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: September 30, 2004

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
November 1, 2004	Common Stock, par value $0.01 per share	14,461,771

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

KVH INDUSTRIES, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)

	September 30, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,639,695	$ 2,848,755
Marketable securities	35,293,180	—
Accounts receivable, net of allowance for doubtful accounts of $332,613 in 2004 and $120,000 in 2003	7,835,392	11,353,175
Costs and estimated earnings in excess of billings on uncompleted contracts	545,124	415,415
Inventories	8,479,078	6,298,151
Prepaid expenses and other deposits	701,524	1,229,064
Deferred income taxes	576,409	650,157
Total current assets	65,070,402	22,794,717
Property and equipment, net	8,406,696	8,722,854
Other assets, less accumulated amortization of approximately $859,000 in 2004 and $764,000 in 2003	220,683	315,201
Deferred income taxes	2,238,430	2,238,430
Total assets	$ 75,936,211	$ 34,071,202
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,655,658	$ 3,590,494
Accrued compensation and employee-related expenses	1,514,290	1,646,776
Accrued professional fees and license and settlement costs	611,609	644,121
Accrued loss on TracVision A5 non-cancelable purchase commitments	1,400,339	—
Accrued product warranty costs	441,122	139,689
Accrued other	409,412	75,692
Current portion of long-term debt	110,684	109,954
Customer deposits	27,422	27,422
Total current liabilities	6,170,536	6,234,148
Long-term debt, excluding current portion	2,424,162	2,503,881
Total liabilities	8,594,698	8,738,029
Stockholders' equity:		
Preferred stock, $0.01 par value. Authorized 1,000,000 shares; none issued.	—	—
Common stock, $0.01 par value. Authorized 20,000,000 shares; issued and outstanding 14,461,471 as of September 30, 2004 and 11,590,103 as of December 31, 2003	144,615	115,901
Additional paid-in capital	84,897,842	36,505,751
Accumulated deficit	(17,705,196)	(11,288,479)
Other comprehensive income	4,252	—
Total stockholders' equity	67,341,513	25,333,173
Total liabilities and stockholders' equity	$ 75,936,211	$ 34,071,202

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
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2004	**2003**	**2004**	**2003**
Net sales	$13,762,403	$13,514,792	$46,291,404	$41,017,886
TracVision A5 revaluation charge	—	—	2,413,420	—
All other cost of sales	9,071,918	7,712,109	30,043,312	22,680,578
Total costs of sales	9,071,918	7,712,109	32,456,732	22,680,578
Gross profit	4,690,485	5,802,683	13,834,672	18,337,308
Operating expenses:				
Research & development	1,356,146	2,140,144	4,975,365	6,565,708
Sales & marketing	3,957,268	2,917,349	11,619,625	8,150,129
Administration	1,222,127	1,387,699	3,849,463	3,467,317
Income (loss) from operations	(1,845,056)	(642,509)	(6,609,781)	154,154
Other:				
Other income (expense)	10,382	(21,892)	(11,599)	(68,361)
Interest income (expense), net	174,322	(37,053)	278,411	(115,288)
Loss before income taxes	(1,660,352)	(701,454)	(6,342,969)	(29,495)
Income tax expense (benefit)	(63,505)	(235,293)	73,748	(184,287)
Net income (loss)	$ (1,596,847)	$ (466,161)	$ (6,416,717)	$ 154,792
Per share information:				
Earnings (loss) per share				
Basic and diluted	$ (0.11)	$ (0.04)	$ (0.46)	$ 0.01
Number of shares used in per share calculation:				
Basic	14,453,662	11,487,900	13,983,349	11,352,489
Diluted	14,453,662	11,487,900	13,983,349	11,845,942

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
(Unaudited)

	Nine months ended September 30,	
	2004	2003
Operating activities:		
Net income (loss)	$ (6,416,717)	$ 154,792
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,521,079	1,195,445
Deferred income taxes	73,748	64,006
Provision for doubtful accounts	334,034	34,334
Loss on disposal of equipment	104,603	—
TracVision A5 revaluation and related charges	2,465,545	—
Changes in operating assets and liabilities:		
Accounts and contracts receivable	3,183,749	158,479
Costs and estimated earnings in excess of billings on uncompleted contracts	(129,709)	(61,913)
Inventories	(3,016,502)	(2,457,897)
Prepaid expenses and other deposits	147,058	1,921
Accounts payable	(1,934,836)	2,165,096
Accrued expenses	240,524	586,425
Customer deposits	—	(60,435)
Net cash provided by (used in) operating activities	(3,427,424)	1,780,253
Investing activities:		
Purchase of marketable securities	(35,288,928)	—
Capital expenditures	(1,220,103)	(2,455,450)
Proceeds from sale of equipment	5,097	—
Net cash used in investing activities	(36,503,934)	(2,455,450)
Financing activities:		
Repayments of long-term debt	(78,989)	(69,335)
Proceeds from sale of common stock, net	48,369,719	—
Employee stock option and stock purchase transactions	431,568	1,078,273
Net cash provided by financing activities	48,722,298	1,008,938
Net increase in cash and cash equivalents	8,790,940	333,741
Cash and cash equivalents at beginning of period	2,848,755	7,239,255
Cash and cash equivalents at end of period	$ 11,639,695	$ 7,572,996
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 136,986	$ 163,316

See accompanying Notes to Condensed Consolidated Financial Statements.

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ITEM 1. Financial Statements (continued)

KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited, all tabular amounts in thousands except 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 independent public accountants, 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 15, 2004 with the Securities and Exchange Commission. Copies of the Company's Form 10-K are available upon request. The results for the three and nine months ended September 30, 2004 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 September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net income (loss) as reported	**$(1,597)**	**$ (466)**	**$(6,417)**	**$ 155**
Compensation expense under SFAS 123, net of tax at expected tax rate for the period	(544)	(542)	(1,366)	(984)
Pro forma net loss	**$(2,141)**	**$(1,008)**	**$(7,783)**	**$ (829)**
Income (loss) per share – basic and diluted				
As reported	$ (0.11)	$ (0.04)	$ (0.46)	$ 0.01
Pro forma	$ (0.15)	$ (0.09)	$ (0.56)	$(0.07)

(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.

