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

Overview

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

In 1991, we began marketing our second generation OneWay VSAT. In 1992, we began marketing our TwoWay VSAT with Spacenet as part of Spacenet's Skystar Advantage VSAT service offering, and we began marketing our TwoWay VSATs to GTECH as part of GTECH's GSAT lottery networks. Since that time, we have experienced significant growth in orders, sales and earnings from our OneWay and Skystar Advantage products. Additionally, we began marketing the FaraWay VSAT in 1994, the DialAway VSAT at the end of 1996, and the SkySurfer VSAT in 1997. The Skystar Advantage is our largest-selling product, accounting for approximately 60% of our sales revenue during 1997, and for more than 49% of our sales revenue during 1998. During 1997 and 1998, we shipped more than 32,300 and 49,535 VSATs, respectively, along with related equipment and software.

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

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

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

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

Recording of Revenue

In the case of product sales, we generally recognize revenue when the product is shipped. In the case of network services sales, Spacenet generally has two ways of recognizing revenue, depending on whether or not the customer takes ownership of the network equipment. In the first type of network services sale, the customer purchases hardware, software, and satellite capacity and maintenance services, and Spacenet records revenue when the network is installed and operational (or, in cases where the customer obtains its own installation services, when the equipment is shipped). In many of these cases, Spacenet is paid progress payments upon signing, achievement of certain milestones and installation. For ongoing maintenance, satellite capacity and support services, customers pay monthly fees, which are recorded as service revenues.

Recording of Revenue

In the other type of network services sale, Spacenet procures and installs the equipment and software, obtains the satellite capacity and provides network operations and monitoring for the customer over the contract term (generally three to five years). Under this type of network services sale, Spacenet retains ownership and operation of the network, and receives a monthly service fee (and record revenue) over the term of the contract. Following our acquisition of Spacenet, we expect such networking service arrangements to grow as a percentage of our revenue. As a result, we expect that a growing portion of the VSAT equipment we manufacture will be capitalized on our balance sheet and will result in an increase in our capital expenditures. We also believe that the growth of our business may result in an increase of our inventory and receivables levels and increased working capital needs. We intend to meet such anticipated increases in capital expenditures and working capital with cash on hand including proceeds from the Offering. See "—Liquidity and Capital Resources."

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

Cost of revenues, for both products and services, includes the cost of system design, equipment, satellite capacity, software customization and third party maintenance and installation. For equipment contracts, cost of revenues is expensed as revenues are recognized. For network service contracts, cost of revenues is expensed as revenues are recognized over the term of the contract. For maintenance contracts, cost of revenues is expensed as the maintenance cost is incurred or over the term of the contract. As a result of the Spacenet acquisition, we incurred aggregate charges of $26.4 million for the year ended December 31, 1998. In addition, prior to closing the Spacenet acquisition, Spacenet incurred a charge of approximately $33.2 million to eliminate obsolete and unnecessary inventory and property, plant and equipment and to replace and upgrade certain legacy VSAT network equipment used by certain Spacenet customers. We expect to replace approximately 50% of the equipment in 1999 and the remainder in the year 2000. We will perform these replacements and upgrades, but we expect that in most cases, our replacement of that equipment will be accompanied by the customer's entering into a long-term network services contract.

We devote significant resources to research and development of all our products. We have contractually agreed to commit $4.5 million in 1999 and $2.0 million in 2000 to development of certain technology related to our DialAway Telephony product. This technology will be co-owned with our affiliate, GVT. See Item 1: "Description of Business—Marketing, Distribution and Strategic Alliances—Strategic Alliances and Joint Ventures." Our initial research and development was funded by the Israel-U.S. Binational Industrial Research and Development Foundation ("BIRD"), but currently none of our research and development is funded by BIRD. In Israel, a portion of our research and development expenditures is funded by the Office of the Chief Scientist. We have also received, and expect to continue to receive, grants from the research consortia to which we are a party, which are partly funded by the Office of the Chief Scientist. We expect, however, that the amount of funding from the Office of the Chief Scientist will decrease due to Israeli budgetary constraints.

During 1997 and 1998, approximately 23.5% and 19.2%, respectively, of our research and development expenditures before acquired research and development, were funded by the Office of the Chief Scientist and the research consortia. Under the terms of the funding provided by the Office of the Chief Scientist and BIRD, we are required to pay royalties on sales of the products developed from the funded project until an amount ranging from 100% to 150% of the grants has been repaid. Grants from the research consortia do not require the payment of royalties. Royalties to the Office of the Chief Scientist and BIRD, which are included in selling, general and administrative expenses, were $371,000 during 1997 and $820,000 during 1998.

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

Substantially all of our production facilities in Israel are eligible for certain tax benefits. As a result, we expect that a majority of our income for 1999 and 2000 will be tax exempt, while the balance will be taxed at a reduced rate of 15% to 25%. See "—Effective Corporate Tax Rate."

We believe that accumulated losses of Spacenet reflect certain one-time adjustments and write-offs resulting primarily from its acquisition of AT&T Tridom. We believe that the combination of Gilat and Spacenet will result in positive operating results due to the reduced research and development, general and administrative expenses as a percentage of revenues as well as unification of product lines. We also expect to derive additional benefits from the commitment of GE Americom and certain of its affiliates to purchase a certain amount of our products through the end of 1999. As part of the merger agreement, in the event such purchases do not amount to $37.5 million, 40% of the shortfall will be credited against the 1999 service fees that we will owe to GE Americom under certain satellite transponder service agreements.

