## Patents and Intellectual Property

We currently rely on a combination of patent, trade secret, copyright and trademark law, together with non-disclosure agreements and technical measures, to establish and protect proprietary rights in our products. We hold a United States patent for a commercial satellite communication system that allows random access to allotted frequency segments on satellites. The patented system allows our customers to utilize lower cost networks, while maintaining sufficient throughput and response times. Through Gilat Florida, we also hold a United States patent for the ISAT frame relay system. In addition, we also hold several patents relating to spread spectrum.

We believe that our patents are important to our business. We also believe, however, that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how as well as the development of new products are generally as important as patent protection in establishing and maintaining a competitive advantage. We believe that the value of our products is dependent upon our proprietary software and hardware remaining "trade secrets" or subject to copyright protection. Generally, we enter into non-disclosure and invention assignment agreements with our employees and subcontractors. However, we cannot assure that our proprietary technology will remain a trade secret, or that others will not develop a similar technology or use such technology in products competitive with those offered by us.

On May 8, 2000, Gilat Satellite Networks Ltd. and Spacenet Inc. were named as defendants in an action filed in the United States District Court for the District of Maryland. Plaintiff Hughes Electronics Corporation alleges the infringement of four patents, and seeks to enjoin further alleged infringement (See "Item 3: Litigation". We intend to vigorously defend against these claims. We do not believe we are infringing the patents.

In addition, from time to time, we may be notified of claims that we may be infringing patents, copyrights, or other intellectual property rights owned by third parties. While we do not believe we are currently infringing any intellectual property rights of third parties, we cannot assure that other companies will not, in the future, pursue claims against us with respect to the alleged infringement of patents, copyrights or other intellectual property rights owned by third parties. In addition, litigation may be necessary to protect our intellectual property rights and trade secrets, to determine the validity of and scope of the propriety rights of others or to defend against third-party claims of invalidity. Any litigation could result in substantial costs and diversion of resources and could have a material adverse effect on Gilat's business, financial condition and operating results.

We cannot assure that additional infringement, invalidity, right to use or ownership claims by third parties or claims for indemnification resulting from infringement claims will not be asserted in the future. If any claims or actions are asserted against us, we may seek to obtain a license under a third party's intellectual property rights. We cannot assure, however, that a license will be available under terms that are acceptable to us, if at all. The failure to obtain a license under a patent or intellectual property right from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacture of the product covered by the patent or intellectual property right. In addition, we may be required to redesign our products to eliminate infringement if a license is not available. Such redesign, if possible, could result in substantial delays in marketing of products and in significant costs. In addition, should we decide to litigate such claims, such litigation could be extremely expensive and time consuming and could materially adversely affect our business, financial condition and operating results, regardless of the outcome of the litigation.

## Government Regulation

Regulatory Overview. The international telecommunications environment is highly regulated. As a provider of communications services in the United States, we are subject to the regulatory authority of

the United States, primarily the Federal Communications Commission (the "FCC"). We are also subject to regulation by the national communications authorities of other countries in which we provide service. Each of these entities can potentially impose operational restrictions on us. The changing policies and regulations of the United States and other countries will continue to affect the international telecommunications industry. We cannot predict the impact that these changes will have on our business or whether the general deregulatory trend in recent years will continue. We believe that continued deregulation would be beneficial to us, but also could reduce the limitations facing many of our existing competitors and potential new competitors.

We are required to obtain approvals from numerous national and local authorities in the ordinary course of our business in connection with most arrangements for the provision of services. The necessary approvals generally have not been difficult for us to obtain in a timely manner. However, the failure to obtain particular approvals has delayed, and in the future may delay our provision of services. Moreover, it is possible that any approvals that may be granted may be subject to materially adverse conditions.

**United States Regulation.** All entities that use radio frequencies to provide communications services in the United States are subject to the jurisdiction of the FCC under the Communications Act of 1934, as amended (the "Communications Act"). The Communications Act prohibits the operation of satellite earth station facilities and VSAT systems such as those operated by us except under licenses issued by the FCC. Major changes in earth station or VSAT operations require modifications to the FCC licenses, which must also be approved by the FCC. The licenses we hold are granted for ten year terms. The FCC generally renews satellite earth station and VSAT licenses routinely, but we cannot assure that our licenses will be renewed at their expiration dates or that such renewals will be for full terms. In addition, certain aspects of our business may be subject to state and local regulation including, for example, local zoning laws affecting the installation of satellite antennas.

**International Regulation.** We must comply with the applicable laws and obtain the approval of the regulatory authority of each country in which we propose to provide network services or operate VSATs. The laws and regulatory requirements regulating access to satellite systems vary from country to country. Some countries have substantially deregulated satellite communications, while other countries maintain strict monopoly regimes. The application procedure can be time-consuming and costly, and the terms of licenses vary for different countries. In addition, in some countries there may be restrictions on our ability to interconnect with the local switched telephone network.

## Employees

As of May 1, 2000, we had approximately 1191 full-time employees, including 199 employees in administration and finance, 150 employees in marketing and sales, 281 employees in engineering, research and development and 560 employees in manufacturing, operations and technical support. Of these employees, 494 employees were based in our facilities in Israel, 587 were employed in the United States, 78 in Europe, and 32 in Asia, the Far East, and other parts of the world.

We also utilize temporary employees, as necessary, to supplement our manufacturing and other capabilities. We believe that our relations with our employees are satisfactory.

We and our employees are not parties to any collective bargaining agreements. However, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) ("Histadrut") and the Coordination Bureau of Economic Organizations (including the Manufacturers' Association of Israel) are applicable to Israeli employees by order (the "Extension Order") of the Israeli Ministry of Labor and Welfare. These provisions principally concern the length of the work day and the work week, minimum wages for workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other



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conditions of employment. Furthermore, pursuant to such provisions, the wages of most of our employees are automatically adjusted based on changes in the Israeli CPI. The amount and frequency of these adjustments are modified from time to time.

Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause. Our ongoing severance obligations are partially funded by making monthly payments to approved severance funds or insurance policies, with the remainder accrued as a long-term liability in our financial statements. See note 7 to Notes to the Consolidated Financial Statements. In addition, Israeli employees and employers are required to pay specified sums to the National Insurance Institute, is similar to the U.S. Social Security Administration. Since January 1, 1995, such amounts also include payments for national health insurance. The payments to the National Insurance Institute are approximately 14.6% of wages (up to a specified amount), of which the employee contributes approximately 66% and the employer contributes approximately 34%. The majority of our permanent employees are covered by life and pension insurance policies providing customary benefits to employees, including retirement and severance benefits. For Israeli employees, we contribute 13.33% to 15.83% (depending on the employee) of base wages to such plans and the permanent employees contribute 5% of base wages.

## Conditions In Israel

We are incorporated under the laws of, and our offices and manufacturing facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel. Our operations would be materially adversely affected if major hostilities involving Israel should occur or if trade between Israel and its present trading partners should be curtailed.

### Political and Economic Conditions

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. However, a peace agreement between Israel and Egypt was signed in 1979, a peace agreement between Israel and Jordan was signed in 1994 and, since 1993, several agreements between Israel and Palestinian representatives have been signed. In addition, Israel and several other Arab States have announced their intention to establish trade and other relations and are discussing certain projects. As of the date hereof, Israel has not entered into any peace agreement with Syria or Lebanon, although Israel recently withdrew all of its forces from South Lebanon. There is substantial uncertainty about how the ''peace process'' will develop or what effect it may have upon us.

Despite the progress towards peace between Israel, its Arab neighbors and the Palestinians, certain countries, companies and organizations continue to participate in a boycott of Israeli firms. We do not believe that the boycott has had a material adverse effect on us, but there can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on the expansion of our business.

As discussed below (see "Item 9: Management's Discussion and Analysis of Financial Condition and Results of Operations—Impact of Inflation and Currency Fluctuations"), the costs of our operations in Israel are generally incurred in NIS. If the inflation rate in Israel exceeds the rate of devaluation of the NIS against the dollar in any period, the costs of our Israeli operations, as measured in dollars, could increase. Israel's economy has, at various times in the past, experienced high rates of inflation.

**Trade Agreements**

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory of the General Agreement on Trade in Services and to the Agreement on Basic Telecommunications Services. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the European Union concluded a Free Trade Agreement in July 1975 that confers certain advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In June 2000, Israel was admitted as an Associate Member of the European Union. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area ("FTA"). The FTA has eliminated all tariff and certain non-tariff barriers on most trade between the two countries. On January 1, 1993, Israel and the European Free Trade Association ("EFTA") entered into an agreement establishing a free-trade zone between Israel and the EFTA nations. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, the People's Republic of China and nations in Eastern Europe.

## Risk Factors; Forward-Looking Statements

The following factors, in addition to other information contained in this annual report on Form 20-F should be considered carefully.

This annual report on Form 20-F includes certain statements that are intended to be, and are hereby identified as, "forward looking statements" for the purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties, and assumptions about Gilat, including, among other things:

- our anticipated growth strategies
- our intention to introduce new products
- anticipated trends in our business, including trends in the market for communication network products and services
- future expenditures for capital projects
- our ability to continue to control costs and maintain quality

These statements may be found in Item 1: "Description of Business" and Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations," and in this annual report on Form 20-F generally. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in "Risk Factors" and elsewhere in this annual report on Form 20-F.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this annual report on Form 20-F might not occur.



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**Ability to manage our rapid growth and expansion**

We have grown significantly in the last few years and expect to continue to grow rapidly. This growth is likely to place a significant strain on our resources and systems, as we expand our manufacturing, testing, quality control, delivery and service operations. In particular, we are in the process of implementing a new management information system to assist in managing our anticipated growth.

We cannot assure that we will be able to meet all our product delivery and service commitments, or that we will be able to implement successfully the new management information system. Inability to manage our growth effectively will expose us to potential loss of customers, contractual penalties, damage to reputation and various costs and expense. This could have a material adverse effect on our business, financial condition and operating results.

**Dependence on a limited number of large sales and limited number of products**

A significant portion of our sales are derived from large-scale contracts with major customers. Generally, we are selected as suppliers of these customers in a bid process. The number of major bids for VSAT-based networks in any given year is limited and the competition is intense. Our losing a relatively small number of bids could have a significant adverse impact on our operating results. In addition, the USPS contract does not require the USPS to purchase any specific number of VSATs by any specific date. See "Item 1: Decription of Business—Customers—USPS Transaction."

In addition, in recent years we have derived the largest portion of single product sales from the sale of our SkyStar Advantage product. Any change in the market acceptance of this product, or of other key products such as our telephony products, could have a material adverse effect on our business.

**Need to develop, introduce and market new products and services**

Our market is characterized by rapid technological changes, frequent new product announcements and evolving industry standards. Significant technological changes could render our existing products and technology obsolete. To be successful, we must anticipate changes in technology and industry standards and continuously develop and introduce new products and services as well as enhancements to existing products and services. If we are unable to address the needs of our customers successfully and to respond to technological advances on a cost-effective and timely basis, or if new products are not accepted by the market, then our business, financial condition and operating results could be adversely affected.

**Backlog of orders may not be filled and contracts may not be renewed**

At present, we have a substantial backlog of orders, consisting of network service contracts, generally for three to five years, and of new orders for products and services. See "Item 1: Marketing, Distribution and Strategic Alliances – Backlog". We may be unable to fill all the backlog or to fully recognize the revenues expected from this backlog for any of the following reasons:

- Existing service contracts can be terminated due to customers' dissatisfaction with the service we provide
- Existing contracts may be terminated because of our inability to timely provide and install additional products or requested new applications

The loss of existing contracts and a decrease in the number of renewals of orders or of new large orders, would have a material adverse effect on our business, financial condition and operating results. In addition, a portion of our service contracts are short-term with expiration or cancellation upon 90 days'





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notice or less. If a substantial number of our service customers choose to cancel or not to renew their contracts, our business could be adversely affected.

**Potential delays in the supply or increase in price of components required to build our VSATs**

Several of the components required to build our VSATs are manufactured by a limited number of suppliers. In the past we have not experienced any difficulties with our suppliers. However, we can not assure the continuous availability of key components or our ability to forecast our component requirements sufficiently in advance. Any interruption in supply would cause delays in manufacturing and shipping products. Those delays and the cost of developing alternative sources of supply could have a material adverse effect on our business, financial condition and operating results.

Our research and development and operations groups are working with our vendors and subcontractors to obtain components for our products in higher quantities at reduced prices to enable us to lower the overall price of our products. If we are unable to obtain the necessary volumes on time, or at optimally low prices, sales of our products may be lower than expected which could have a material adverse effect on our business, financial condition and operating results.

**Dependence on availability of satellite transponder space**

Our VSAT-based services depend on satellite transponder space purchased from third-party suppliers. For networks in the United States, we primarily use satellite capacity acquired from GE Americom. We also use capacity on several regional satellites in Western and Eastern Europe, Latin America, India and other areas of Asia. In connection with our acquisition of Spacenet, we entered into a series of agreements with GE Americom. These agreements provide protected services for customer networks on transponders on three satellites currently operated by GE Americom and on one satellite to be constructed, operated and launched by GE Americom, as well as certain preemptible services for in-house use on an additional satellite operated by GE Americom. See "Item 1: Description of Business-Satellite Capacity" and Item 13: "Ineerest of Management in Certain Transactions—The Satellite Transponder Agreements." We cannot assure that this transponder capacity will be sufficient to meet our growing needs, or that we will be able to obtain additional transponder space at competitive prices from GE Americom or from other suppliers should we need to do so. In addition, our transponder service contracts generally do not provide for alternative services in the event of satellite failure, and we do not maintain insurance against such failures. Therefore, if a satellite becomes inoperable, and alternative services are not available, our revenues would be adversely affected.

**Potential competition with existing customers**

As service providers, we compete with certain existing customers for our products who provide VSAT-related services to end-users. These customers could consequently sever their business relationships with us or, alternatively, we may elect to refrain from selling additional products to them. The loss of those customers, some of whom may be significant, could have a material adverse effect on our business, financial condition and operating results.

**Competition in the network communications industry**

Gilat operates in a highly competitive industry of network communications. Many of our competitors have substantially greater financial resources, providing them with greater research and development and marketing capabilities. These competitors are also more experienced in obtaining regulatory approvals for their products and services and in marketing them. Our relative position may place us at a disadvantage in responding to our competitors' pricing strategies, technological advances and other initiatives.



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Gilat's principal competitor in the supply of VSAT networks is Hughes Network Systems ("Hughes"), which offers a full line of VSAT products and services. Hughes obtains satellite capacity on the satellite system operated by its affiliates Hughes Galaxy and PanAmSat.

The following table lists additional competitors of Gilat:

| Competitor | Area of Competition |
|---|---|
| NEC Corporation | FaraWay VSAT system |
| Comstream Corp. | FaraWay VSAT system |
| ViaSat Inc. | FaraWay VSAT system |
| Titan Information Systems Corp. | DialAway VSAT system |
| STM Wireless, Inc. | DialAway VSAT system |
| ACT Networks, Inc. | ISAT Frame relay system |
| Globe Comm Systems Inc. | ISAT Frame relay system |
| Engineering Technical Services Inc. | ISAT Frame relay system |

In addition, Gilat competes with various companies that offer communication network systems based on other non-satellite technologies such as terrestrial lines (including cable, DSL, fixed wireless, ISDN lines and fiber optics), frame relay, radio and microwave transmissions. These technologies can often be cheaper than VSAT technology while still providing a sufficient variety of the features required by customers. Competitors of this type include major established carriers such as AT&T, MCI Worldcom, Sprint, British Telecom, Deutsche Telekom, France Telecom, global consortia of PTTs and others.

**Dependence on proprietary VSAT technology**

Proprietary rights are important to our success and our competitive position. We establish and protect the proprietary rights and technology used in our products by the use of patents, trade secrets, copyrights and trademarks. We also utilize non-disclosure and invention assignment agreements.

Our actions to protect our proprietary rights may be insufficient to prevent others from developing similar products to ours. In addition, the laws of many foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States.

**Dependence on our key management and technical personnel**

We believe that our success depends on the continued employment of the following senior management team:

| Name | Position | Employment Agreement |
|---|---|---|
| Yoel Gat | Chairman and Chief Executive Officer | Year-to-year |
| Amiram Levinberg | President and Chief Operating Officer | Year-to-year |
| Yoav Leibovitch | Vice President, Finance and Administration and Chief Financial Officer | Year-to-year |

If any of our key personnel is unable or unwilling to continue in his present position, our business, financial condition and operating results could be materially adversely affected.

Competition for personnel, particularly for employees with technical expertise, is intense. Our business, financial condition and operating results will be materially adversely affected if we cannot hire and retain suitable personnel.



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**Dependence on a single facility makes us susceptible to its condition**

Most of our manufacturing capacity, our principal offices and principal research and development facilities are concentrated in a single location in Israel.

Fire, natural disaster or any other cause of material disruption in our operation in this location could have a material adverse effect on our business, financial condition and operating results. In addition, the particular risks relating to our location in Israel are described below.