For the three and nine months ended September 30, 2004, common stock equivalents equaled approximately 89,000 and 258,000, respectively, and have been 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 September 30, 2004 and 2003 equaled 1,224,382 and 1,132,071, respectively.

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KVH INDUSTRIES, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited, all tabular 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 September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net income (loss)	$ (1,597)	$ (466)	$ (6,417)	$ 155
Weighted average common shares outstanding – basic	14,454	11,488	13,983	11,352
Incremental common shares issuable: stock options	—	—	—	494
Weighted average common shares outstanding assuming dilution	14,454	11,488	13,983	11,846
Income (loss) per share – diluted	$ (0.11)	$ (0.04)	$ (0.46)	$ 0.01

(4) Cash, Cash Equivalents and Marketable Securities

In accordance with the Company's investment policy, cash in excess of operational needs is invested in investment-grade corporate and U.S. government debt as well as certain asset backed securities. The Company considers all highly liquid investments with an original maturity of ninety days or less, as of the date of purchase, to be cash equivalents. The Company 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.

(5) Inventories

Inventories are stated at the lower of cost or market using the first-in first-out costing method. Inventories as of September 30, 2004, and December 31, 2003, include the costs of material, labor, and factory overhead. Inventories consist of the following:

	September 30, 2004	December 31, 2003
Raw materials	$ 5,325	$ 4,571
Work in process	266	49
Finished goods	2,888	1,678
	$ 8,479	$ 6,298

(6) 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. Total charges for the nine-month period ended September 30, 2004 were as follows:

Loss on non-cancelable future inventory purchase commitments	$1,480
Revaluation of current inventory to net realizable value	836
Loss on disposal of TracVision A5 tooling and equipment (1)	97
TracVision A5 revaluation charge recognized in cost of sales	$2,413
Other TracVision A5 pricing initiative charges not included in cost of sales	150
Total TracVision A5 revaluation and other charges	$2,563

(1) For presentation purposes, loss on disposal of TracVision A5 tooling and equipment was included within the Statement of Cash Flow caption - Loss on disposal of equipment.

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

(6) Inventory revaluation and other special charges (continued)

Three and Nine Months Ended September 30, 2004

Category	Balance as of June 30, 2004	Additions / Adjustment to the Provision	Current Utilization	Balance as of September 30, 2004
Non-cancelable future inventory purchase commitments	$ 1,480	$ (43)	$ (72)	$ 1,365
Other TracVision A5 pricing initiative	150	43	(158)	35
Accrued loss on TracVision A5 non-cancelable purchase commitments	$ 1,630	$ —	$ (230)	$ 1,400

(7) Common Stock Issuance

On February 13, 2004, KVH completed an underwritten public offering of 2,750,000 shares of its common stock at $18.75 per share. Net proceeds to KVH, after deducting all associated financing expenses, were approximately $48.0 million and are expected to be used for working capital and general corporate purposes. Financing expenses totaled approximately $3.6 million and included $2.8 million in underwriters' fees. As of December 31, 2003, approximately $380,000 in deferred financing fees was included within prepaid expenses and other deposits.

(8) Comprehensive Income (Loss)

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

For the three and nine months ended September 30, 2004 and 2003, the Company's comprehensive income (loss) is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net income (loss)	$ (1,597)	$ (466)	$ (6,417)	$ 155
Unrealized gain on available-for-sale securities	50	—	4	—
Total comprehensive income (loss)	$ (1,547)	$ (466)	$ (6,413)	$ 155

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

(9) Segment Reporting

Under common operational management, KVH designs, develops, manufactures and markets its mobile satellite communication products and defense-related navigation, guidance and stabilization products for use in a wide variety of applications. Products are generally sold directly to third-party consumer electronic dealers and retailers, or in the case of defense-related products, either to government contractors or directly to U.S. and other foreign government agencies. Primarily, sales originating in North America consist of sales within the United States and Canada and, to a lesser extent, Mexico, Asia/Pacific and some Latin and South American countries. North American sales also include all defense-related product sales throughout the world. Sales originating from KVH's Denmark office principally consist of sales into Western European countries, including the United Kingdom, France, Italy, and Spain, as well as a growing number of sales into Russia and certain Middle Eastern countries.

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

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

(9) Segment Reporting (continued)

The following table provides, for the periods indicated, sales originating from the following geographic segments:

	North American	European	Total
Three months ended September 30, 2004			
Sales to: United States and Canada	$11,417	$ —	$11,417
Europe	740	1,196	1,936
Other geographic areas	276	133	409
Intercompany sales	811	24	835
Subtotal	13,244	1,353	14,597
Eliminations	(811)	(24)	(835)
Net sales	$12,433	$ 1,329	$13,762
Segment net loss	$ (1,452)	$ (145)	$ (1,597)
Depreciation and amortization	$ 509	$ 11	$ 520
Total assets	$73,738	$ 2,198	$75,936
Three months ended September 30, 2003			
Sales to: United States and Canada	$11,691	$ —	$11,691
Europe	606	991	1,597
Other geographic areas	203	24	227
Intercompany sales	465	2	467
Subtotal	12,965	1,017	13,982
Eliminations	(465)	(2)	(467)
Net sales	$12,500	$ 1,015	$13,515
Segment net loss	$ (386)	$ (80)	$ (466)
Depreciation and amortization	$ 423	$ 7	$ 430
Total assets	$34,510	$ 1,890	$36,400
Nine months ended September 30, 2004			
Sales to: United States and Canada	$37,003	$ —	$37,003
Europe	1,634	6,230	7,864
Other geographic areas	1,055	369	1,424
Intercompany sales	4,342	78	4,420
Subtotal	44,034	6,677	50,711
Eliminations	(4,342)	(78)	(4,420)
Net sales	$39,692	$ 6,599	$46,291
Segment net income (loss)	$ (6,589)	$ 172	$ (6,417)
Depreciation and amortization	$ 1,490	$ 31	$ 1,521
Nine months ended September 30, 2003			
Sales to: United States and Canada	$33,323	$ —	$33,323
Europe	2,969	4,094	7,063
Other geographic areas	453	179	632
Intercompany sales	2,913	2	2,915
Subtotal	39,658	4,275	43,933
Eliminations	(2,913)	(2)	(2,915)
Net sales	$36,745	$ 4,273	$41,018
Segment net income	$ 119	$ 36	$ 155
Depreciation and amortization	$ 1,177	$ 18	$ 1,195