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

Results of Operations of Gilat

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

Percentage of Sales

	Years Ended December 31				
	1996	Adjusted 1996(1)	1997	1998	Adjusted 1998(2)
Sales	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	57.9	57.9	56.7	61.9	55.8
Gross profit	42.1	42.1	43.3	38.1	44.3
Research and development costs					
Expenses incurred	11.0	11.0	10.2	10.2	10.2
Less – grants	2.6	2.6	2.4	2.0	2.0
	8.4	8.4	7.8	8.2	8.2
Acquired research and development	0.0	0.0	0.0	51.5	0.0
Net research and development costs	8.4	8.4	7.8	59.7	8.2
Selling, general and administrative expenses	18.8	18.8	19.6	18.7	18.7
Restructuring charges	0.0	0.0	0.0	9.2	0.0
Merger expenses	10.8	0.0	0.0	0.0	0.0
Operating income (loss)	4.1	14.9	15.9	(49.5)	17.4
Financial income (expenses) - net	1.6	1.6	0.5	(0.8)	(0.8)
Write-off of investments associated with restructuring	0.0	0.0	0.0	(1.7)	0.0
Other income - net	1.8	1.8	0.0	0.1	0.1
Income (loss) before taxes on income	7.5	18.3	16.4	(51.9)	16.7
Taxes on income	0.1	0.1	0.1	0.2	0.2
Income (loss) after taxes on income	7.4	18.2	16.3	(52.1)	16.5
Share in losses of associated companies	0.0	0.0	0.0	0.5	0.5
Net income (loss)	7.4%	18.2%	16.3%	(52.6)%	16.0

(1) Results of operations for year ended December 31, 1996, excluding the Gilat Florida merger expenses of approximately $8 million.

(2) Results of operations for year ended December 31, 1998, excluding the Spacenet restructuring charges, write offs associated with restructuring and expenses related to acquired research and development of approximately $106.4 million.

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

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

Gross Profit. Gross profit increased by 31.8% to approximately $59.2 million in 1998 from approximately $44.9 million in 1997. Our gross profit margin decreased to 38.1% in 1998 from 43.3% in 1997 due to write-off of inventories associated with restructuring. If such write-off had not been included, our gross profit margin would have increased to 44.3% due primarily to a relative decrease in our cost of sales as a result of more efficient manufacturing processes, lower cost of components and a change in the overall product mix.

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

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

Restructuring Charges and Related Expenses. As a result of the Spacenet acquisition, we incurred restructuring charges of $14.2 million for the year ended December 31, 1998 mainly for compensation to customers and other third parties, $9.5 million of inventory write-offs relating to rationalization of product lines, which are presented in cost of sales and $2.7 million of write-off of investments associated with restructuring.

Operating Income (Loss). Our operating income decreased to a loss of approximately $76.9 million in 1998 from an income of approximately $16.5 million in 1997, primarily due to the restructuring charges, write offs associated with restructuring and expenses related to acquired research and development as described above. If restructuring charges, write offs associated with restructuring and expenses related to acquired research and development had not been included, operating income would have been $26.9 million for the year ended December 31, 1998, (representing an increase of 62.8% over 1997) with the increase due primarily to increased sales.

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

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

Net Income (Loss). As a result of all the foregoing factors, we had a loss of approximately $81.6 million in 1998 in comparison to net income of approximately $16.9 million in 1997. If restructuring charges, write offs associated with restructuring and expenses related to acquired research and development had not been included in the Company's results, the net income for the year ended December 31, 1998, would have been $24.8 million (representing an increase of 46.4% over 1997).

Earnings (Loss) Per Share. Basic loss per share for 1998 was $7.38 per share as compared to basic earnings per share of $1.56 per share in 1997. Diluted loss per share for 1998 was $7.38 per share as compared to diluted earnings per share of $1.51 per share in 1997. If restructuring charges, write offs associated with restructuring and expenses related to acquired research and development had not been included in the Company's results, basic earnings per share for 1998 would have been $2.24 per share and diluted earnings per share for 1998 would have been $2.14 per share.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Sales. Sales increased by 39.9% to approximately $103.7 million in 1997 from approximately $74.1 million in 1996. Our growth in sales was attributable primarily to a substantial increase in sales of Skystar Advantage VSAT products as well as increased sales of OneWay VSAT products, FaraWay VSAT products and paging receiver products and first sales of DialAway VSAT products and SkySurfer VSAT products. The increase in sales volume was partly offset by downward pressures on prices in the industry.

Gross Profit. Gross profit increased by 44.0% to approximately $44.9 million in 1997 from approximately $31.2 million in 1996. Our gross profit margin increased to 43.3% in 1997 from 42.1% in 1996 due primarily to a relative decrease in our cost of sales as a result of more efficient manufacturing processes, lower cost of components and a change in the overall product mix.

Research and Development Expenses. Gross research and development costs increased by 30.6% to approximately $10.6 million in 1997 from approximately $8.1 million in 1996, and decreased as a percentage of sales to 10.2% in 1997 from 11.0% in 1996. The dollar increase in such costs in 1997 was due primarily to the hiring of additional research and development personnel, the further development of the FaraWay and DialAway product lines for corporate and rural telephony applications, the expansion of research and development to reduce the costs and increase the functionality of our OneWay and TwoWay VSAT product lines, including IP-based products, as well as of our ISAT and paging receiver products and to conducting generic research relating to the research consortia of which we are a member. Research and development grants from the Office of the Chief Scientist, as a percentage of gross research and development costs, remained at the same level of 23.5% in 1997 as in 1996. The grants from the Office of the Chief Scientist (other than from the research consortia) are subject to royalties on sales of products resulting from the funded project. Research and development costs, net increased to approximately $8.1 million in 1997 from approximately $6.2 million in 1996 but decreased as a percentage of sales to 7.8% in 1997 from 8.4% in 1996. In 1997 and 1996, we received or accrued an aggregate of approximately $3.7 million in research and development grants from the Office of the Chief Scientist through the four research consortia of which we are a member. We are not required to pay royalties on sales of products developed with these grants.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by 45.7% to approximately $20.3 million in 1997 from approximately $13.9 million in 1996. As a percentage of sales, selling, general and administrative expenses increased to 19.6% in 1997 from 18.8% in 1996. Increased expenditures in 1997 were primarily attributable to the expansion of our marketing efforts (including expansion of international offices), GVT operations, IP-based product-related expenses and the addition of administrative and marketing personnel.