**Risks relating to our international sales and operations**

We sell and distribute our products and also provide our services internationally, particularly in the United States, Europe and Latin America. A component of our strategy is to continue to expand into new international markets, such as China and South America. Our operations can be limited or disrupted by various factors known to affect international trade. These factors include the following:

- imposition of governmental controls and regulations
- export license requirements
- political instability
- trade restrictions and changes in tariffs
- difficulties in staffing and managing foreign operations
- longer payment cycles and difficulties in collecting accounts receivable
- seasonal reductions in business activities

**Difficulties in obtaining regulatory approvals for our telecommunication services**

Our telecommunication services require licenses and approvals by the FCC in the United States, and by regulatory bodies in other countries. The approval process can often take substantial time and require substantial resources, and any approvals that may be granted may be subject to materially adverse conditions. In addition, even after obtaining the required approvals the regulating agencies may, at any time, impose additional requirements. We can not assure our ability to comply with any new requirements on a timely or economic basis.

**Limitation on production outside of Israel and on transfer of technology**

Because some of our products were developed with Israeli governmental financial support, we cannot manufacture them or transfer the technology embodied in them outside of Israel without governmental approval. Those approvals, if granted, may be conditioned, among other things, upon significantly higher royalty payments to the Israeli government. See "Item 7: Taxation."

**Fluctuations in operating results and volatility of share price**

Our operating results may vary significantly from quarter to quarter. Historically, we have recognized a greater proportion of our revenues in the last quarter of each year. The causes of fluctuations include, among other things:

- the timing, size and composition of orders from customers

- our timing of introducing new products and product enhancements and the level of their market acceptance
- the mix of products and services we offer
- the changes in the competitive environment in which we operate

The market price of our ordinary shares has been subject to volatility and could be subject to wide fluctuations in response to numerous factors, many of which are beyond our control. These factors include the following:

- actual fluctuations or anticipated variations in our operating results
- announcements of technological innovations
- customer orders or new products or contracts
- competitors' positions in the market
- changes in financial estimates by securities analysts
- conditions and trends in the VSAT and other technology industries
- our earnings releases and the earning releases of our competitors
- the general state of the securities markets (with particular emphasis on the technology and Israeli sectors thereof)

In addition, the stock market in general, and the market for technology companies in particular, has been highly volatile. Investors may not be able to resell their shares following periods of volatility. The trading prices of many technology-related companies' stocks have recently reached historical highs and have reflected relative valuations substantially above historical levels. These trading prices may not be sustained.

**The Hughes litigation and the potential for further litigation due to intellectual property infringements**

On May 8, 2000, Gilat Satellite Networks Ltd. and Spacenet Inc. were named as defendants in an action filed in the United States District Court for the District of Maryland. Plaintiff Hughes Electronics Corporation (the parent of Hughes Network Systems), alleges the infringement of four patents, and seeks to enjoin further alleged infringement. We do not believe we are infringing the patents. However, the litigation may continue for an extended period and, regardless of the outcome of the litigation, may require the expenditure of significant sums for legal fees, experts, and other related costs, and may materially adversely affect our business, financial condition and operating results. If the plaintiff is successful, we might be required to pay license fees for using the patented technology. We cannot assure, however, that a license will be available under terms that are acceptable to us, if at all. The failure to obtain a license could cause us to incur substantial liabilities and to suspend the manufacture of the products that utilize the patented technology. In addition, we may be required to redesign our products so as not to use the patented technology. Such redesign, if possible, could result in substantial delays in marketing our products, as well as significant costs. We intend to vigorously defend against these claims.

In addition, we may, from time to time, be notified of other claims that we may be infringing patents, copyrights, or other intellectual property rights owned by third parties. While we do not believe we are currently infringing any intellectual property rights of third parties, we cannot assure that other companies will not, in the future, pursue claims against us with respect to the alleged infringement of patents, copyrights or other intellectual property rights owned by third parties. In addition, litigation may be necessary to protect our intellectual property rights and trade secrets, to determine the validity of and scope of the propriety rights of others or to defend against third-party claims of invalidity. Any litigation could result in substantial costs and diversion of resources and could have a material adverse effect on Gilat's business, financial condition and operating results.

**Potential product liability claims**

We may be subject to legal claims relating to the products we sell or the services we provide. Our agreements with our business customers generally contain provisions designed to limit our exposure to potential product liability claims. We also maintain a product liability insurance policy. Our insurance may not cover all relevant claims or may not provide sufficient coverage. To date, we have not experienced any material product liability claims. Our business, financial condition and operating results could be materially adversely affected if costs resulting from future claims are not covered by our insurance or exceed our coverage.

**Concentration of control over Gilat**

GE Americom beneficially owns approximately 18.7% of our outstanding ordinary shares as of June 15, 2000. GE Americom and several other principal shareholders, who beneficially own (including options exercisable within 60 days) an additional approximately 9.49% of our ordinary shares, have entered into a shareholders' agreement. As a result of this agreement, a group of our principal shareholders, collectively owning only about 28.17% of our outstanding ordinary shares, is able to exercise effective control over most of our business. For a review of the shareholders' agreement including certain exceptions to the above, see "Item 13: Interest of Management in Certain Transactions—The Shareholders' Agreement." In addition, Israeli law requires a minimum 75% of the shareholders to approve certain significant corporate changes, including merger and consolidation. Consequently, subject to the terms of the Shareholders' Agreement, GE Americom could block approval of such resolutions.

**No intention to pay dividends**

We have never paid cash dividends on our ordinary shares and do not anticipate paying any cash dividends in the foreseeable future. We intend to retain any earnings for use in our business. In addition, the terms of some of our financing arrangements restrict us from paying dividends to our shareholders.

**Our stock split may result in a decreased company capitalization**

In February 2000, we announced our intention to split our stock.. The share split is subject to the approval of the shareholders at the next annual meeting and we cannot assure that such approval will be given.

Upon the effective date of our stock split, we may experience a decrease in the share price of our ordinary shares. This decrease in share price may be temporary although we cannot assure that the price per Ordinary Share will return to pre-split price levels.

**Availability of Israeli Government benefits to our company**

Under the Israeli Law for Encouragement of Capital Investments, 1959, facilities that meet certain conditions can apply for an "Approved Enterprise" status. This status confers certain benefits including

tax benefits. All of our existing facilities have been designated as "Approved Enterprises." Our historical operating results reflect substantial tax benefits which amount to approximately $3,872,000, $0, and $10,524,000 for 1997, 1998 and 1999, respectively.

In addition, under the Law for Encouragement of Research and Development, 1984, we have received research and development grants from the Office of the Chief Scientist of the Ministry of Trade and Industry of the State of Israel (the "Office of the Chief Scientist"). These grants are repayable from royalties on sales of products developed with these grants. Under the terms of the grants, we are required to manufacture these products in the State of Israel unless we receive a permit from the Office of the Chief Scientist to manufacture abroad. If we receive a permit to manufacture abroad, we may be required to pay a higher royalty rate on sales of these products, and we may also be required to repay a greater overall amount. In addition, we have received grants from research consortia that are partly funded by the Office of the Chief Scientist. The consortia grants do not require the payment of royalties.

During 1997, 1998, and 1999 we accrued $2,494,00, $2,910,000 and $2,300,000, respectively in royalty-bearing and non-royalty-bearing grants from the Office of the Chief Scientist.

The Government of Israel has indicated its intention to reexamine its policies in these areas. The Israeli Government has also shortened the period of the tax exemption applicable to "Approved Enterprises" from four years to two years. This change only applies to our last four "Approved Enterprises" and to any future "Approved Enterprises" if any. See "Item 1: Description of Business—Research and Development; Third-Party Funding."

With respect to repayment of grants from the Office of the Chief Scientist, in 1997, the Government increased the annual rate of royalties from between 2% to 3% of associated product sales to between 3% and 5% of associated product sales (including service and other related revenues). Israeli authorities have also indicated that the grant program may be further reduced in the future.

We cannot be sure that these and other governmental programs and tax benefits will be continued in the future at their current levels or at all. Recently, a committee appointed by the Israel Finance Minister recommended reducing certain tax benefits. The termination or reduction of the benefits available to us would significantly increase our costs and could have a material adverse effect on our business, financial condition and operation results. See "Item 7: Taxation."

In addition, in order to maintain our eligibility for the grants and tax benefits we receive, we must continue to meet certain conditions, including making certain investments in fixed assets and operations. If we fail to meet such conditions in the future, we could be required to refund tax benefits already received, with interest and linkage differences to the Israeli Consumer Price Index (the "Israeli CPI").

**Impact of inflation and foreign currency fluctuations**

Our international sales expose us to fluctuations in foreign currencies. Substantially all of our sales are denominated in US dollars. Conversely, a significant portion of our expenses, mainly salaries, is incurred in NIS and is linked to the Israeli CPI. When the Israeli inflation rate exceeds the rate of the NIS devaluation against the foreign currencies, then our NIS expenses increase to the extent of the difference between the rates. A significant disparity of this kind may have a material adverse effect on our operating results.

**Risks relating to our location in Israel**

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and most of our manufacturing facilities. Political, economic and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors

have engaged in a number of armed conflicts. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite the progress towards peace between Israel and its Arab neighbors and the Palestinians, major hostilities may revive. Such hostilities may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business.

Generally, male adult citizens and permanent residents of Israel under the age of 51 are obligated to perform 14 to 31 days of military reserve duty annually, depending on their age. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. The full impact on our workforce or business if some of our officers and employees are called upon to perform military service is difficult to predict. See "Conditions in Israel."

**Uncertainty of enforceability of civil liabilities against foreign persons**

Our directors and officers and the Israeli experts named in this annual report on Form 20-F reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, because the majority of our assets are located in Israel, any judgment obtained in the United States against us or any of our directors and officers may not be collectible within the United States.

## ITEM 2: DESCRIPTION OF PROPERTY

In April 1996, we moved to approximately 62,000 square feet of office, manufacturing and warehousing facilities in Petah Tikva, Israel, which was expanded by an additional 57,000 square feet at the end of 1997. We purchased approximately 93,000 square feet of additional facilities in 1997 for a contract price of approximately $17.4 million, including taxes and related expenses. We have paid the full amount of the purchase price and the construction, was completed in 1999. We have also exercised our contractual option to acquire approximately 79,000 square feet of space, including parking and commercial space, at a price of approximately $16.6 million including taxes and related expenses. Preliminary construction has begun and is expected to be completed by the end of the first quarter 2001. In addition we have (i) purchased 34,120 square feet of additional space in an adjoining building, at a price of approximately $3.2 million; and (ii) acquired an additional 65,000 square feet of adjoining real property for future expansion.

We currently maintain a 15,000 square foot facility in Yokneam, Israel which was recently doubled from 7,500 square feet, for software research and development. Monthly rent is approximately $8,350; and the lease is for five years, with an option for an additional five years.

The current facility of Gilat Florida in West Melbourne, Florida is comprised of approximately 31,000 square feet and houses the Gilat Florida executive, sales, manufacturing, and research and development activities, under a ten-year lease which began May 1, 1997. Monthly rent is approximately $15,938.

Our offices in McLean, Virginia originally comprised approximately 70,000 square feet, and were recently expanded by an additional approximately 63,000 square feet at a total current monthly rental of approximately $251,000. These offices house not only our personnel, but also contain one of our U.S. network operations centers. In June 2000, we signed an agreement and paid a $1 million escrow deposit for the purchase of the land and building of Spacenet's current facilities for a purchase price of $24,325,000. We expect to close this purchase transaction in the third quarter of 2000, although the closing may be delayed. We currently lease a facility in Marietta, Georgia comprising approximately 70,000 square feet, which is used for a second U.S. network operations center. The facilities lease is expected to be assigned to GTH for the GTH network operations center in July 2000. We also maintain

space in Manassas, Virginia, Chicago, Illinois and Houston, Texas for sales and operations personnel and for equipment storage.

Our German operations center leases a 21,000 square foot facility in Backnang, Germany at a current monthly rental of approximately $25,000. This space is used by our German-based management, sales and operations personnel and contains our European network operations center. We recently purchased approximately 140,400 square feet of land in Backnang for $500,000, on which we plan to construct a new operations center. We commenced construction of the new building in 2000 and expect to complete construction by the fourth quarter of 2001, although completion may be delayed.

We maintain offices in Santa Clara, California, Austin, Texas, Sunrise, Florida, Atlanta, Georgia, Amsterdam, Paris and Hong Kong, and in South America, in Brazil, Argentina, Chile, Colombia, Mexico, and Peru, along with representative offices in Beijing, and Melbourne, Australia, London, Prague, Pretoria, São Paulo, Buenos Aires and New Delhi, and small facilities in other locations. We are currently establishing a representative office in Almaty, Kazakhstan to provide pre-sales marketing and support and expect to lease office space under a multi-year lease commencing in the third quarter of 2000.

## ITEM 3: LEGAL PROCEEDINGS

We are a party to various legal proceedings incident to our business, most of which were assumed in our acquisitions and are still the subject of various indemnities obtained in such acquisitions. Except as noted below, there are no material legal proceedings pending or, to our knowledge, threatened against us or our subsidiaries, and we are not involved in any legal proceedings that our management believes, individually or in the aggregate, would have a material adverse effect on our business, financial condition or operating results.

On May 8, 2000, Gilat Satellite Networks Ltd. and Spacenet Inc. were named as defendants in an action filed in the United States District Court for the District of Maryland, entitled *Hughes Electronics Corporation v. Gilat Satellite Networks Ltd. and Spacenet Inc.* Plaintiff Hughes Electronics Corporation (the parent of Hughes Network Systems), alleges the infringement of four patents, and seeks to enjoin further alleged infringement. We intend to vigorously defend against these claims. We do not believe we are infringing the patents.

On January 4, 1999, Gilat Satellite Networks Inc. was named as a defendant in an action filed in the Circuit Court for Montgomery County, Maryland entitled *Hughes Network Systems v. David Shiff, Sheldon Revkin, and Gilat Satellite Networks, Inc.* Plaintiff Hughes Network Systems sought to enjoin Sheldon Revkin and David Shiff from working for Gilat in its Spacenet operations, and to enjoin Gilat from employing them for a limited period of time. On July 9, 1999, Hughes Network Systems voluntarily withdrew the complaint and amended complaint thereby terminating the action.

We are also a party to various regulatory proceedings incident to our business. To the knowledge of our management, none of such proceedings is material to us or to our subsidiaries.



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as of June 15, 2000

## ITEM 4: CONTROL OF REGISTRANT

The following table sets forth certain information with respect to the beneficial ownership of our ordinary shares as of June 15, 2000 (including options exercisable within 60 days) with respect to: (i) each person who is believed by us to be the beneficial owner of more than 5% of the ordinary shares; and (ii) all directors and officers as a group. Except where otherwise indicated, we believe, based on information furnished by the owners, that the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to such shares, subject to any applicable community property laws.

| Name and Address | Number of Ordinary Shares Beneficially Owned | Percent of Ordinary Shares Outstanding |
|---|---|---|
| GE Americom(1)............................................... 3135 Flaston Turnpike, Fairfield, Connecticut 06431-0001 | 4,308,000 | 18.67 |
| Wellington Management Company, LLP(2)............. 75 State Street, Boston, Massachusetts 02109 | 1,377,430 | 5.97 |
| All officers and directors as a group (22 persons)(3) ........................................ | 1,524,489 | 6.61 |

(1) Excludes 292,699 ordinary shares held indirectly by General Electric Company through various subsidiary companies, including mutual funds and pension trusts managed by General Electric Company.

(2) Based on information available to Gilat.

(3) Includes 550,841 ordinary shares for which options to 18 executive officers are currently exercisable within 60 days but have not yet been exercised, but does not include 182,418 ordinary shares held by DIC Financial Management Ltd. ("DICFM") and 746,917 Ordinary Share held by DIC Loans Ltd. ("DIC Loans"). DICFM and DIC Loans, Israeli corporations, are controlled by Discount Investment Corporation Ltd. ("DIC"), which is in turn controlled by IDB Development Corporation Ltd. ("IDBD"). Companies controlled by Oudi Recanati, Elaine Recanati, Leon Y. Recanati and Judith Yovel Recanati and their children, respectively, together beneficially own approximately 51.95% of the equity and voting power in IDB Holding Corporation Ltd. ("IDBH"), the parent of IDBD. Elaine Recanati is the aunt of Oudi Recanati, Leon Y. Recanati and Judith Yovel Recanati: Leon Y. Recanati and Judith Yovel Recanati are brother and sister. Leon Y. Recanati is co-Chairman of the Board of Directors and co-Chief Executive Officer of IDBH and co-Chairman of the Board of Directors of IDBD. Based on the foregoing, IDBH and IDBD (by reason of their control of DIC), DIC (by reason of its control of DICFM and DIC Loans) and Oudi Recanati, Elaine Recanati, Leon Y. Recanati and Judith Yovel Recanati, may be deemed to share with DICFM and DIC Loans the power to vote and dispose of the ordinary shares held by such companies. For information with respect to a voting agreement and shareholders agreement entered into by certain shareholders, see "Item 13: Interest of Management in Certain Transactions."