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

(10) Business and Credit Concentrations

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

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net sales to foreign customers outside the U.S. and Canada	17.0%	13.5%	20.1%	18.8%
Net sales to mobile satellite communications customer A	15.8%	11.5%	10.9%	8.2%
Net sales to mobile satellite communications customer B	6.3%	13.1%	10.8%	10.6%

(11) Legal Matters

In September, 2004, the Company was served with a complaint filed in Federal District Court of Rhode Island on April 25, 2003, by a former employee of the Company on his own behalf and on behalf of the United States of America, alleging: (i) wrongful termination of employment; and (ii) violations of the False Claims Act in connection with the sale of products to the U.S. Government or its contractors. This matter was dismissed on September 27, 2004, with prejudice as to the employee and without prejudice with respect to the U.S. Government. Except for legal defense fees, no expense was recorded in connection with this dismissal.

KVH is a defendant in a putative 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 thereunder on behalf of purchasers of KVH securities in the period 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 August 16, 2004, Hamid Mehrvar filed a putative shareholders' derivative action in the Rhode Island State Superior Court for Newport County against KVH and certain officers and directors of KVH. The suit asserts state law claims on behalf of KVH between January 2004 and the present arising from the allegations set forth in the class action complaints in the U.S. District Court described above.

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.

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

Introduction

The statements included in this quarterly report on Form 10-Q made by our management, 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 automotive, recreational vehicle and marine markets, as well as 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 Humvees and light armored vehicles. We also offer precision fiber optic gyro-based systems that help stabilize military platforms such as gun turrets and radar units and also provide guidance for munitions. We sell our defense products directly to U.S. and allied governments and government contractors, as well as through an international network of authorized independent sales representatives.

We generate revenue primarily from the sale of our mobile satellite communications and defense products. We also generate a portion of our revenues from the sale of our legacy recreational navigation systems. Our legacy navigation product line primarily includes digital compass-based navigation products for the marine market.

The following table provides, for the periods indicated, our net sales by product line category.

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
	(in thousands)		(in thousands)	
Mobile satellite communications	$10,281	$ 9,146	$36,531	$26,099
Defense	3,045	3,819	8,474	12,943
Legacy	436	550	1,286	1,976
Net sales	$13,762	$13,515	$46,291	$41,018

In addition to revenue from product sales, our mobile satellite communications revenue includes fees earned from product repairs, fees from the resale of satellite phone and Internet usage services, and certain DIRECTV account activation services provided in conjunction with the sale of our products. We provide, for a fee, third-party satellite phone and Internet airtime to our Tracphone and TracNet customers who choose to activate their services 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 includes engineering services provided under extended-term development contracts. To date, aggregate revenues earned from product repairs, resale of satellite phone and Internet usage services, DIRECTV activations and earnings under extended-term development contracts in any period presented have been less than 10% of our revenues.

Our defense business is generally characterized by a small number of customers who place a small number of discrete and relatively large dollar value orders. Based upon sales through the nine months of 2004, our top four defense customers, including the U.S. military as a single customer, accounted for 57.9% and 52.3% of our net sales attributable to defense products and 12.8% and 9.6%, of our total net sales, in the three and nine months ended September 30, 2004, respectively. In the three and nine-month periods ended September 30, 2003, the same four defense customers, including the U.S. military as a single customer, accounted for 65.3% and 52.4%, respectively, of our net sales attributable to defense products and 18.4% and 16.5%, respectively, of our total net sales. The top customer list can change significantly from quarter to quarter. Orders for our defense products generally range in size from several hundred thousand dollars to more than one million dollars. Accordingly, our quarterly net sales of defense products usually consist of relatively few orders. Each order can have a significant impact on our net sales, and because our defense products generally have higher margins than our mobile satellite communications products, each order can have an impact on our net income that is disproportionately large relative to the revenue generated by the order. Moreover, customers of our defense products are governments and government contractors who generally must adhere to lengthy procurement processes, which make the timing of individual orders difficult to predict and often result in long sales cycles. Government customers and their contractors can generally cancel orders for our products for convenience.

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

In addition to our internally funded research and development efforts, we also conduct research and development activities that are funded by our customers. These activities relate primarily to the customization of our defense products to meet customer requirements. In accordance with accounting principles generally accepted in the United States of America, we account for customer-funded research as revenue, and we account for the associated research costs as cost of goods sold. As a result, some of our expenditures for research and development activities are not included in the research and development expense that we calculate and present in our statement of operations. The following table presents our total research efforts, representing the sum of research, cost of goods sold and the operating expense of research and development as described in our statement of operations. Our management believes this information is useful because it provides a better understanding of our total expenditures on research and development activities.

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
	(in thousands)		(in thousands)	
Research and development expense presented on statement of operations	$ 1,356	$ 2,140	$ 4,975	$ 6,566
Cost of customer-funded research and development included in cost of goods sold	371	276	774	833
Total expenditures on research and development activities	$ 1,727	$ 2,416	$ 5,749	$ 7,399

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. 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 disclosures 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, 2003. The accounting policies that we believe are the most beneficial in understanding and evaluating our reported financial results include the following:

Revenue Recognition

Revenue from Product Sales

Revenue from product sales is recognized when persuasive evidence of an arrangement exists, goods are shipped, title and risk of loss have passed and collectibility is reasonably assured. We establish reserves for potential sales returns and allowances, and evaluate, on a monthly basis, the adequacy of those reserves based upon historical experience and our expectations for future returns.