Merger expenses associated with the Gilat Florida merger in December 1996 amounted to approximately $8.0 million in 1996, with no merger-related expenses in 1997.

Operating Income. Primarily as a result of the absence of merger expenses, our operating income increased by 439.9% to approximately $16.5 million in 1997 from approximately $3.1 million in 1996. Excluding merger expenses, our operating income increased by 49.4% to approximately $16.5 million in 1997 from $11.0 million in 1996. As a percentage of sales, excluding merger expenses, operating income increased to 15.9% in 1997 from 14.9% in 1996. This increase was primarily due to the strong growth in sales, lower costs of sales and reduced research and development costs which were partly offset by an increase in selling, general and administrative expenses.

Financial Income, net. Financial income, net decreased to $0.5 million in 1997 from $1.2 million in 1996 mainly due to the payment of interest on convertible subordinated notes issued in 1997 (part of the proceeds of which were used for working capital, investments and property, plant and equipment) and amortization of related issuance costs. As of December 31, 1997, we had approximately $24.7 million invested in short-term bank deposits (including deposits with a maturity of three months or less) and $40.0 million in long-term bank deposits.

Net Income (Loss). As a result of all the foregoing factors, our net income increased by 209.6% to approximately $16.9 million in 1997 from approximately $5.5 million in 1996. Our net income as a percentage of sales increased in 1997 to 16.3% from 7.4% in 1996 due primarily to the absence of merger expenses. Excluding merger expenses, net income increased by 25.9% from $13.5 million to $16.9 million. As a percentage of sales, net income decreased to 16.3% in 1997 from 18.2% in 1996.

Earnings Per Share. Basic earnings per share in 1997 were $1.56 per share as compared to $0.51 per share in 1996. Diluted earnings per share in 1997 were $1.51 per share as compared to $0.50 per share in 1996. If the expenses associated with the Gilat Florida merger had not been included in our results, basic earnings per share for 1996 would have been $1.24 per share and diluted earnings per share for 1996 would have been $1.22 per share.

Variability of Quarterly Operating Results

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

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

Liquidity and Capital Resources

Since inception, our financing requirements have been met primarily through cash generated by operations, funds generated by private equity investments in 1990 and 1991, our public offerings in 1993 (approximately $24.5 million) and 1995 (approximately $37.5 million), our issuance of convertible subordinated notes in 1997 (approximately $71.8 million) and our public offering in 1999 (approximately $254.8 million), as well as funding from the Office of the Chief Scientist and BIRD. In addition, we also financed our operations through borrowings under available credit facilities as discussed below. We intend to meet our anticipated increases in capital expenditures and working capital requirements with cash-on-hand and proceeds from the Offering.

We have used available funds primarily for working capital. In 1998, funds were used to increase inventories by approximately $1.5 million and trade receivables by approximately $35.2 million. The increase in inventories in 1998 represented increased component purchases to meet higher production levels and an increase in work-in-process and finished products, primarily related to customer orders planned for shipment early in the following quarter. Funds were also used to increase investment in companies by approximately $14.2 million (including $8.5 million in loans to an associated company and $2.7 million from deconsolidation of the investment in GVT) and property, plant and equipment by approximately $15.8 million in 1998. This increase in property, plant and equipment represents a portion of our investment in our new facility in Petah Tikva, Israel, as well as additional purchases of computer and electronic equipment and office furniture and equipment. Approximately $3.9 million was provided by an increase in trade payables, approximately $24.0 million was provided by a decrease in other receivables and an increase in accrued expenses, approximately $5.7 million was used to decrease other payables, and approximately $20.4 million was provided by short term bank credit.

As of December 31, 1998, we had approximately $7.6 million in cash, cash equivalents and short-term bank deposits and approximately 40.7 million of long-term bank deposits, compared to approximately $26.1 million in cash, cash equivalents and short-term bank deposits and approximately 40.0 million of long-term bank deposits as of December 31, 1997. Our ratio of shareholders' equity to total assets as of December 31, 1998, increased to 53.7% from 51.1% as of December 31, 1997.

As of December 31, 1998, we had a bank line of credit of approximately $20 million with Israel Discount Bank Ltd. (an affiliate of one of our major shareholders), under which approximately $11.4 million of short-term debt was outstanding as of that date. We also had a bank line of credit of approximately $26.5 million with Bank Leumi Le Israel B.M., under which approximately $11.6 million of short-term debt was outstanding as of December 31, 1998. The short-term bank credits are secured by a negative pledge prohibiting us from selling or otherwise transferring any assets except in the ordinary course of business, from placing a lien on our assets without the bank's consent and from declaring dividends to our shareholders.

In 1997, funds were used to increase inventories by approximately $14.5 million, trade receivables by approximately $12.9 million, and other receivables by approximately $4.1 million. The increase in inventories in 1997 represented increased component purchases to meet higher production levels and an increase in work-in-process and finished products, primarily related to customer orders planned for shipment early in the following quarter. Funds were also used to increase investment in companies by approximately $3.5 million and property, plant and equipment by approximately $25.9 million. This increase in property, plant and equipment in 1997 represents a portion of our investment in our new facility in Petah Tikva, Israel, as well as additional purchases of computer and electronic equipment and office furniture and equipment. Approximately $1.7 million was provided by an increase in trade and other payables and approximately $2.3 million was provided by an increase in accrued expenses.

The convertible subordinated notes that we issued in May 1997 represent unsecured general obligations, and are subordinate in right of payment to certain other of our obligations and are convertible into Ordinary Shares. The notes bear interest at an annual rate of 6.5% and will mature on June 1, 2004, unless redeemed earlier at our option, repurchased by us at the option of the holder upon the occurrence of certain designated events or converted into Ordinary Shares at the option of the holder. The notes do not impose any financial covenants or any restrictions on the payment of dividends, the repurchase of securities or the incurrence of senior indebtedness or other indebtedness. See Note 8 of Notes to the Consolidated Financial Statements.

