PART I

ITEM 1: DESCRIPTION OF BUSINESS

General

Gilat Satellite Networks Ltd. ("Gilat") is a leading provider of products and services for satellite-based communications networks. We design, develop, manufacture, market and service products that enable complete end-to-end telecommunications and data networking solutions, as well as broadband Internet solutions, based on very small aperture terminal ("VSAT") satellite earth stations, related central station (hub) equipment and software. We also provide service offerings which include access to satellite transponder capacity, installation of network equipment, on-line network monitoring and network maintenance and repair services. We distribute our products and services worldwide through our own direct sales force, service providers and agents and, in certain circumstances, joint ventures, alliances, and affiliated companies.

Our networks are primarily used for:

- on-line data delivery and transaction-oriented applications including point-of-sale (for example, credit and debit card authorization), inventory control and real time stock exchange trading
- telephone service in areas that are underserved by the existing telecommunications services or in remote locations without service
- Internet Protocol ("IP") based networking applications such as corporate intranets, corporate training and other broadband multicasting applications, as well as consumer broadband Internet applications.

In 1999, we shipped approximately 41,000 VSATs. According to Comsys, a leading industry source, in 1999, our market share was approximately 51% of the total interactive VSATs for which contracts were awarded worldwide that year. Comsys also reported that in 1998 Gilat had approximately 30% of the worldwide interactive VSAT market based upon the number of VSAT contracts awarded. Major users of our products and services include the United States Postal Service, John Deere, ZapMe!, Rite Aid, Peugeot-Citroën and Telkom South Africa.

Satellite-based communications networks offer several advantages over ground-based communication facilities. Among these advantages are the following:

- Ubiquitous reach, providing equal access to bandwidth in urban and remote areas under a single tier network
- high data transmission speeds
- fixed transmission costs, insensitive to distance or the number of receiving stations
- a persistent "always on" connection to the Internet, without the need to dial up to the Internet Service Provider
- cost savings over competing technologies for many applications
- independence from telecommunication companies and other network providers

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- exceptional reliability
- consistent and rapid response time in comparison to dial-up lines
- rapid deployment of networks and flexibility in their configuration, integration and location
- a versatile platform which allows for the provision of multiple applications and services

Gilat was incorporated in Israel in 1987. Gilat's corporate headquarters, executive offices and research and development, engineering and manufacturing facilities are located at Gilat House, 21 Yegia Kapayim Street, Daniv Park, Kiryat Arye, Petah Tikva 49130, Israel. The telephone number is (972) 3-925-2000.

Unless the context otherwise requires, references in this annual report on Form 20-F to "Gilat", "we", "our" refer to Gilat Satellite Networks Ltd. and its subsidiaries. Our subsidiaries include Gilat Satellite Networks, Inc., Gilat Satellite Networks (Europe) S.A., Gilat Satellite Networks (Holland) B.V. and its subsidiaries, Gilat Satellite Networks (Hong Kong) Ltd., Gilat Florida Inc. ("Gilat Florida"), Gilat do Brasil Ltda., and Spacenet Inc. and its subsidiaries, including Servicio Satelital S.A., and certain foreign affiliates including Gilat Europe GmbH (formerly named Spacenet Europe GmbH) ("Spacenet"). We refer to our European operations, including those from Spacenet, as "Gilat Europe."

The name "Gilat™" and the names "TwoWay™," "OneWay™," "FaraWay™", "DialAway®", SkySurfer™, SkyBlaster™, SkyWay™, Skydata®, ISAT®, WebSat™, Clearlink™, E-Trunk™, and Skystar Advantage® appearing in this report on Form 20-F are trademarks of Gilat and its subsidiaries. GSAT® is a registered trademark of GTECH Corporation. Other trademarks appearing in this annual report on Form 20-F are owned by their respective holders.

Spacenet

On December 31, 1998, we completed the acquisition of Spacenet, a company engaged in providing VSAT-based network services, from GE American Communications, Inc. ("GE Americom"), a subsidiary of General Electric Corporation, and certain affiliates. As of June 15, 2000, GE Americom owns approximately 18.7% of our outstanding ordinary shares, and is our single largest shareholder. GE Americom has the ability to nominate up to two Directors to our Board as long as it owns at least 50% of the shares it received as part of the transaction. GE Americom has also agreed to certain "stand-still" provisions and restrictions on the transferability of its shares. See "Item 13: Interest of Management in Certain Transactions – Merger-Related Agreements - The Shareholders' Agreement." Prior to the acquisition, Spacenet was our single largest customer. Spacenet purchased our VSAT products in order to incorporate them into Spacenet's VSAT-based network service offerings. Aggregate sales to Spacenet represented approximately 34% and 45% of Gilat's total sales in 1997 and 1998, respectively.

As part of the Spacenet acquisition, we entered into several significant agreements with GE Americom. See "Item 13: Interest of Management in Certain Transactions—Merger-Related Agreements." The acquisition of Spacenet has enabled Gilat to expand from primarily manufacturing and selling VSAT equipment to becoming a provider of complete end-to-end telecommunications and data networking solutions based on VSAT satellite earth stations. We believe that this acquisition has greatly enhanced our ability to develop and offer new products and services and to maintain our position as one of the leaders in the VSAT industry, especially since our major competitor is also a provider of both equipment and services. For example, with the Spacenet acquisition, we acquired certain advanced VSAT technology developed under the name Turbosat. In 1999, we completed the improvements to Turbosat's functionality and features and integrated the technology (except certain CDMA technology) into a new product platform. In order to capitalize on Gilat's brand recognition, we have decided to name Gilat's and

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Spacenet's operations in Europe "Gilat Europe" and we are currently completing the formal name change of each of our European entities to Gilat Europe.

Gilat-To-Home

In March 2000, we established a joint venture named Gilat-to-Home, Inc. ("GTH") with The Microsoft Network LLC ("MSN"), EchoStar Communications Corporation ("EchoStar") and ING Furman Selz Investors ("ING"), to provide broadband Internet access via satellite to residential, small office/home office ("SOHO") and small business customers in North America. MSN and EchoStar have invested $50,000,000 each and ING $25,000,000 in cash in GTH in exchange for both senior convertible preferred and common shares equal to 17.61%, 17.61% and 7.16%, respectively, of the outstanding capital of GTH; Gilat owns approximately 41.09% of GTH's outstanding shares and certain Gilat related parties collectively own approximately 9.03%. These share holdings are 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. Gilat and Spacenet entered into certain supply and support agreements with GTH. See "Marketing, Distribution, and Strategic Alliances – Strategic Alliances and Joint Ventures", and "Item 13: "Interest of Management in Certain Transactions".

Global Village Telecom (Antilles) N.V. ("GVT Antilles")

We initiated our rural telephony project in 1997 through our then wholly owned subsidiary, Global Village Telecom N.V. ("GVT Antilles"). In April 1998, through a $40 million private placement with international investors (the "Other Investors"), our interest in GVT Antilles was reduced to a minority.

In April 2000, we completed a share exchange transaction in which we acquired all the outstanding shares of the Other Investors in GVT Antilles in exchange for the transfer to a new company organized by the Other Investors of GVT Antilles' entire right and interest in two Brazilian subsidiaries, which were formed to provide telephone and other telecommunications services in South Central Brazil. All other agreements among the parties under the original private placement transaction were terminated and the Other Investors were given the right to the name and marks "GVT" and "Global Village Telecom". As part of this April 2000 transaction, we also provided the Other Investors' new company with a $40 million loan in exchange for a note convertible into common shares equal to approximately 9.1% of this new company's then outstanding shares.

As a result of the transaction, we own substantially all of the outstanding shares of GVT Antilles with employees of GVT Antilles holding the balance. We recently renamed GVT Antilles Gilat-To-Home Latin America (Antilles) N.V. ("GTH LA Antilles"). Subject to certain governmental and other consents and approvals where needed, and as part of our planned consumer Internet initiative in Latin America, we are completing the process of renaming the Peru and Chile subsidiaries of GTH LA Antilles, to Gilat-To-Home Latin America, and the Colombia subsidiary to Gilat Colombia.

Financing Transactions

In February 1999 we completed a public 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 "Offering"). As of June 15, 2000, we have 23,061,711 ordinary shares outstanding.

In February 2000, we completed a private offering of $350 million of convertible subordinated notes due 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.

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In June 2000, we exercised our right to redeem our 6½% Convertible Subordinated Notes due 2004 that were issued on May 14, 1997 (the "Notes"). The Notes were redeemable in full at 102 percent 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.

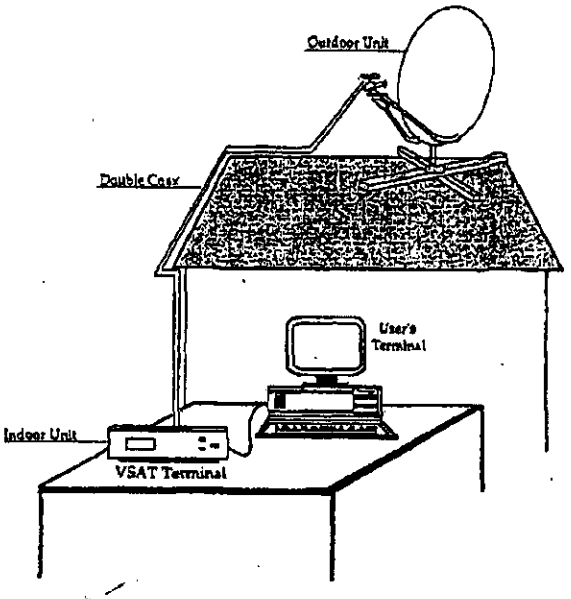
Industry Background

VSAT Industry Background

The emergence of the Very Small Aperture Terminal (VSAT) in the 1970s marked the beginning of a new era in satellite communication. A VSAT network consists of:

- several dozen to several thousand VSAT remote sites with small antennas
- a large central earth station called a hub, which includes a large antenna and enables the connection of all the VSATs in the network
- satellite transponder capacity

A VSAT remote site includes an indoor unit and an outdoor unit (See Figure 1). The indoor unit usually fits on a desktop (much like a modem) and contains the circuitry that activates the communications link between the user's equipment and the satellite. The outdoor unit includes a small antenna, usually 2 to 6 feet, that can be mounted on an end-user's roof, ground or wall and electronic equipment that transmits and receives signals to and from the satellite transponder.



VSAT on-site equipment

The hub for a VSAT network consists of a large dish antenna (4.5 to 11 meters) and radio frequency electronics equipment to allow signals to be transmitted between the hub and the satellite trans-

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ponder. A hub also includes electronic equipment to provide for satellite communications, protocol support and network management functions.

Satellite transponder capacity is available on existing satellites positioned in geostationary orbit (at 35,800 km above the equator). Once in orbit, a satellite beam can cover a geographic area the size of the continental United States or Western Europe. This coverage area is known as the satellite's footprint. The satellite receives information from a VSAT, amplifies it, and transmits it back to earth on a different frequency. A single satellite transponder has a capacity of approximately 100 million bits/seconds of information. This means that if the transponder is accessed for only 90 seconds per day, more than 1 billion bytes of data, the equivalent of 865,000 double-spaced pages, would be transmitted.