Contracted Service Revenue

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

Product Service Revenue

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

Satellite Service Activation and Usage Revenue

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

Accounts Receivable

Our estimate for allowance for doubtful accounts related to trade receivables is primarily based on specific, historical criteria. We evaluate specific accounts where we have information that the customer may have an inability to meet its financial obligations. We make judgments, based on facts and circumstances, regarding the need to record a specific reserve for that customer against amounts owed to reduce the receivable to the amount that we expect to collect. We also provide for a general reserve based on an aging analysis of our accounts receivable. We evaluate these reserves on a monthly basis and adjust them as we receive additional information that impacts the amount reserved. If circumstances change, we could change our estimates of the recoverability of amounts owed to us by a material amount.

Inventories

Inventory is valued at the lower of cost or market. We regularly review current inventory quantities on hand, actual and projected sales volumes, as well as current and anticipated selling prices of our products. Where there is evidence that the utility of goods, in their distribution in the ordinary course of business, will be less than the recorded cost, whether due to competitive pricing pressures, implemented or anticipated strategic price reduction initiatives, physical deterioration, obsolescence, or other causes, the difference is recognized as a loss in the current period. This is generally accomplished by stating such goods at a lower level commonly designated as market. Carrying values of any products or inventory components identified as having costs in excess of market are reduced by such amounts to ensure net capitalized costs do not exceed the net realizable value.

Accrued net losses on non-cancelable purchase commitments for inventory, derived from, and measured in the same way, as inventory losses are also recognized in the current period.

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 bases and operating loss carry forwards. On a quarterly basis, we assess the recoverability of our deferred tax assets by considering whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on the history of annual operating losses in our ongoing business, we determined that it was more likely than not that a portion of the deferred tax assets was not recoverable and therefore a valuation allowance was established. We determined that the remaining deferred tax assets were recoverable based on certain tax planning strategies. The amount of the deferred tax assets considered realizable could be reduced in the future if there are changes in the feasibility of those tax-planning strategies. Conversely, some, 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 September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net sales	100.0%	100.0%	100.0%	100.0%
TracVison A5 revaluation charge	—	—	5.2	—
Other cost of goods sold	65.9	57.1	64.9	55.3
Total cost of goods sold	65.9	57.1	70.1	55.3
Gross profit	34.1	42.9	29.9	44.7
Operating expenses:				
Research and development	9.9	15.8	10.7	16.0
Sales and marketing	28.8	21.6	25.2	19.9
General and administrative	8.8	10.3	8.3	8.5
Total operating expenses	47.5	47.7	44.2	44.4
Operating income (loss)	(13.4)	(4.8)	(14.3)	0.3
Other income (expense), net	1.3	(0.3)	0.6	(0.4)
Loss before income tax expense	(12.1)	(5.1)	(13.7)	(0.1)
Income tax benefit (expense)	0.5	1.7	(0.2)	0.5
Net income (loss)	(11.6)%	(3.4)%	(13.9)%	0.4%

Three Months Ended September 30, 2004 and 2003

Operating Summary

Net loss for the three months ended September 30, 2004, was $1.6 million, or ($0.11) per basic and diluted common share, representing a significant decline from the net loss of $466,000, or ($0.04) per basic and diluted common share, in the three months ended September 30, 2003. The 2004 results primarily reflected a 2.0% increase in sales over 2003, offset by an 8.8 percentage point of revenue decline in gross margin.

The decline in gross profit from 42.9% in the third quarter of 2003 to 34.1% in the third quarter of 2004 was primarily due to lower margin on sales of the TracVision A5 product compounded by a lower percentage of sales of our higher margin military products. (See further discussion of the inventory revaluation charge in Note 6 to the Notes of Condensed Consolidated Financial Statements).

Operating expenses as a percentage of revenue were unchanged as decreases in both research and development and general and administrative expenses were offset by increases in sales and marketing expenditures associated with the growth in our satellite communications product sales and TracVision A5 satellite TV antenna marketing expenses.

As a result of our public offering of 2,750,000 shares of common stock in February 2004, we increased the weighted average shares outstanding used in calculating net income per share for the three months and nine months ended September 30, 2004 by 2,750,000 shares and 2,318,431 shares, respectively.

Net Sales

Net sales increased by $248,000, or 1.8%, to $13.8 million in the three months ended September 30, 2004, from $13.5 million in the same period in 2003. Sales of mobile satellite communications products showed significant growth, increasing 12.4% to $10.3 million in the three months ended September 30, 2004, from $9.1 million in the same period in 2003. This increase was primarily attributable to unit volume increases in our marine and land mobile satellite communications products and services, including our recently introduced TracVision A5 automotive antenna system and TracVision G8 marine antenna system. Growth in both our marine and land mobile satellite communications products primarily reflects the expanding mobile satellite and communication markets both in North America and Europe, our introduction of new products, and our continued focus on developing and expanding our sales to major distributors, large account retailers and original equipment manufacturers.

Defense sales decreased by $774,000, or 20.3%, to $3.0 million in the three months ended September 30, 2004, from $3.8 million in the same period in 2003. The decline in defense sales was attributable to the decrease in sales of our tactical navigation systems. During the third quarter of 2003, our tactical navigation product sales reflected the impact of the U.S. military's continuing deployment for the conflict in Iraq. Fiber optic component sales increased modestly from the third quarter of 2003 to the third quarter of 2004, in part as a result of increased sales of our new products, including our DSP-3000 fiber optic gyro.

Legacy marine and OEM sensor shipments declined by $114,000, or 20.7% from the third quarter of 2003 to the third quarter of 2004. The decline primarily reflects the impact of continued delays experienced with one of our component suppliers.

