

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
 Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
 Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Date	Class	Outstanding shares
August 3, 2010	Common Stock, par value \$0.01 per share	14,450,937

Table of Contents

KVH INDUSTRIES, INC. AND SUBSIDIARIES

Form 10-Q

INDEX

	Page No.
PART I. FINANCIAL INFORMATION	
ITEM 1. <u>FINANCIAL STATEMENTS</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2010 (unaudited) and December 31, 2009</u>	3
<u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009 (unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009 (unaudited)</u>	5
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	6
ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	13
ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	20
ITEM 4. <u>CONTROLS AND PROCEDURES</u>	20
PART II. OTHER INFORMATION	
ITEM 1. <u>LEGAL PROCEEDINGS</u>	21
ITEM 1A. <u>RISK FACTORS</u>	21
ITEM 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	30
ITEM 6. <u>EXHIBITS</u>	31
<u>SIGNATURE</u>	32
<u>EXHIBIT INDEX</u>	33

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****KVH INDUSTRIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share amounts, unaudited)

	June 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 7,031	\$ 5,871
Marketable securities	38,518	35,433
Accounts receivable, net of allowance for doubtful accounts of approximately \$570 as of June 30, 2010 and \$844 as of December 31, 2009	18,263	15,803
Inventories	14,196	13,387
Prepaid expenses and other assets	1,534	1,602
Costs and estimated earnings in excess of billings on uncompleted contracts	13	13
Deferred income taxes	1,471	17
Total current assets	81,026	72,126
Property and equipment, less accumulated depreciation of \$23,228 as of June 30, 2010 and \$21,503 as of December 31, 2009		
	17,760	15,777
Other non-current assets	6,247	6,509
Deferred income taxes	5,862	3,334
Total assets	\$ 110,895	\$ 97,746
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 5,261	\$ 3,611
Accrued compensation and employee-related expenses	4,000	3,577
Accrued other	2,817	1,667
Accrued product warranty costs	1,216	1,084
Accrued professional services	390	419
Deferred revenue	1,003	961
Current portion of long-term debt	121	117
Total current liabilities	14,808	11,436
Other long-term liabilities	822	902
Long-term debt excluding current portion	3,747	3,808
Total liabilities	19,377	16,146
Commitments and contingencies (notes 3 and 10)		
Stockholders' equity:		
Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued		

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

Common stock, \$0.01 par value. Authorized 30,000,000 shares, 15,613,789 and 15,355,602 shares issued at June 30, 2010 and December 31, 2009; 14,412,465 and 14,154,278 shares outstanding at June 30, 2010 and December 31, 2009, respectively	156	154
Additional paid-in capital	99,148	96,274
Accumulated earnings (deficit)	1,985	(5,406)
Accumulated other comprehensive (loss) income	(300)	49
Less: treasury stock at cost, common stock, 1,201,324 shares as of June 30, 2010 and December 31, 2009	(9,471)	(9,471)
Total stockholders equity	91,518	81,600
Total liabilities and stockholders equity	\$ 110,895	\$ 97,746

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**KVH INDUSTRIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except share and per share amounts, unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Sales:				
Product	\$ 24,379	\$ 18,129	\$ 48,412	\$ 33,693
Service	5,118	3,727	9,067	6,438
Net sales	29,497	21,856	57,479	40,131
Costs and expenses:				
Costs of product sales	13,688	11,389	26,809	22,479
Costs of service sales	4,314	2,688	7,371	4,375
Sales, marketing and support	4,738	3,971	9,236	8,130
Research and development	2,500	1,858	5,083	3,973
General and administrative	2,316	1,853	4,681	3,780
Total costs and expenses	27,556	21,759	53,180	42,737
Income (loss) from operations	1,941	97	4,299	(2,606)
Interest income	92	93	183	205
Interest expense	59	25	82	37
Other income, net	32	10	63	8
Income (loss) before income taxes	2,006	175	4,463	(2,430)
Income tax benefit	3,318	16	2,927	64
Net income (loss)	\$ 5,324	\$ 191	\$ 7,390	\$ (2,366)
Per share information:				
Net income (loss) per share				
Basic	\$ 0.37	\$ 0.01	\$ 0.52	\$ (0.17)
Diluted	\$ 0.36	\$ 0.01	\$ 0.50	\$ (0.17)
Number of shares used in per share calculation:				
Basic	14,373	13,956	14,298	13,982
Diluted	14,770	14,113	14,738	13,982