## ITEM 5: NATURE OF THE TRADING MARKET

Our ordinary shares are quoted on the Nasdaq National Market under the symbol "GILTF." The following table sets forth, for the periods indicated, the range of high and low closing sale price for the ordinary shares, as reported by Nasdaq:

| | High | Low |
|---|---|---|
| 1997: | | |
| First Quarter......... | $36.500 | $26.625 |
| Second Quarter..... | $36.750 | $27.000 |
| Third Quarter....... | $37.063 | $31.250 |
| Fourth Quarter ...... | $40.500 | $27.000 |
| 1998: | | |
| First Quarter......... | $36.500 | $22.500 |
| Second Quarter..... | $39.250 | $30.500 |
| Third Quarter....... | $46.125 | $32.313 |
| Fourth Quarter ..... | $56.375 | $37.500 |
| 1999: | | |
| First Quarter......... | $63.000 | $52.250 |
| Second Quarter .... | $60.750 | $47.125 |
| Third Quarter....... | $62.375 | $42.313 |
| Fourth Quarter ..... | $121.125 | $43.063 |
| 2000: | | |
| First Quarter......... | $172.000 | $103.500 |
| Second Quarter (to June 15) | $124.125 | $68.563 |

As of June 15, 2000 there were 113 record holders of ordinary shares, of which 101 represented U.S. record holders owning an aggregate of approximately 97.0% of the outstanding ordinary shares.

We have never paid cash dividends to our shareholders and we currently do not intend to pay dividends for the foreseeable future. We intend to reinvest earnings in the development and expansion of our business. We have decided to reinvest permanently the amount of tax exempt income derived from our "Approved Enterprises" and not to distribute such income as dividends. See note 10 of Notes to the Consolidated Financial Statements listed in Item 19. We may only pay cash dividends in any fiscal year out of "profits," as determined under Israeli law. In addition, the terms of certain financing arrangements restrict us from paying dividends to our shareholders.

In the event we declare dividends in the future, we will pay those dividends in NIS. Because exchange rates between NIS and the dollar fluctuate continuously, a U.S. shareholder will be subject to currency fluctuation between the date when the dividends are declared and the date the dividends are paid.

In February 2000, we announced our intention to split our stock. The share split is subject to the approval of the shareholders at the next annual meeting and we cannot assure that such approval will be given.

## ITEM 6: EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Non-residents of Israel who purchase any of our ordinary shares with certain non-Israeli currencies (including the dollar) will be able to convert dividends, liquidation distributions and the proceeds from the sale of such ordinary shares into freely repatriable non-Israeli currencies at the rate of



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exchange prevailing at the time of conversion (provided that Israeli Income Tax has been paid or withheld on such amounts).

## ITEM 7: TAXATION

The following is a short summary of certain Israeli tax consequences to persons holding our ordinary shares. The discussion is not intended and should not be construed as legal or professional tax advice and is not exhaustive of all possible tax considerations.

On May 4, 2000, a special committee appointed by the Israeli Minister of Finance for the purpose of reviewing the Israeli system of direct taxation submitted its report. The report makes several recommendations that if enacted into law by the Israeli Parliament may have substantial tax implications on us and our shareholders. The Israeli Government adopted the recommendations, with the intention that the applicable legislation will be effective as of January 1, 2001. During the legislative process, the recommendations contained in the Report may be subject to substantial changes. References to the recommendations in their current form are included in the discussion below.

Nonresidents of Israel are subject to income tax on income accrued or derived from sources in Israel or received in Israel. These sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. Gilat is required to withhold income tax at the rate of 25% (15% for dividends generated by an Approved Enterprise) on all distributions of dividends other than bonus shares (stock dividends), unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. Under the income tax treaty between the United States and Israel (the "Treaty"), the maximum tax on dividends paid to a holder of ordinary shares who is a United States resident (as defined in the Treaty) is 25%.

Israeli law imposes a capital gains tax on the sale of securities and other capital assets. Under current law, however, gains from sales of the ordinary shares of Gilat are exempt from Israeli capital gains tax for so long as (i) the shares are quoted on Nasdaq or listed on a stock exchange recognized by the Israeli Ministry of Finance and (ii) Gilat qualifies as an Industrial Company or Industrial Holding Company under the Law for Encouragement of Industry (Taxes), 1969. The report recommends revoking this exemption with the effect that Israeli and foreign individual investors would generally be subject to a 25% capital gain tax upon realization of their investment. This recommendation will not, however, affect the Treaty. Under the Treaty, a holder of ordinary shares who is a United States resident will be exempt from Israeli capital gains tax on the sale, exchange or other disposition of such ordinary shares unless such holder owns, directly or indirectly, 10% or more of the voting power of Gilat.

A nonresident of Israel who receives interest, dividend or royalty income derived from or accrued in Israel, from which tax was withheld at the source, is generally exempt from the duty to file tax returns in Israel with respect to such income, provided such income was not derived from a business conducted in Israel by the taxpayer. Israel presently has no estate or gift tax, though the report recommends introducing these taxes.

In addition, the report recommends increasing to 25% the corporate tax rate available under the Law for the Encouragement of Capital Investments, 1959, during certain portions of the Approved Enterprise benefits period to companies owned in whole or in part by foreign investors. Currently, depending on the percentage of foreign ownership, this rate can be as low as 10%, , and as high as 25%, which is the corporate tax rate available to the Approved Enterprises of companies without any foreign ownership. Furthermore, the Report recommends revoking a current exemption available to income of Approved Enterprises that is not distributed as a cash dividend and, setting a corporate tax rate of 10% for profits generated during certain portions of the Approved Enterprise benefits period.

## ITEM 8: SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated statement of operations data set forth below with respect to the years ended December 31, 1995, 1996, 1997, 1998 and 1999 and the consolidated balance sheet data as of December 31, 1995, 1996, 1997. 1998 and 1999 have been prepared in accordance with Israel GAAP and audited by Kesselman & Kesselman, independent certified public accountants in Israel and a member of PricewaterhouseCoopers International Limited. Israeli GAAP varies in certain aspects from U.S. GAAP as described in notes 7 and 15f to the Consolidated Financial Statements. The selected consolidated-financial data set forth below should be read in conjunction with Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and notes thereto included in Item 19 in this Form 20-F.



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| | YEARS ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 1995[1] | 1996[1] | 1997 | 1998 | 1999 |
| | (In thousands, except per share data) | | | | |
| **Statement of Operations Data:** | | | | | |
| Revenues | $54,532 | $74,126 | $103,690 | $155,335 | $337,873 |
| Cost of Revenues: | | | | | |
| Cost of products sold and revenue rendered | 31,483 | 42,917 | 58,742 | 86,603 | 220,139 |
| Write-off of inventories associated with restructuring | — | — | — | 9,495 | 4,634 |
| | 31,483 | 42,917 | 58,742 | 96,098 | 224,773 |
| Gross profit | 23,049 | 31,209 | 44,948 | 59,237 | 113,100 |
| Research and development costs: | | | | | |
| Expenses incurred | 6,532 | 8,129 | 10,615 | 15,815 | 27,159 |
| Less-grants | 1,066 | 1,913 | 2,494 | 3,035 | 2,368 |
| | 5,466 | 6,216 | 8,121 | 12,780 | 24,791 |
| Acquired research and development | — | — | — | 80,000 | — |
| Net research and development costs | 5,466 | 6,216 | 8,121 | 92,780 | 24,791 |
| Selling, general and administrative expenses | 9,544 | 13,945 | 20,321 | 29,077 | 68,414 |
| | 8,039 | 11,048 | 16,506 | (62,620) | 19,895 |
| Restructuring charges | | | | 11,989* | (356) |
| Merger expenses | — | 7,991 | — | — | — |
| Operating income (loss) | 8,039 | 3,057 | 16,506 | (74,609) | 20,251 |
| Financial income (expenses)—net | 575 | 1,170 | 538 | (1,247) | 3,267 |
| Write-off of investments associated with restructuring | | | | (2,700) | (896) |
| Other income —net | — | 1,329 | 30 | 162 | — |
| Income (loss) before taxes on income | 8,614 | 5,556 | 17,074 | (78,394) | 22,622 |
| Taxes on income | — | 84 | 130 | 286 | 2,475 |
| Income (loss) after taxes on income | 8,614 | 5,472 | 16,944 | (78,680) | 20,147 |
| Share in losses of associated companies | — | — | — | 703 | 536 |
| Net income (loss) | $8,614 | $5,472[2] | $16,944 | ($79,383) | $19,611 |
| Earnings(loss) per share under U.S. GAAP | | | | | |
| Basic | $0.92 | $0.51[2] | $1.56 | ($7.18)[3] | $0.96 |
| Diluted | $0.89 | $0.50[2] | $1.51 | ($7.18)[3] | $0.92 |
| Weighted average number of shares used in computation of earnings (loss) per share – in thousands under U.S. GAAP | | | | | |
| Basic | 9,413 | 10,816 | 10,895 | 11,059 | 20,447 |
| Diluted | 9,632 | 11,049 | 11,255 | 11,059 | 21,429 |
| Earnings (loss) per share under Israeli GAAP | | | | | |
| Basic | $0.89 | $0.50 | $1.50 | *($6.37) | $0.83 |
| Diluted | $0.89 | $0.50 | $1.47 | *($6.37) | $0.83 |
| Weighted average number of shares used in computation of earnings (loss) per share – in thousands under Israeli GAAP | | | | | |
| Basic | 9,829 | 11,355 | 11,448 | 12,121 | 25,177 |
| Dilluted | 9,829 | 11,355 | 12,152 | 12,121 | 25,177 |

* Restated, See note 1q in Notes to the Consolidated Financial Statements

| Balance Sheet Data: | DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1999 |
| | (In thousands) | | | | |
| Working capital | $61,623 | $61,632 | $85,081 | $89,227* | $265,307 |
| Total assets | 97,423 | 112,201 | 211,960 | 401,284* | 678,853 |
| Short-term bank credit and current Maturities of long-term debt | 4,806 | 582 | 2,719 | 23,158 | 6,986 |
| Long-term liabilities | 13 | - | - | 284 | 8,089 |
| Convertible subordinated notes | - | - | 75,000 | 75,000 | 75,000 |
| Shareholders' equity | 81,563 | 89,758 | 108,338 | 222,620* | 499,823 |

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(1) Includes the results of Gilat Florida into which a wholly-owned subsidiary of Gilat was merged on December 30, 1996, and accounted for pursuant to the pooling-of-interests method.

(2) If the merger expenses associated with the Gilat Florida Merger had not been included in Gilat's results, net income for the year ended December 31, 1996 would have been approximately $13,463,000 and basic earnings per share for that year would have been $1.24 and diluted earnings per share would have been $1.22.

(3) If the restructuring charges, write offs associated with restructuring and expenses related to acquired research and development associated with the Spacenet Acquisition had not been included in Gilat's results, net income for the year ended December 31, 1998 would have been approximately $24,801,000 and basic earnings per share under U.S. GAAP for that year would have been $2.24 and diluted earnings per share under U.S. GAAP would have been $2.14.

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* Restated, See note 1q in Notes to the Consolidated Financial Statements

## ITEM 9: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Overview**

Gilat commenced operations in 1987 and shipped its initial product, a first generation OneWay VSAT, in 1989. Since that time, we have devoted significant resources to developing and enhancing our VSAT product lines and establishing strategic alliances primarily with major telecommunications companies and equipment suppliers. We have also broadened our marketing strategy to emphasize sales to customers directly and through new distribution channels.

In 1991, we began marketing our second generation OneWay VSAT. In 1992, we began marketing our TwoWay VSAT with Spacenet as part of Spacenet's Skystar Advantage VSAT service offering, and we began marketing our TwoWay VSATs to GTECH as part of GTECH's GSAT lottery networks. Over the years, we experienced significant growth in orders, sales and earnings from our OneWay and Skystar Advantage products. Additionally, we began marketing the FaraWay VSAT in 1994, the DialAway VSAT at the end of 1996, the SkySurfer VSAT in 1997, and the SkyBlaster VSAT in 1999. The Skystar Advantage is our largest-selling product, accounting for approximately 49% of our sales revenue during 1998, and for approximately 49% of our sales revenue during 1999.

On December 30, 1996, we acquired Gilat Florida (previously named Skydata, Inc.), a company engaged in the development, manufacturing and marketing of VSAT-based paging and broadcast products. The transaction was effected through the merger of a wholly-owned subsidiary of Gilat into Gilat Florida. The merger was accounted for as a pooling of interests. Accordingly, Gilat's financial information has been restated to retroactively include the accounts and operations of Gilat Florida prior to 1996.

On December 31, 1998, we acquired Spacenet. The acquisition was accounted for by the purchase method. Prior to the acquisition, Gilat and Spacenet had engaged in a strategic alliance for a number of years. Spacenet was the largest customer of Gilat's products, with aggregate sales to Spacenet representing approximately 28%, 34% and 45% of Gilat's total sales in 1996, 1997 and 1998, respectively. With the acquisition of Spacenet, we have begun to offer satellite-based network services as well as products. For a discussion of certain continuing acquisition-related commitments, see "Item 13: Interest of Management in Certain Transactions".

In February 1999 we completed the offering of 5,456,750 ordinary shares, of which 4,711,750 ordinary shares were sold by Gilat and 745,000 by certain shareholders. The proceeds to Gilat, before expenses but after the underwriters discount, were $257,826,960.

In February 2000, we completed a private offering of $350 million of 4.25% convertible subordinated notes due in 2005. The notes are convertible into our ordinary shares at a conversion price of $186.18 per share. Each note bears annual interest of 4.25% payable semiannually.

In March 2000, we completed a $10 million investment transaction with Knowledge Net Holdings LLC, a subsidiary of Knowledge Universe Inc. in exchange for 10 million common units (approximately 5.6% of the outstanding units) of KnowledgeBroadcasting.com LLC ("KBC"), and a one year warrant to purchase an additional 20 million units at the same unit price. We also granted KBC a five year warrant to purchase approximately 191,000 of our ordinary shares at a purchase price of $157.05 per share, and a five year option to acquire equipment and services. Acquisitions of equipment and services made pursuant to this option in the first two years will be paid for by KBC with up to 20 million units of KBC valued at the original purchase price, and thereafter, on terms to be agreed by the parties. KBC is a web-based media company that distributes content using interactive broadband satellite and other technologies.

In April 2000, we completed the funding and formation of U.S.-based Gilat-To-Home Inc., a joint venture with Microsoft Corporation, EchoStar Communications Corporation, and ING Furman Selz. Gilat-To-Home was formed to provide satellite-based broadband Internet services to consumers in the U.S. Following the collective investment of $125 million by the other parties to this joint venture, Gilat, along with certain related parties, holds approximately 51% of Gilat-To-Home, on a fully diluted basis including shares reserved for options to be granted to employees but not including warrants and debt conversion rights issued as part of bank financing..

In addition, in April 2000, we completed a share purchase transaction pursuant to which we, together with certain employees, now hold 100% of GTH LA (Antilles) (formerly named Global Village Telecom (Netherlands Antilles) N.V ("GVT Antilles")). This transaction is more fully described in "Item 1: Description of Business -- Strategic Alliances and Joint Ventures". GVT Antilles was established to operate rural telephony communications networks, mostly in developing countries and is now part of our planned consumer Internet initiative in Latin America. This acquisition expands our presence in South America and provides existing on-ground VSAT networks.

In June 2000, we exercised our right to redeem our 6¼% convertible subordinated notes issued on May 14, 1997 and due on June 1, 2004. The notes were redeemable in full at 102% of the principal amount plus accrued and unpaid interest, setting the redemption price per $1,000 note at $1,020.72. All of the note holders opted to convert their notes into Gilat's ordinary shares prior to the redemption date and we consequently issued 1,785,695 ordinary shares to such holders.

We earn revenue from sales of our satellite-based networking products and services to our customers worldwide. The charges to customers for satellite networking products and services vary with the number of sites, the length of the contract, the amount of satellite capacity, the types of technologies and protocols employed and the degree of customization or development required to implement the network.

In the case of product sales, we recognize revenue when the product is shipped. The present value of payments due under sales-type lease contracts are recorded as revenues and cost of sales is charged with the book value of equipment at the time of shipment. Future interest income is deferred and recognized over the related lease term. We recognize revenues from long-term contracts on the percentage-of-completion method, measured using the ratio of material costs incurred to date to estimated total material costs for each contract. Spacenet generally has two ways of recognizing revenue, depending on whether or not the customer takes ownership of the network equipment. In the first type of network services sale, the customer purchases hardware, software, and satellite capacity and maintenance services, and Spacenet records revenue when the network is installed and operational (or, in cases where the customer obtains its own installation services, when the equipment is shipped). In many of these cases, Spacenet is paid progress payments upon signing, achievement of certain milestones and installation. For ongoing maintenance, satellite capacity and support services, customers pay monthly fees, which are recorded as service revenues.