We expect that the principal uses of our cash during 1999 will be for working capital, capital expenditures and expenses related to the integration of Spacenet. In addition, our uses of cash will include the expansion of our manufacturing, testing, quality control, delivery and service capabilities in Israel, expansion of our international marketing activities, research and development, and additional capital investment for our service-based offerings.

Acquisition of Spacenet

On December 31, 1998, we completed the acquisition of Spacenet, a company engaged in providing VSAT-based network services and prior to the acquisition, a wholly-owned subsidiary of GE Americom. The transaction was completed pursuant to an Agreement and Plan of Merger entered into on September 25, 1998, between Gilat, GE Americom, and Spacenet. We acquired Spacenet from GE Americom in exchange for 5 million shares of newly issued Gilat ordinary shares. The acquisition was structured as a merger intended to qualify as a "tax-free" reorganization. See Item 13: "Interest of Management in Certain Transactions—Merger-Related Agreements—The Tax Matters Agreement." — p. 78

Prior to the acquisition, Spacenet was the single largest customer for our equipment. Spacenet purchased our VSAT products in order to incorporate them into Spacenet's VSAT-based network service offerings. Aggregate sales to Spacenet represented approximately 28%, 34% and 45% of Gilat's total sales in 1996, 1997 and 1998, respectively.

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 greatly enhances 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. The Spacenet acquisition has added a significant customer base in the United States, Europe, Asia and South America and access to Spacenet's other relationships in the global VSAT industry.

As part of the acquisition, we entered into several significant agreements with GE. See Item 13: "Interest of Management in Certain Transactions—Merger-Related Agreements." In addition, as part of the Spacenet acquisition, we acquired certain advanced VSAT technology developed under the name Turbosat. We plan to utilize the Turbosat technology in a new product and market this technology under our own name. See Item 1: "Description of Business – Products and Services - - New Product Under Development." p. 78

In-Process Research and Development.

On December 31, 1998, we completed the purchase of Spacenet for $190 million. A major value-enhancing asset acquired in the Spacenet acquisition was the technology developed by Spacenet as part of its planned new Turbosat product. At that time, we planned to utilize the Turbosat technology in a new product.

As part of the process of analyzing the purchase of Spacenet, management made a decision to buy technology that had not yet been commercialized rather than develop the technology internally. Our management based this decision on factors such as the amount of time it would take to bring the technology to market and the quality of the Spacenet research and development effort. We also considered our own resource allocation and our progress on comparable technology. Our management expects to use the same decision process in the future. The allocation to in-process research and development of $80 million represents the estimated fair value using the methodology described under "Valuation Assumptions" below.

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

At the time of the acquisition and now, we believe the Turbosat technology will be targeted at a new customer base for us which has very different requirements than the market served by Gilat's existing Skystar Advantage – the small home office market and a portion of the market previously captured by frame relay technology.

Substantial progress had been made related to the research and development of Turbosat technology at the acquisition date. The major achievements related to this product at the time included functional and production ready VSAT ODU, VSAT IDU case, IDU motherboard, hub modulator, UNICOM cards and NMS and IP protocol suites. The subset of software features had been delivered and was operating in beta testing. The completed hardware and software components comprise a large part of the Turbosat system. We estimated that between 70% and 75% of the final Turbosat technology was complete as of the acquisition closing date. The primary remaining risks at the acquisition date were divided between completion of outstanding hardware, stress testing of software and full integration, including of the CDMA technology. Of the hardware, only two major components were incomplete, the hub demodulator and the modem ASIC for the remote modem card.

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

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

Cost of Turbo Sat

$20 mm work completed

$6 mm to do

$26 mm Total

Prior to the acquisition, Spacenet had incurred approximately $20 million in Turbosat development-related costs. At the acquisition date, costs to complete the research and development efforts related to Turbosat were expected to be approximately $6 million, which continues to be management's estimate.

Management estimates that the remaining Turbosat technology development will be completed during the fourth quarter of 1999, excluding integration of the CDMA technology, for which we are directing research and development activities over the next 12 months.

In developing our financial projections of future revenues and costs, we included the positive impact of the introduction of the new Skystar Advantage with Turbosat feature set on our future earnings estimates and our capability to expand in new markets, including the small home office market. We are reasonably confident in the successful completion of the development of the Turbosat technology. See "Risk Factors – Risks associated with new product research and development in process at Spacenet."

Valuation Assumptions

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

The selection of the discount rate was based on consideration of a weighted average cost of capital, as well as other factors including the technology's useful life, profitability level, uncertainty of advances, and stage of completion. A risk adjusted discount rate of 40% was utilized to discount projected cash flows.

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

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

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

Year 2000 and Euro Compliance Risk

The Year 2000 issue arises from computer programs using two digits rather than four to define the applicable year. Date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations causing disruptions of operations, including, among others, a temporary inability to process transactions, send invoices, or engage in similar normal business activities. Euro compliance issues arise from the upcoming conversion of many European monetary systems to the use of the euro as the national currency rather than their current currency. We have been identifying corrections to software that need to be made to avoid a Year 2000 or euro compliance problem. We are also working with our vendors to ensure that their products become Year 2000 and euro compliant. We expect to correct all of our internal Year 2000 compliance issues prior to January 1, 2000 and to ensure euro compliance in a timely manner, but it is presently not known whether our vendors will be fully compliant at that stage. Any failure by us or our vendors to resolve any Year 2000 or euro compliance issues on a timely basis could have a material impact on our operations. Costs of Year 2000 compliance, while significant, are not expected to be material, although charges by vendors or third party service providers for Year 2000 and euro compliance matters cannot currently be estimated. In accordance with Emerging Issues Task Force Opinion No. 96-14 of the Financial Accounting Standards Board of the United States, "Accounting for the Costs of Modifying Computer Software for the Year 2000," we will expense all costs as incurred.