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**KVH INDUSTRIES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands, unaudited)

	Six months ended June 30,	
	2010	2009
Cash flows from operating activities:		
Net income (loss)	\$ 7,390	\$ (2,366)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	1,746	1,215
Compensation expense related to awards and employee stock purchase plan	1,121	797
Provision for doubtful accounts	76	409
Deferred income taxes	(3,982)	
Changes in operating assets and liabilities:		
Accounts receivable	(2,536)	784
Costs and estimated earnings in excess of billings on uncompleted contracts		(34)
Inventories	(809)	2,913
Prepaid expenses and other assets	68	(777)
Other non-current assets	262	(1,381)
Accounts payable	1,650	(2,341)
Accrued expenses	1,365	229
Deferred revenue	42	699
Other long-term liabilities	(80)	82
Net cash provided by operating activities	6,313	229
Cash flows from investing activities:		
Capital expenditures	(3,729)	(2,057)
Proceeds from sale of property and equipment		18
Purchases of marketable securities	(13,805)	(13,820)
Maturities and sales of marketable securities	10,684	14,119
Net cash used in investing activities	(6,850)	(1,740)
Cash flows from financing activities:		
Payment of employee restricted stock withholdings	(482)	(47)
Proceeds from stock options exercised and employee stock purchase plan	2,236	115
Repurchase of common stock		(601)
Repayments of mortgage loan	(57)	(2,045)
Borrowings from mortgage loan		4,000
Net cash provided by financing activities	1,697	1,422
Net change in cash and cash equivalents	1,160	(89)
Cash and cash equivalents at beginning of period	5,871	4,979
Cash and cash equivalents at end of period	\$ 7,031	\$ 4,890

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

KVH INDUSTRIES, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

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

(1) Description of Business

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

KVH's mobile communications products enable customers to receive live digital television, voice and Internet services in marine vessels, recreational vehicles, automobiles and commercial airplanes while in motion via satellite services. KVH sells its mobile communications products through an extensive international network of retailers, distributors and dealers. KVH also leases products directly to end users.

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

KVH's mobile communications service sales includes sales earned from product repairs, sales from satellite voice and Internet airtime services, extended warranty sales and certain DIRECTV and DISH Network account subsidies and referral fees earned in conjunction with the sale of its products. KVH provides, for monthly usage fees, third-party satellite connectivity for voice, data and Internet services to its Inmarsat TracPhone customers who choose to activate their subscriptions with KVH. KVH also earns monthly fixed and usage fees for satellite connectivity sales from broadband Internet, data and Voice over Internet Protocol (VoIP) service to its TracPhone V7 customers. Under current DIRECTV and DISH Network programs, KVH is eligible to receive a one-time subsidy for each DIRECTV receiver activated for service and a new mobile account activation fee from DIRECTV and DISH Network for each customer who activates their DIRECTV or DISH Network service directly through KVH. In addition, KVH sells extended warranty programs primarily for its mobile communications products.

KVH's guidance and stabilization service sales include product repairs and engineering services provided under development contracts.

(2) Basis of Presentation

The accompanying condensed consolidated financial statements of KVH Industries, Inc. and its wholly owned subsidiaries, KVH Europe A/S, KVH Industries Asia Pte. Ltd. and KVH South America Comunicacao Por Satelite Ltda. (collectively, KVH or the Company), have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission regarding interim financial reporting. Given that KVH Europe A/S, KVH Industries Asia Pte. Ltd. and KVH South America Comunicacao Por Satelite Ltda. operate as the Company's European and Asian international distributors, all of their operating expenses are reflected within sales, marketing and support within the accompanying condensed consolidated statements of operations. All significant intercompany accounts and transactions have been eliminated in consolidation. 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 for the year ended December 31, 2009 filed on March 9, 2010 with the Securities and Exchange Commission. The results for the three and six months ended June 30, 2010 are not necessarily indicative of operating results for the remainder of the year.