In the other type of network services sale, Spacenet procures and installs the equipment and software, obtains the satellite capacity and provides network operations and monitoring for the customer over the contract term (generally three to five years). Under this type of network services sale, Spacenet retains ownership and operation of the network, and receives a monthly service fee (and recognizes revenue) over the term of the contract. Since our acquisition of Spacenet, these networking service arrangements have grown and we expect that they will continue to grow as a percentage of our revenue. As a result, a growing portion of the VSAT equipment we manufacture is capitalized on our balance sheet and has resulted in an increase in our capital expenditures. We also believe that the growth of our business may result in an increase of our inventory and receivables levels and increased working capital needs. We

intend to meet such anticipated increases in capital expenditures and working capital with cash on hand. See "—Liquidity and Capital Resources."

We have started to depreciate the cost of the equipment used in our network service offerings on a 5-year basis. Our service contracts, however, may be for periods of as little as 3 years, which may require us to write-off the unamortized cost of the equipment in the event the contract is not renewed and we are unable to place such equipment with other customers. We expect, however, that most of our customers will elect to renew their service contracts and that we will not be required, in most instances, to effect such write-offs.

Cost of revenues, for both products and services, includes the cost of system design, equipment, satellite capacity, software customization and third party maintenance and installation. For equipment contracts, cost of revenues is expensed as revenues are recognized. For network service contracts, cost of revenues is expensed as revenues are recognized over the term of the contract. For maintenance contracts, cost of revenues is expensed as the maintenance cost is incurred or over the term of the contract. As a result of the Spacenet acquisition, we incurred aggregate restructuring expenses of $29.4 million for the two years ended December 31, 1999. In addition, Spacenet incurred a charge of approximately $12.4 million to eliminate unnecessary inventory and property, plant and equipment, which is included in the goodwill and $33.6 million in expenses related to the replacement and upgrade of certain legacy VSAT network equipment used by certain Spacenet customers. We replaced approximately 75% of this legacy equipment in 1999 and expect to replace the remainder in 2000. In 1999, most equipment replacements were accompanied by the customers' entry into long-term network services contracts.

We devote significant resources to research and development of all our products. Our initial research and development was funded by the Israel-U.S. Binational Industrial Research and Development Foundation ("BIRD"), but currently none of our research and development is funded by BIRD. In Israel, a portion of our research and development expenditures is funded by the Office of the Chief Scientist of the Ministry of Industry and Trade (the "Office of the Chief Scientist"). We have also received, and expect to continue to receive, grants through participation in research consortia, which are funded by the Office of the Chief Scientist, as well as grants from research and development programs sponsored by the European Commission and the U.S.-Israel Science and Technology Foundation ("USISTF"). We expect, however, that the amount of funding from the Office of the Chief Scientist will decrease due to Israeli budgetary constraints.

During 1998 and 1999, approximately 19.2% and 8.7%, respectively, of our research and development expenditures before acquired research and development, were covered by the Office of the Chief Scientist, the research consortia, USISTF, and the European Commission. Under the terms of the funding provided during these and earlier years by the Office of the Chief Scientist, BIRD, and USISTF, we are required to pay royalties on sales of the products developed from the funded project until an amount ranging from 100% to 150% of the grants has been repaid. Grants received through participation in the research consortia and under the European Commission program do not require the payment of royalties. Royalties to the Office of the Chief Scientist and BIRD, which are included in selling, general and administrative expenses, were $820,000 during 1998 and $719,000 during 1999. To date, we have not made any sales in connection with the USISTF project and consequently have not accrued or paid any royalties to USISTF.

Selling, general and administrative expenses also include sales and marketing costs, customer support, accounting and administration. We expect that selling, general and administrative expenses will increase in total amount over the next few years as sales efforts are expanded.

Substantially all of our production facilities in Israel are eligible for certain tax benefits. As a result, we expect that a substantial part of our income for 2000 and 2001 will be tax exempt, while the balance will be taxed at rates ranging from of 15% to 36%. See "—Effective Corporate Tax Rate."

As part of the Merger Agreement, GE Americom and certain of its affiliates were committed to purchase $37.5 million of our products through the end of 1999. GE Americom agreed to pay us a credit against service fees owed to GE Americom under certain satellite transponder service agreements, equal to 40% of any shortfalls in this purchase commitment. GE Americom did not purchase any of our equipment in 1999 and therefore we were entitled to a credit equal to 40% of the full amount of $37.5 million, or $15 million, which was recorded as revenues in 1999. In addition, pursuant to two settlement agreements entered into by the parties in December 1999, GE Americom paid us $25 million for post-closing adjustments and undisclosed liabilities related to the Merger, and for reimbursement of expenses.

The currency of the primary economic environment in which most of our operations are conducted is the dollar, and as such, we use the dollar as our functional currency. Transactions and balances originally denominated in dollars are presented at their original amounts. Gains and losses arising from non-dollar transactions and balances are included in the determination of net income.

**Results of Operations of Gilat**

The following table sets forth, for the periods indicated, the percentage of revenues represented by certain line items from Gilat's consolidated statements of income.

**Percentage of Revenues**

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 1997 | 1998 | Adjusted 1998(1) | 1999 | Adjusted 1999(2) |
| Revenues | 100.0% | 100.0% | 100.0% | 100% | 100% |
| Cost of Revenues | 56.7 | 61.9 | 55.8 | 66.5 | 55.6 |
| Gross profit | 43.3 | 38.1 | 44.2 | 33.5 | 44.4 |
| Research and development costs | | | | | |
| Expenses incurred | 10.2 | 10.2 | 10.2 | 8.0 | 8.0 |
| Less – grants | 2.4 | 2.0 | 2.0 | 0.7 | 0.7 |
| | 7.8 | 8.2 | 8.2 | 7.3 | 7.3 |
| Acquired research and development | 0.0 | 51.5 | 0.0 | 0.0 | 0.0 |
| Net research and development costs | 7.8 | 59.7 | 8.2 | 7.3 | 7.3 |
| Selling, general and administrative expenses | 19.6 | 18.7 | 18.7 | 20.3 | 19.9 |
| Restructuring charges | 0.0 | *7.7 | 0.0 | (0.1) | 0.0 |
| Operating income (loss) | 15.9 | (48.0) | 17.3 | 6.0 | 17.2 |
| Financial income (expenses) - net | 0.5 | (0.8) | (0.8) | 1.0 | 1.0 |
| Write-off of investments associated with restructuring | 0.0 | (1.7) | 0.0 | (0.3) | |
| Other income – net | 0.0 | 0.1 | 0.1 | 0.0 | 0.0 |
| Income (loss) before taxes on income | 16.4 | (50.4) | 16.6 | 6.7 | 18.2 |
| Taxes on income | 0.1 | 0.2 | 0.2 | 0.7 | 0.7 |
| Income (loss) after taxes on income | 16.3 | (50.6) | 16.4 | 6.0 | 17.5 |
| Share in losses of associated companies | 0.0 | 0.5 | 0.5 | 0.2 | 0.2 |
| Net income (loss) | 16.3% | (51.1)% | 15.9% | 5.8% | 17.3% |

***Restated, see note 1q to Notes to the Consolidated Financial Statements**

(1) Results of operations for year ended December 31, 1998, excluding the Spacenet restructuring charges, write-offs associated with restructuring and expenses related to acquired research and development of approximately $104.2 million.

(2) Results of operations for year ended December 31, 1999, excluding expenses associated with the Spacenet acquisition and restructuring of approximately $38.8 million.

**Year Ended December 31, 1999 Compared to Year Ended December 31, 1998**

**Revenues.** Our revenues increased by 117.5% to approximately $337.9 million in 1999 from approximately $155.3 million in 1998. The growth in revenues was attributable primarily to the acquisition of Spacenet on December 31, 1998, which allowed us to expand our revenue base from primarily manufacturing and selling VSAT equipment to service revenues based on the offering of complete end-to-end telecommunications and data networking solutions. In addition, we experienced an increase in demand for Skystar Advantage products, and for SkyBlaster following its introduction in 1999. This was partly offset by downward pressure on prices in the industry.

**Gross profit.** Gross profit increased by 90.9% to approximately $113.1 million in 1999 from approximately $59.2 million in 1998. The gross profit margin decreased to 33.5% in 1999 from 38.1% in 1998 due to expenses related to migration from offering Spacenet's Clearlink system to offering our Skystar Advantage, and a write-off of inventories associated with restructuring. In our 1998 financial statements, goodwill was restated and decreased by $21 million for expenses related to migration from Clearlink to Skystar Advantage, inventories were restated and increased by $12 million, accrued expenses were restated and decreased by $11.3 million, and retained earnings were restated and increased by $2.3 million. The actual migration expenses were included in the 1999 expenses, mainly in cost of goods sold. If such migration expenses and write-off of inventories had not been included, our gross profit margin would have increased to 44.4% in 1999 from 44.2% in 1998.

**Research and Development Expenses.** Research and development expenses in 1998 included $80 million for a write-off of acquired in-process research and development associated with the Spacenet acquisition. In-process research and development expenses arise from new product development projects that are in various stages of completion at the acquired enterprise at the date of acquisition. Gross research and development costs without the acquired in-process research and development increased by 71.7% to approximately $27.2 million in 1999, from approximately $15.8 million in 1998, and as a percentage of revenues, decreased to 8.0% in 1999 from 10.2% in 1998, mainly due to the rapid increase in revenues including from services, which by nature do not require significant R&D resources. The dollar increase in such costs in 1999 was primarily due to hiring additional research and development personnel; the further development of the SkyBlaster, Skystar Advantage and FaraWay product lines; the expansion of research and development to reduce the costs and increase the functionality of our interactive VSAT product lines, and conducting generic research relating to our participation in research consortia. Research and development grants, as a percentage of gross research and development costs, decreased to 8.7% in 1999 compared to 19.2% in 1998. Research and development costs, without acquired research and development showed a net increase to approximately $24.8 million in 1999 from approximately $12.8 million in 1998, and a decrease as a percentage of sales to 7.3% in 1999 from 8.2 % in 1998.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by 135.3% in 1999 to approximately $68.4 million from approximately $29.1 million in 1998. As a percentage of revenues, selling, general and administrative expenses increased to 20.3% in 1999 from 18.7% in 1998. Selling, general and administrative expenses include expenses related to migration from Clearlink to Skystar Advantage. If such migration expenses had not been included, the selling, general and administrative expenses would have increased by 131.0% in 1999 to approximately $67.2 million, or 19.9% as a percentage of revenues. Increased expenditures in 1999 were primarily attributable to the consolidation of Spacenet and the expansion of our marketing and selling efforts through the hiring of personnel, and the opening of new offices around the world.

**Restructuring Charges and Related Expenses.** Restructuring expenses as a result of the Spacenet acquisition other than inventory write-offs and write-off of investments which are presented in other lines, were $0.4 million lower than was recorded in 1998. Inventory write-offs relating to rationalization of product lines which are presented in cost of revenues, were $4.6 million higher than was recorded in 1998, and write-offs of investments associated with restructuring were $0.9 million higher than was recorded in 1998. Restructuring charges in 1998 were restated by a decrease of $2.25 million, as explained in note 1q to notes to the Consolidated Financial Statements.

**Operating Income (Loss).** Operating income increased to approximately $20.3 million in 1999 from a loss of approximately $74.6 million after restatement as explained in the preceding paragraph in 1998, primarily due to the expenses related to migration from Clearlink to Skystar Advantage, restructuring charges, write-offs associated with restructuring, and expenses related to acquired research and development as described above. If expenses related to the migration, restructuring charges, write-offs associated with restructuring and expenses related to acquired research and development had not been included, operating income would have been $58.2 million for the year ended December 31, 1999, compared to $26.9 million for the year ended December, 1998, an increase of 116.4%, with the increase due primarily to increased sales.

**Financial Income (Expenses), Net.** Financial income, net amounted to approximately $3.3 million in 1999, compared to financial expenses, net of approximately $1.2 million in 1998, mainly due to interest income on bank deposits from our public offering in February, 1999.

**Taxes on Income.** Taxes on income were approximately $2.5 million in 1999 compared to approximately $0.3 million in 1998.

**Share in Losses of Associated Companies.** Share in losses of associated companies was approximately $0.5 million in 1999, compared to approximately $0.7 million in 1998.

**Net Income (Loss).** As a result of all the foregoing factors, we had net income of approximately $19.6 million in 1999 compared to a loss of approximately $79.4 million, after restatement as explained above, in 1998. If migration expenses, restructuring charges, write-offs associated with restructuring and expenses related to acquired research and development had not been included in the results, net income for the year ended December 31, 1999, would have been $58.4 million compared to $24.8 million for the year ended December 31, 1998, an increase of 135.6%.

**Earnings (Loss) Per Share.** Basic earnings per share for 1999 under U.S. GAAP was $0.96 per share ($0.83 per share under Israeli GAAP) as compared to basic loss per share of $7.18 per share ($6.37 per share under Israeli GAAP) in 1998. Diluted earnings per share for 1999 was $0.92 per share ($0.83 per share under Israeli GAAP) as compared to diluted loss per share of $7.18 per share ($6.37 per share under Israeli GAAP) in 1998. If migration expenses, restructuring charges, write-offs associated with restructuring and expenses related to acquired research and development had not been included in the results, basic earnings per share for 1999 under U.S. GAAP would have been $2.86 per share as compared to $2.24 in 1998, and diluted earnings per share for 1999 under U.S. GAAP would have been $2.73 per share as compared to $2.14 in 1998.

**Year Ended December 31, 1998 Compared to Year Ended December 31, 1997**

**Revenues.** Our revenues increased by 49.8% to approximately $155.3 million in 1998 from approximately $103.7 million in 1997. The growth in revenues was attributable primarily to a substantial increase in sales of telephony products (FaraWay and DialAway) as well as increased sales of Skystar Advantage products and Internet Protocol (''IP'') based products. The increase in revenues was partly offset by downward pressure on prices in the industry.

**Gross Profit.** Gross profit increased by 31.8% to approximately $59.2 million in 1998 from approximately $44.9 million in 1997. Our gross profit margin decreased to 38.1% in 1998 from 43.3% in 1997 due to write-off of inventories associated with restructuring. If such write-off had not been included, our gross profit margin would have increased to 44.2% due primarily to a relative decrease in our cost of revenues as a result of more efficient manufacturing processes, lower cost of components and a change in the overall product mix.

**Research and Development Expenses.** Research and development expenses include $80 million for the write-off of acquired in-process research and development associated with the Spacenet acquisition. In-process research and development expenses arise from new product development projects that are in various stages of completion at the acquired enterprise at the date of acquisition. Gross research and development costs without acquired research and development increased by 49.0% to approximately $15.8 million in 1998, from approximately $10.6 million in 1997 and as a percentage of revenues remained at the same level of 10.2% in 1998 as in 1997. The dollar increase in such costs in 1998 was due primarily to the hiring of additional research and development personnel, the further development of the FaraWay, SkySurfer and SkyBlaster product lines for corporate and rural telephony applications, the expansion of research and development to reduce the costs and increase the functionality of our unidirectional and interactive VSAT product lines, including IP-based products, as well as ISAT and paging receiver products and to conducting generic research relating to the research consortia. Research and development grants, as a percentage of gross research and development costs, decreased to 19.2% in 1998 compared to 23.5% in 1997. Research and development costs, without acquired research and development net increased to approximately $12.8 million in 1998 from approximately $8.1 million in 1997, and increased as a percentage of revenues to 8.2% in 1998 from 7.8% in 1997.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by 43.1% in 1998 to approximately $29.1 million from approximately $20.3 million in 1997. As a percentage of revenues, selling, general and administrative expenses decreased to 18.7% in 1998 from approximately 19.6% in 1997. Increased expenditures in 1998 were primarily attributable to the expansion of our marketing and selling efforts through the hiring of personnel, increased commissions paid to sales personnel, agents and distributors, and the opening of new offices.

**Restructuring Charges and Related Expenses.** As a result of the Spacenet acquisition, we incurred restructuring charges of $12.0 million after restatement, as explained in note 1q to Notes to the Consolidated Financial Statements, for the year ended December 31, 1998, mainly for compensation to customers and other third parties, $9.5 million of inventory write-offs relating to rationalization of product lines, which are presented in cost of revenues and $2.7 million of write-off of investments associated with restructuring.

**Operating Income (Loss).** Our operating income decreased to a loss of approximately $74.6 million after restatement, as explained in note 1q to Notes to the Consolidated Financial Statements, in 1998 from an income of approximately $16.5 million in 1997, primarily due to the restructuring charges, write offs associated with restructuring and expenses related to acquired research and development as described above. If restructuring charges, write offs associated with restructuring and expenses related to acquired research and development had not been included, operating income would have been $26.9 million for the year ended December 31, 1998, (representing an increase of 62.8% over 1997) with the increase due primarily to increased revenues.

**Financial Income (Expenses), Net.** Financial expenses, net amounted approximately to $1.2 million in 1998, compared to financial income, net of approximately $0.5 million in 1997, mainly due to payment of interest on subordinated notes while related interest earned on deposits in banks decreased due to use of funds.

**Share in Losses of Associated Companies.** Share in losses of associated companies was approximately $0.7 million in 1998 with no parallel amount in 1997.