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. Cost of goods sold increased by $1.4 million, or 17.6%, to $9.1 million in the three months ended September 30, 2004 from $7.7 million in the same period in 2003. The increase was primarily the result of the following:

- continued shift in product mix from higher-margin defense-related products to the comparably lower margin mobile satellite communication products;
- higher per unit costs of the TracVision A5 automotive antenna systems relative to our other product lines;
- TracVision A5 and other new product warranty costs; and
- higher manufacturing costs, primarily resulting from additions to support systems and infrastructure, including leased manufacturing space.

Customer-funded research and development costs included in cost of goods sold were approximately $371,000 and $276,000, respectively, in the three months ended September 30, 2004 and 2003.

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 decreased by $784,000, or 36.6%, to $1.4 million in the third quarter of 2004 from $2.1 million in the same period in 2003. As a percentage of net sales, research and development expense decreased to 9.9% in the third quarter of 2004 from 15.8% in the same period in 2003. The decrease reflects a reduction of engineering investment since the introduction of several major new products, including the TracVision A5 and the TracVision G8, as well as the DSP-3000 and TG-6000 fiber optic gyros.

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 increased by $1.0 million, or 35.6%, to $4.0 million in the third quarter of 2004 from $2.9 million in the same period in 2003. As a percentage of net sales, sales and marketing expense increased to 28.8% in 2004 from 21.6% in the same period in 2003. The dollar increase was primarily a result of continued additional marketing and distribution costs to further support the growth in our satellite communications sales and the continued promotional and marketing activities that support additional market awareness of the TracVision A5 and other land mobile satellite communication products. Expanded large account and trade show promotions within the marine and land-mobile markets and higher communication-product sales commissions that scale with sales volume, also contributed to this increase. To a lesser extent, increased reserves for potential European doubtful accounts also contributed to the overall increased sales expense for the quarter.

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 decreased by $166,000, or 11.9%, to $1.2 million in 2004 from $1.4 million in the same period in 2003 primarily as a result of a single license and patent settlement charge recorded in the third quarter of 2003. Partially offsetting the decrease in expenses were increases in accounting compliance costs and legal expenses. As a percentage of net sales, general and administrative expense decreased to 8.8% in 2004 from 10.3% in the same period in 2003.

Income Taxes

In the third quarters of 2004 and 2003, we recorded income tax benefit of approximately $64,000 and $235,000, respectively. During the third quarter of 2003, $235,000 of income tax benefit was recorded upon receiving a favorable outcome of an IRS audit of our income tax returns for the fiscal years 1996 through 1998. During the third quarter of 2004, a benefit was recorded primarily in relation to the decrease in year-to-date profitability of our foreign subsidiary. We recognized no U.S. net income tax benefit because the recognizable deferred tax benefit was entirely offset by an equal amount of deferred tax valuation allowance.

Nine Months Ended September 30, 2004 and 2003

Operating Summary

Net loss for the nine months ended September 30, 2004, was $6.4 million, or ($0.46) per basic and diluted common share, and was significantly below the net income of $155,000, or $0.01 per basic and diluted common share, in the nine months ended September 30, 2003. The year-to-date results reflected a 12.9% increase in sales over 2003, offset primarily by:

- a $2.4 million, or 5.2 percentage point of revenue, second-quarter TracVision A5 lower of cost or market inventory and non-cancelable future purchase commitment revaluation adjustment; and
- a 9.6 percentage point of revenue decline in gross margin, excluding the TracVision A5 revaluation adjustment, primarily associated with a lower concentration of sales in the higher-margin defense products.

Year-to-date total operating expenses increased by $2.3 million or 12.4%, from $18.2 million in 2003 to $20.4 million in 2004 due mostly to increased new product sales and marketing expenses and, to a lesser extent, general and administrative professional fees. However, as a percentage of sales, the total operating expenses remained stable from 2003 to 2004, changing from 44.4% of revenue to 44.2%.

Net Sales

Nine-month period net sales increased by $5.3 million, or 12.9%, to $46.3 million in 2004 from $41.0 million in 2003. Sales of our mobile satellite communications products, including our TracVision A5, continued to show significant growth, increasing 40.0% to $36.5 million in the nine months ended September 30, 2004, from $26.1 million in the same period in 2003. This increase was primarily attributable to unit volume increases in our marine and land mobile satellite communications products and services, including our TracVision A5 automotive antenna system and TracVision G8 marine antenna system, both introduced in late 2003. Sales results also reflect our realized expansion within the mobile satellite and communication markets, particularly in North America and Europe, our introduction of new products, and our sales to major distributors, large account retailers and original equipment manufacturers.

Defense sales decreased by $4.5 million, or 34.5%, to $8.5 million in the nine months ended September 30, 2004, from $12.9 million in the same period in 2003. A decline in sales of our tactical navigation systems represented the entire decline in defense sales.

Year-to-date legacy marine and OEM sensor shipments declined by 34.9% from $2.0 million in 2003 to $1.3 million in 2004. This decline is a continuation of a long-term trend plus the continued impact of a temporary component supply issue.

Cost of Goods Sold

Total cost of goods sold for the nine months ended September 30, 2004, increased by $9.8 million, or 43.1%, to $32.5 million from $22.7 million in the same period in 2003. Increases in the costs of goods sold for the nine months ended September 30, 2004, from the same period in 2003 primarily resulted from:

- a $2.4 million TracVision A5 lower of cost or market inventory and non-cancelable future purchase commitment revaluation adjustment;
- continued shift in product mix from higher-margin defense-related products to comparably lower margin mobile satellite communication products;
- higher per unit cost of TracVision A5 automotive antenna systems relative to our other product lines;
- TracVision A5 and other new product warranty costs; and

- higher manufacturing costs, primarily resulting from additions to support systems and infrastructure, including leased manufacturing space.

Customer-funded research and development costs included in cost of goods sold were approximately $774,000 and $833,000 in the nine months ended September 30, 2004 and 2003, respectively.

Operating Expenses

Total research and development expense decreased by $1.6 million, or 24.2%, to $5.0 million in the first nine months of 2004 from $6.6 million in the same period in 2003. As a percentage of net sales, year-to-date research and development expense decreased to 10.7% in 2004 from 16.0% in the same period in 2003. The decrease reflects a reduction of engineering investment following the introduction of several major new products, including the TracVision A5 and the TracVision G8, as well as the DSP-3000 and TG-6000 fiber optic gyros.