(3) Significant Estimates and Assumptions

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

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

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

Table of Contents**KVH INDUSTRIES, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited, all amounts in thousands except share and per share amounts)****(4) Stock-Based Compensation**

The Company recognizes stock-based compensation in accordance with the provisions of Accounting Standards Codification (ASC) 718, *Compensation-Stock Based Compensation*. Stock-based compensation expense was \$553 and \$408 for the three months ended June 30, 2010 and June 30, 2009, respectively and \$1,121 and \$797 for the six months ended June 30, 2010 and June 30, 2009, respectively. As of June 30, 2010, there was \$437 of total unrecognized compensation expense related to stock options, which is expected to be recognized over a weighted-average period of 1.72 years. As of June 30, 2010, there was \$3,565 of total unrecognized compensation expense related to restricted stock awards, which is expected to be recognized over a weighted-average period of 2.81 years.

The Company granted zero and 175,000 restricted stock awards to employees under the terms of the Amended and Restated 2006 Stock Incentive Plan during the three and six months ended June 30, 2010, respectively. The restricted stock awards vest ratably over four years from the date of grant subject to the recipient remaining employed through the applicable vesting dates. Compensation expense for restricted stock awards is measured at fair value on the date of grant based on the number of shares granted and the quoted market closing price of the Company's common stock. Such value is recognized as expense over the vesting period of the award, net of estimated forfeitures.

(5) Net Income (Loss) per Common Share

Basic net income (loss) per share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share incorporates the dilutive effect of common stock equivalent options, warrants and other convertible securities, if any, as determined with the treasury stock accounting method. Common stock equivalents related to options for 15,850 shares of common stock for the three and six months ended June 30, 2010, respectively have been excluded from the fully diluted calculation of net income per share, as inclusion would be anti-dilutive.

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

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Weighted average common shares outstanding basic	14,373,414	13,955,730	14,298,305	13,981,881
Dilutive common shares issuable in connection with stock plans	396,767	157,659	439,730	
Weighted average common shares outstanding diluted	14,770,181	14,113,389	14,738,035	13,981,881

(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, 2010 and December 31, 2009 include the costs of material, labor, and factory overhead. Components of inventories consist of the following:

	June 30, 2010	December 31, 2009
Raw materials	\$ 9,640	\$ 9,121
Work in process	1,426	1,118
Finished goods	3,130	3,148

\$ 14,196 \$ 13,387

(7) Comprehensive Income (Loss)

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Net income (loss)	\$ 5,324	\$ 191	\$ 7,390	\$ (2,366)
Unrealized gain (loss) on available-for-sale securities	3	(6)	(37)	(61)
Unrealized loss on derivatives	(313)		(313)	
Total comprehensive income (loss)	\$ 5,014	\$ 185	\$ 7,040	\$ (2,427)

Table of Contents**KVH INDUSTRIES, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited, all amounts in thousands except share and per share amounts)****(8) Product Warranty**

The Company's products carry limited warranties that range from one to three years and vary by product. The warranty period begins on the date of retail purchase by the original purchaser. The Company accrues estimated product warranty costs at the time of sale and any additional amounts are recorded when such costs are probable and can be reasonably estimated. Factors that affect the Company's warranty liability include the number of units sold, historical and anticipated rates of warranty repairs and the estimated cost per repair. Warranty and related costs are reflected within sales, marketing and support in the accompanying statements of operations. As of June 30, 2010 and December 31, 2009, the Company had accrued product warranty costs of \$1,216 and \$1,084, respectively. The following table summarizes product warranty activity for the six-month periods presented:

	Six months ended June 30,	
	2010	2009
Beginning balance	\$ 1,084	\$ 1,139
Charges to expense	504	291
Costs incurred	(372)	(328)
Ending balance	\$ 1,216	\$ 1,102

(9) Segment Reporting

Under common operational management, the Company designs, develops, manufactures and markets its navigation, guidance and stabilization and mobile communication products for use in a wide variety of applications. Products are generally sold directly to third-party consumer electronic dealers and retailers, original equipment manufacturers, government contractors or 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 guidance and stabilization product sales throughout the world. Sales originating from the Company's Denmark subsidiary principally consist of sales into all European countries, both inside and outside the European Union, as well as Africa, the Middle East and India. Sales originating from the Company's Singapore subsidiary principally consist of sales to Asian countries. Sales originating from the Company's South American Subsidiary principally consist of sales to Latin and South American countries.

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

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

Three months ended June 30, 2010	Sales Originating From				Total
	North America	Europe	Asia	South America	
Mobile communication sales to the United States	\$ 12,595	\$	\$	\$	\$ 12,595

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

Mobile communication sales to Canada	134		134
Mobile communication sales to Europe	213	2,505	2,718
Mobile communication sales to other geographic areas	105	1,106	1,211
Guidance and stabilization sales to the United States	5,108		5,108
Guidance and stabilization sales to Canada	1,200		1,200
Guidance and stabilization sales to Europe	6,047		6,047

Table of Contents**KVH INDUSTRIES, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited, all amounts in thousands except share and per share amounts)**

	Sales Originating From				Total
	North America	Europe	Asia	South America	
Guidance and stabilization sales to other geographic areas	484				484
Intercompany sales	2,044	58			2,102
Subtotal	27,930	3,669			31,599
Eliminations	(2,044)	(58)			(2,102)
Net sales	\$ 25,886	\$ 3,611	\$	\$	\$ 29,497
Segment net income	\$ 5,234	\$ 90	\$	\$	\$ 5,324
Depreciation	\$ 912	\$ 8	\$	\$	\$ 920
Total assets	\$ 103,878	\$ 7,017	\$	\$	\$ 110,895

Three months ended June 30, 2009	Sales Originating From			Total
	North America	Europe	Asia	
Mobile communication sales to the United States	\$ 8,430	\$		\$ 8,430
Mobile communication sales to Canada	45			45
Mobile communication sales to Europe	357	2,669		3,026
Mobile communication sales to other geographic areas	106	923		1,029
Guidance and stabilization sales to the United States	4,597			4,597
Guidance and stabilization sales to Canada	1,064			1,064
Guidance and stabilization sales to Europe	3,214			3,214
Guidance and stabilization sales to other geographic areas	451			451
Intercompany sales	1,770			1,770
Subtotal	20,034	3,592		23,626
Eliminations	(1,770)			(1,770)
Net sales	\$ 18,264	\$ 3,592		\$ 21,856
Segment net (loss) income	\$ (157)	\$ 348		\$ 191
Depreciation	\$ 617	\$ 8		\$ 625
Total assets	\$ 88,225	\$ 5,270		\$ 93,495

Six months ended June 30, 2010	Sales Originating From				Total
	North America	Europe	Asia	South America	
Mobile communication sales to the United States	\$ 24,078	\$	\$	\$	\$ 24,078
Mobile communication sales to Canada	370				370
Mobile communication sales to Europe	348	5,350			5,698
Mobile communication sales to other geographic areas	349	2,224			2,573
Guidance and stabilization sales to the United States	9,922				9,922
Guidance and stabilization sales to Canada	2,124				2,124
Guidance and stabilization sales to Europe	11,321				11,321
Guidance and stabilization sales to other geographic areas	1,393				1,393

Edgar Filing: KVH INDUSTRIES INC \DE\ - Form 10-Q

Intercompany sales	4,296	122		4,418
Subtotal	54,201	7,696		61,897
Eliminations	(4,296)	(122)		(4,418)
Net sales	\$ 49,905	\$ 7,574	\$	\$ 57,479
Segment net income	\$ 7,108			