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At Best Ideas 2020, I presented the investment case for a portfolio holding in the Needham Funds, KVH Industries, Inc. (KVHI). KVH made strategic progress in 2020, but results suffered in non-strategic areas and the stock's performance was flat. I believe that KVH again represents good value and I herewith provide an update for MOI Global 2021.

The Needham Funds' mission is to create wealth for long-term investors. Through December 18, 2020, the Needham Aggressive Growth Fund returned 51.98% for the institutional class (NEAIX) and 51.05% for the retail class (NEAGX) compared to 18.07% for the Russell 2000 Growth Index.

I believe that the market inefficiently values the prospects of some companies beyond a 1-2-year time frame. A new product or distribution strategy may have a significant impact on a small company and it may require patience for the desired results to show in a company's financials. I call these companies "Hidden Compounds."

There are three parts to my investment process:

- 1) Finding Hidden Compounds.
- 2) Holding the Hidden Compounds through their transition to Quality Compounds.
- 3) Holding Quality Compounds. As Quality Compounds, these companies exhibit quality factors such as above-average return-on-capital and profitability. As these factors are recognized by the market, the companies tend to re-rate at higher multiples. Often, the hardest part of investing is having the patience to hold on. With a trailing 12-month turnover of 12%, the Fund's average holding period is 8 years. We hold until something fundamental has changed with our view of the business.

Investment Criteria

I look to make investments in companies with great management teams, which to me, includes founders, family, or long-tenured managers. I also look for high return-on-capital, or the potential for a high return, and the opportunity for the company to grow 5-10 times larger.

I look for companies available at an attractive valuation that may be in an investment stage, operating near break-even, and below potential operating margin. The company's investments may be in operating expenses or capital equipment to open a new office, expand capacity or bring a new product to market. When I purchase a new investment, I

believe that financial results could come as soon as 6-12 months. However, investment periods may last longer than expected while the companies are making progress.

KVH Industries, Inc. (KVHI)

KVH strives to improve the life of the seafarer and improve vessel operations. KVH's Connectivity-as-a-Service *Agile Plans* connects seafarers to their families and lives on shore. The new KVH Watch IoT offering enables remote monitoring and maintenance for the many critical and complex systems on ships. KVH also supplies assured navigation products for military and commercial customers on land and sea. Military vehicles and autonomous vehicles need to know where they are when GPS is not available or accurate.

KVH has a stock price near \$10 per share, a market capitalization of approximately \$200 million, \$41 million of cash, \$7 million of PPP debt that is likely to be forgiven and annual revenue of \$160 million. KVH went public in 1996.

The Upside Opportunity

I believe KVH could earn \$1.50 to \$2 or more based on \$250 million of revenue, 45-50% gross margins and 15-20% operating margins. There could also be \$3-5 per share of cash. With a 15-20 multiple I can see a \$25 to \$45 stock price. The stock closed on December 18 at \$10.49.

KVH's AgilePlans and Watch Connectivity-as-a-Service could each contribute \$100 to \$200 million or more of revenue. Its photonic-integrated chip, fiber-optic gyroscope (FOG), tactical navigation system (TACNAV), and other products and services could contribute an additional \$50 to \$200 million of revenue.

As KVH addresses a number of large markets, it's possible that KVH could become an even larger company with even higher earnings per share. Of course, there is risk that these new products and services might not be adopted in scale and competitors could develop superior solutions. Revenue, earnings and stock price appreciation may not happen.

The Downside Risk

Using sum of the parts, I believe KVH's downside could be \$11-12 per share.

KVH's inertial navigation business, including fiber-optic gyroscopes and TACNAV tactical navigation units has annual revenue of \$35-40 million and might attract a low-end defense industry multiple of 1.5x revenue, or \$50-60 million. Mobile connectivity service revenue of \$80-85 million could attract a low-end 1.0x multiple or \$80-85 million. KVH has another \$40-50 million of VSAT (very-small aperture antennae), TracVision TV antennae, video services, news service and digital compass revenue which could be worth another \$40-50 million. These elements total \$9-10 per share plus \$2.20 per share of net cash.

It has taken 4-5 years longer than I anticipated for KVH to develop a business model that

combines its communications technology and content.

One of KVH's satellite partners, SKY Perfect JSAT of Japan, invested \$4.5 million at \$11.95 per share, which was a 10% premium to the market price in February 2018. In November 2019, KVH's Board of Directors authorized repurchase of up to 1 million shares of the 18 million outstanding. These suggest that a smart industry participant and the company's board believe KVH represents value at \$11-12 per share.

Additionally, there is an activist investor involved with KVH. Vintage Capital Management holds a 9.3% stake that was disclosed in 2017. Vintage is a "value-oriented, operations focused private equity and public equity investor specializing in the defense, manufacturing... sectors with an over 20-year track record... We seek to invest in companies in which the transaction or the resulting application of our broad expertise can unlock substantial value rapidly."

In 2020, Bob Tavares joined KVH's Board of Directors. Mr. Tavares previously was appointed by Vintage Capital to serve as CEO of API Technologies, where he created significant shareholder value that resulted in a sale to private equity holders. We are enthusiastic about KVH's management team and strategy and believe Mr. Tavares brings a new perspective to the board room. Should KVH fail to execute on its business plan, we believe Vintage might push for sale of the company or structural changes to realize value.

When Might the Value in KVH Be Recognized?

The skeptic might say that in 38 years of business, KVH's management has grown the business, but not created value for shareholders. Why should 2021 be any different?

In 2020, COVID-19 forced shutdowns that hurt several of KVH's product lines. Leisure and land-based TV antenna sales suffered. The NEWSlink service for the cruise industry and high-end hotels was down 50-70%. These are not strategic areas for the company.

2021 could be a year of revenue growth from the AgilePlans subscription service and the new PIC-based inertial navigation products. Longer-term, KVH Watch and fiber-optic gyroscopes for the autonomous vehicle market could address significant market opportunities. These all address markets that might be much larger than KVH's current market. We own the stock in anticipation of KVH addressing these markets and growing to be a much larger company over the years ahead. Investments like KVH take patience.

Portfolio holdings subject to change. Needham Funds' ownership as percentage of net assets in KVHI as of 9/30/20: NEEGX: 4.30%; NEAGX: 5.47%; NESGX: 3.99%.

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Investment returns and principal value will fluctuate, and when redeemed, shares may be worth more or less than their original cost. Past performance does not guarantee future results and current performance may be higher or lower than these results. Performance current to the most recent month-end may be obtained by calling our transfer agent at 1-800-625-7071. Total return figures include reinvestment of all dividends and capital gains.

Short sales present the risk that the price of the security sold short will increase in value between the time of the short sale and the time the Fund must purchase the security to return it to the lender. The Fund may not be able to close a short position at a favorable price or time and the loss of value on a short sale is potentially unlimited.

All three of the Needham Funds have substantial exposure to small and micro capitalized companies. Funds holding smaller capitalized companies are subject to greater price fluctuation than those of larger companies.

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