Sales and marketing expense increased by $3.5 million, or 42.6%, to $11.6 million in 2004 from $8.2 million in the same period in 2003. As a percentage of net sales, sales and marketing expense increased to 25.2% in 2004 from 19.9% in the same period in 2003. Similar to the result for the quarters ended September 30, 2004 and 2003, the increase was primarily a result of additional satellite communications sales, marketing, distribution and technical support costs, the continued promotional and marketing activities supporting improved market awareness of the TracVision A5 and other land mobile satellite communication products, expanded large account and trade show promotions, and increased communication-product sales commissions that scale with sales volume.

General and administrative expense increased by $382,000, or 11.0%, to $3.8 million in 2004 from $3.5 million in the same period in 2003. As a percentage of net sales, general and administrative expense decreased to 8.3% in 2004 from 8.5% in the same period in 2003. Legal and accounting compliance expenses accounted for the majority of our general and administrative cost increases. Additional salary and salary-related costs also contributed to this increase.

Income Taxes

In the nine months ended September 30, 2004, we recorded a foreign income tax provision of approximately $74,000 as a result of profitability in our foreign subsidiary. In the nine months ended 2003, we recorded approximately $235,000 in tax benefit upon receiving a favorable outcome from an IRS audit of our income tax returns for the fiscal years 1996 through 1998. The $235,000 recovery in 2003 was partially offset by $51,000 in foreign subsidiary taxes associated with local profitability.

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 2,750,000 shares of our common stock at $18.75 per share. We received net proceeds of approximately $48.0 million after deducting all associated offering expenses incurred in both 2003 and 2004. As of September 30, 2004, we had $46.9 million in cash, cash equivalents and marketable securities and $58.9 million in working capital.

For the nine months ended September 30, 2004, we used $3.4 million in cash to fund our operations. Cash flow from operations, as reconciled from our net loss of $6.4 million for the nine months ended September 30, 2004 included $1.5 million for depreciation and amortization as well as a non-cash $2.5 million adjustment for the effect of the TracVision A5 lower of cost or market revaluation charge. Net cash used in operating activities during the first nine months of 2004 also included the following:

- a $3.2 million reduction in accounts and contracts receivable;
- $3.0 million of investment in inventory resulting from the expansion of our product offerings as well as build-up of stocking levels in anticipation of future sales growth, particularly for the TracVision A5 mobile satellite antenna;
- a $1.9 million decrease in accounts payable balances primarily associated with the timing of payments; and
- a $334,000 provision for doubtful accounts.

The increase in the provision for doubtful accounts represents additional reserves established to address collection delays associated with a longtime European distributor. The reserve does not cover the total outstanding balance, but rather reflects our current assessment of the collection risk in accordance with our credit policies and procedures.

Net cash used in investing activities was $36.5 million for the nine months ended September 30, 2004, and primarily represents the investment of cash in excess of operational needs into marketable securities. We also used $1.2 million to purchase manufacturing and other capital equipment primarily to support our sales growth and development activities.

Net cash provided by financing activities was $48.7 million for the nine months ended September 30, 2004. In addition to our February 2004 $48.4 million net equity offering proceeds, we also received $432,000 from common stock issuances under our employee stock option and stock purchase programs. These proceeds were partially offset by $79,000 in 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 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 up to $10.0 million of the unused portion of the loan facility. The loan facility advances funds using an asset availability formula based upon 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 written notice to the bank. As of September 30, 2004, 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 $46.9 million 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 acceptable terms.

FORWARD LOOKING STATEMENTS – TRENDS, RISKS AND UNCERTAINTIES

This “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contains forward-looking statements that are subject to a number of risks and uncertainties, as described below, among others. These are important factors that could cause actual results to differ materially from those anticipated.

We may not be profitable in the future.

We have a history of unprofitable operations. During the first nine months of 2004 we incurred a net loss of $6.4 million. Moreover, we incurred net annual losses of $1.5 million in both 2003 and 2002 and $6.3 million in 2001. As of September 30, 2004, we had an accumulated deficit of $17.7 million.

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

Our TracVision A5 is the first commercially available, low profile mobile satellite TV antenna practical for use on minivans, SUVs and other passenger vehicles. We began shipping the TracVision A5 in September 2003. Accordingly, the market for this product is new and emerging. Consumers may not respond favorably to live satellite TV in passenger vehicles, and the market may not accept the TracVision A5. The early stage of development of this market makes it difficult for us to predict customer demand accurately. For example, sales of the TracVision A5 during the last three fiscal quarters were below our initial expectations. We believe this was due in part to pricing, required product upgrades, and production delays resulting from component supply issues. Although we have reduced the price of the TracVision A5 and taken other steps to address these issues, similar issues or latent defects in the TracVision A5 could adversely affect sales.

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

- the extent to which customers perceive mobile satellite TV services as a luxury or a preferred convenience;

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

In addition, in order for us to meet our sales objectives for the TracVision A5 for the remainder of 2004, it is important that we achieve certain key sales and marketing milestones. For example, we believe we need to continue to develop and expand our sales and marketing relationship with DIRECTV, establish and develop accounts with key van and SUV conversion manufacturers, develop broad consumer awareness of the product, and expand our distribution network. If we are unable to accomplish these milestones in a timely manner, we may not achieve our sales objectives for the TracVision A5.

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

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

Initial product profit margins for the TracVision A5 have been low. To reach our targeted profit margins, we must continuously 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 ongoing cost reduction programs 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.