The current generation of high power Ku-band satellites and sophisticated VSAT earth stations are particularly well suited to provide high speed business communications services as well as broadband web-based services. The use of the Ku-band frequencies (as opposed to the C-band used by older generations of satellites) offers reduced interference with ground communications. This enables satellites to use the higher broadcasting power necessary to support VSAT earth stations and makes it cost-effective to transmit to or among numerous locations. With increasing satellite power and the latest generation of VSAT software, VSAT earth stations are becoming smaller and less expensive, reducing overall network cost.

Before the emergence of VSATs, commercial communication via satellite was very costly because it required an expensive ground terminal and a very large dish antenna. Satellite-based communications solutions were therefore limited to only those large companies which could afford them. In contrast, VSATs are significantly less expensive than other satellite solutions partly because they do not require end-users to dedicate staff specialists or make a sizable infrastructure investment.

VSAT networks also offer several advantages compared to ground-based communications networks:

- High quality and dedicated transmission availability
- The capability of transmitting extremely large data flows
- Fixed transmission costs, insensitive to distance or the number of receiving stations
- Rapid and cost effective deployment in geographically isolated regions like mining areas and developing countries
- Direct access to the Internet backbone

Market Opportunity

The market for communication network products and services has experienced rapid growth in recent years, and we believe that it will continue to do so into the future. Some of the key factors responsible for this growth include:

- rapidly growing demand for communications capacity driven by the increase in bandwidth-intensive applications, including the Internet;
- continuous technological advances which are broadening applications for, decreasing the cost of, and increasing the capacity of, both satellite and ground-based networks;
- global deregulation and privatization of government-owned telecommunications monopolies which allow for greater access to communications alternatives.

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The above trends have benefited a range of alternative technologies such as switched digital networks (ISDN service), digital subscriber line (DSL) connectivity, cable modem connectivity, frame relay and asynchronous transfer mode systems, as well as VSAT-based systems. The growth in the use of VSATs has been strong and consistent. According to industry sources, the installed worldwide VSAT base grew from 8,000 terminals in 1986 to over 500,000 terminals in 1999.

We provide VSAT-based communications solutions to target growth opportunities in four rapidly expanding market sectors, each of which is further described below:

- data networks for:

– interactive enterprise networking applications such as consumer ATM, credit card, debit card and lottery transactions, retailer and manufacturer inventory control, and utilities' monitoring and control systems for power lines and pipelines

– unidirectional applications such as data broadcasting and paging systems

- fixed telephone service offerings, including IP applications, in remote and rural areas and in underserved urban areas, primarily in developing countries

- broadband and IP-based applications targeted to network dependent business and private corporate networks for business television, video teleconferencing, employee training, publishing information and sharing data among employees, vendors and customers, as well as other web-related applications

- consumer broadband applications for Internet use; e-commerce, multimedia, and other consumer web-based applications.

VSAT-Based Data Networks

The significant growth in interactive data network services during the last decade has led to increased demand for satellite-based networks. VSAT and satellite technology is particularly well suited to those data networks which need to (i) reach many locations over vast distances simultaneously, (ii) solve a "last mile" or congestion problem, allowing high bandwidth access in areas currently limited to slow connections like copper wire, (iii) transmit to remote locations and to emerging markets where the terrestrial telecommunications infrastructure is not well developed, and (iv) rapidly provide services across a large geographic area served by multiple terrestrial providers.

Due to the above advantages, corporate users are increasingly realizing the benefits of VSAT networks. As a result, VSAT networks are experiencing significant growth as a substitute for, or complement to, ground-based services such as frame relay and ISDN.

VSAT-Based Fixed Telephony Products

In a large number of remote, rural and urban areas, primarily in developing countries, there is limited or no telephone service due to inadequate telecommunications infrastructure. In these areas, VSAT networks are able to utilize existing satellite infrastructure to rapidly provide high quality cost-effective telecommunications solutions. In contrast to ground-based networks, VSAT networks are simple to reconfigure or expand, relatively immune to difficulties of topography and can be located almost anywhere. Additionally, VSATs can be installed and connected to a network in a matter of hours and seldom require maintenance.

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As a result of the above advantages, the market for VSAT-based fixed telephony products is rapidly growing. This market consists of public telephone operators that need to fulfill universal service obligations, large companies which require private networks to provide communications between branch offices and corporate headquarters, and service providers targeting rural and residential areas in developing countries.

VSAT-Based Internet Applications

As more businesses evolve from establishing an Internet presence to utilizing securely connected geographically dispersed locations, the demand for high quality IP-based connectivity and value-added services will grow. New VSAT market sectors are emerging from web-related applications. One is private corporate networks that use IP protocol for delivering interactive data and broadcast information such as training, business television, and intranet. Another is a group of emerging network dependent enterprises, whose product is the network, and which is content-based and relies upon an efficient IP network for delivery and return.

VSAT-Based Consumer Broadband Services

The term broadband services refers to networks that provide high-capacity, high-speed transmission of data that allow users to run applications faster than is usually possible over standard modems, take advantage of dynamic multimedia, and have the Internet "always on" at work and at home. In addition to the satellite broadband solution, there are three terrestrial means of providing broadband services to consumers: cable, DSL, and fixed wireless.

The VSAT-based consumer broadband service can be differentiated from terrestrial competitors by the following characteristics:

- Rapid Availability. Cable and DSL providers must install the appropriate infrastructure at a high investment and with an extensive time to market delay. In contrast, the satellite solution requires the use of hubs which can be commissioned within a matter of days and can serve thousands of sites and allows for quick installation of user sites. The VSAT solution will be widely available upon commercial launch.

- Efficient Distribution. The consumer broadband service has the ability to broadcast and multicast broadband content to the subscriber without encountering the last mile bottlenecks of terrestrial networks. Content, such as stock quotes and live programming can be broadcast to a user community while the always-on return path enables unicast transactions (such as stock trading) desired by the user.

Products and Services

We currently offer three VSAT product lines, each of which is generally incorporated into a VSAT network consisting of a remote terminal linked to a central hub or control center via a satellite. In addition, Spacenet, Gilat Europe, and Servicio Satelital offer satellite-based network products and services including private communications networks carrying high speed two-way data, Internet, intranet, fax and voice transmission. We offer the full range of end-to-end products and services described below.

VSAT Products

The following table sets forth our current principal product lines:

Products by VSAT Market Type

Type	Products/Application		
Data	SkyStar Advantage —Interactive	ISAT —Frame Relay	SkyWay RF Transceivers —Data Broadcast
Telephony and Voice	FaraWay —Satellite Telephony	DialAway —Rural Telephony	
Internet	SkySurfer —One-way Internet Access	SkyBlaster —Two-way Internet Access	

In focusing on providing one platform for interactive VSAT products and on consolidating our other product offerings to meet current customer demand we are phasing out production of our SkySurfer product in favor of our Skystar Advantage and SkyBlaster product lines, although we continue to support existing customers of that product.

Data Delivery Products:

Skystar Advantage VSAT. Our Skystar Advantage VSAT product, when integrated into a network, is used in transaction-oriented, point-to-multipoint satellite communication networks. The Skystar Advantage VSAT is designed to enable reliable and cost-effective interactive communications between a central hub and several tens to several thousand geographically dispersed sites. The applications currently served by our products include the following: credit and debit card authorization for retail sales; point-of-sale information and ATM networks; on-line recording and validation of lottery tickets; prescription verification, inventory control and review of customer profiles; inventory control and delivery scheduling at the manufacturing level; supervisory control and data acquisition networks for oil and gas pipelines; on-line remote stock exchange trading for brokers; distance learning and Internet access. Additional voice channel add-ons are available, as well as a video broadcasting application, both of which are offered by third party vendors.

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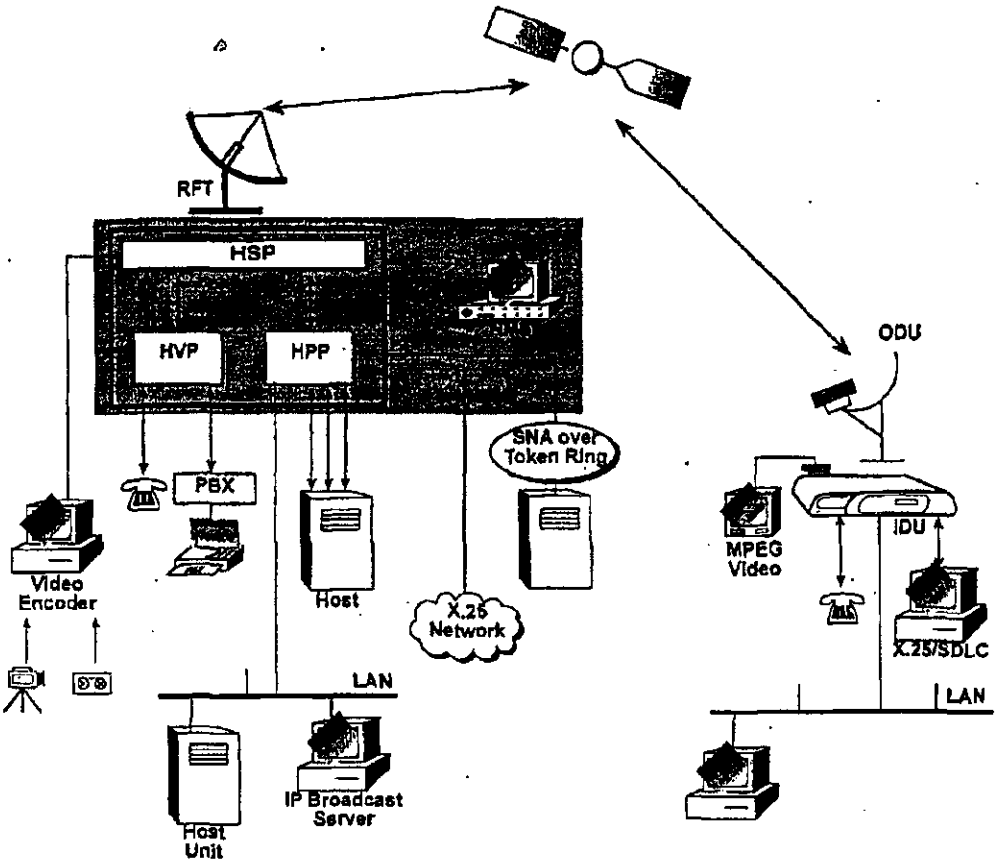

Architecture. As illustrated in Figure 2, our Skystar Advantage VSAT product consists of remote terminals, hub equipment and related software. Our remote terminal consists of a small outdoor antenna (typically 0.55 to 1.2 meters in diameter for the Ku-band frequency and 1.8 to 2.4 meters in diameter for the C-band frequency), an outdoor electronics unit ("ODU") and an indoor electronics unit ("IDU"). The ODU receives signals from a satellite transponder using a Low Noise Block ("LNB") frequency down-converter and transmits signals to the satellite transponder using our proprietary frequency up-converter and power amplifier. The IDU incorporates a satellite modem utilizing digital signal processing technology and a powerful central processing unit ("CPU"). The CPU controls communications through the satellite (including the satellite access scheme) and provides the platform for interface to the end-user's remote terminal equipment. The small antenna typically is supplied by a third-party vendor or purchased directly by our customer. We design and manufacture the IDU, design and integrate the ODU and supply that part of the software (the connectivity software) that, among other things, controls the satellite access scheme.