Impact of Inflation and Currency Fluctuations

Almost all of our sales are made in dollars and most of our expenses are in dollars and NIS. The dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is not offset (or is offset on a lagging basis) by a devaluation of the NIS in relation to the dollar. The influence on the dollar cost of our operations in Israel relates primarily to the cost of salaries in Israel, which are paid in NIS and constitute a substantial portion of our expenses in NIS. In the past several years, the inflation rate in Israel has exceeded the rate of devaluation of the NIS against the dollar, although during 1997 and 1998 the rate of devaluation of the NIS against the dollar exceeded the inflation rate in Israel. For example, during 1995 and 1996, the rate of inflation in Israel was 8.1% and 10.6%, respectively, while the NIS was devalued against the dollar by 3.9% and 3.7%, respectively. Although this trend was reversed during 1997 and 1998 (when the rate of inflation was 7.0% and 8.6% respectively and the rate of devaluation was 8.8% and 17.6% respectively), there can be no assurance that this reversal will continue. If future inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of such devaluation lags behind increases in inflation in Israel, we may be materially adversely affected.

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

Effective Corporate Tax Rate

Israeli companies are generally subject to income tax at the rate of 36% of taxable income. However, substantially all of our production facilities in Israel have been granted Approved Enterprise status under the Law for Encouragement of Capital Investments, 1959, and consequently are eligible for certain tax benefits for the first several years in which they generate taxable income. We currently have eight Approved Enterprises, and have applied for approval for a ninth enterprise. Income derived from the eight Approved Enterprises is entitled to tax benefits for periods of 7 years (in the case of two of the enterprises) or 10 years (for the remaining six enterprises), from the first year in which we generate income from the respective Approved Enterprise, on the basis of the nature of the incentives selected by us. The period of reduced tax for the ninth enterprise, if approved, is expected to be 10 years, although the terms of the approval may provide for a different period. The main tax benefits are a tax exemption for two or four years and a reduced tax rate of 15% to 25% for the remainder of the benefits period. As a result of these programs, our effective corporate tax rate was 0% in 1993, 2.1% in 1994, 0% in 1995, 1.5% in 1996, 0.8% in 1997 and in 1998 we had a loss due to restructuring charges, write offs associated with restructuring and expenses related to acquired research and development. We anticipate that a majority of our income for 1999 will be tax-exempt, while the balance will be taxed at a reduced rate of 15% to 25%.

ITEM 9A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

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

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

Exchange Rate Risk Management

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

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

	1999
Liabilities – short term	**(in thousands)**
Variable rate debt:	
In dollars	$9,700
Average interest rate	5.37–5.537%
In NIS	$12,670
Average interest rate	14.2-14.4%

Interest Rate Risk Management

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

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

	1999	2000	2001	Maturity Unknown
Assets:		(in thousands)		
Short term: Fixed rate Interest rate	$1,000 0%			
Long term: Fixed rate Interest rate		$40,701 5.76-6.67%		$7,500 0%
Liabilities:				
1) long-term fixed rate debt- In dollars Interest rate			$75,000 6.5%	
2) short-term variable rate debt- In dollars average interest rate In NIS average interest rate	$9,700 5.37-5.537% $12,670 14.2-14.4%			
Interest rate option(*)		$20,000		

(*) In May, 1997 we bought a three year call option to protect us in the event the Libor interest rate exceeds 7.5%. Upon the exercising of the option, we will be entitled to the difference between the then Libor interest rate and 7.5%, multiplied by $20,000,000.

In 1998, we made the following loans to an associated company:

(i) Short-term loan in the amount of $1,000,000 which does not bear interest. The alternative interest rate is 5% per annum.

(ii) Long-term loan in the amount of $7,500,000 which was given in conjunction with our investment in that associated company. The loan does not bear interest and is without a maturity date.

In February 1999, the Company raised net proceeds of approximately $255 million in the Offering. A portion of the proceeds was used for working capital and other purposes. The remaining portion of the proceeds was invested in short- and long-term (up to two years) dollar deposits, so the Company has no currency or interest exposure from these deposits.

ITEM 10: DIRECTORS AND OFFICERS OF REGISTRANT

Directors and Executive Officers

Our directors and executive officers and key executives of our subsidiaries as of June 16, 1999 are as follows:

Name	Age	Position
Yoel Gat(1)(2)	47	Chairman of the Board of Directors and Chief Executive Officer
Amiram Levinberg(1)(2)	43	President, Chief Operating Officer and Director
Shlomo Tirosh(3)	53	Director
Dov Tadmor(1)(3)(4)	69	Director
John Connelly(4)	55	Director
Dr. Gideon Kaplan	43	Vice President, Technology
Yoav Leibovitch	41	Vice President, Finance and Administration and Chief Financial Officer
Erez Antebi	39	Vice President, Marketing and General Manager for Asia, Australia and Africa
Joann R. Blasberg	47	Vice President and General Counsel
Alan Freece	51	Chief Executive Officer and President, Gilat Florida
Sheldon Revkin	55	President and Chief Operating Officer, Spacenet
David R. Shiff	41	Vice President, Sales and Marketing, Spacenet

(1) Member of the Stock Option Committee.
(2) Member of the Compensation Committee.
(3) Member of the Audit Committee.
(4) Mr. Tadmor is a nominee of DICFM and PEC and Mr. Connelly is a nominee of GE Americom, pursuant to a voting agreement among certain of the principal shareholders of Gilat concerning the election of directors.

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

Amiram Levinberg is a co-founder of Gilat and has been a Director and Chief Operating Officer since inception, and since July 1995 has served as President. Mr. Levinberg is a member of the Stock Option and Compensation Committees of the Board. Until July 1995, he served as Vice President of Engineering. In this capacity, he supervised the development of Gilat's OneWay and Skystar Advantage

VSATs. Mr. Levinberg is also a director of Gilat Communications. From 1977 to 1987, Mr. Levinberg served in a research and development unit of the IDF, where he managed a large research and development project. He was awarded the Israel Defense Award in 1988. Mr. Levinberg is a graduate of the Technion, with a bachelor of science degree in electrical engineering and electronics and masters of science degree in digital communications.