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

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

- new military and operational doctrines that affect military equipment needs;

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

These factors can cause substantial fluctuations in sales of TACNAV and our other defense products from period to period and have had an adverse affect on our military sales during recent quarters. Moreover, TACNAV and most of our other defense products must meet military quality standards, and our products may not continue to meet existing or more rigorous standards adopted in the future. Any failure to meet military contract specifications may produce delays as we attempt to improve our design, development, manufacturing or quality control processes. Furthermore, government customers and their contractors can generally cancel orders for our products for convenience. Even under firm orders with government customers, funding must usually be appropriated in the budget process in order for the government to complete the contract. The cancellation of or failure to fund orders for our products could substantially reduce our net sales.

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

We derive a substantial portion of our defense revenues from a small number of customers. Based upon sales through the nine months of 2004, our top four defense customers, including the U.S. military as a single customer, accounted for 57.9% and 52.3% of our net sales attributable to defense products and 12.8% and 9.6%, of our total net sales, in the three months and nine months ended September 30, 2004, respectively. In the three and nine-month periods ended September 30, 2003, the same four defense customers, including the U.S. military as a single customer, accounted for 65.3% and 52.4%, respectively, of our net sales attributable to defense products and 18.4% and 16.5%, respectively, of our total net sales. The loss of any of these customers would 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 margins than our mobile satellite communications products, the loss of an order for defense products could have a disproportionately adverse effect on our net sales and results of operations.

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

Our mobile satellite communications products have historically had lower product margins than our defense products. In the first nine months of 2004, sales of our mobile satellite communications products grew while sales of defense products declined compared to the first nine months of 2003. If this change in the mix profile of satellite communications and defense products were to continue, it could result in lower gross margins in the future.

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

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

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

We obtain many key components for our products from third-party suppliers, and in some cases we use a single or a limited number of suppliers. 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.

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

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

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

Our TracVision products include only the equipment necessary to receive satellite television services; we do not broadcast satellite television programming. Instead, customers must obtain programming from another source. We currently offer marine and land mobile TracVision products compatible with the DIRECTV and DISH Network services in the continental United States, the ExpressVu service in Canada and various other regional services in other parts of the world. Our initial TracVision A5 product is compatible only with the DIRECTV service in the continental United States. If customers become dissatisfied with the programming, pricing, service, availability or other aspects of these satellite television services or if any one or more of these services becomes unavailable for any reason, we could suffer a substantial decline in sales of our TracVision products. The companies that operate these services have no obligation to inform us of technological or other changes that could impair the performance of our TracVision products.

Similarly, our Tracphone and TracNet products currently depend on satellite services provided by third parties. We rely on Inmarsat for satellite communications services for our Tracphone products. We rely on Bell ExpressVu for TracNet service in North America and Telemar for TracNet service in Europe. We also rely on Globalstar, a subsidiary of Thermo Capital Partners LLC, for the satellite return link for TracNet.

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

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

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

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

Our operating performance depends significantly on general economic conditions. Net sales of our satellite communications products are largely generated by discretionary consumer spending, and demand for these products can demonstrate slower growth than we 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. If global and regional economic conditions fail to improve or deteriorate, demand for our products could be adversely affected.

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

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

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

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

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

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

To meet our growth objectives, we must attract and retain highly skilled technical, operational, managerial, and sales and marketing personnel. If we fail to attract and retain the necessary personnel, we may be unable to achieve our business objectives and may lose our competitive position, which could lead to a significant decline in net sales. We face significant competition for these skilled professionals from other companies, research and academic institutions, government entities and other organizations.

Our success depends on the services of our executive officers and key employees.

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

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

The mobile satellite communications markets and defense navigation, guidance and stabilization markets in which we participate are very competitive, and we expect this competition to persist and intensify in the future. We may not be able to compete successfully against current and future competitors, which could impair our ability to sell our products. To remain competitive, we must enhance our existing products and develop new products, and we may have to reduce the prices of our products. Moreover, new competitors may emerge, and entire product lines may be threatened by new technologies or market trends that reduce the value of those product lines.

In the defense navigation, guidance and stabilization markets, we compete primarily with Honeywell International Inc., Kearfott Guidance & Navigation Corporation, Leica Microsystems AG, Northrop Grumman Corporation and Smiths Group PLC. In the market for mobile satellite communications products, we compete with a variety of companies. In the land mobile market for satellite TV communications equipment, we compete directly with King Controls, MotoSAT, TracStar Systems, Inc., RaySat and Winegard Company. In the land mobile market for Internet communications equipment, we compete directly with Hughes Network System's DIRECWAY service and indirectly with cellular telephone service providers, whose services are substantially cheaper than TracNet. In the marine market for satellite TV communications equipment, we compete with Navigator Technology, Orbit Satellite Television & Radio Network and Sea Tel. In the marine market for telephone, fax, data and Internet communications equipment, we compete with Furuno Electric Co., Ltd., Globalstar LP, Iridium Satellite LLC, Japan Radio Company and Nera ASA. Among the factors that may affect our ability to compete in our markets are the following:

- any 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.

Sales to customers outside the United States and Canada accounted for approximately 17.0% and 20.1% of our net sales in the three and nine months ended September 30, 2004 and 13.5% and 18.8% of our net sales in the three and nine months ended September 30, 2003, respectively. We have only one foreign sales office, which is located in Denmark, and we otherwise support our international sales from our operations in the United States. Our limited operations in foreign countries may impair our ability to compete successfully in international markets and to meet the service and support needs of our customers in countries where we have no infrastructure. We are subject to a number of risks associated with our international business activities, which may increase our costs and require significant management attention. These risks include:

- technical challenges we may face in adapting our mobile satellite communication products to function with different satellite services and technology in use in various regions around the world, including multiple satellite services in Europe;
- restrictions on the sale of certain defense products to foreign military and government customers;
- additional costs and delays associated with obtaining approvals and licenses under applicable export regulations;
- increased costs of providing customer support in multiple languages;
- satisfaction of international regulatory requirements and procurement of any necessary licenses or permits;
- more limited protection of our intellectual property;

- potentially adverse tax consequences, including restrictions on the repatriation of earnings;
- protectionist laws and business practices that favor local competitors, which could slow our growth in international markets;
- potentially longer sales cycles, which could slow our revenue growth from international sales;
- potentially longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- losses arising from foreign currency exchange rate fluctuations; and
- 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 our defense products are subject to the International Traffic in Arms Regulations and require a license from the U.S. Department of State prior to shipment.