The hub for the network incorporating our Skystar Advantage VSAT products consists of a radio frequency terminal ("RFT") and baseband equipment. The RFT incorporates a large dish antenna (typically 4.5 to 11 meters) and RF electronics equipment (up and down frequency converters, low noise amplifiers and high power amplifiers). The baseband equipment is comprised of the hub satellite processor ("HSP"), hub protocol processor ("HPP") and network management system ("NMS"). The HSP hardware provides the communication connectivity to the remote terminals and the HPP provides the interface between the HSP and the customer host computer running end-user applications. The NMS monitors and

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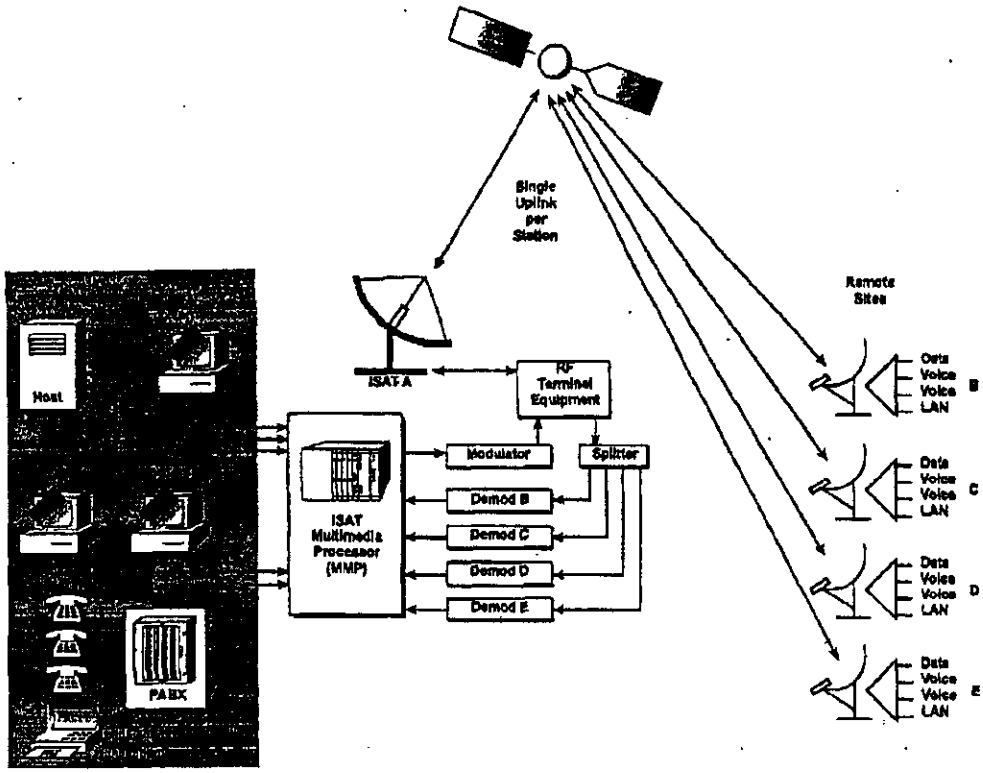
controls all the remote terminals and the hub equipment. We design and manufacture the HSP software and hardware. The RFT is typically provided by third-party vendors. The HPP and NMS are provided by us in the Skystar Advantage network, and by GTECH in its VSAT network, which is known as "GSAT."

Features. Our Skystar Advantage VSAT product utilizes a patented two-dimensional, random satellite access scheme that enables us to use low-cost ODU hardware and allows the VSAT network to handle momentary peak traffic loads without any significant degradation of response time. The Skystar Advantage VSAT now offers a feature enabling Internet connectivity, and additional voice channel capability, enabling voice communication between the hub site and a remote location. A VSAT network incorporating our Skystar Advantage VSAT product can offer features including: low-cost terminal equipment; rapid response time; high network availability; small antenna size which allows for easy installation and maintenance; very low transmission error rate; high hardware reliability; a variety of customer interfaces such as local area networks ("LAN") (e.g., Token-Ring and Ethernet); and flexible architecture (support for commonly used data communications protocols, including X.25, SNA/SDLC, ASYNC and TCP/IP; easy integration of additional value-added services such as data, audio and video broadcasting; and modular design that enables easy and staged network expansion).

In 1999, the research and development of the Turbosat technology purchased in 1998 from Spacenet progressed, with most of the Turbosat's improved functionality and features completed and the technology being integrated (other than the CDMA technology) into a new product platform, Skystar Advantage TG (Turbo Generation), which is now our main Skystar Advantage platform. Our current development efforts for the Skystar Advantage VSAT are directed toward increasing the outbound bit rate capacity, adding MPEG1 and MPEG2 video multicast capabilities, and improving the current TCP/IP set of features, and cost reduction.

As of December 31, 1999 we had shipped approximately 92,400 Skystar Advantage VSATs to customers worldwide.

ISAT™. Our ISAT networking products are designed to provide high-end solutions for voice, fax and data communications for small-to-medium VSAT networks. ISAT uses a sophisticated frame relay switching engine and a patented satellite access technique to implement full or partial mesh or star topology networks. A mesh configuration allows "single hop" connection of subscribers' equipment by which remote terminals can communicate with one another without going through the hub. In a star configuration, remote terminals are connected only through the hub, with some delay in communication whenever two remote terminals communicate with each other. We offer ISAT networks to 2 types of customers. The first typically requires voice and data connectivity between 3 to 20 stations in a single-hop, full mesh network, usually to implement a private voice and LAN network between offices or factories to bypass often unreliable local phone service. The second type of customer requires similar services, but needs connectivity between 3 to 50 stations and a single hub location in a star or partial mesh type network.



Architecture. As illustrated in Figure 3, an ISAT network consists of several remote terminals and a PC-based NMS installed at one of the network terminals for network status and software control of data rates and other network parameters. The remote terminal consists of a small outdoor antenna (typically 1.2 to 3.8 meters), an RF transceiver for Ku-band and C-band reception and transmission, baseband equipment with a modulator and one or more demodulators, a control and routing unit incorporating a Multimedia Processor ("MMP") engine supporting voice, data, and LAN interfaces, and a Station Interface Unit to monitor and control interface between terminal equipment at each site and the master station network management software. ISAT systems use a "Frame Relay" protocol for transferring messages over the network. At each terminal, outgoing packets are statistically multiplexed into a single data stream by the MMP. The data stream is then converted into a single outbound modulated carrier and transmitted to the satellite for rebroadcast. Each ISAT carrier operates on a discrete, assigned satellite frequency.

In a full or partial mesh network, each terminal has demodulator equipment to receive carriers from each of the other network terminals with which direct communication is needed. The star equipment configuration is identical to the full mesh, except remote terminals require a demodulator only for the master terminal signal. The data rate transmitted over the satellite from each terminal is set to match the traffic requirements of the station. Standard ISAT equipment provides software-programmable rates over the range 9.6 kilobits per second to over 2 megabits per second. Different terminals within a network may have different rates to accommodate unique site traffic requirements.

Features. ISAT networks can be provided with a Demand Assigned Multiple Access ("DAMA") overlay, allowing occasional connectivity to be established as required between star-type remote stations, for voice networks with only occasional voice requirements between stations. ISAT terminals feature high hardware reliability; easy installation and maintenance; a variety of customer interfaces; and flexible architecture.

WebSat™ is an enhancement to ISAT, which integrates an IP accelerator to overcome typical satellite speed limitations for IP data and manages data flow from multiple connections using Quality of Service bandwidth controls. We have recently developed E-Trunk™, as an enhancement to ISAT. E-Trunk provides voice carriers with an efficient alternative to terrestrial trunking. E-Trunk's use of a Frame

Relay link protocol and patented satellite access technique can eliminate costly hub facilities and simplify interconnections for both cellular and traditional wireline telephony systems. A typical E-Trunk network is designed to service 3 to 100 sites, with each remote site servicing from 1 to 20 E1 circuits (30 to 600 lines) of voice traffic, or more for a central site.

Our current development efforts for the ISAT are directed towards cost reduction and replacement of outsourced components with devices that we have developed and produced.

As of December 31, 1999, we had shipped approximately 460 ISAT terminals to customers worldwide.

SkyWay™ Series of RF Transceivers. Our SkyWay high-power series of transceivers provide a solution for Single Channel Per Carrier and Multiple Channel Per Carrier VSAT terminals, and small-to-medium and medium-to-large Internet, voice, data, and video VSAT networks. This series of transceivers operate in the C-band, extended C-band, and Ku band and are produced in our Gilat Florida facility.

Architecture. The SkyWay series of RF transceivers consist of an IDU, ODU, and depending upon the application, a Low Noise Amplifier down converter, LNB, or a Solid State Booster ("SSB"). The IDU controls ODU functions through a front panel keypad and an LCD display.