**Net Income (Loss).** As a result of all the foregoing factors, we had a loss of approximately $79.4 million in 1998, after restatement as explained in note 1q to Notes to the Consolidated Financial Statements, in comparison to net income of approximately $16.9 million in 1997. If restructuring charges, write offs associated with restructuring and expenses related to acquired research and development had not been included in the Company's results, the net income for the year ended December 31, 1998, would have been $24.8 million (representing an increase of 46.4% over 1997).

**Earnings (Loss) Per Share.** Basic loss per share for 1998 under U.S. GAAP was $ 7.18 per share ($6.37 per share under Israeli GAAP) after restatement, as explained in note 1q to Notes to the Consolidated Financial Statements, as compared to basic earnings per share of $1.56 per share ($1.50 per share under Israeli GAAP) in 1997. Diluted loss per share after restatement for 1998 was $7.18 per share ($6.37 per share under Israeli GAAP) as compared to diluted earnings per share of $1.51 per share ($1.47 under Israeli GAAP) in 1997. If restructuring charges, write offs associated with restructuring and expenses related to acquired research and development had not been included in the our results, basic earnings per share for 1998 would have been $2.24 per share and diluted earnings per share for 1998 under U.S. GAAP would have been $2.14 per share.

**Variability of Quarterly Operating Results**

Our revenues and profitability may vary from quarter to quarter and in any given year, depending primarily on the sales mix of our family of products and the mix of the various components of the products (i.e., the volume of sales of remote terminals versus hub equipment and software and add-on enhancements), sale prices, and production costs, as well as entry into new service contracts, the termination of existing service contracts, or different profitability levels between different service contracts. Sales of the Skystar Advantage and FaraWay products to a customer typically consist of numerous remote terminals and related hub equipment and software, which carry different sales prices and margins.

Annual and quarterly fluctuations in our results of operations may be caused by the timing and composition of orders by our customers. Our future results also may be affected by a number of factors including our ability to continue to develop, introduce and deliver enhanced products on a timely basis and expand into new product offerings at competitive prices, to anticipate effectively customer demands, and to manage future inventory levels in line with anticipated demand. These results may also be affected by currency exchange rate fluctuations and economic conditions in the geographical areas in which we operate. In addition, our revenues may vary significantly from quarter to quarter as a result of, among other factors, the timing of new product announcements and releases by us and our competitors. We cannot be sure that the growth in revenues, gross profit and net income achieved by us in prior quarters will continue or that revenues, gross profit and net income in any particular quarter will not be lower than those of the preceding quarters, including comparable quarters. Our expense levels are based, in part, on expectations as to future revenues. If revenues are below expectations, operating results are likely to be adversely affected. As a result, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Due to all of the foregoing factors, it is likely that in some future quarters our revenues or operating results will be below the expectations of public market analysts or investors. In such event, the market price of our ordinary shares would likely be materially adversely affected.



FOR PUBLIC INSPECTION

## Liquidity and Capital Resources

Since inception, our financing requirements have been met primarily through cash generated by operations, funds generated by private equity investments in 1990 and 1991, our public offerings in 1993 (approximately $24.5 million) 1995 (approximately $37.5 million), and 1999 (approximately 254.5 million), and our issuance of convertible subordinated notes in 1997 (approximately $71.8 million) and 2000 (approximately $338.8 million), as well as funding from research and development grants. In addition, we also financed our operations through borrowings under available credit facilities as discussed below. We intend to meet our anticipated increases in capital expenditures and working capital requirements with cash-on-hand.

We have used available funds primarily for working capital. In 1999, funds were used to increase trade receivables by approximately $40.0 million, other receivables by approximately $79.5 million, accrued expenses decreased by approximately $6.8 million, and approximately $16.2 million were used to decrease short term bank credit. Funds were also used to increase investment in companies by approximately $11.9 million and property, plant and equipment by approximately $92.0 million in 1999. This increase in property, plant and equipment represents a portion of our investment in our new facility in Petah Tikva, Israel, as well as additional purchases of computer and electronic equipment and office furniture and equipment. Approximately $14.7 million was provided by an increase in trade payables, approximately $13.0 million was provided by an increase in other payables (including other long-term liabilities), and approximately $13.9 million was provided by a decrease in inventories. The decrease in inventories was due to migration from Clearlink to Skystar Advantage.

As of December 31, 1999, we had approximately $94.9 million in cash, cash equivalents and short-term bank deposits and approximately $50.0 million of long-term bank deposits, compared to approximately $7.6 million in cash, cash equivalents and short-term bank deposits and approximately $40.7 million of long-term bank deposits as of December 31, 1998. Our ratio of shareholders' equity to total assets as of December 31, 1999, increased to 73.6% from 55.5%, after restatement, as explained in note 1q of Notes to the Consolidated Financial Statements, as of December 31, 1998.

As of December 31, 1999, we had a bank line of credit of approximately $10 million with Israel Discount Bank Ltd. (an affiliate of one of our major shareholders), under which approximately $4.6 million of short-term debt was outstanding as of that date. We also had a bank line of credit of approximately $24 million with Bank Leumi Le Israel B.M., under which approximately $2.3 million of short-term debt was outstanding as of December 31, 1999. The short-term bank credits are secured by a negative pledge prohibiting us from selling or otherwise transferring any assets except in the ordinary course of business, from placing a lien on our assets without the bank's consent and from declaring dividends to our shareholders.

In 1998, funds were used to increase inventories by approximately $1.5 million and trade receivables by approximately $35.2 million. The increase in inventories in 1998 represented increased component purchases to meet higher production levels and an increase in work-in-process and finished products, primarily related to customer orders planned for shipment early in the following quarter including products needed for the migration from Clearlink to Skystar Advantage. Funds were also used to increase investments by approximately $14.2 million (including $8.5 million in loans to an associated company and $2.7 million used in connection with deconsolidation of the investment in GVT Antilles) approximately $5.7 million was used to decrease other payables,and $15.8 million was used to increase property, plant and equipment. This increase in property, plant and equipment represents a portion of our investment in our new facility in Petah Tikva, Israel, as well as additional purchases of computer and electronic equipment and office furniture and equipment. Approximately $3.9 million was provided by an increase in trade payables, approximately $22.3 million after restatement, as explained in note 1q to Notes to the Consolidated Financial Statements, was provided by a decrease in other receivables and an increase in accrued expenses, and approximately $20.4 million was provided by short term bank credit.

In June 2000, we exercised our right to redeem our 6½% convertible subordinated notes issued on May 14, 1997 and due on June 1, 2004. The notes were redeemable in full at 102% of the principal amount plus accrued and unpaid interest, setting the redemption price per $1,000 note at $1,020.72. All of the note holders opted to convert their notes into Gilat's ordinary shares prior to the redemption date. See note 8 of Notes to the Consolidated Financial Statements.

The convertible subordinated notes that were issued in February 2000 represent unsecured general obligations, are subordinate in right of payment to certain of our obligations, and are convertible into our ordinary shares. The notes bear interest at an annual rate of 4.25% and will mature on March 15, 2005, unless:

- redeemed by us on or after March 18, 2003;
- repurchased by us at the option of the holders upon the occurrence of certain designated events; or
- converted into our ordinary shares at the option of the holders at a conversion price of $186.18 per ordinary share.

The notes do not impose any financial covenants or any restrictions on the payment of dividends, the repurchase of securities or the incurrence of senior indebtedness or other indebtedness. See note 16 of Notes to the Consolidated Financial Statements.

We expect that the principal uses of our cash during 2000 will be for working capital, capital expenditures and strategic investments. In addition, our uses of cash will include the expansion of our manufacturing, testing, quality control, delivery and service capabilities in Israel, expansion of our international marketing activities, research and development, and additional capital investment for our service-based offerings.

**Acquisition of Spacenet**

On December 31, 1998, we completed the acquisition of Spacenet, a company engaged in providing VSAT-based network services and prior to the acquisition, a wholly-owned subsidiary of GE Americom. The transaction was completed pursuant to an Agreement and Plan of Merger entered into on September 25, 1998, between Gilat, GE Americom, and Spacenet. We acquired Spacenet from GE Americom in exchange for 5 million shares of newly issued Gilat ordinary shares. The acquisition was structured as a merger intended to qualify as a "tax-free" reorganization. See "Item 13: Interest of Management in Certain Transactions—Merger-Related Agreements—The Tax Matters Agreement." As part of the acquisition, we entered into several significant agreements with GE. See "Item 13: Interest of Management in Certain Transactions—Merger-Related Agreements."

**In-Process Research and Development.**

A major value-enhancing asset acquired in the Spacenet acquisition was the technology developed by Spacenet as part of its planned new Turbosat product. At that time, we planned to utilize the Turbosat technology in a new product.

As part of the process of analyzing the purchase of Spacenet, management made a decision to buy technology that had not yet been commercialized rather than develop the technology internally. Our management based this decision on factors such as the amount of time it would take to bring the technology to market and the quality of the Spacenet research and development effort. We also considered our own resource allocation and our progress on comparable technology. Our management expects to use

the same decision process in the future. The allocation to in-process research and development of $80 million represents the estimated fair value using the methodology described under "Valuation Assumptions" below.

At the time of the acquisition, the Turbosat technology, though not yet fully developed, was intended to increase throughput, expand product features to serve additional applications and reduce cost. The technology was also expected to accommodate changes in customer's performance and application requirements through its ability to be upgraded to a satellite multimedia platform or a terrestrial router. One of the most important features of the acquired Turbosat technology is that it enables a wide range of flexibility through the application of spread spectrum and CDMA technologies as the satellite access method. Other distinguishing features are its advanced level capability for data, audio and video broadcasting.

At the time of the acquisition, we expected the full software feature to be complete in late first quarter 1999 and a fully integrated Turbosat to be ready for release by June 1999, at which time we expected to begin generating economic benefits from the value of the completed development associated with the in-process research and development. At that time, we also expected that if successfully completed, the new product incorporating the Turbosat feature set would be marketed by us under the Skystar Advantage trademark while maintaining backward compatibility.

In 1999, the research and development of Turbosat technology progressed, with most of Turbosat's improved functionality and features completed and the technology being integrated (other than CDMA) into a new product platform, Skystar Advantage TG (Turbo Generation), which is now our main Skystar Advantage platform and is being implemented for the USPS network and other networks.

Prior to the acquisition, Spacenet had incurred approximately $20 million in Turbosat development-related costs. At the acquisition date, costs to complete the research and development efforts related to Turbosat were expected to be approximately $6 million. In 1999 our gross research and development expenses were approximately $27 million, which included expenses related to integration of the Turbosat technology into the Skystar Advantage platform. We have not completed research and development of the Turbosat CDMA technology, although we continue to consider potential integration of this technology in our VSAT products and for which we are directing research and development activities over the next 12 months.

**Valuation Assumptions**

In connection with the Spacenet acquisition in 1998, we estimated the fair value of in-process research and development using an income approach. This involved estimating the present value of the estimated after-tax cash flows expected to be generated by the purchased in-process research and development, using risk adjusted discount rates and revenue forecasts as appropriate. Product revenues attributable to the Turbosat technology were estimated to be $118 million in 1999 and to grow thereafter through the end of the product's life in 2005 as new product technologies are expected to be introduced by us. Product revenue growth was expected to decrease gradually from 42% in 2001 to 15% in 2003 and 6.9% in 2005. Service revenues and lease payments were expected to continue at a declining rate through the year 2011. Revenues were estimated based on relevant market size and growth factors, expected industry trends, individual product sales cycles, maintenance and service life and the estimate life of the product's underlying technology. Product costs included hardware, installation, space segment fees, and maintenance costs. Estimated operating expenses included cost of goods sold, selling, general and administrative expenses and engineering expenses. The estimates were consistent with historical pricing, margins and expense levels for our other products.

The selection of the discount rate was based on consideration of a weighted average cost of capital, as well as other factors including the technology's useful life, profitability level, uncertainty of

advances, and stage of completion. A risk adjusted discount rate of 40% was utilized to discount projected cash flows.

Only a proportional value consistent with the technology's already completed development effort was considered in-process research and development for financial reporting purposes. Value associated with the technology's remaining development effort was not included in the valuation. We further believed that the estimated in process research and development amount determined represented fair value and did not exceed the amount a third party would pay for the project.

We allocated anticipated cash flows from an in-process research and development project to reflect contributions of the core infrastructure technology. At the date of acquisition, the Turbosat technology for which a value had been assigned to in-process research and development efforts had not yet reached technological feasibility and had no alternative future uses. Accordingly, the value allocated to this R&D project was capitalized and immediately expensed at acquisition. If the project is not wholly successful or not fully completed in a timely fashion, management's product pricing and growth rates may not be achieved and we would not realize the financial benefits expected from the project at the time of the acquisition.

Based on an independent appraiser's report obtained by management, on December 31, 1998, we recorded a charge of $80 million for the write-off of acquired in-process research and development associated with the Spacenet acquisition. In-process research and development expenses arise from new product development projects that are in various stages of completion at the acquired enterprise at the date of acquisition.

**Impact of Inflation and Currency Fluctuations**

Almost all of our sales and service contracts are in dollars and most of our expenses are in dollars and NIS. The dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is not offset (or is offset on a lagging basis) by a devaluation of the NIS in relation to the dollar. The influence on the dollar cost of our operations in Israel relates primarily to the cost of salaries in Israel, which are paid in NIS and constitute a substantial portion of our expenses in NIS. During 1999, the rate of inflation in Israel was 1.3% while the value of the dollar against the NIS decreased by 0.17%. During 1997 and 1998 the rate of devaluation of the NIS against the dollar exceeded the inflation rate in Israel. In 1997 the rate of inflation was 7.0% and the rate of devaluation was 8.8%. In 1998 the rate of inflation was 8.6% and the rate of devaluation was 17.6%. In earlier years, there was a reversed trend when the inflation rate exceeded the rate of devaluation of the NIS against the dollar. For example, during 1995 the rate of inflation in Israel was 8.1% and during 1996 the rate of inflation was 10.6%, while the NIS was devalued against the dollar by 3.9% in 1995 and by 3.7% in 1996. If future inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of such devaluation lags behind increases in inflation in Israel, our results of operations may be materially adversely affected.

In addition, we pay for the purchase of certain components of our products in Japanese yen. As a result, an increase in the value of the Japanese yen in comparison to the dollar could increase the cost of revenues. We have entered into a hedging agreement with our principal Japanese supplier in an effort to reduce the effects of fluctuations in the exchange rate, although there can be no assurance that such agreement will effectively hedge our Japanese yen exposure.

**Effective Corporate Tax Rate**

Israeli companies are generally subject to income tax at the rate of 36% of taxable income. However, substantially all of our production facilities in Israel have been granted Approved Enterprise status under the Law for Encouragement of Capital Investments, 1959, and consequently are eligible for certain tax benefits for the first several years in which they generate taxable income. We currently have

nine Approved Enterprises, and have applied for approval for a tenth enterprise. Income derived from the nine Approved Enterprises is entitled to tax benefits for periods of 7 years (in the case of two of the enterprises) or 10 years (for the remaining seven enterprises), from the first year in which we generate income from the respective Approved Enterprise, on the basis of the nature of the incentives selected by us. The period of reduced tax for the tenth enterprise, if approved, is expected to be 10 years, although the terms of the approval may provide for a different period. The main tax benefits are a tax exemption for two or four years and a reduced tax rate of 15% to 25% for the remainder of the benefits period depending upon the level of foreign ownership of the company. As a result of these programs, our effective corporate tax rate was 0% in 1993, 2.1% in 1994, 0% in 1995, 1.5% in 1996, 0.8% in 1997, and 10.9% in 1999. The increase in 1999 was due mainly to one time charges associated with the restructuring and losses in subsidiaries for which no deferred income taxes were recorded. In 1998 we had a loss due to restructuring charges, write offs associated with restructuring and expenses related to acquired research and development. We anticipate that a substantial part of our income for 2000 will be tax-exempt, while the balance will be taxed at rates ranging from 15% to 36%.

On May 4, 2000, a committee appointed by the Israeli Finance Minister known as the "Ben-Bassat Committee" submitted its report on reform of the Israeli direct tax system (the "Report"). The Report makes several recommendations that if enacted into law by the Israeli Parliament, may have substantial tax implications on us and on our shareholders. The Israeli Government adopted the recommendations, with the intention that the applicable legislation will be effective as of January 1, 2001. During the legislative process, the recommendations contained in the Report may be subject to substantial changes.

The Report recommends increasing to 25% the corporate tax rate available under the Law for the Encouragement of Capital Investments, 1959, during certain portions of the Approved Enterprise benefits period to companies owned in whole or in part by foreign investors. Currently depending on the percentage of foreign ownership this rate can be as low as 10%, , and as high as 25%, which is the corporate tax rate available to the Approved Enterprises of companies without any foreign ownership. Furthermore, the Report recommends revoking a current exemption available to income of Approved Enterprises that is not distributed as a cash dividend and, setting a corporate tax rate of 10% for profits generated during certain portions of the Approved Enterprise benefits period.

**Recently issued accounting pronouncements**

In June 1998, the FASB issued FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". FAS 133 established new accounting and reporting standards for derivatives and hedging activities. FAS 133 requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. FAS 133 is effective for calendar-year companies from January 1, 2000. We are currently evaluating the impact FAS 133 will have on our financial statements.