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

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

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

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

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

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 putative 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 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 putative shareholders' derivative action pending in Rhode Island State Superior Court. This suit asserts state law claims on our behalf between January 2004 and the present arising from the allegations set forth in the class action complaints in the U.S. District Court 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 does divert 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.

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

We have experienced significant fluctuations in our net sales and results of operations from one quarter to the next. Our future net sales and results of operations could vary significantly from quarter to quarter due to a number of factors, many of which are outside our control. Accordingly, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of future performance. It is possible that our net sales or results of operations in a quarter will fall below the expectations of securities analysts or investors. If this occurs, the market price of our common stock could fall significantly. Our results of operations in any quarter can fluctuate for many reasons, including:

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

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.

Under Section 404 of the Sarbanes-Oxley Act, we are required to include a report of management in our next annual report on Form 10-K that contains an assessment of the effectiveness of our internal controls over financial reporting, as well as an attestation by our independent auditors regarding the content of this report. If our independent auditors are unable to provide us with an unqualified report as to the effectiveness of our internal controls over financial reporting, investors could lose confidence in the reliability of our financial statements, which could result in a decline in the price of our common stock.

The market price of our common stock may be volatile.

Our stock price has been volatile. From January 1, 2003, to September 30, 2004, the trading price of our common stock ranged from $6.61 to $34.73. Many factors may cause the market price of our common stock to fluctuate, including:

- variations in our quarterly results of operations;
- the introduction of new products by us or our competitors;
- changing needs of military customers;
- changes in estimates of our performance or recommendations by securities analysts;
- the hiring or departure of key personnel;
- acquisitions or strategic alliances involving us or our competitors;
- changes in, or adoptions of, accounting principles; and
- market conditions in our industries and the economy as a whole.

In addition, the stock market can experience extreme price and volume fluctuations. These fluctuations are often unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of our common stock. When the market price of a company's stock drops significantly, stockholders often institute securities class action litigation against that company. Litigation against us would cause us to incur substantial costs, divert the time and attention of our management and other resources or otherwise harm our business.

Our charter and by-laws and Delaware law may deter takeovers.

Our certificate of incorporation, by-laws and Delaware law contain provisions that could have an anti-takeover effect and discourage, delay or prevent a change in control or an acquisition that many stockholders may find attractive. These provisions may also discourage proxy contests and make it more difficult for our stockholders to take some corporate actions, including the election of directors. These provisions relate to:

- the ability of our board of directors to issue preferred stock, and determine its terms, without a stockholder vote;
- the classification of our board of directors, which effectively prevents stockholders from electing a majority of the directors at any one annual meeting of stockholders;
- the limitation that directors may be removed only for cause by the affirmative vote of the holders of two-thirds of our shares of capital stock entitled to vote;
- the prohibition against stockholder actions by written consent;
- the inability of stockholders to call a special meeting of stockholders; and
- advance notice requirements for stockholder proposals and director nominations.

ITEM 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 operations in Denmark are transacted in the Danish Krone or Euro and reported in the U.S. dollar, the functional currency. For foreign currency exposures existing at September 30, 2004, 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. The calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar.

From time to time, we purchase foreign currency forward exchange contracts having durations of no more than 3 months. These forward exchange contracts 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. Changes in the fair value are recognized in earnings. As of September 30, 2004, the difference between the cumulative change in the fair value of the hedge instruments and the cumulative change in the value of the hedged transactions was not material. Accordingly, the fair value of these forward contracts was not material.

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 $35,000 decrease in the fair value of our investments as of September 30, 2004. However, due to the conservative nature of our investments, the relatively short duration of their maturities, our ability to convert some or all of our long-term investments to less interest rate-sensitive holdings and our general intent to hold most securities until maturity, we believe interest rate risk is mitigated. As of September 30, 2004, approximately 80% of the $35.3 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 September 30, 2004.

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 months ended September 30, 2004, there were no changes in our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In September 2004, we were served with a complaint originally filed in the U.S. District Court for the District of Rhode Island on April 25, 2003 by a former employee of ours on his own behalf and on behalf of the United States of America, alleging: (i) wrongful termination of employment and (ii) violations of the False Claims Act in connection with the sale of products to the U.S. Government or its contractors. This matter was dismissed on September 27, 2004, with prejudice as to the employee and without prejudice with respect to the U.S. Government.

We are a defendant in a putative 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 thereunder on behalf of purchasers of our securities in the period 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 August 16, 2004, Hamid Mehrvar filed a putative shareholders' derivative action in the Rhode Island State Superior Court for Newport County against us and certain of our officers and directors. The suit asserts state law claims on behalf of KVH between January 2004 and the present arising from the allegations set forth in the class action complaints in the U.S. District Court described above.

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

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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

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SIGNATURE

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

Date: November 8, 2004

KVH Industries, Inc.

By: /s/ Patrick J. Spratt

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

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Exhibit Index

Exhibit	Description
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

EXHIBIT – 31.1

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)) for the registrant and have:

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

(b) [omitted]

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

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

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

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

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

Date: November 8, 2004

/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)) for the registrant and have:

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

(b) [omitted]

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

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

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

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

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

Date: November 8, 2004

/s/ Patrick J. Spratt

Patrick J. Spratt
Chief Financial Officer

EXHIBIT – 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. § 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2003

In connection with the Quarterly Report on Form 10-Q of KVH Industries, Inc. (the “Company”) for the quarter ended September 30, 2004, 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.

/s/ Martin A. Kits van Heyningen

President & Chief Executive Officer

Date: November 8, 2004

EXHIBIT – 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. § 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2003

In connection with the Quarterly Report on Form 10-Q of KVH Industries, Inc. (the "Company") for the quarter ended September 30, 2004, 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.

/s/ Patrick J. Spratt

Chief Accounting & Financial Officer

Date: November 8, 2004