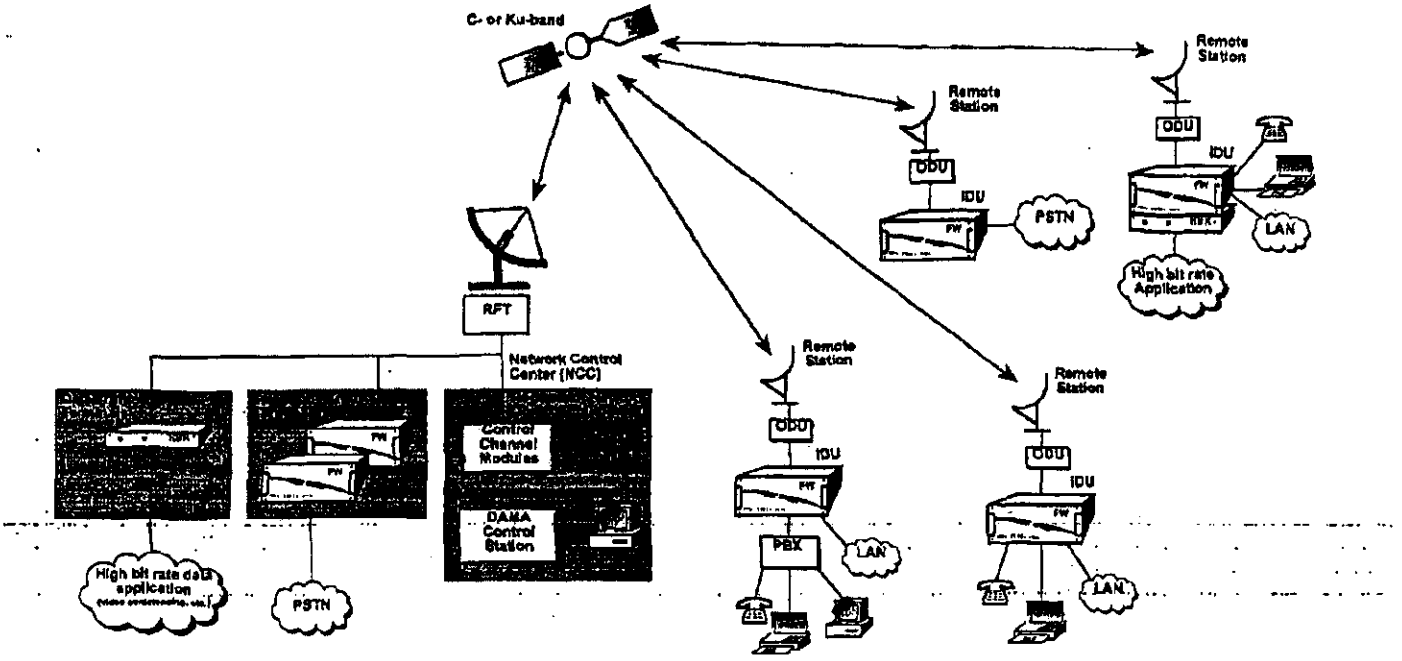
Features. All the frequency converters use phase-locked oscillators, locked on the same frequency reference source. An auxiliary reference output is available for locking external equipment to the same reference source. The SSB contains a high power amplifier. The industry standard 70 MHz modem interface provides a straightforward connection to most modems. Auxiliary outputs for transmit and receive signals permit direct monitoring of intermediate frequency signals. The built-in processors and software provide the user with full control over the transceiver system. Monitor and control functions include SSB mute, frequency-set, alarm indication, output threshold, and external fault indication from the SSB. Full access is possible either through the front panel or an RS232/RS422 port.

As of December 31, 1999, we had shipped approximately 560 SkyWay transceivers.

Telephony and Voice Products:

FaraWay VSAT. Gilat and COMSAT RSI (the assets of which were acquired by ParaGea Communications), are parties to a joint venture for the development of the FaraWay VSAT, a satellite telephony VSAT which provides mesh connectivity, voice and data services via satellite to remote locations and other areas that lack adequate telecommunications infrastructure. See "Strategic Alliances and Joint Ventures." FaraWay VSATs are intended to provide:

- A reliable telecommunications network (with fax, telephone and data capabilities) for corporate and business users in developing countries that have minimal or no telecommunications infrastructure
- Multi-channel toll quality telephone service to geographically isolated rural residential areas in developing countries
- Cost-effective telephone service that can be installed quickly for temporary remote installations (e.g., oil and gas exploration sites, small rural government agencies and new factories) until terrestrial services are available.

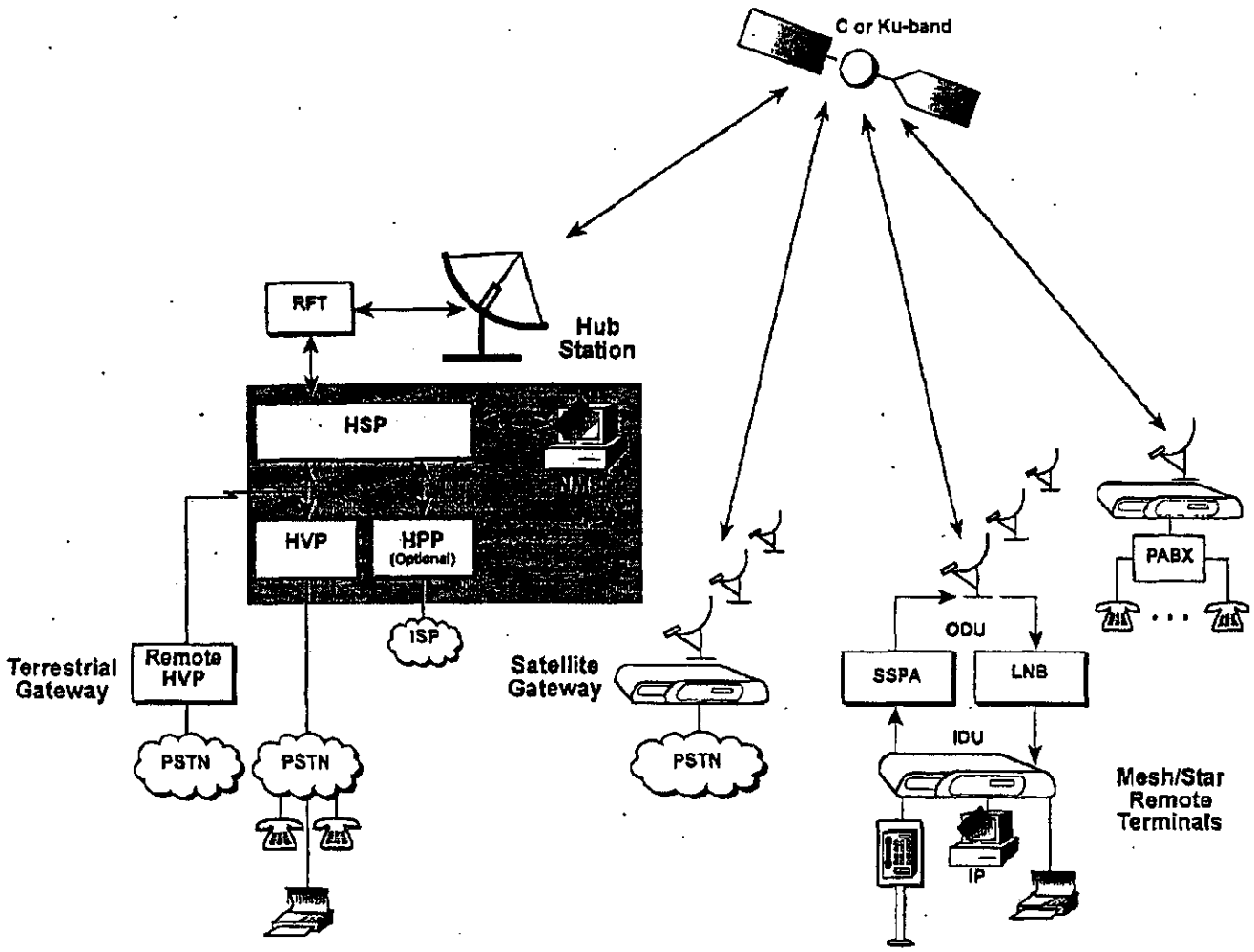


Architecture. The FaraWay telephony product employs a unique VSAT architecture and satellite access scheme and supports either a mesh or star configuration utilizing DAMA for more efficient use of the satellite. As illustrated in Figure 4, the product architecture permits connections to either private telephone equipment, pay telephones, small private switches or a public switch, and data terminals, as well as to any combination of this equipment. A Data Interface Module ("DIM") enables high data rate applications in both star and mesh configurations.

The remote terminal of the FaraWay includes a dish antenna (typically 1.8 to 3.7 meters in diameter), an ODU and an IDU. The IDU connects directly to subscribers' telephone equipment or central office. The FaraWay hub, which may be connected to a public switch, includes a large dish antenna (typically 4.6 to 13 meters in diameter), RF electronics, a network resource and call-processing controller, an NMS, a call accounting computer and traffic terminal. The network resource controller assigns satellite frequencies to the equipment at both ends of the communication link; the NMS monitors and controls the overall network; the call accounting computer provides data for external network billing; and the traffic terminal provides the hub's interface to the public switch.

Features. The FaraWay VSAT offers a cost-effective, flexible solution for connecting 2-40 telephone lines from a public switch to a local PABX switch or directly to subscribers' premises via satellite and to support voice, fax and high data rate applications. The product features include: Ku-band and C-band frequency operation; flexible interfaces including different signaling systems; support of up to 30,000 calls per hour and 8,000 remote stations; and ITU-approved 16 and 8 kilobit per second voice encoding.

In 1999, we completed the development of a PC Network Terminal ("PC NT")-based NMS for the FaraWay VSAT. Our current development efforts for the FaraWay VSAT are directed towards continuing development of an enhanced digital E1 interface module, capable of supporting almost all existing digital telephony signaling protocols.



As of December 31, 1999, we had shipped approximately 1,600 FaraWay VSATs to customers.

DialAway VSAT Our DialAway VSAT product is intended to provide inexpensive, near toll quality telephone service including voice and fax communication and high speed Internet access for small businesses and villages in remote or urban areas lacking an adequate telephone infrastructure. The product has been designed to offer subscriber or pay telephone and public call offices with up to 3 lines. Our rural telephony product operates in a mesh or multi-star configuration in which the remote terminals communicate with each other in single hop full mesh or with hub and gateway stations. At the same time the DialAway offers "always on" high speed two way Internet access. We believe that the cost benefits of the product can meet the telephony needs of the targeted rural telephony users, as well as such users' current and future needs for Internet access.

Architecture. As illustrated above in Figure 5, a DialAway network consists of a central hub, PSTN gateways, satellite channels and remote terminals. A remote terminal consists of a small outdoor antenna (typically 0.98 to 1.2 meters), an ODU and our IDU with one to three telephony extension cards. The hub consists of an RFT and baseband equipment. The RFT incorporates a large dish antenna (typically 4.5 to 11 meters) and RF electronics equipment (up and down frequency converters, low noise amplifiers and high power amplifiers). The baseband includes an HSP, a Hub Voice Processor ("HVP") with voice cards, and an NMS. The NMS monitors and controls all the remote terminals and the hub equipment. The

hub design permits easy incorporation of new features, as well as independent sizing for inbound (remote to hub) and outbound (hub to remote) bandwidths. The hub station is also the point of presence (POP) for Internet traffic. Telephony traffic can be also routed to regional gateways which can utilize satellite or terrestrial infrastructure.

With the DialAway, the analog voice input is digitized and compressed to 4.8 or 6.4 kilobits per second. The compressed voice is organized into packets and transmitted to the hub or to another remote VSAT via the satellite. At the destination, a voice/fax card decodes the incoming voice packets into digitized voice which is then reconverted into analog form.

Features. Our DialAway VSAT product offers a PC NT-based NMS and such features as full support of telephone line services; high speed Internet access, full mesh architecture, call data processing; low cost; simple installation and operation; high hardware reliability; remote control and monitoring; and low power consumption.

Our current development efforts for the DialAway are directed towards development of new product features, improving IP support, and decreasing the product's power consumption.