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

Dov Tadmor has been a Director of Gilat since July 1994 and is a member of the Audit and Stock Option Committees of the Board. Mr. Tadmor has served as Managing Director of DIC and DICFM from 1985 until March 1999. Mr. Tadmor is Chairman of the Boards of Directors of Scitex Corporation Ltd. and a member of the Boards of Directors of IDBH, IDBD, Cellcom (Israel) Ltd., NICE Systems Ltd. and El-Yam Ships Ltd. Mr. Tadmor holds a bachelor of law degree from the School of Law and Economics in Tel Aviv.

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

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

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

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

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

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

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

David R. Shiff joined Spacenet in December 1998, as Vice President of Sales and Marketing. Prior to joining Spacenet, Mr. Shiff spent 15 years with Hughes Network Systems, a division of Hughes Electronics. For the last two years he served as Assistant Vice President, North American Sales, for the Satellite Networks Divisions of HNS. Mr. Shiff holds a degree in mechanical engineering from the University of Wisconsin.

Terms of Directors

Directors are elected at the annual shareholders meeting to serve until the next annual meeting of the shareholders and until their respective successors are elected and qualified. Our Articles of Association provide that the directors may appoint additional directors (whether to fill a vacancy or to expand the Board). Our Articles of Association provide that the Board may delegate all of its powers to committees of the Board as it deems appropriate, subject to the provisions of the Israeli Companies Ordinance (New Version) 1983, as amended (the "Companies Ordinance"). Officers of Gilat serve at the discretion of the Board or until their successors are appointed.

Alternate Directors

Our Articles of Association provide that a director may appoint, by written notice to Gilat, any individual (whether or not such person is then a member of the Board) to serve as an alternate director, subject to the consent of the Board if the alternate is not then a member of the Board. Any alternate director shall have all of the rights and obligations of the director appointing him or her, except the power to appoint an alternate (unless otherwise specifically provided for in the appointment of such alternate).

The alternate director may not act at any meeting at which the director appointing him or her is present. Such alternate may act as the alternate for several directors and have the corresponding number of votes. Unless the time period or scope of any such appointment is limited by the appointing director, such appointment is effective for all purposes and for an indefinite time, but will expire upon the expiration of the appointing director's term. Currently, no alternate directors have been appointed.

Board Compensation

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

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

Approval of Certain Transactions under the Companies Ordinance; Audit Committee

We are subject to the provisions of the Israeli Companies Ordinance. The Companies Ordinance codifies the duty of care and fiduciary duties which an Office Holder has to the company. An "Office Holder" is defined in the Companies Ordinance as a director, managing director, chief business manager, executive vice president, vice president, other manager directly subordinate to the managing director and any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. The Office Holders of Gilat currently include each of the persons described above under "Directors and Executive Officers." Under the Companies Ordinance, all arrangements as to compensation of Office Holders who are not directors require the approval of the company's Board. Arrangements as to compensation for Office Holders who are directors require the approval of the Audit Committee and the Board of Directors and if the Office Holders are also shareholders, the approval of the shareholders at a general meeting.

The Companies Ordinance requires that certain transactions, actions and arrangements be approved as provided for in a company's Articles of Association and/or by an audit committee of the company's board, a majority of whose members do not individually hold more than 5% of the company's shares and none of whom are employees of the company, as well as by the board itself. We have appointed the Audit Committee, which we believe complies with the criteria set forth in the Companies Ordinance. Certain transactions also require, in addition to Audit Committee and Board approval, approval by our shareholders at a general meeting.

The disclosure provisions of the Companies Ordinance require that an Office Holder promptly disclose any direct or indirect personal interest that he or his affiliates may have, and all related material information known to him, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an extraordinary transaction (as defined in the Companies Ordinance), the Office Holder also must disclose any personal interest held by certain of the Office Holder's relatives. If the Office Holder complies with such disclosure requirements, the company may approve the transaction in accordance with the provisions of its Articles of Association. If the transaction is with a third party in which the Office Holder has a personal interest, the approval must confirm that the Office Holder acted in good faith and the transaction is not adverse to the company's interest. In addition, if the transaction is an extraordinary transaction, then in addition to any approval required by the Articles of Association, it also must be approved by the company's audit committee, its board and, in certain circumstances, the shareholders of the company at a general meeting. The vote of a majority of the disinterested directors of the audit committee and the board participating in a duly convened meeting is required for approval of such matters.

Office Holders who have a personal interest in a matter which is considered at a meeting of the board or the audit committee may not be present at such meeting, may not participate in the discussions and may not vote on any such matter.

For information concerning the direct and indirect personal interests of certain of our Office Holders and principal shareholders in certain transactions, see Item 13: "Interest of Management in Certain Transactions."

Indemnification

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

ITEM 11: COMPENSATION OF DIRECTORS AND OFFICERS

Compensation of Directors and Officers

The following table sets forth the aggregate compensation paid to or accrued on behalf of all of our directors and officers as a group for the year ended December 31, 1998:

	Salaries, Fees, Directors' Fees, Commissions and Bonuses	Pension, Retirement and Similar Benefits
All directors and officers as a group (17 persons*).	$ 3,390,712	$ 795,494

*including one person who ceased being an officer in 1998, one person who ceased being a director in 1999 and one person who ceased being an officer in 1999

Through June 16, 1999, we had granted options under the Stock Option Plans to our then officers and directors for a total of 1,035,100 Ordinary Shares, of which 104,012 have been exercised. See Item 12: "Options to Purchase Securities from Registrant or Subsidiaries."

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

Management Employment Agreements

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

Advisory Board

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

ITEM 12: OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT OR SUBSIDIARIES

Stock Option Plans

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

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

(i) the 1995 Stock Option Plan (Incentive and Restricted Stock Options) (the "1995 ISO/RSO Plan"), which provides for the granting of incentive and restricted stock options for the purchase of up to 1,940,000 Ordinary Shares (increased by 1,820,000 from the original amount as a result of resolutions of the Board in July 1996, February 1997, February, September and November 1998, which were approved by the shareholders in the respective annual meetings of shareholders);

(ii) the 1995 Section 102 Stock Option/Stock Purchase Plan (the "1995 Section 102 Plan"), which provides for the granting of options to purchase up to 1,620,000 Ordinary Shares (increased by 1,400,000 as a result of resolutions of the Board in July 1996, February 1997, and February 1998); and

(iii) the 1995 Advisory Board Stock Option Plan (the "1995 Advisory Board Plan"), which provides for the granting of options to purchase up to 150,000 Ordinary Shares (decreased by 20,000 as a result of resolutions of the Board in July 1996 and February 1997).

The purpose of the 1993 Plans and 1995 Plans is to enable us to attract and retain qualified persons as employees, officers, directors, consultants and advisors and to motivate such persons by providing them with an equity participation in Gilat. In addition, the 1993 and 1995 ISO/RSO Plans are designed to afford qualified optionees certain tax benefits available under the United States Internal

Revenue Code of 1986, as amended (the "Code"). The 1993 and 1995 Section 102 Plans are designed to afford qualified optionees certain tax benefits under the Israel Income Tax Ordinance. The 1995 Advisory Board Plan is designed to allow for the granting of options to members of the Advisory Board. The 1993 Plans will expire on January 27, 2003 and the 1995 Plans will expire on June 29, 2005 (10 years after their adoption), unless terminated earlier by the Board.

Each of the 1993 Plans and the 1995 Plans is administered by a Stock Option Committee appointed by the Board. The Stock Option Committee (comprised of Messrs. Gat, Levinberg, Anghel and Tadmor) has broad discretion, subject to certain limitations, to determine the persons entitled to receive options or rights to purchase under the 1993 Plans and 1995 Plans, the terms and conditions on which options or rights to purchase are granted and the number of shares subject thereto. The Stock Option Committee also has discretion to determine the nature of the consideration to be paid upon the exercise of an option and/or right to purchase granted under the 1993 Plans and the 1995 Plans. Such consideration generally may consist of cash, or, at the discretion of the Board, cash and a recourse promissory note.

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

The Ordinary Shares acquired upon exercise of an option are subject to restrictions on transfer, sale or hypothecation. Options are exercisable and restrictions on disposition of shares lapse according to the terms of the individual agreements under which such options were granted or shares issued. Ordinary Shares as to which the rights associated with such shares have not vested will be held by a trustee designated by us.

As of June 16, 1999, we granted options to purchase a total of 306,075 Ordinary Shares under the 1993 Plans and 3,289,636 Ordinary Shares under the 1995 Plans for an aggregate of 3,595,711 Ordinary Shares subject to options under such plans. The exercise prices for such options vary from $8.125 to $55.125 and all such options expire at various times from September 2003 to May 2009. Of such options, 1,035,100 options were granted to officers and directors. As of June 16., 1999, options under the plans for a total of 437,765 shares had been exercised.

In December 1992, we granted options outside of any stock option plan to two then officers. One officer, who has since again become an officer of an affiliate of Gilat, was granted an option to purchase 24,500 Ordinary Shares, at an exercise price of $0.33 per ordinary share, and the other was granted an option to purchase 33,333 Ordinary Shares at an exercise price of $12.00 per share, both on terms and conditions comparable to those provided for under the 1993 Plans. As of June 16, 1999, 16,000 of these options have been exercised.

In May 1999, the Board approved the establishment of a new stock option plan under Section 102 of the Israel Income Tax Ordinance with 500,000 Ordinary Shares to be reserved for issuance. Management was directed to prepare the plan and obtain the necessary regulatory approvals. The approvals have not yet been obtained and no options have been granted. The plan is also subject to approval of the next annual meeting.

ITEM 13: INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS

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

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

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

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

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

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

Transactions with Gilat Communications. In July 1996, we entered into an agreement with Gilat Communications Ltd. ("Gilat Communications") under which Gilat Communications has been granted non-exclusive distribution rights to sell and provide technical support for our products in South

7 oct. 2002

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

Throughout 1998, we sold approximately $3.3 million in equipment to Gilat Communications for distribution and as a value added reseller. The sales were in accordance with our standard sale terms and conditions. Certain of our officers, directors, principal and other shareholders are also shareholders of Gilat Communications. For more information regarding certain transactions between us and Gilat Communications, see Notes 9 and 15 of Notes to Consolidated Financial Statements listed in Item 19.

Merger-Related Agreements

In connection with our acquisition of Spacenet, we entered into a Merger Agreement and a series of related agreements. The parties to those agreements include GE Americom which as of June 16, 1999 holds approximately 23.84% of our outstanding Ordinary Shares. The terms of those agreements, and of certain important provisions of the Merger Agreement are summarized below.

7 **Post-Closing Adjustments.** The Merger Agreement contemplates certain post-closing adjustments described below that may result in (a) our paying or receiving certain amounts in cash or (b) our issuing additional Ordinary Shares to GE Americom in respect of such adjustments. Most of the post-closing adjustments relate to an agreement between the parties that the net assets on the combined closing balance sheet of Spacenet and its subsidiaries should equal $85 million and that any shortfall or excess, as the case may be, should be addressed through post-closing adjustments. Other adjustments relate to the collection of accounts receivable, the sale of specified items of Spacenet inventory and the allocation of certain tax benefits. $85 mm

GE Americom Equipment Purchase Commitment. GE Americom and its affiliates have committed to purchase certain products from Gilat through the end of 1999. If the total purchase orders for such products is less than $37.5 million, 40% of the shortfall will be credited against the 1999 service fees owed by us to GE Americom under the Satellite Transponder Service Agreements described below.

Indemnification. Subject to the limitations set forth in the Merger Agreement, GE Americom has indemnified Gilat and Spacenet, and Gilat has indemnified GE Americom, from and against any losses arising from indemnified obligations. The indemnification obligations primarily relate to damages arising from breaches by the other party of representations and warranties under the transaction documents, as well as indemnities with respect to specified obligations of each of the parties. The obligations generally expire on a final survival date which, subject to certain exceptions, is 18 months after the Closing Date.

The Transitional Services Agreement. Under the Transitional Services Agreement, GE Americom has agreed, in consideration of the issuance of 5,505 Ordinary Shares, to provide Spacenet and its subsidiaries specified transitional services, including finance services, accounting services, purchasing services, cash management services, computer-related services and payroll processing services, until $210,291

thru Aug. 31, 1999

August 31, 1999. These services will be provided at no additional cost for Gilat, except for those services identified as being outsourced which will be provided at a cost equal to GE Americom's outsourced costs. The Transitional Services Agreement also provides that GE Americom will provide certain additional support or other similar services during the transition period that Gilat identifies as being reasonably necessary to the operations of Spacenet as presently conducted. These additional services will generally be provided at a mutually agreed price, which will not exceed the direct and documented costs to GE Americom. The transitional services Agreement or any specific transitional services may be terminated by Gilat at any time during the transition period by providing a written notice of termination.

The Trademark Agreement. Under the Trademark Agreement, General Electric Company has agreed to grant to Gilat, in consideration of 72,496 Ordinary Shares, a non-exclusive worldwide license to use the GE symbol in connection with certain products sold by Spacenet, Spacenet GmbH and Spacenet BV, and certain services performed by Gilat, Spacenet, Spacenet GmbH and Spacenet BV. The Trademark Agreement requires that Gilat and Spacenet adhere to certain specified standards of quality. The Trademark Agreement provides that Gilat will use the GE symbol only in connection with the specified products and services, including use in its packaging, labeling, general publicity, letterheads, signs and other forms of advertising, instructions books and other literature. In addition, the Trademark Agreement provides that Gilat will not use the GE symbol as part of a trade name. The term of the Trademark Agreement is three years and it may be renewed under certain circumstances for one additional year. The Trademark Agreement will terminate (i) on the date that Gilat ceases to own 100% of the voting securities of Spacenet Inc. and (ii) as to Spacenet BV or Spacenet GmbH, on the date that Gilat ceases to own 100% of the voting securities of such entity. Gilat has agreed to indemnify General Electric Company for all claims arising out of the Trademark Agreement or the manufacture of products or performance of services by Gilat under the licensed mark.

The Shareholders' Agreement. At the time of the Spacenet acquisition, Yoel Gat, Amiram Levinberg, Joshua Levinberg, Shlomo Tirosh and Gideon Kaplan (collectively, the "Founders Group"), DICFM and PEC (collectively, the "IDB Group"), and GE, GE Americom, General Electric Finance Holding GmbH and General Electric Plastics BV (for purposes of the following description, collectively, "GE") entered into a Shareholders' Agreement.

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

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

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

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

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

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

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

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

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

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

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

The Letter Agreements. Under the Transponder Letter Agreement dated September 25, 1998, GE Americom and Gilat have agreed, among other things, that (i) Gilat will analyze Spacenet's current space segment use and requirements on or before December 31, 1998 and will take certain transponder capacity on GE Americom satellites at the prices set forth in the Spacenet Letter Agreement described below and (ii) Gilat will receive long-term fixed prices which Gilat believes are competitive and certain rights of first refusal for additional space segment capacity. Pursuant to a separate letter agreement, dated September 25, 1998 (the "Spacenet Letter Agreement"), GE Americom will provide additional bandwidth and power as well as service protection levels to Spacenet to the extent there is insufficient bandwidth, power or protection levels available to accommodate existing customer requirements under Spacenet's existing transponder service agreements with GE Americom and third party providers. Upon completion of the procedures contemplated by these letter agreements, certain modifications to the Satellite Transponder Service Agreements may result.

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

The Merger is intended to qualify as a "tax-free" reorganization under Section 368(a) of the Code. The Tax Matters Agreement contains representations and covenants of the parties relating to the tax-free nature of the Merger. In addition, GE Americom has agreed to enter into a gain recognition agreement (the "GRA") with the Internal Revenue Service, in which GE Americom will agree in certain circumstances during the period ending at the end of the fifth full taxable year following the Merger to recognize gain as if the Merger were taxable to GE Americom. In connection with the GRA, Gilat has agreed in the Tax Matters Agreement not to take certain actions, including, without limitation, the disposition of the stock of Spacenet and the disposition of "substantially all" of the assets of Spacenet and the Spacenet subsidiaries, if doing so would cause GE Americom to recognize gain under the GRA. The

Tax Matters Agreement provides that Gilat, Spacenet and the Spacenet subsidiaries, on the one hand, and GE Americom, on the other, will indemnify the other party from any tax resulting from certain breaches of representations and covenants relating to the tax-free nature of the Merger. Each party's liability for purposes of such indemnification will be limited in certain respects pursuant to the terms of the Tax Matters Agreement.

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

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

PART II

ITEM 14: DESCRIPTION OF SECURITIES TO BE REGISTERED

Not applicable.

PART III

ITEM 15: DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

Not applicable.

PART IV

ITEM 17: FINANCIAL STATEMENTS

Not applicable.

ITEM 18: FINANCIAL STATEMENTS

The Consolidated Financial Statements and related notes thereto required by this item are contained on pages F-1 through F-40 hereof.

ITEM 19: FINANCIAL STATEMENTS AND EXHIBITS

(a) Index to Consolidated Financial Statements — PAGE

(b) Exhibits

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