In December 1999, the United States Securities and Exchange Commission issued Staff Accounting Bulletin No. 101-"Revenue Recognition in Financial Statements". SAB 101 summarizes the SEC's interpretation of the application of GAAP to revenue recognition.

We are currently evaluating the impact that SAB 101 will have on our financial statements.

## ITEM 9A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

**General**

The currency of our primary economic environment is the dollar. However, we have balances and activities in other currencies. We are therefore exposed to market risks arising from changes in currency exchange rates. We are also exposed to market risks arising from changes in interest rates.

From time to time, we use financial instruments and derivatives in order to limit our exposure to risks arising from changes in exchange rates between the dollar and the NIS and other currencies and in interest rates. However, we cannot assure that the use of such instruments will eliminate our exposure to additional exchange rate or interest rates risks.

**Exchange Rate Risk Management**

Our functional currency and that of most of our subsidiaries is the dollar. Accordingly, we attempt to protect ourselves against exposure arising from the difference between assets and liabilities in each currency other than the dollar ("Balance Sheet Exposure"). We strive to limit our exposure through "natural" hedging, i.e., attempting to maintain similar levels of assets and liabilities in any given currency, to the extent possible. However, this method of "natural" hedging is not always achievable..

The table below details the balance of the Balance Sheet Exposure by currency:

| | December 31, 1999 |
|---|---|
| **Liabilities – short term** | **(in thousands)** |
| Variable rate debt: | |
| In NIS | 5,276 |
| Interest rate | 11.3%-12.1% |

**Interest Rate Risk Management**

Due to the existence of assets and liabilities with different interest rates and maturity dates, we are exposed to changes in interest rates.



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The table below details the Balance Sheet Exposure by currency and interest rates:

| | Expected Maturity Dates | | |
|---|---|---|---|
| | 2000 | 2001 | Maturity Unknown |
| **Assets:** | (In thousands) | | |
| Short term- in US dollars: | 61,540 | | |
| Fixed rate | | | |
| Interest rate | 5.4%-6.69% | | |
| Long term – in US dollars: | | 50,000 | $9,000 |
| Fixed rate | | | |
| Interest rate | | 5.71%-5.79% | 0% |
| **Liabilities:** | | | |
| 1) long-term – in US dollars: | $75,000 | | |
| fixed rate debt- In dollars | | | |
| Interest rate | 6.5% | | |
| 2) short-term variable rate debt- | | | |
| In dollars | 1,710 | | |
| average interest rate | 6.85% | | |
| In NIS | 5,276 | | |
| average interest rate | 11.3%-12.1% | | |
| Interest rate option(*) | $20,000 | | |

(*) In May, 1997 we bought a three year call option to protect us in the event the Libor interest rate exceeds 7.5%. Upon the exercising of the option, we will be entitled to the difference between the then Libor interest rate and 7.5%, multiplied by $20,000,000. This call option was not exercised and expired in May 2000.

In 1998 and 1999, we made long-term loans in the amount of $9,000,000 to an associated company: $8,500,000 in 1998 and $500,000 in 1999. The loans do not bear interest and are without a maturity date.

In February 2000, we completed a private offering of $350 million of convertible subordinated notes due in 2005, to Qualified Institutional Buyers. The notes are convertible into ordinary shares at a conversion price of $186.18 per share. Each note will bear annual interest of 4.25% payable semiannually. See also note 16a of the Notes to the Consolidated Financial Statements.

## ITEM 10: DIRECTORS AND OFFICERS OF REGISTRANT

**Directors and Executive Officers**

Our directors and executive officers and key executives of our subsidiaries as of June 16, 2000 are as follows:

| Name | Age | Position |
|---|---|---|
| Yoel Gat(1)(2) | 48 | Chairman of the Board of Directors and Chief Executive Officer |
| Amiram Levinberg(1)(2) | 44 | President, Chief Operating Officer and Director |
| Shlomo Tirosh(3) | 54 | Director |
| Dov Tadmor(1)(3) | 70 | Director |
| John Connelly(4) | 56 | Director |
| Dr. Gideon Kaplan | 44 | Vice President, Technology |
| Yoav Leibovitch | 42 | Vice President, Finance and Administration and Chief Financial Officer |
| Joshua Levinberg | 46 | Senior Vice President, Business Development |
| Joann R. Blasberg | 48 | Vice President and General Counsel |
| Erez Antebi | 40 | Vice President, General Manager for Asia, Australia and Africa |
| Alan Freece | 52 | Chief Executive Officer and President, Gilat Florida |
| Sheldon Revkin | 56 | President and Chief Operating Officer, Spacenet |
| David R. Shiff | 42 | Vice President, Sales and Marketing, Spacenet |
| Robert Givens | 54 | President, Gilat Europe |

(1) Member of the Stock Option Committee. For approval of stock option grants to employees who are also directors, the Stock Option Committee also includes Mr. Tadmor.
(2) Member of the Compensation Committee.
(3) Member of the Audit Committee.
(4) Mr. Connelly is a nominee of GE Americom, pursuant to a voting agreement among certain of the principal shareholders of Gilat concerning the election of directors.

*Yoel Gat* is a co-founder of Gilat and has been its Chief Executive Officer and a Director since Gilat's inception and since July 1995 has served as the Chairman of the Board of Directors. Mr. Gat is a member of the Stock Option and Compensation Committees of the Board. Until July 1995, Mr. Gat also served as the President of Gilat. From 1974 to 1987, Mr. Gat served in the Israel Defense Forces ("IDF"). In his last position in service, Mr. Gat was a senior electronics engineer in the Israel Ministry of Defense ("IMOD"). Mr. Gat is a two-time winner of the Israel Defense Award (1979 and 1988), Israel's most prestigious research and development award. Mr. Gat is also Chairman of the Board of Directors of KSAT, in which Gilat holds a minority interest. Mr. Gat also served as the Chairman of the MOST Consortium and is a director of ILAN-GAT Engineering Ltd., a civil contracting company whose shares are publicly traded on the Tel Aviv Stock Exchange and of which members of his family are major shareholders. Mr. Gat is Chairman of the Board of Directors of Gilat-To-Home, Inc. Mr. Gat received a bachelor of science degree in electrical engineering and electronics from the Technion—Israel Institute of Technology and a masters degree in management science from the Recanati Graduate School of Business Administration of Tel Aviv University, where he concentrated on information systems.

*Amiram Levinberg* is a co-founder of Gilat and has been a Director and Chief Operating Officer since inception, and since July 1995 has served as President. Mr. Levinberg is a member of the Stock Option and Compensation Committees of the Board. Until July 1995, he served as Vice President of Engineering. In this capacity, he supervised the development of Gilat's OneWay and Skystar Advantage VSATs. Mr. Levinberg is also a director of Gilat Communications. From 1977 to 1987, Mr. Levinberg served in a research and development unit of the IDF, where he managed a large research and development





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project. He was awarded the Israel Defense Award in 1988. Mr. Levinberg is a graduate of the Technion, with a bachelor of science degree in electrical engineering and electronics and masters of science degree in digital communications.

***Shlomo Tirosh*** is a co-founder of Gilat and has been a member of the Board of Directors since inception, serving as Chairman of the Board of Directors until July 1995. Mr. Tirosh is a member of the Audit Committee of the Board. Since July 1990, Mr. Tirosh has served as Chairman of the Board, Chief Executive Officer and President of Gilat Communications. From 1964 to 1987, Mr. Tirosh served in the IDF, where he held a variety of professional and field command positions (retiring with the rank of colonel). From 1980 to 1985, he headed a large research and development unit, and from 1985 to 1987, he managed a large-scale technology project for the IMOD. In 1988, he received the Israel Defense Award. Mr. Tirosh holds a bachelor of arts degree (summa cum laude) in economics from Bar-Ilan University in Ramat Gan.

***Dov Tadmor*** has been a Director of Gilat since July 1994 and is a member of the Audit and Stock Option Committees of the Board. Mr. Tadmor served as Managing Director of DIC and DICFM from 1985 until March 1999. Mr. Tadmor holds a bachelor of law degree from the School of Law and Economics in Tel Aviv.

In August 1999, an indictment was filed by the Tel Aviv District Attorney's Office in the Tel Aviv Magistrate's Court alleging certain violations of the Israeli Securities Law by DIC and certain of its officers, including Mr. Dov Tadmor, in his capacity as the former CEO of DIC. The indictment alleges that DIC's annual and quarterly financial statements for the period 1990-1995 were misleading in connection with the failure to attach to DIC's financial statements sent to the Tel Aviv Stock Exchange and the Israel Registrar of Companies the financial statements of three private Israeli companies of which DIC was a shareholder. In December 1999, Mr. Tadmor and the other defendants pleaded not guilty to the charges, although one of the defendants subsequently entered into a plea agreement with the prosecution. The court commenced evidentiary proceedings in May 2000.

***John Connelly*** was appointed a Director in January 1999. Since 1992, Mr. Connelly has served as Chairman and Chief Executive Officer of GE Americom. Mr. Connelly joined the General Electric Company in 1967, and has served in a number of capacities at General Electric and its affiliates since that time. Mr. Connelly holds a bachelor of science degree form Niagara University and a masters in business administration from St. John's University.

***Gideon Kaplan*** joined Gilat in 1989 as Vice President of Technology. From late 1987 to 1989, Dr. Kaplan was employed as a research engineer with QUALCOMM, Inc., a mobile satellite communications and cellular radio company. From 1978 to 1987, Dr. Kaplan served in a research and development unit of the IDF and received the Israel Defense Award in 1984. Dr. Kaplan received a bachelor of science degree in electrical engineering, a master of science degree and doctorate in electrical engineering from the Technion.

***Yoav Leibovitch*** joined Gilat in early 1991 as Vice President of Finance and Administration and Chief Financial Officer. Since joining Gilat, Mr. Leibovitch has also served as acting Chief Financial Officer of Gilat Inc. He is a director of GVT. From 1989 to 1990, Mr. Leibovitch worked in the United States at Doubleday Books and Music Clubs as special advisor for new business development. From 1985 to 1989, he was the Financial Officer of a partnership among Bertelsmann, A.G., a large German media and communication company; Clal Corporation, a major Israeli industrial holding company; and Yediot Aharonot, an Israeli daily newspaper. Mr. Leibovitch is a graduate of the Hebrew University of Jerusalem with a bachelor of arts degree in economics and accounting, and a masters degree in business administration specializing in finance and banking. Mr. Leibovitch is a Certified Public Accountant in Israel.

*Joshua Levinberg* is a co-founder of Gilat and since June 1999 serves as Senior Vice President for Business Development of Gilat, having previously served in that position from 1994 to April 1998. At that time, Mr. Levinberg became Chief Executive Officer of GVT until June 1999. From 1989 until September 1994, he served as Executive Vice President and General Manager of Gilat Satellite Networks, Inc. From 1987 until the formation of Gilat Satellite Networks, Inc. in 1989, Mr. Levinberg was Vice President of Business Development of Gilat. From 1985 to 1987, Mr. Levinberg held various positions, including Manager of System Development and Marketing Manager at the Israeli subsidiary of DSP Group Inc., a U.S. company specializing in digital signal processing. From 1979 to 1985, he worked in the Communications Engineering Department of Elrisa Ltd., a manufacturer of sophisticated weapons and communications systems. Mr. Levinberg is a graduate of Tel Aviv University, with a bachelor of science degree in electrical engineering and electronics. Amiram Levinberg, a director, President and Chief Operating Officer of Gilat, and Joshua Levinberg are brothers.

*Joann R. Blasberg* joined Gilat in August 1995 as Vice President and General Counsel. Prior to joining Gilat, Ms. Blasberg was a partner in the firm of Kleinhendler & Halevy, Israeli counsel to Gilat, having been associated with that firm from May 1987. Prior to immigrating to Israel in December 1986, Ms. Blasberg was an associate with the firms of Siff & Rosen from May 1984 and Kronish Leib Weiner & Hellman from August 1982 until May 1984. Ms. Blasberg served as Principal Law Clerk to Chief Judge Lawrence H. Cooke of the New York State Court of Appeals from 1979 to August 1982. Ms. Blasberg received a law degree in 1979 from Brooklyn Law School (summa cum laude) and received a bachelors degree in sociology from Queens College.

*Erez Antebi* currently serves as Gilat's Vice President, General Manager for Asia, Australia and Africa. From September 1994 until the beginning of 1998, he served as Vice President and General Manager of Gilat Inc. Mr. Antebi joined Gilat in May 1991 as product manager for the Skystar Advantage VSAT product. From August 1993 until August 1994, he served as Vice President Engineering and Program Management of Gilat Inc. Prior to joining Gilat, Mr. Antebi worked for a private importing business from 1989 to 1991, after having served as marketing manager for high frequency radio communications for Tadiran Limited, a defense electronics and telecommunications company, from 1987 to 1989 and as a radar systems development engineer at Rafael, the research and development and manufacturing arm of the IDF, from 1981 to 1987. Mr. Antebi received a bachelor of science degree and master of science degree in electrical engineering from the Technion.

*Alan Freece* joined Gilat Florida in July 1997 as President and became Chief Executive Officer of that company in January 1998. Prior to joining Gilat Florida, Mr. Freece was Vice President of Marketing and Business Development at Spacenet from 1995 to 1997. From 1984 to 1994, Mr. Freece served in several capacities, including Vice President of Marketing and Sales and President for Scientific Atlanta Private Networks VSAT Division. From 1973 to 1984, he was with Harris's Satellite Communications Division. Mr. Freece received a bachelor of science degree in electrical engineering from the University of Illinois and a masters degree in business administration from the University of Florida.

*Sheldon (Shelly) Revkin* joined Spacenet in January 1999, as President and Chief Operating Officer. Prior to joining Spacenet, Mr. Revkin was Senior Vice President and General Manager of the Wireless Networks Division of Hughes Network Systems, Inc. (HNS). Mr. Revkin joined HNS in 1978 and held several executive-level marketing, sales and operations positions within the company. Revkin holds a bachelor of science degree in electrical engineering from Pratt Institute in New York City, a master of science degree in electrical engineering from Polytech University in Brooklyn, New York, and a master of business administration degree in finance and marketing from Lynchburg College in Lynchburg, VA. Revkin is a member of Eta Kappa Nu, Tau Beta Pi, and the Institute of Electrical and Electronics Engineering (IEEE).

*David R. Shiff* joined Spacenet in December 1998, as Vice President of Sales and Marketing. Prior to joining Spacenet, Mr. Shiff spent 15 years with Hughes Network Systems, a division of Hughes

Electronics. For the last two years he served as Assistant Vice President, North American Sales, for the Satellite Networks Divisions of HNS. Mr. Shiff holds a degree in mechanical engineering from the University of Wisconsin.

*Robert Givens* joined Gilat in the Spring of 2000 as President of Gilat Europe. Prior to joining Gilat, Mr. Givens was employed by Global One Communications S.A. from 1996 until 2000, first as Chief Financial Officer and then as Executive Vice President and General Manager for Europe and Eastern Europe. From 1982 to 1996, Mr. Givens operated Profit Development, a transition management company he founded to provide temporary management for European and American companies undergoing corporate change. Prior to 1982, he held various management and financial positions with Groupe Chargeurs from 1977 to 1981, Corning Glass Works from 1976 to 1977, Fairchild Camera and Instrument Corp. from 1972 to 1976, Smith Kline Beecham from 1970 to 1972 and Ford Motor Company from 1968 to 1970. Mr. Givens received a bachelor of science degree in finance from Miami University, and a masters degree in international business administration from Columbia University and continued his studies in post graduate accounting at the Wharton School.

**Terms of Directors**

Directors are elected at the annual shareholders meeting to serve until the next annual meeting of the shareholders and until their respective successors are elected and qualified. Our Articles of Association provide that the directors may appoint additional directors (whether to fill a vacancy or to expand the Board). Our Articles of Association provide that the Board may delegate all of its powers to committees of the Board as it deems appropriate, subject to the provisions of the Israeli Companies Ordinance (the "Companies Law"). Officers of Gilat serve at the discretion of the Board or until their successors are appointed.

**Alternate Directors**

Our Articles of Association provide that a director may appoint, by written notice to Gilat, any individual (whether or not such person is then a member of the Board) to serve as an alternate director, subject to the consent of the Board if the alternate is not then a member of the Board. Any alternate director shall have all of the rights and obligations of the director appointing him or her, except the power to appoint an alternate (unless otherwise specifically provided for in the appointment of such alternate). The alternate director may not act at any meeting at which the director appointing him or her is present. Such alternate may act as the alternate for several directors and have the corresponding number of votes. Unless the time period or scope of any such appointment is limited by the appointing director, such appointment is effective for all purposes and for an indefinite time, but will expire upon the expiration of the appointing director's term. Currently, no alternate directors have been appointed.

**Board Compensation**

By resolution of the Board and the shareholders adopted in 1996, directors who are not executive officers receive annual compensation of $10,000 for their services on the Board or any committee thereof beginning in 1996. All of the non-management directors are reimbursed for their expenses for each Board meeting attended.

**Outside Directors and Audit Committee**

Under the new Israeli Companies Law, which became effective February 1, 2000, public companies are required to elect two outside directors who must meet specified standards of independence. Companies that are registered under the laws of Israel and whose shares are listed for trading on a stock exchange outside of Israel, such as our company, are treated as public companies with respect to the outside directors requirement. The outside directors may not have any economic relationship with us.

Therefore any person who was an employee of a company or had a commercial or professional connection with it including controlling shareholders, 25% shareholders, and their relatives or employees cannot serve as outside directors.

Outside directors are elected by shareholders. The shareholders voting in favor of their election must include at least one-third of the shares of the non-controlling shareholders of the company who are present at the meeting. This minority approval requirement need not be met if the total shareholdings of those non-controlling shareholders who vote against their election represent 1% or less of all of the voting rights in the company. Outside directors serve for a three-year term, which may be renewed for only one additional three-year term. Outside directors can be removed from office only by the same special percentage of shareholders as can elect them, or by a court, and then only if the outside directors cease to meet the statutory qualifications with respect to their appointment or if they violate their duty of loyalty to the company. If, when an outside director is elected, all members of the board of directors of a company are of one gender, the outside director to be elected must be of the other gender.

Any committee of the board of directors must include at least one outside director. An outside director is entitled to compensation as provided in regulations adopted under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service. Pursuant to regulations promulgated under the Companies Law, our two independent directors may be deemed to be outside directors.

The Companies Law also provides that publicly traded companies must appoint an audit committee. The responsibilities of the audit committee include identifying irregularities in the management of the company's business and approving related party transactions as required by law. An audit committee must consist of at least three members, and include all of the company's outside directors. However, the chairman of the board of directors, any director employed by the company or providing services to the company on a regular basis, any controlling shareholder and any relative of a controlling shareholder may not be a member of the audit committee. An audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder (defined below), unless at the time of approval two outside directors are serving as members of the audit committee and at least one of the outside directors was present at the meeting in which an approval was granted.

In addition, the Companies Law requires the board of directors of a public company to appoint an internal auditor nominated by the audit committee. A person who does not satisfy the Companies Law's independence requirements may not be appointed as an internal auditor. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice.

Pursuant to the listing requirements of the Nasdaq National Market, we are currently required to have at least two independent directors on our Board of Directors and to establish an audit committee, at least a majority of whose members are independent of management. Messrs. Tadmor and Tirosh, both of whom we believe are independent of management, currently serve on the Audit Committee of the Board

Nasdaq recently amended its rules to require that listed companies have at least three independent directors on the audit committee, all of whom are financially literate and one of whom has accounting or related financial expertise. We must comply with these amended rules by June 14, 2001.

**Approval of Related Party Transactions Under Israeli Law**

The Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. Under the Companies Law, an "office holder" is a director, general manager, chief business manager, deputy general manager, vice general manager, other manager directly

subordinate to the General Manager or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title.

An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care requires an office holder to act at a level of care which a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (1) information regarding the appropriateness of a given action brought for his approval or performed by him by virtue of his position and (2) all other information of importance pertaining to the foregoing actions. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and his personal affairs, avoiding any competition with the company, avoiding the exploitation of any business opportunity of the company in order to receive personal gain for the office holder or others, and disclosing to the company any information or documents relating to the company's affairs which the office holder has received due to his position as an office holder.

The individuals listed as directors or executive officers in the table above would be considered office holders. Under the Companies Law, all arrangements as to compensation of office holders who are not directors require approval of our Board of Directors, provided, however, that it was not an extraordinary transaction under the Companies Law, and provided further that there are no other special requirements under the company's articles of association. The compensation of office holders who are directors must be approved by our Audit Committee, Board of Directors and shareholders.

The Companies Law requires that an office holder promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by us. In addition, if the transaction is an extraordinary transaction, that is, a transaction other than in the ordinary course of business, other than on market terms, or likely to have a material impact on our profitability, assets or liabilities, the office holder must also disclose any personal interest held by the office holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing, or by any corporation in which the office holder is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager.

Some transactions, actions and arrangements involving an office holder, or a third party in which an office holder has an interest, must be approved by the board of directors or as otherwise provided for in a company's articles of association, as not being adverse to the company's interest. In some cases, such a transaction must be approved by the audit committee and by the board of directors itself, with further shareholder approval required in the case of extraordinary transactions. An office holder who has a personal interest in a matter, which is considered at a meeting of the board of directors or the audit committee, may not be present during the board of directors or audit committee discussions and may not vote on this matter.

The Companies Law also provides that an extraordinary transaction between a public company and a controlling shareholder, or an extraordinary transaction in which a controlling shareholder of the company has a personal interest but which are between a public company and another entity, or the terms of compensation of a controlling shareholder, if he is an employee of the company, and the terms of office of a controlling shareholder if he is an officer of the company must be approved by the audit committee, the board of directors and shareholders.

The shareholder approval for an extraordinary transaction must include at least one-third of the shareholders who have no personal interest in the transaction and are present at this meeting. The transaction can be approved by shareholders without this one-third approval, if the total shareholdings of those shareholders who have no personal interest and voted against the transaction do not represent more than 1% of the voting rights in the company. In addition, a private placement of securities that will increase the relative holdings of a shareholder that holds 5% or more of the company's outstanding share capital or

that will cause any person to become, as a result of the issuance, a holder of more than 5% of the company's outstanding share capital, requires approval by the board of directors and the shareholders of the company.

The Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 25% shareholder of the company. This rule does not apply if there is already another 25% shareholder of the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 45% shareholder of the company unless there is another person holding at that time more than 50% of the voting rights of the company.

Regulations under the Companies Law provide that the Companies Law's tender offer rules do not apply to a company whose shares are publicly traded either outside of Israel or both in and outside of Israel, if pursuant to the applicable foreign securities laws and stock exchange rules there is a restriction on the acquisition of any level of control of the company, or if the acquisition of any level of control of the company requires the purchaser to make a tender offer to the public shareholders.

**Indemnification of Directors and Officers**

The Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his duty of loyalty, but may exculpate in advance an office holder from his liability to the company, in whole or in part, with respect to a breach of his duty of care.

The Companies Law provides that a company may not indemnify an office holder, nor enter into an insurance contract which would provide coverage for any monetary liability incurred as a result of, any of the following:

- a breach by the office holder of his duty of loyalty unless the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;
- a breach by the office holder of his duty of care if such breach was done intentionally or in disregard of the circumstances of the breach of its consequences;
- any act or omission done with, the intent to, derive an illegal personal benefit; or any fine levied against the office holder as a result of a criminal offense.

In order to allow indemnification in advance for office holders under the Articles of Association as described, our shareholders shall be required to amend our Articles of Association to include the following provisions:

- A provision authorizing us to grant in advance an undertaking to indemnify an office holder, provided that the undertaking is limited to types of events which the board of directors deems to be anticipated and limited to an amount determined by the board of directors to be reasonable under the circumstances.
- A provision authorizing us to retroactively indemnify an office holder.

In addition, pursuant to the Companies Law and our Articles of Association, indemnification of and procurement of insurance coverage for our Office Holders must be approved by our audit committee and our Board of Directors and, in specified circumstances, by our shareholders.

We provide indemnification to our Office Holders to the fullest extent permitted by law. Our Articles of Association include a provision to the effect that, to the extent permitted by the Companies Law, we may (i) procure insurance for or indemnify any Office Holder, provided that the procurement of any such insurance or provision of any such indemnification, as the case may be, is approved by the Audit Committee and otherwise as required by law and (ii) procure insurance for or indemnify any person who is not an Office Holder, including, without limitation, any employee, agent, consultant or contractor who is not an Office Holder. We have obtained directors' and officers' liability insurance covering our officers and directors and those of our subsidiaries for certain claims.

## ITEM 11: COMPENSATION OF DIRECTORS AND OFFICERS

**Compensation of Directors and Officers**

The following table sets forth the aggregate compensation paid to or accrued on behalf of all of our directors and officers as a group for the year ended December 31, 1999:

| | Salaries, Fees, Directors' Fees, Commissions and Bonuses | Pension, Retirement and Similar Benefits |
|---|---|---|
| All directors and officers as a group (22 persons*) | $7,195,000 | $751,000 |

*including those directors and executive officers referred to in Item 4 (except for four persons who became officers in 2000), one person who ceased being an officer during 1999, and two persons who ceased being directors in 1999.

Through June 15, 2000, we had granted options under the Stock Option Plans to our then officers and directors for a total of 3,008,727 ordinary shares, of which 526,341 have been exercised. See "Item 12: Options to Purchase Securities from Registrant or Subsidiaries."

By Board and shareholder action in July and August 1994, respectively, we authorized future bonuses to four of our executive officers, two of whom are also directors. Such bonuses shall be paid as follows: if our consolidated operating income (as defined in the resolution of the Board and the shareholders) in any year through December 31, 1999 is greater than $10 million, we will pay such officers an aggregate one-time bonus in NIS equal to $510,000, linked to the Israeli CPI (plus an amount equal to any taxes payable on such bonus). The bonus will be divided among them as set forth in resolutions of the Board and the shareholders meeting. The bonus, which was to be paid as soon as practicable after the end of the year in which the operating income exceeded $10 million, was paid in 1998. By Board and shareholder action in June and August 1995, the Board was also authorized to grant annual bonuses to two officers who are also directors. In February and August 1997, the Board and the shareholders authorized an amendment to the annual bonus provision, to exclude merger and acquisition costs in calculating net profit for bonus purposes. In May and August 1999, the Board and shareholders authorized the grant of a bonus to an officer who is also a director in recognition of his efforts in completing the Offering. In February 2000, the Board, subject to shareholder approval at the next annual meeting, authorized the cancellation of loans to two officers who are also directors, the amendment of their employment agreements for salary and bonus adjustments, and the grant of options which will commence vesting over a three year period.

**Management Employment Agreements**

Yoel Gat and Amiram Levinberg, two of our co-founders, are currently employed under employment agreements renewable annually on December 31 of each year. The employment agreements are subject to earlier termination by each officer upon 60 days' notice to us. The agreements provide for an adjustment to the annual bonuses payable to Messrs. Gat and Levinberg under their employment agreements, and Mr. Gat's agreement provides for a personal annual allowance benefit of $150,000 to cover personal expenses related to extended stays in the United States expected to result from the

integration of Spacenet. Among other provisions, such agreements contain non-competition and confidentiality provisions.

**Advisory Board**

We have authorized an Advisory Board to be composed of senior members of the business and technology community with expertise in areas of our business, who will be expected to advise and assist us in determining and implementing our strategic course of action, as well as fostering contacts with potential customers for our products. There are currently no appointees to the Advisory Board.

## ITEM 12: OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT OR SUBSIDIARIES

**Stock Option Plans**

In January 1993, we adopted the Stock Option Plan (Incentive and Restricted Stock Options) (the "1993 ISO/RSO Plan") and Section 102 Option/Restricted Stock Purchase Plan (the "1993 Section 102 Plan") (collectively, the "1993 Plans"). The 1993 Plans provide for the granting of options and/or rights to purchase (in the case of the 1993 Section 102 Plan) up to an aggregate of 318,500 ordinary shares to our officers, directors, key employees or consultants or any of our subsidiaries.

In June 1995, we adopted the following plans, referred to together as the "1995 Plans":

(i) the 1995 Stock Option Plan (Incentive and Restricted Stock Options) (the "1995 ISO/RSO Plan"), which provides for the granting of incentive and restricted stock options for the purchase of up to 3,190,000 ordinary shares (increased by 1,250,000 as a result of resolutions of the Board in August 1999, and February and May 2000, which are subject to approval by the shareholders at the next annual meeting of shareholders;

(ii) the 1995 Section 102 Stock Option/Stock Purchase Plan (the "1995 Section 102 Plan"), which provides for the granting of options to purchase up to 5,120,000 ordinary shares (increased by 3,500,000 as a result of resolutions of the Board in November 1999 and May 2000; and

(iii) the 1995 Advisory Board Stock Option Plan (the "1995 Advisory Board Plan"), which provides for the granting of options to purchase up to 150,000 ordinary shares.

The purpose of the 1993 Plans and 1995 Plans is to enable us to attract and retain qualified persons as employees, officers, directors, consultants and advisors and to motivate such persons by providing them with an equity participation in Gilat. In addition, the 1993 and 1995 ISO/RSO Plans are designed to afford qualified optionees certain tax benefits available under the United States Internal Revenue Code of 1986, as amended (the "Code"). The 1993 and 1995 Section 102 Plans are designed to afford qualified optionees certain tax benefits under the Israel Income Tax Ordinance. The 1995 Advisory Board Plan is designed to allow for the granting of options to members of the Advisory Board. The 1993 Plans will expire on January 27, 2003 and the 1995 Plans will expire on June 29, 2005 (10 years after their adoption), unless terminated earlier by the Board.

Each of the 1993 Plans and the 1995 Plans is administered by a Stock Option Committee appointed by the Board. The Stock Option Committee (comprised of Messrs. Gat and Levinberg for employees and officers who are not directors and Messrs. Gat, Levinberg and Tadmor for employees who are also directors) has broad discretion, subject to certain limitations, to determine the persons entitled to receive options or rights to purchase under the 1993 Plans and 1995 Plans, the terms and conditions on

which options or rights to purchase are granted and the number of shares subject thereto. The Stock Option Committee also has discretion to determine the nature of the consideration to be paid upon the exercise of an option and/or right to purchase granted under the 1993 Plans and the 1995 Plans. Such consideration generally may consist of cash, or, at the discretion of the Board, cash and a recourse promissory note.

Stock options issued as incentive stock options pursuant to both the 1993 and 1995 ISO/RSO Plans will only be granted to the employees of Gilat or its subsidiaries. The exercise price of incentive stock options issued pursuant to both the 1993 and 1995 ISO/RSO Plans must be at least equal to the fair market value of the ordinary shares as of the date of the grant (and, in the case of optionees who own more than 10% of the voting stock, the exercise price must equal at least 110% of the fair market value of the ordinary shares as of the date of the grant). The exercise price of restricted stock options issued pursuant to the 1993 and 1995 ISO/RSO Plans and the 1995 Advisory Board Plan must not be less than the lower of (i) 50% of the book value of the ordinary shares as of the end of the fiscal year immediately preceding the date of such grant, or (ii) 50% of the fair market value per share of ordinary shares as of the date of the grant. The price per share under options awarded pursuant to the 1993 and 1995 Section 102 Plans may be any price determined by the Stock Option Committee.

Options are exercisable and restrictions on disposition of shares lapse according to the terms of the individual agreements under which such options were granted or shares issued. ordinary shares as to which the rights associated with such shares have not vested will be held by a trustee designated by us.

As of June 15, 2000, we granted options to purchase a total of 304,950 ordinary shares under the 1993 Plans and 7,896,424 ordinary shares under the 1995 Plans for an aggregate of 8,201,374 ordinary shares subject to options under such plans. The exercise prices for such options vary from $8.125 to $136.50 and all such options expire at various times from September 2003 to May 2010. Of such options, 3,008,727 options were granted to officers and directors. As of June 15, options under the plans for a total of 727,286 shares had been exercised.

In December 1992, we granted options outside of any stock option plan to two then officers. One officer, who has since again become an officer of Gilat, was granted an option to purchase 24,500 ordinary shares, at an exercise price of $0.33 per ordinary share, and the other was granted an option to purchase 33,333 ordinary shares at an exercise price of $12.00 per share, both on terms and conditions comparable to those provided for under the 1993 Plans. As of June 15, 2000, 33,333 of these options have been exercised.

In May 1999, the Board approved the establishment of a new stock option plan under Section 102 of the Israel Income Tax Ordinance with 500,000 ordinary shares to be reserved for issuance. Management was directed to prepare the plan and obtain the necessary regulatory approvals. The plan was approved by the shareholders at the 1999 annual meeting but the request for regulatory approval was withdrawn and there are no current plans to activate the plan in the near future.

## ITEM 13: INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS

**Shareholder Registration Rights Agreement.** On August 20, 1990, Gilat entered into a Preferred Stock Purchase Agreement with Yoel Gat, Amiram Levinberg, Joshua Levinberg, Shlomo Tirosh and Gideon Kaplan (the "Founders"), Athena Venture Partners L.P. and certain related entities, DICFM, PEC and certain individual investors (the "Investors") under which the Investors invested a total of approximately $3.0 million in exchange for Gilat's Preferred Shares (which Preferred Shares were converted into ordinary shares at the time of Gilat's initial public offering). PEC has since transferred its shares to DIC Loans and DIC Loans has replaced PEC as a member of the Investors. In connection with such agreement, we entered into a Registration Rights Agreement pursuant to which, among other things,

(i) we agreed that at any time after the earlier of February 28, 1994 or six months after the effective date of the first registration statement for our initial public offering of securities, the holders of at least 10% of the ordinary shares who were parties to the Preferred Stock Purchase Agreement could request that we file a registration statement for such shares (a "demand registration"),

(ii) we agreed to include the Founders' and Investors' ordinary shares in a registration proposed after one year following the first registration (a "company registration"),

(iii) we agreed to pay the expenses of a demand or company registration (subject to certain limitations), and

(iv) the Founders and Investors agreed that during a period to be specified by us and the underwriter (but not more than one year) following the effective date of a registration statement for the Company's securities, and to the extent requested by us and the underwriter, they would not directly or indirectly sell or offer the shares held by them, except ordinary shares included in such registration, provided that all officers and directors and all other persons with registration rights enter into a similar agreement.

Under the Registration Rights Agreement, we agreed to indemnify each of the selling shareholders and any person who controls any of such shareholders, to the extent permitted by applicable law, against any losses arising from any alleged untrue statement of a material fact or any alleged omission of a material fact in the registration statement or the prospectus for our public offering in October 1995 or from any violation by Gilat of the Securities Act or the Exchange Act. Our indemnity does not cover any losses that arise from any alleged untrue statement or omission or violation made in reliance upon information provided to us by such selling shareholder. In addition, each of the selling shareholders agreed to indemnify us and our directors and officers against any losses arising from any information provided to us by such selling shareholder for use in the registration statement or the prospectus. We had obtained insurance covering our officers and directors and the selling shareholders to the extent permitted by law with respect to certain matters in connection with the registration statement and prospectus for the October 1995 offering.

**Transactions with Gilat Communications.** In July 1996, we entered into an agreement with Gilat Communications Ltd. ("Gilat Communications") under which Gilat Communications has been granted non-exclusive distribution rights to sell and provide technical support for our products in South Africa. In October 1997, we and Gilat Communications entered into a 5-year marketing and purchase agreement (the "1997 Agreement") that replaced and terminated an earlier agreement entered into in 1993. Pursuant to the 1997 Agreement, Gilat Communications has been granted the exclusive right to market the lines of satellite communications products and related components and options, and to provide services with such products in Israel and areas controlled by the Palestinian Authority. Under the 1997 Agreement, Gilat Communications is required to meet certain annual minimum purchase requirements for each of three specified categories of our products, and during the initial term and any renewal term, Gilat Communications may not, without our prior written consent, engage in certain activities competitive with our business. If Gilat Communications satisfies the annual minimum purchase requirements, the parties are required to enter into good faith negotiations to renew the 1997 Agreement three months prior to its expiration. In addition, under the 1997 Agreement, Gilat Communications was granted non-exclusive rights to distribute and sell our products worldwide when and only if sold as part of, or to be used in conjunction with, Gilat Communications' products.

Throughout 1999, we sold approximately $8.1 million in equipment to Gilat Communications for distribution and as a value added reseller. The sales were in accordance with our standard sale terms and conditions. Certain of our officers, directors, principal and other shareholders are also shareholders of Gilat

Communications. For more information regarding certain transactions between us and Gilat Communications, see notes 9 and 15 of Notes to Consolidated Financial Statements listed in Item 19.

**Merger-Related Agreements**

In connection with our acquisition of Spacenet, we entered into a Merger Agreement and a series of related agreements. The parties to those agreements include GE Americom which as of June 15, 2000 holds approximately 18.7% of our outstanding ordinary shares. The terms of those agreements, and of certain important provisions of the Merger Agreement are summarized below.

**Post-Closing and Other Adjustments.** The Merger Agreement contemplates certain post-closing adjustments regarding the possibility of (a) our paying or receiving certain amounts in cash or (b) our issuing additional ordinary shares to GE Americom in respect of such adjustments. Most of the post-closing adjustments relate to an agreement between the parties that the net assets on the combined closing balance sheet of Spacenet and its subsidiaries should equal $85 million and that any shortfall or excess, as the case may be, should be addressed through post-closing adjustments. Other adjustments relate to the collection of accounts receivable, the sale of specified items of Spacenet inventory and the allocation of certain tax benefits. Pursuant to two settlement agreements entered into by the parties in December 1999, GE Americom paid us $25 million for post-closing adjustments and undisclosed liabilities related to the Merger, and for reimbursement of expenses.

**GE Americom Equipment Purchase Commitment.** GE Americom and certain of its affiliates were committed to purchase $37.5 million of our products through the end of 1999. GE Americom agreed to pay us a credit against service fees we owed to GE Americom under certain Satellite Transponder Service Agreements, equal to 40% of any shortfalls in this purchase commitment. As a result of this agreement, in 1999, GE Americom paid us $15 million.

**Indemnification.** Subject to the limitations set forth in the Merger Agreement, GE Americom has indemnified Gilat and Spacenet, and Gilat has indemnified GE Americom, from and against any losses arising from indemnified obligations. The indemnification obligations primarily relate to damages arising from breaches by the other party of representations and warranties under the transaction documents, as well as indemnities with respect to specified obligations of each of the parties. The indemnification obligations were narrowed as a result of the settlement agreements described above.

**The Transitional Services Agreement.** Under the Transitional Services Agreement, in consideration of the issuance of 5,505 ordinary shares, GE Americom provided Spacenet and its subsidiaries, specified transitional services, including finance services, accounting services, purchasing services, cash management services, computer-related services, payroll processing services and other reasonably necessary services, through August 31, 1999.

**The Trademark Agreement.** Under the Trademark Agreement, General Electric Company has agreed to grant to Gilat, in consideration of 72,496 ordinary shares, a non-exclusive worldwide license to use the GE symbol in connection with certain products sold by Spacenet, Spacenet GmbH and Spacenet BV, and certain services performed by Gilat, Spacenet, Spacenet GmbH and Spacenet BV. The Trademark Agreement requires that Gilat and Spacenet adhere to certain specified permitted uses and standards of quality. The Trademark Agreement provides that Gilat will use the GE symbol only in connection with the specified products and services, including use in its packaging, labeling, general publicity, letterheads, signs and other forms of advertising, instructions books and other literature. In addition, the Trademark Agreement provides that Gilat will not use the GE symbol as part of a trade name. The term of the Trademark Agreement is three years and it may be renewed under certain circumstances for one additional year. Gilat has agreed to indemnify General Electric Company for all claims arising out of the Trademark Agreement or the manufacture of products or performance of services by Gilat under the licensed mark.

**The Shareholders' Agreement.** At the time of the Spacenet acquisition, Yoel Gat, Amiram Levinberg, Joshua Levinberg, Shlomo Tirosh and Gideon Kaplan (collectively, the "Founders Group"), DICFM and PEC (collectively, the "IDB Group"), and GE, GE Americom, General Electric Finance Holding GmbH and General Electric Plastics BV (for purposes of the following description, collectively, "GE") entered into a Shareholders' Agreement. PEC has since transferred its shares to DIC Loans, and DIC Loans has replaced PEC as a member of the IDB Group.

Under the Shareholders' Agreement, the Founders Group, the IDB Group and GE have agreed to vote their ordinary shares in order that the Board of Directors of Gilat be comprised of seven members, and in favor of the respective nominees of each of the groups to the following extent:

- The Founders Group will be entitled to nominate three directors, as long as (i) the Founders Group collectively owns at least 30% of the ordinary shares owned by them when the Shareholders' Agreement was signed, or (ii) at least one of the members of the Founders Group is serving as an employee of Gilat;

- The IDB Group will be entitled to nominate two directors, as long as the IDB Group collectively owns at least 50% of the ordinary shares owned by them when the Shareholder's Agreement was signed, or one director if the IDB Group owns between 25% and 50% of those shares; and

- GE will be entitled to nominate two directors, as long as GE owns at least 50% of the ordinary shares owned by GE when the Shareholders' Agreement was signed, or one director if GE owns between 33% and 50% of those shares.

In addition, each of the shareholders has agreed that it will vote all of its ordinary shares in accordance with the recommendations of the Board of Directors in respect of any matter brought to a vote of the shareholders of Gilat, unless (i) the matter relates to certain significant merger, restructuring or other transactions or (ii) is directly and materially adverse to the interests of the shareholder. The shareholders have further agreed, for a period of three years, to vote in favor of the retention of Gilat's present senior executive officers in their respective offices.

Under the Shareholders' Agreement, GE has agreed to certain "stand-still" provisions, including agreements not to acquire any assets, businesses or properties of Gilat, or any ordinary shares which would result in GE being the beneficial owner of greater than 33% of the ordinary shares of Gilat, without the prior approval of the holders of a majority of the ordinary shares held by the Founders Group or the IDB Group.

GE has also agreed not to solicit proxies, call any special meeting of shareholders of Gilat, or propose any form of business combination involving Gilat. GE's standstill agreement is subject to a number of exceptions, including a release of any restrictions in the event of a bona fide third party tender offer, or in the event that the Founders Group and the IDB Group no longer collectively hold at least 50% of the ordinary shares held by them at the time the Shareholders' Agreement was signed.

Subject to certain exceptions, the Shareholders' Agreement also provides for restrictions on the transferability or pledge of the ordinary shares held by the GE parties for a period of three years from the date of the Shareholders' Agreement, including general restrictions on the disposition of ordinary shares to certain competitors of Gilat. In addition, the Shareholders' Agreement will generally provide for pro rata rights of first refusal for the other parties with respect to the transfer of any ordinary shares by any other affiliated party to any independent third party.

**The Registration Rights Agreement.** At the time of the Spacenet acquisition, the holders of the Registrable Securities (as defined below) were granted certain registration rights by Gilat. The

"Registrable Securities" generally include the ordinary shares issued to GE and held by GE or any of its affiliates, or by any other person who is at such time a holder of Shares originally issued to GE and representing at least 5% of the then outstanding ordinary shares. Gilat initially agreed to the immediate registration of all Registrable Securities solely in connection with the transfer of such shares to one or more affiliates of GE. The Registration Rights Agreement also provides for certain demand registration rights of GE and the holders of Registrable Securities. Gilat will not be required to effect any registration during the pendency of certain blackout periods. GE also has the right to participate (subject to certain limited exceptions) on a piggy-back basis in all registrations of Gilat's securities in connection with any offering of its securities. The Registration Rights Agreement provides that Gilat will indemnify the selling holders of Registrable Securities, and that the selling holders of Registrable Securities will indemnify Gilat, in each case, against certain liabilities and expenses, including liabilities under the Securities Act, or will contribute to payments that the other may be required to make in respect thereof.

**The Right of First Refusal Agreement.** Under the Right of First Refusal Agreement, GE Americom has granted to Gilat, for a period of three years, a limited right of first refusal to be the provider in respect of any proposal by GE Americom to obtain (i) any VSAT return channel equipment for broadcast network and (ii) any integration services for the incorporation of VSAT return channel equipment into a broadcast network. In addition, for a corresponding period, Gilat has agreed to grant to GE Americom a limited right of first refusal to be the provider in respect of any proposal by Gilat to obtain any additional space segment capacity on a communications satellite providing services within the United States. Gilat has also agreed that certain integration services performed by Gilat for GE Americom under the above-described right of first refusal will be at a discount of at least 20% from the price provided by the relevant third-party provider. Under the Right of First Refusal Agreement, GE Americom has agreed that if GE Americom commences offering GE*Star services, GE Americom will create a distribution program and will offer Gilat the right to become a world-wide distributor of GE*Star services for a three-year period pursuant to the program terms and conditions established by GE Americom. In addition, if GE Americom offers any third party an opportunity to become an exclusive distributor of GE*Star services in any territory, Gilat will generally be offered an opportunity to act as a co-exclusive distributor in such territory. If Gilat elects to become a distributor of GE*Star services, GE Americom will under certain circumstances provide Gilat a discount on all wholesale GE*Star services.

**The Satellite Transponder Service Agreements.** Under the Satellite Transponder Service Agreements, GE Americom has agreed to provide to Gilat (i) certain protected services on four transponders on satellite GSTAR4 operated by GE Americom, (ii) certain protected services on one transponder on satellite GE-3 operated by GE Americom, (iii) certain protected services on three transponders on satellite GE-5 to be constructed, launched and operated by GE Americom, (iv) certain preemptible testing services relating to specified bandwidth and downlink EIRP on one transponder on satellite SN-3 operated by GE Americom, and (v) certain protected Ku-band service on portions of certain transponders on satellite GSTAR4 operated by GE Americom. The terms of the services provided under each of the Satellite Transponder Service Agreements are specified in each such agreement. Generally, the services will be provided until the earliest of the end of the life, date of replacement or failure of the relevant satellite, the date on which the relevant transponder fails or is preempted, or a specified termination date provided in each agreement. Except in the case of the agreement described in clause (iv) above, Gilat pays GE Americom a monthly recurring service charge (generally on a per-transponder basis) in accordance with a schedule provided in each agreement. Subject to certain exceptions, the Satellite Transponder Service Agreements provide for Gilat to indemnify GE Americom and certain affiliates for claims arising out of services provided thereunder.

**The Letter Agreements.** Under the Transponder Letter Agreement dated September 25, 1998, GE Americom and Gilat have agreed, among other things, that (i) Gilat would analyze Spacenet's current space segment use and requirements on or before December 31, 1998 and will take certain transponder capacity on GE Americom satellites at the prices set forth in the Spacenet Letter Agreement described below and (ii) Gilat will receive long-term fixed prices which Gilat believes are competitive and certain

rights of first refusal for additional space segment capacity. Pursuant to a separate letter agreement, dated September 25, 1998 (the "Spacenet Letter Agreement"), GE Americom will provide additional bandwidth and power as well as service protection levels to Spacenet to the extent there is insufficient bandwidth, power or protection levels available to accommodate existing customer requirements under Spacenet's existing transponder service agreements with GE Americom and third party providers.

**The Tax Matters Agreement.** On September 25, 1998, GE Americom, Spacenet, the Spacenet subsidiaries and Gilat entered into the Tax Matters Agreement in connection with the Merger Agreement. The Tax Matters Agreement provides for, among other , the parties' responsibility for payment of taxes, filing of tax returns, and control of any audit or other tax proceeding relating to Spacenet and the Spacenet subsidiaries. The Tax Matters Agreement also contains representations, covenants and indemnities relating to general tax matters of the parties.

The Merger was intended to qualify as a "tax-free" reorganization under Section 368(a) of the Code. The Tax Matters Agreement contains representations and covenants of the parties relating to the tax-free nature of the Merger. In addition, GE Americom agreed to enter into a gain recognition agreement (the "GRA") with the Internal Revenue Service, in which under certain circumstances during the period ending at the end of the fifth full taxable year following the Merger, GE Americom will agree to recognize gain as if the Merger were taxable to GE Americom. In connection with the GRA, Gilat has agreed in the Tax Matters Agreement not to take certain actions, including, without limitation, the disposition of the stock of Spacenet and the disposition of "substantially all" of the assets of Spacenet and the Spacenet subsidiaries, if doing so would cause GE Americom to recognize gain under the GRA. The Tax Matters Agreement provides that Gilat, Spacenet and the Spacenet subsidiaries, on the one hand, and GE Americom, on the other, will indemnify the other party from any tax resulting from certain breaches of representations and covenants relating to the tax-free nature of the Merger. Each party's liability for purposes of such indemnification will be limited in certain respects pursuant to the terms of the Tax Matters Agreement.

The Tax Matters Agreement provides that the amount of any cash that GE Americom has a right to receive under the Tax Matters Agreement or any other agreement related to the Merger will be reduced to the extent that the receipt of such amount would cause the fair market value of the cash and property other than ordinary shares received by GE Americom in connection with the Merger, in exchange for the stock of Spacenet, to exceed 25% of the fair market value of the ordinary shares delivered by Gilat to GE Americom at Closing, subject to certain exceptions pursuant to the Tax Matters Agreement.

The Tax Matters Agreement provides that, in certain circumstances, if the Merger is subject to tax pursuant to Section 367 or Section 368 of the Code (including, if GE Americom recognizes gain pursuant to the GRA), then GE Americom shall, subject to applicable United States and Israeli securities laws, be entitled to sell such number of ordinary shares reasonably necessary in the opinion of a nationally recognized investment bank to realize net proceeds equal to the amount of such tax plus the amount of any tax paid by GE Americom in connection with the sale by GE Americom of such ordinary shares.

PART II

ITEM 14: DESCRIPTION OF SECURITIES TO BE REGISTERED

Not applicable.

PART III

ITEM 15: DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 16: CHANGES IN SECURITIES, CHANGES IN SECURITY FOR REGISTERED SECURITIES AND USE OF PROCEEDS

Not applicable.

PART IV

ITEM 17: FINANCIAL STATEMENTS

Not applicable.



FOR PUBLIC INSPECTION

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## ITEM 18: FINANCIAL STATEMENTS

The Consolidated Financial Statements and related notes thereto required by this item are contained on pages F-1 through F-43 hereof.

## ITEM 19: FINANCIAL STATEMENTS AND EXHIBITS

(a) Index to Consolidated Financial Statements **PAGE**


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Consolidated Statements of Income for the Years Ended December 31, 1997, 1998 and 1999 ........ F-5
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 1997, 1998 and 1999 ........ F-6
Consolidated Statements of Cash Flows for the Years Ended December 31, 1997, 1998 and 1999 ........ F-7
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(b) Exhibits

2.1 Consent of Kesselman & Kesselman
2.2 Consent of Berman, Hopkins, Wright & Laham, LLP