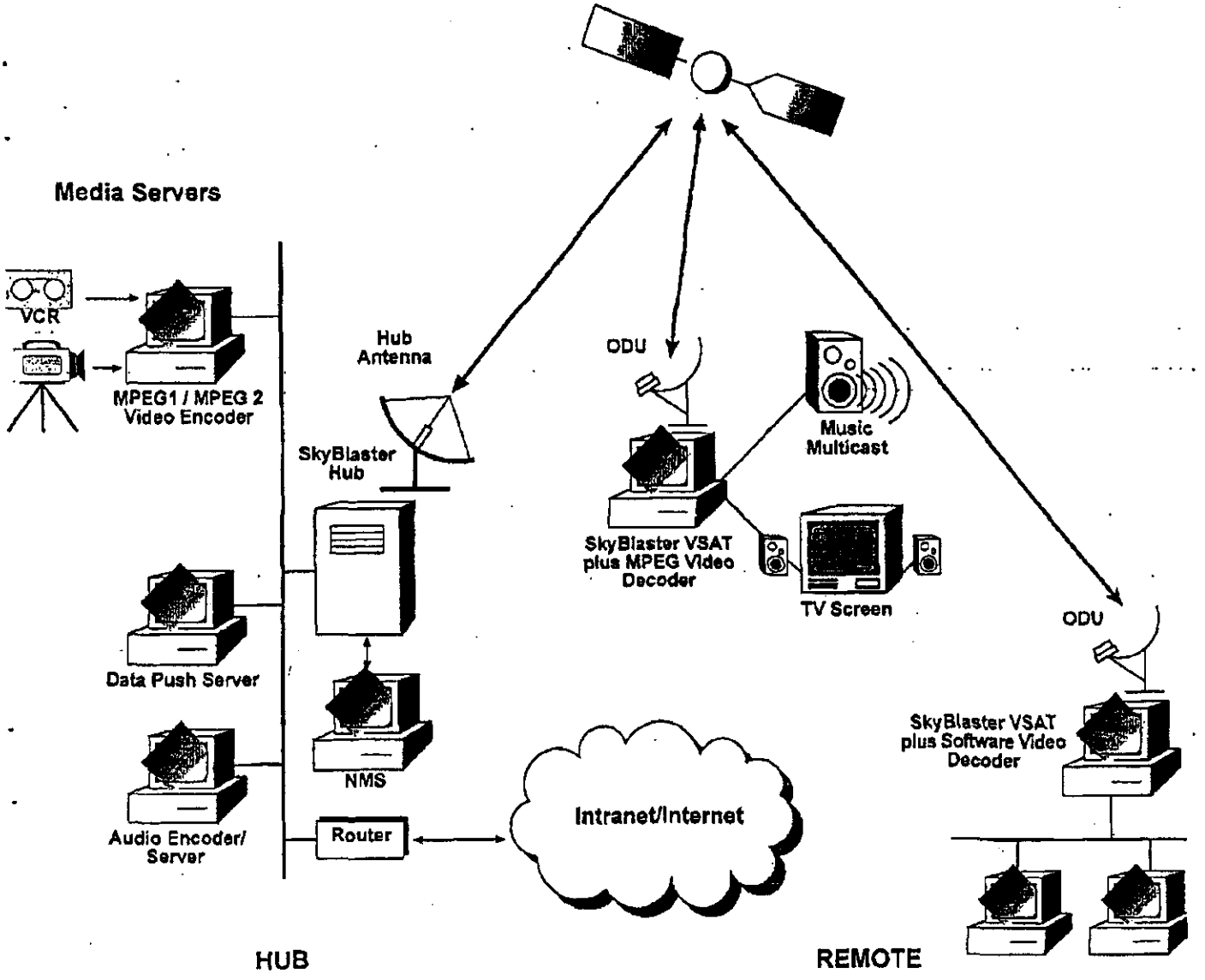
As of December 31, 1999, we had shipped approximately 13,200 DialAway VSATs.

IP-Based Products:

SkyBlaster VSAT. The SkyBlaster VSAT, introduced in 1999, is our latest two-way IP-based product and consists of a DVB receiver card and a satellite transmitter PCI card as a return channel. The SkyBlaster is targeted for use in communities of interest, corporations, small to mid-size businesses, small office/home office and consumer users.

With our unique satellite return access scheme, PC users have access to fully interactive broadband VSATs on corporate LAN servers or PC desktops. SkyBlaster provides IP-based communications solutions for broadband corporate and public networks.

SkyBlaster features an open IP platform which supports applications developed by us or by third party vendors, such as interactive corporate training; reliable data and video multicasting; interactive business television and reliable push-based applications.



Architecture. As illustrated above in Figure 6, the SkyBlaster VSAT combines two PCI cards:

- DVB receiver
- Satellite transmitter

The DVB receiver card supports a scalable bit rate of 2 to 40 Mbps. Inbound data can be transmitted at bit rates of 38.4 to 153.6 Kbps, using a unique Frequency Time Division Multiple Access ("FTDMA") satellite access scheme, . The cards can be installed in any Gilat-qualified PC server, supporting data recasting over the LAN, or be provided as a stand-alone IDU. Research and development efforts are focused on increasing the bit rates to 307.2.

The hub station was designed for installation at the customer premises as a private hub. Alternately, a shared hub can be located at a service provider site. Single-tier architecture allows for PC connectivity directly to the application and media servers. As shown in the diagram, any media server connected to the hub, such as a video, audio or data push server, is allocated with a reserved committed bit-

rate that guarantees high-speed accessibility. Therefore, multiple streams carrying video, audio and data can operate at the same time without interfering with one another. The hub station features:

- NMS (Network Management System)
- HTS (Hub Transmission Server)
- DVB IPE (IP Encapsulator)
- DVB Satellite Modulator
- HSP (Hub Satellite Processor)
- Conditional Access (security)
- Scheduling

Satellite Access. SkyBlaster uses a proprietary two-dimensional access scheme. This enables the use of low-cost ODU hardware, minimizes space segment use and allows the VSAT network to handle momentary peak traffic loads without significant degradation in response time. The network is immune to outages caused by frequency interference.

The unique FTDMA scheme provides no back off in time for retransmissions and consistent utilization of the entire bandwidth by all remote sites. The satellite access scheme, coupled with a transmit slot size that can be optimized to the network, provides superior network throughput stability and load balancing.

We are currently developing an external stand-alone box for the SkyBlaster that we expect to introduce by the first quarter of 2001, in order to enable easy installation of the product. We are also involved in extensive research and development efforts aimed to reduce the price and increase the efficiency of the technical components of the SkyBlaster product.

As of December 31, 1999, we had shipped approximately 7,600 of our SkyBlaster VSATs to customers worldwide.

SkySurfer VSAT. Our SkySurfer VSAT receiver product is a PC-based Digital Video Broadcast ("DVB") satellite receiver used in IP environments to provide satellite-based multicast and unicast communications. We are currently phasing out our production of the SkySurfer product in favor of the SkyBlaster product line, although we continue to support existing SkySurfer customers. The SkySurfer streams IP traffic from a central site to a large number of geographically dispersed remote sites. It is an open IP platform that enables easy integration of any IP-based application. The main applications running on SkySurfer networks are web-based interactive corporate training and distance learning, interactive business television, multicast video and audio streaming, broadband Intranet/Internet access and reliable push based applications.

The SkySurfer remote unit receives high bit-rate traffic via satellite (from 2 to 40 Mbps) and currently utilizes the user's return path (terrestrial VSAT) for transmission. The SkySurfer hub provides users with a scalable 2-40 Mbps channel for IP traffic.

Architecture. The SkySurfer VSAT consists of a central transmission hub and the remote SkySurfer receiver cards. The central hub consists of several Hub Transmission Servers ("HTS") which receive the content from the server at the central site or anywhere over the Internet. Each HTS is a PC server running applications that we developed. The HTS transmits the data to the satellite modulator which converts the data to the intermediate frequency ("IF") range. The output of the modulator is transmitted to the

satellite by standard RF transmission equipment. Our NMS, situated at the transmission site, controls the parameters of the hub and remote SkySurfer units.

The remote SkySurfer VSAT consists of (i) a 32-bit PCI adapter card that fits in any standard PC and enables receipt of high-speed data (up to 40 Mbps) by a PC or LAN server, (ii) a small outdoor antenna and (iii) an LNB. A return path can be established over any existing terrestrial or two-way VSAT connection.

As of December 31, 1999, we had shipped approximately 11,500 of our SkySurfer VSATs to customers worldwide.

Features. For interactive business television and corporate communications, the SkySurfer VSAT offers IP-based multicast and Intranet technologies that provide interactive business television with Motion Picture Expert Group ("MPEG") decoding quality. We have provided turnkey solutions, beginning with the customer's video source, continuing with the video encoding server (including the IP multicast data layer) and ending with the video decoder card.

For corporate training, using third party proprietary training technology, SkySurfer enables full broadband software video decoding with multicast capabilities for on-line training to hundreds of employee LANs and PCs simultaneously.

For push-based applications, SkySurfer, which has been bundled with third party technology, offers an integrated end-to-end push client server solution, optimized for satellite delivery and IP multicast. This integrated solution allows companies to deliver corporate information and software from a variety of sources and to notify employees and management of its availability.

For broadband Intranet/Internet access, SkySurfer enables data rates of more than 1 Mbps, while accessing corporate Web servers or Internet sites. LAN users can also access the global Internet through the SkySurfer gateway, without installing SkySurfer at their PCs.

VSAT Network Services

In our two primary geographic markets, the United States and Europe, we now provide full network services through our network management centers, in addition to product sales. We offer a full spectrum of services, from installation and maintenance services to comprehensive service offerings in which we package the VSAT system with installation, network operations, maintenance and access to satellite transponder capacity. Our services include:

- Network Analysis
- Network Implementation
- Shared Hub Services
- Network Operations
- Maintenance
- Customer Technical Services
- Access to Satellite Capacity

In addition, we also provide network services in Argentina and support for network services in India.

Network Analysis. Network analysis involves designing the system in response to specific customer needs, determining critical system parameters, such as data protocols and network response times, assisting in generating component and subsystem specifications for the network's hardware, hub requirements (private or shared), and satellite capacity.

Network Implementation. The network implementation process covers hub installation and network rollout, which entails installing and connecting all of the remote VSAT locations to the network. Network rollouts are planned and managed by the Gilat program management organization. The program manager serves as the customer's single point of contact and is responsible for delivering the network on time, on budget, and to specification.

Many of the activities for installing a VSAT network take place at the customer's facilities, such as: site survey, site preparation and installation of ground, roof, and/or wall-supported mounts with lightning protection, connection of the ODU and IDU to the antenna and Inter Facility Link ("IFL") cable, powering up the system, pointing the antenna, initializing the VSAT and confirming proper operation with the hub, connecting the VSAT with the customer's local equipment (such as LAN or point-of-sale), and providing an orientation to the local customer personnel. A typical installation can be completed in four to six hours. We are increasing our installation capabilities and currently can install approximately 3,500 sites per month in the US.

Hub installation services vary, depending on whether the customer's network involves a private hub or use of one of our shared hub facilities in McLean, Virginia, Chicago, Atlanta, Germany, the Czech Republic or Argentina. The primary distinction between the two is that a private hub installation involves more emphasis on site preparation, equipment installation and training, while a shared hub installation focuses on the compatibility with the shared hub and the customer's data center.

We currently use in-house personnel for hub installation and third parties to perform most VSAT installation activity in our service markets. The program manager, working with our in-house implementation staff, insures that our third-party installation teams arrive at the customer's site on schedule and are equipped with the necessary equipment to complete the installation. The third-party installers are trained and certified on the Gilat hardware platforms.

Shared Hub Services. The hub is the most costly and complex component of a VSAT system. Some customers prefer to outsource the management and operation of the hub, either by leveraging our competency in managing networks or by gaining additional cost efficiencies through sharing the hub hardware and operations costs with multiple customers. Gilat presently staffs its primary shared hubs in the U.S., Germany and Argentina, with a highly specialized technical staff on a 24-hour basis. Our shared hub service typically includes use of hardware, maintenance, ground-based backhaul circuits, satellite uplinking and operations for which the customer pays a monthly fee.

Network Operations. Our network operations services coordinate and manage the operations of customers' networks and monitor the quality of services delivered on a 24-hour basis from one of our three network management centers (NMC). Our largest NMC is located in McLean, Virginia, and is staffed by over 40 technicians who are trained in network fault isolation, problem resolution and customer service. We also have NMCs in Atlanta, Germany and Argentina. When customers experience an outage on their network, they call the NMC, where a trained professional, using proprietary monitoring and control technology, will work to restore service. In instances in which service cannot be restored through the troubleshooting process, the NMC technician will dispatch one of our third-party field service technicians to repair or replace the on-site hardware and restore operations to the site.

In 1999, Gilat NMCs managed approximately 32,000 data and video sites in the United States and approximately 36,500 sites worldwide.

Maintenance. Once an NMC technician determines that a field service dispatch is required to fix a problem, our maintenance and logistics organizations provide service to the customer. We offer a variety of maintenance plans to support our customer networks. All of the plans include toll-free trouble reporting service from one of our NMCs, field service, replacement of equipment, warehousing of spare parts, shipping and repairs. The objective is to provide an on-site response within an average of four hours for most sites. In the United States, we have contracted with IBM-TSS, a third-party repair service provider, to operate nationwide service centers that are staffed with Gilat-trained and certified field service technicians. Other trained and certified third-party vendors are contracted in our international service markets.

Our maintenance services are supported by our internal logistics and repair organization, which is responsible for stocking parts in over 100 warehouses in the U.S., Europe and Argentina.

Customer Technical Services. Our technical services group includes engineering test and support services during the project implementation phase and on-going telephone and on-site support for complex networking issues. The customer technical services group provides application trouble shooting, network optimization, customer training, and documentation services.

Protocols and Methodologies. The development of new software protocols and methodologies has resulted in improved use of available network capacity and decreased delays in transmission of information. Our networks support multiple protocols simultaneously, including SDLC, Bisync, X.25, X.3/X.28/X.29 PAD, Token Ring LLC, Ethernet LLC, X.25 Broadcast and TCP/IP. The performance of these protocols across satellite bandwidth is optimized by techniques such as TCP/IP "spoofing," which improves data throughput efficiency. In addition, our VSAT networks have built-in protocol conversion capabilities, including X.25 to Async PAD, SDLC to Token Ring, Bisync to Token Ring, X.25 to Bisync, X.25 to SDLC and TCP/IP over Ethernet to TCP/IP over Token Ring, which allow our VSAT networks to operate with multiple protocols without the purchase of additional equipment.

Satellite Capacity. Satellite transmission channels are an integral part of our VSAT network offers in the U.S., Europe and Argentina. We continually monitor our space segment capacity, all of which we procure from GE Americom and other third parties, in order to ensure that sufficient transmission capacity is available for prospective customers, as well as growth in bandwith for existing networks. The capacity is provided for the term of the agreement, typically five years, and may be increased under the term as the customer's traffic grows. For networks in the United States, we primarily use satellite capacity acquired from GE Americom, which currently operates a fleet of 12 satellites, as well as from other suppliers. In connection with the Spacenet acquisition, we entered into a series of agreements with GE Americom under which GE Americom provides us with backup and additional satellite services. These agreements are described below under the heading "Certain Relationships and Related Party Transactions—The Satellite Transponder Service Agreements." We also use capacity on several regional satellites in Europe and Latin America.

We believe that there is a large and growing quantity of satellite capacity available from a number of providers in the United States and in the rest of the world from whom we can obtain transmitter capacity at competitive rates, as our business requires.

Service Offerings. Service offerings combine a rental of all necessary network hardware with all of the above network services into an end-to-end customer solution. In a service offering, we retain ownership and operation of the network equipment, delivering to the customer a specified network speed, response time and network availability for a set price per month per site. Generally, service offerings contracts have a five-year maturity. However, we also provide three-year service contracts in response to market demand.

Service offerings respond to our customers' needs to outsource non-core competencies and mitigate technical obsolescence and make the purchase of satellite network services similar to the procurement of ground-based network services.

Historically, our main service offerings have been based on the Skystar Advantage two-way data platform. However, we are also leveraging our existing network services infrastructure with new service offerings that include the SkyBlaster product line.

Marketing, Distribution and Strategic Alliances

Marketing and Distribution. We use both direct and indirect sales channels to market our products and services. Our marketing activities are organized geographically, with groups covering North America, Europe, Latin America, Asia and the rest of the world. In North America and Europe, most of our revenues are generated by our direct sales force, although value-added resellers and distributors account for some of our largest networks. In Asia and the rest of the world, we rely primarily on local agents and distributors. In all markets, we occasionally work with system integration companies for large and complex projects.

The sales teams are comprised of account managers and sales engineers, who are the primary account interfaces and work to establish account relationships and determine technical and business requirements for the network. These teams also support the other distribution channels with advanced technical capabilities and application experience. Sales cycles in the VSAT network market are lengthy and it is not unusual for a sale to require 18 months from initial lead through signature of the contract. The sales process includes several network design iterations, network demonstrations, pilot networks comprised of a few sites, and in some cases special software development which is completed before contract signing. For VSAT networks sold as a complete service offering, the sale cycle is typically shorter and can be as low as 90 days from the initial lead through the signature of the contract.

We have a sales and marketing group of 150 full-time employees (as of May 1, 2000) who offer our products and services, primarily in the United States and Europe. Approximately 27% of the sales and marketing group is based in the United States, approximately 13% is based in Europe, and approximately 39% is based in Israel. Sales of our services generally are substantial in size and involve a long-term sales process.

We currently have marketing and technical support staff in the United States, Europe and Israel. In addition, we maintain marketing and support offices in Argentina, Brazil, Australia, Thailand and India, which provide ongoing marketing and technical support for our products for our strategic partners and their customers. These offices also work with our strategic partners to identify target markets and applications and define products to meet those needs. In addition, we have established representative offices in London and Beijing to support our marketing efforts and support and coordinate local marketing offices in Europe and the Far East. We are currently establishing a representative office in Kazakhstan to provide pre-sales marketing and support in that region.

We also sell our products and services to postal, telephone and telegraph organizations ("PTTs") and other major carriers, resellers and other companies in the United States and internationally who purchase network products and services from us for resale to their customers. PTTs and other major carriers employ substantial sales forces and have the advantage of being existing providers to many of our target customers, which makes marketing easier and increases awareness of customer needs.

The following table sets forth Gilat's revenues by geographic area for the periods indicated below as a percent of Gilat's total sales:

	Years Ended December 31,		
	1997	1998	1999
United States	49.5%[1]	51.8%[1]	56.4%[3]
Europe	8.9%	6.7%	16.2%[3]
South and Latin America	11.1%[2]	6.9%[2,3]	13.0%[3]
China	4.6%[3]	3.5%[3]	1.7%[3]
Israel	3.3%[3]	2.7%[3]	2.5%[3]
South Africa	0.1%[3]	13.4%	0.4%
Other	22.5%	15.0%	9.8%
Total	100.0%	100.0%	100.0%

[1] Includes revenues of 11.6% and 2.8% derived from sales made through GTECH and Spacenet in the United States with shipments made directly to end-users in Europe (including regional service operators and distributors) for the years ended December 31, 1997 and 1998, respectively. See note 15 of Notes to Consolidated Financial Statements listed in Item 19.

[2] Including revenues from a subsidiary of GTECH in Brazil of 6.8% and 1.1%for the years ended December 31, 1997 and 1998, respectively.

[3] Includes revenues from related parties of 3.6%, 8.2%, and 15.6% for the years ended December 31, 1997, 1998, and 1999, respectively. Revenues for 1999 include $15 million from GE Americom, which was paid in accordance with the Merger-Related Agreements, pursuant to which GE Americom was required to pay us to the extent it did not meet certain equipment purchase commitments. See note 15 of Notes to Consolidated Financial Statements listed in Item 19.

Backlog. In 1999, we received orders for over 70,000 interactive VSAT units. Our interactive VSAT orders for 1999 are more than twice the orders received for interactive VSATs in 1998. The 1999 year-end backlog for equipment sales and revenues from multi-year service contracts for our VSAT products was over $300 million, an increase of more than 70% from the 1998 backlog of $175 million. The backlog calculation includes, with regard to the previously announced MCI Worldcom/USPS contract, only expected revenues on that contract from installations planned through year-end 2000, although this 10-year contract, which does not require USPS to purchase any specific number of VSATs by any specific date, could total as many as 26,000 sites.

Strategic Alliances and Joint Ventures. In addition to our direct and indirect sales channels, we have established certain key strategic marketing relationships and joint ventures, including the following:

Gilat-To-Home ("GTH"). In March 2000, we established a joint venture named Gilat-to-Home, Inc. ("GTH") with MSN, EchoStar and ING, to provide broadband Internet access via satellite ("Service") to residential, "SOHO" and small business customers in North America. MSN has entered into a four year supply agreement with GTH for the Service according to which GTH will supply and MSN will purchase a minimum quantity of VSAT stand-alone units for MSN customers after completion of a one year milestone process. MSN has entered into an additional service agreement with GTH, which will enable MSN and GTH to offer additional satellite enabled services to MSN customers. MSN will also develop a GTH-MSN co-branded portal, which will be available to GTH customers.

EchoStar and GTH will cooperate for the purpose of providing a broadband Internet access service via satellite to GTH subscribers and EchoStar's DISH Network subscribers. EchoStar will market GTH's broadband Internet access services to DISH Network customers and retailers. GTH will market EchoStar's multichannel video services together with GTH's broadband Internet access product.

We have entered into an agreement to support the performance by GTH of the supply agreement with MSN described above. We have agreed not to compete with GTH in North America. MSN and EchoStar have invested $50,000,000 each and ING $25,000,000 in cash in GTH in exchange for both senior convertible preferred and common shares equal to 17.61%, 17.61% and 7.16%, respectively, of the outstanding capital of GTH. The preferred shares are non-voting, have a liquidation preference, antidilution and preemptive rights, rights of first refusal, and co-sale and registration rights and carry 12% PIK (paid-in-kind) dividends. Gilat owns approximately 41.09% of GTH's outstanding shares and Gilat related parties collectively own approximately 9.03%. These share holdings are 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. We have the right to appoint two members to the GTH Board of Directors.

KnowledgeBroadcasting.com. ("KBC") On March 6, 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"). KBC is a web-based media company formed to distribute knowledge-based content using interactive broadband satellite and other technologies. We also received a one-year warrant (the "Warrant") to purchase up to 20 million additional units in KBC for one dollar per unit ("Warrant Units") and we have been granted an option to purchase content from KBC at preferred pricing, to the extent that KBC makes such content available to third parties. In addition, we have received a five-year right of first refusal, at preferred pricing, for KBC hardware purchases for broadcast networks and VSAT operating services. We are also entitled to appoint one director to the board of KBC as long as we hold a minimum number of KBC units.

As part of this transaction, for five years, KBC may purchase equipment and services from us at preferred prices. For up to two years, to the extent that we do not exercise the Warrant, KBC may pay for up to $20 million of equipment and/or services with KBC common units valued at one dollar per unit (such number of units to be deducted from the total available number of Warrant Units). We also provided KBC with a five year warrant to purchase approximately 191,000 of our ordinary shares at a purchase price of $157.05 per share.

GTECH. Since 1990, we have worked closely with GTECH Corporation ("GTECH") to develop GTECH's GSAT service offering which is used for computerized on-line state and national lottery applications. GTECH is a leading operator and supplier of computerized on-line lottery systems. GTECH's lottery system consists of numerous remote lottery terminals located in retail outlets, central computer systems and game software, as well as communications equipment that connects the terminals and the central computer systems.

In December 1994, we executed a seven-year agreement with GTECH (replacing an agreement executed by the parties in March 1993) pursuant to which we agreed to sell our VSAT product components to GTECH at agreed-upon prices and granted GTECH certain non-exclusive marketing and manufacturing rights to our interactive transaction-oriented VSAT technology for worldwide gaming applications (except in France), including, among others, lotteries, sports betting, pari-mutuel betting and horse and other race betting. Purchases by GTECH of the indoor units (IDUs) from us have been at prices specified in the agreement, and for IDUs manufactured by GTECH directly or through a subcontractor, GTECH has been required to acquire the necessary software from us and to pay us a royalty in respect of each IDU produced.

The GTECH agreement also provides that until March 31, 2001, we will not, directly or indirectly, sell our two-way VSAT technology for gaming applications or supply services similar to those provided to GTECH under the agreement to any person directly or indirectly in competition with GTECH in the gaming business. However, we may sell our TwoWay VSAT (i) through Spacenet for resale to persons or entities involved in the gaming industry, and (ii) to value-added resellers who may sell the TwoWay VSAT for gaming applications.

Under a memorandum of understanding signed in March 1996, GTECH agreed to purchase or manufacture 1,500, 2,000, and 3,000 IDUs in 1997, 1998 and 1999, respectively. These commitments were substantially satisfied. Since 1996, the parties have conducted business pursuant to the memorandum of understanding, and we are currently negotiating a new agreement to replace the exsiting arrangement, which expired in March 2000. We believe that we have a good relationship with GTECH and that the relationship will continue, although we cannot assure that a new agreement will be reached.

ParaGea. In late 1992, we entered into a ten-year joint venture with COMSAT RSI, Inc. (the assets of which were sold to ParaGea Communications) to develop, manufacture and market two-way rural telephone VSAT products. In March 1997, the parties modified the agreement to apply only to the VSAT-based telephony product which had been jointly developed and marketed by COMSAT RSI under the trade name "TerraSat 400" and by Gilat under the name "FaraWay VSAT"; to restructure the product development plans; and to grant each party non-exclusive marketing rights worldwide. In November 1997, a further amendment gave Gilat sole responsibility for development of the FaraWay product for a period of one year, after which both parties have the right to develop the product. Gilat is continuing the independent development and marketing of the current FaraWay VSAT.

KSAT. In January 1998, we entered into an investment agreement with KSAT, a Yukon company listed on the Vancouver Stock Exchange, and Global Space Investments Limited, a partially owned subsidiary of Keppel Telecommunications & Transportation Ltd., a Singapore public company involved in telecommunications activities. Under the agreement, among other things, Global invested $15 million in KSAT (half as equity and half as a loan convertible into equity) and we converted to equity certain convertible instruments we held in KSAT. We also agreed to exchange our direct interests in certain joint ventures in China for shares of KSAT, subject to Chinese government regulatory approvals. Those approvals have been obtained and we completed the share exchange in February 2000. In light of the 1998 KSAT financing and the transfer of our joint venture interests, we hold approximately 39.0% of KSAT (or 30.8% on a fully diluted basis). Two of our officers have been appointed to the Board of Directors of KSAT.

Global Village Telecom N.V. ("GVT Antilles"). We initiated our rural telephony project in 1997 through our then wholly owned subsidiary, Global Village Telecom N.V. ("GVT Antilles") (recently re-named Gilat-To-Home Latin America (Antilles) N.V. ("GTH LA Antilles")). GVT Antilles was established to design, deploy, manage and operate, alone or with local partners, rural telephony communications networks to provide fixed-site, basic telephony service to rural and remote markets in developing countries, as well as other markets for public telephony service. We have been marketing our DialAway VSAT product, and other voice products, through GVT Antilles and GVT Antilles's local partners. As of December 31, 1999, we had shipped to GVT Antilles and its subsidiaries approximately 6,500 DialAway VSATs and three redundant hubs for rural telephony networks in Chile, Peru, and Colombia where GVT won concessions to provide rural telephony services.

In April 1998, GVT Antilles completed a $40 million private placement with an international group of investors (the "Other Investors"), as a result of which our interest in GVT Antilles was reduced to a minority. We invested $2.5 million in GVT as part of the private placement. We also provided a $7.5 million loan convertible into common shares equal to approximately 15% of GVT Antilles.

In April 2000, we completed a share exchange transaction in which we acquired all the outstanding shares of the Other Investors in exchange for the transfer to a new company organized by the Other Investors of GVT Antilles' entire right and interest in two Brazilian subsidiaries which were formed to provide telephone and other telecommunications services in South Central Brazil. All other agreements among the parties under the original private placement transaction were terminated and the Other Investors were given the right to the name and marks "GVT" and "Global Village Telecom". As part of the April 2000 transaction, we also provided the Other Investors' new company with a $40 million loan in exchange for a note convertible into common shares equal to approximately 9.1% of this new company's then outstanding shares.

As a result of the transaction, we own substantially all of the shares of GTH LA Antilles, with employee shareholders of GTH LA Antilles holding the balance. Subject to certain governmental and other consents and approvals, where needed, and as part of our planned customer Internet initiative in Latin America, we are completing the process of renaming the Peru and Chile subsidiaries of GTH LA Antilles to Gilat-To-Home Latin America, and the Colombia subsidiary to Gilat Colombia.

Customers

Customers. The majority of the customers for our products and services are large retail and consumer-oriented businesses, including retail and consumer distribution, convenience stores, restaurants and hospitality, gas stations, hotel, brokerage, banking and financial services, communications, lottery, automotive and governmental. We sell our products directly to these customers or indirectly through resellers. In general, networks for these customers range from approximately 100 to 4,000 sites, although some customers have satellite data networks considerably smaller and others considerably larger than this range.

The Rite Aid drugstore chain uses its VSAT network to reduce network response time for credit card transactions, to process prescriptions through its pharmacy system, to broadcast customized music and promotional programming to its stores on its private radio frequency and to send frequent corporate communications and sales training updates to employees on its own business television system. Automaker Peugeot-Citroën of France uses its network for interactive data applications such as inventory updates, credit authorizations, and warranty documentation.

USPS Transaction. During 1998, we were selected as subcontractor, under a prime contract awarded to MCI Corporation, for the provision of VSAT services to the United States Postal Service. Although the contract does not require the USPS to purchase specific quantities at specific dates, the USPS program is expected to initially link 10,000 small associated office locations throughout the United States, with potential growth to 26,000 sites during the ten-year program. Our VSAT services are providing the USPS with a comprehensive upgrade to existing terrestrial dial-up services now in use at post offices across the United States. The network supports a wide range of applications, including point-of-sale and credit card processing, package delivery confirmation, remote monitoring, software and data file downloading, IP multicasting, and multimedia broadcast. The network is providing the USPS with world-class connectivity to all locations, enabling a state-of-the-art customer service infrastructure. The VSAT network will provide on-line services to as many as 26,000 locations. An additional 7,000 sites are being installed as back-up services to the existing MCI WorldCom Frame Relay network at large associated office locations. As of June 4, 2000, we have installed 1,115 small associated office locations and 5,009 large associated office locations in 44 U.S. states. We expect to install a total of 4,000 small associated office locations and 5,500 large associated office locations by December 31, 2000, although we cannot assure that we will be able to meet that schedule.

Competition

The data communications industry is highly competitive and the level of competition is increasing. As a provider of data network products and services in the United States and internationally, we compete with a large number of telecommunications service providers. Many of these competitors have significant competitive advantages, including long-standing customer relationships, close ties with regulatory and local authorities, and control over connections to local telephone networks. This increasingly competitive environment has put pressure on prices and margins. To compete effectively, we emphasize the price competitiveness of our products as compared to products offered by ground-based and other satellite service providers, the advantages of satellite data networks in general, our network quality, our customization capability, our offering of networks as a turnkey service rather than as an equipment sale and our provision of a single point of contact for products and services.

We have encountered strong competition from major established carriers such as AT&T, MCI WorldCom, Sprint, British Telecom, France Telecom, Deutsche Telekom and global consortia of PTTs and other major carriers, which provide international telephone, private line and private network services using their national telephone networks and those of other carriers. Such carriers also offer technological solutions for customer networks, including ISDN lines and frame relay networks. Fiber optic cable is increasingly available for wide bandwidth networks in the United States and Western Europe, and competitive issues often involve tradeoffs among price, various features and customer needs for specialized services or technologies. We are facing increasing competition from ground-based telecommunications service providers which use frame relay, fiber optic networks and digital network switching to provide competitive network offerings.

Our VSAT networks generally have an advantage over terrestrial networks where the network must reach many locations over large distances, where the customer has a "last mile" or congestion problem that cannot be solved easily with terrestrial facilities and where there is a need for transmission to remote locations or emerging markets, as discussed more fully above. By comparison, ground-based facilities (e.g., fiber optic cables) often have an advantage for carrying large amounts of bulk traffic between a small number of fixed locations. However, the customer's particular circumstances, the pricing offered by suppliers and the effectiveness of the marketing efforts of the competing suppliers also play a key role in this competitive environment.

The major telecom carriers also serve as resellers of our products and services, and are an increasingly important distribution channel in Asia and Latin America. See "—Marketing and Distribution"

Our principal competitor in the supply of satellite networks is Hughes Network Systems, which offers a full line of VSAT products and services and which obtains satellite capacity on the satellite system operated by its affiliates Hughes Galaxy and PanAmSat. In competing with Hughes Network Systems, we emphasize particular technological features of our products and services, our ability to customize networks and perform desired development work, the quality of our customer service and our willingness to be flexible in structuring arrangements for the customer. In addition, we face competition from other satellite network providers, including Loral and its affiliates (such as Orion Network Systems) and, in certain instances, direct broadcast satellite companies.

We expect our principal competition in the VSAT-based consumer broadband arena to come from three terrestrial broadband service technologies: cable, DSL, and fixed wireless. Recently, potential competitors have announced the planned introduction of two-way satellite Internet products and services. We believe that our more mature product will allow us to compete effectively in this market.

In addition, with the GTH offering, we believe that we will be able to compete effectively for consumers and small businesses in rural and suburban markets initially throughout the United States, and subsequently in other regions in the world.

The VSAT-based broadband solution can be differentiated from the terrestrial competition by two primary characteristics: rapid availability and more efficient distribution. Unlike cable and DSL, the satellite-based solution to be provided by GTH will be immediately available upon installation of the equipment at a consumer's home. Additionally, the broadband service to be offered by GTH is expected to offer subscribers broadcast and multicast broadband content without last mile bottlenecks often experienced with terrestrial networks.

We may experience increased competition in the future from existing or new competitors in the hardware, services, and the consumer broadband spheres that may adversely affect our ability to continue to market our products and services successfully. We believe that we have been able to compete successfully with larger telecommunications companies in part by entering into strategic joint development and marketing relationships with major companies such as GTECH and COMSAT RSI, by developing new products such as SkyBlaster, and by emphasizing low-cost product and service features and functions that meet the needs of customers in the markets in which we compete. We also believe that our leadership in the consumer satellite broadband arena through the formation of GTH with market leaders such as Microsoft and EchoStar has created a new channel to sell our products in potentially greater quantities beginning toward the end of this year. We are able to provide these product and service features and functions in part by using our proprietary hardware and software. See "—Patents and Intellectual Property."

We believe that our major competitors have the resources available to develop products with features and functions competitive with or superior to those offered by us. In addition, the entry of new companies into the market or the expansion by existing competitors of their product lines could have an adverse effect on us. However, we believe that our primary competitive advantage is our ability to provide products with relatively low overall cost and high functionality. We also compete on the basis of the performance characteristics of our products and our ability to customize certain network functions. We cannot assure that our competitors will not develop such features or functions, that we will be able to maintain a cost advantage for these products or that new companies will not enter these markets.

We also compete with other companies that offer communications networks and services based on other technologies (e.g., ground-based lines and frame relay, radio transmissions, point-to-point microwave) that can be competitive in terms of price and performance with our products. For example, there is a competing technology for a unidirectional VSAT system that uses a lower-cost remote terminal but requires more satellite space segments capacity than our unidirectional VSAT products. See "Risk Factors—Competition in the network communications industry."

Research and Development

Product Development. We devote significant resources to research and development projects designed to enhance our VSAT products, to expand the applications for which they can be used and to develop new products. As of May 1, 1999, approximately 39% of our employees in Israel and 14% of our employees in the United States were employed in research and development activities. Annual gross research and development expenditures were approximately 8.0%, 10.2% and 10.2% of revenues in the years ended December 31, 1999, 1998 and 1997, respectively. Approximately 8.7%, 19.2%, and 23.5% of our research and development expenditures for the years ended December 31, 1999, 1998 and 1997, respectively, were covered in all three years by the Office of the Chief Scientist, including funds received or accrued through the research consortia (as described below), in 1998 from the European Commission

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and in 1999 from the U.S.-Israel Science and Technology Foundation. Our initial research and development was funded by BIRD, but currently none of our research and development expenditures is funded by BIRD. We cannot assume that funding at any level will continue to be available or that funding will be available on attractive terms.

We intend to continue to devote research and development resources to complete development of certain features, to improve functionality, including supporting greater bandwidth, to improve space segment utilization, to increase throughput and to reduce the cost of our products. We continue to devote substantial research and development efforts to the hardware and software of the Skystar Advantage and FarAway in order to enhance both products' capabilities and to develop new features.

We have devoted research and development resources to development of our DialAway VSAT. This product provides inexpensive, near toll quality, dial tone telephone service for small businesses and villages in remote or urban areas lacking an adequate telecommunications infrastructure. We intend to continue development of the DialAway VSAT to develop new features (such as IP communications), enhance existing features related to the multi-star configuration and reduce costs.

We have developed the SkyBlaster VSAT product and will continue development of this product in order to enhance the product features and effect cost reductions. This product is an interactive VSAT that incorporates a satellite return channel, which enables two-way access to multimedia services via the Internet. The SkyBlaster is targeted for use in communities of interest, corporations, small to mid-size businesses, small office/home office and consumer users. The SkyBlaster is designed to offer improved access through better response time and faster downloading of large files, such as audio and video clips. We have devoted considerable research and development efforts in order to improve the functionality of the SkyBlaster for consumer use, as well as to reduce the costs of the product. We are currently developing an external stand-alone box for the SkyBlaster that we expect to introduce by the first quarter of 2001, in order to enable easy installation of the SkyBlaster product.

Our current products and services typically operate on either the Ku or C satellite bands. We are currently involved in exploring the possible utilization of the Ka satellite band with our products and services in the future.

We develop our own network software and software for our VSAT product lines. We generally license our software to customers as part of the sale of our network products and services. We also license certain third party software for use in our products.

We regard our software and our internally developed hardware as proprietary and have implemented protective measures both of a legal and practical nature. We have obtained and registered several patents in the United States and in various other countries in which we offer our products and services. We rely upon the copyright laws to protect against unauthorized copying of the object code of our software, and upon copyright and trade secret laws for the protection of the source code of our software. We derive additional protection for our software by licensing only the object code to customers and keeping the source code confidential. In addition, we enter into standard confidentiality agreements with our customers to protect our software technology and trade secrets. We have also made copyright, trademark and service mark registrations in the United States and abroad for additional protection of our intellectual property. Despite all of these measures, it is possible that competitors could copy certain aspects of our soft ware or hardware or obtain information which we regard as a trade secret in violation of legal protections.

We periodically receive communications asserting that our products or applications thereof infringe a third party's patent rights or copyrights. We also send similar communications to third parties which we believe may be infringing our patents. In May 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 the further infringement. We intend to vigorously defend against these claims. We do not believe that we are infringing the patents. See "Item 3 -- Legal Proceedings." Other than the litigation with Hughes, there is no pending litigation against us regarding any infringement claim.

Third-Party Funding. Through December 31, 1999, we accrued a total of approximately $3,517,000 in grants from the Office of the Chief Scientist for the development of our OneWay VSAT products, DialAway VSAT product, and mesh satellite communication network products for voice and data. Through that date, we have repaid all the royalties we are required to repay with respect to grants totaling $345,000 for the OneWay VSAT. Under the terms of our funding from the Office of the Chief Scientist for the DialAway and the mesh satellite communications network product, royalties of 3% to 5% are payable on sales of these products developed from the funded project, up to 100% of the dollar-linked grant received in respect of the project (from January 1, 1999, annual interest based on LIBOR also began to accrue). Through December 31, 1999, we paid or accrued royalties of $1,416,000 to the Office of the Chief Scientist for the DialAway project. The terms of these grants prohibit the manufacture of developed OneWay products or developed DialAway products outside of Israel and the transfer of technology developed pursuant to the terms of these grants to any person without the prior written consent of the Office of the Chief Scientist. We received such consent in connection with the OneWay product for the China joint ventures. These restrictions do not apply to the sale or export from Israel of products developed with that know-how. Also, these limitations do not apply to products which have not been funded by the Office of the Chief Scientist.

Through December 31, 1999, we received or accrued grants of approximately $1.0 million from BIRD for the development of the Skystar Advantage VSAT and FaraWay VSAT products. Under the terms of BIRD funding, generally royalties of 2.5% to 5% on sales of products whose development is so funded are payable until 150% of the dollar amount funded (linked to the Consumer Price Index of the United States) is repaid. As of December 31, 1999, we have paid or accrued to BIRD approximately $1.7 million in royalties. As of that date, we have completed repayment of royalties to BIRD with respect to our Skystar Advantage VSAT products and our FaraWay VSAT product.

Through December 31, 1999, we received grants of approximately $125,000 from the European Commission in connection with a joint research and development project with a number of European high technology companies for a satellite-based interactive television platform. These grants are non-royalty bearing.

Through December 31, 1999, we accrued grants of approximately $68,000 from the U.S.-Israel Science and Technology Foundation ("USISTF") in connection with a joint research and development project with a U.S. company for a next generation Internet application. USISTF provides the lesser of $1 million or 50% of allowable costs actually incurred in the project. Under the terms of the USISTF funding, royalties of 2% on the sale of products based upon the developed innovation are payable until 100% of the grant is repaid. To date we have not made any sales in connection with the USISTF funding and consequently have not accrued or paid royalties to USISTF.

Research and Development Consortium Participation. In addition to royalty-bearing grants from the Office of the Chief Scientist and BIRD, we have received non-royalty bearing grants from the Office of the Chief Scientist through participation in generic research consortia, each comprised of several major high technology companies in Israel, with participation of one or more representatives from Israeli academic institutions. We expect to receive further grants through participation in those consortia that are continuing. The consortia that we have participated in are:

- the Israel Satellite Earth Station Generic Research and Development Consortium (devoted to basic technology research for the satellite earth stations industry) which was completed by the end of 1998;

- the Israel Advanced Digital Communication Generic Research and Development Consortium (devoted to generic technology research of advanced digital communication) which was completed by the end of 1998;

- the GaAs MMIC Consortium (devoted to generic technology research of MMIC components and advanced communications which was completed by the end of 1999);

- the MOST Consortium (devoted to generic technology research for on-line broadband multimedia services which was completed by March 31, 2000); and

- the ISIS Consortium (devoted to generic technology research for the information superhighway in space) which began in February 1999.

In addition to these consortia, we have recently received preliminary grant approval for participation in the Large Scale Rural Telephony Consortium, which is devoted to generic technology research for satellite-based rural telephony solutions. Final approval of the consortia is expected by the fourth quarter of 2000 and we can not be certain that final approval will be granted in the amounts requested or at all.

In general, any member of a consortium that develops technology in the framework of that consortium retains the intellectual property rights to technology developed and all the members of the consortium have the right to utilize and implement any such technology without having to pay royalties to the developing consortium member. Transfer of consortium-developed technology or manufacturing of developed products outside of Israel is subject to restrictions and the approval of the Office of the Chief Scientist and in certain projects of the management of the consortium.

Under each of the research consortia, the Office of the Chief Scientist reimburses 66% of the approved budget for that consortium and each individual member of the consortium contributes the remaining 34% for such individual member's research and development activities. No royalties are payable with respect to this funding. Expenses in excess of the approved budget are borne by the consortia members.

As of December 31, 1999, we have accrued approximately $10.6 million in grants from the Office of the Chief Scientist through the consortia, including $0.9 million for equipment.

The following table sets forth, for the years indicated, our gross research and development expenditures, the portion of such expenditures which was funded by royalty-bearing and non-royalty bearing grants, acquired research and development and the net cost of our research and development activities: