Patents and Intellectual Property

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

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

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

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

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

Government Regulation

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

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

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

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

Employees

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

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

We and our employees are not parties to any collective bargaining agreements. However, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) ("Histadrut") and the Coordination Bureau of Economic Organizations (including the Manufacturers' Association of Israel) are applicable to Israeli employees by order (the "Extension Order") of the Israeli Ministry of Labor and Welfare. These provisions principally concern the length of the work day and the work week, minimum wages for workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. Furthermore, pursuant to such provisions, the wages of most of our employees are automatically adjusted based on changes in the Israeli CPI. The amount and frequency of these adjustments are modified from time to time.

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

Conditions In Israel

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

Political and Economic Conditions

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

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

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

Trade Agreements

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

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

Risk Factors; Forward-Looking Statements

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

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

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

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

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

Ability to manage our rapid growth and expansion

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

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

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

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

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

Need to develop, introduce and market new products and services

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

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

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

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

The loss of existing contracts and a decrease in the number of renewals of orders or of new large orders, would have a material adverse effect on our business, financial condition and operating results. In addition, a portion of our service contracts are short-term with expiration or cancellation upon 90 days' notice or less. If a substantial number of our service customers choose to cancel or not to renew their contracts, our business could be adversely affected.

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

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

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

Dependence on availability of satellite transponder space

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

Potential competition with existing customers

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

Competition in the network communications industry

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

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

The following table lists additional competitors of Gilat:

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

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

Dependence on proprietary VSAT technology

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

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

Dependence on our key management and technical personnel

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

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

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

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

Dependence on a single facility makes us susceptible to its condition

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

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

Risks relating to our international sales and operations

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

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

Difficulties in obtaining regulatory approvals for our telecommunication services

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

Limitation on production outside of Israel and on transfer of technology

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

Fluctuations in operating results and volatility of share price

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

- the timing, size and composition of orders from customers

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

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

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

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

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

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

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

Potential product liability claims

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

Concentration of control over Gilat

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

No intention to pay dividends

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

Our stock split may result in a decreased company capitalization

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

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

Availability of Israeli Government benefits to our company

Under the Israeli Law for Encouragement of Capital Investments, 1959, facilities that meet certain conditions can apply for an "Approved Enterprise" status. This status confers certain benefits including tax benefits. All of our existing facilities have been designated as "Approved Enterprises." Our historical operating results reflect substantial tax benefits which amount to approximately $3,872,000, $0, and $10,524,000 for 1997, 1998 and 1999, respectively.

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

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

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

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

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

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

Impact of inflation and foreign currency fluctuations

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

Risks relating to our location in Israel

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and most of our manufacturing facilities. Political, economic and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite the progress towards peace between Israel and its Arab neighbors and the Palestinians, major hostilities may revive. Such hostilities may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business.

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

Uncertainty of enforceability of civil liabilities against foreign persons

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

ITEM 2: DESCRIPTION OF PROPERTY

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

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

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

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

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

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

ITEM 3: LEGAL PROCEEDINGS

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

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

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

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

as of

June 15, 2000

ITEM 4: CONTROL OF REGISTRANT

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

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

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

(2) Based on information available to Gilat.

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

ITEM 5: NATURE OF THE TRADING MARKET

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

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

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

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

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

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

ITEM 6: EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Non-residents of Israel who purchase any of our ordinary shares with certain non-Israeli currencies (including the dollar) will be able to convert dividends, liquidation distributions and the proceeds from the sale of such ordinary shares into freely repatriable non-Israeli currencies at the rate of exchange prevailing at the time of conversion (provided that Israeli Income Tax has been paid or withheld on such amounts).

ITEM 7: TAXATION

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

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

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

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

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

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

ITEM 8: SELECTED CONSOLIDATED FINANCIAL DATA

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

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

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

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

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

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

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

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

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

Overview

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

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

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

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

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

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

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

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

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

In June 2000, we exercised our right to redeem our 6½% convertible subordinated notes issued on May 14, 1997 and due on June 1, 2004. The notes were redeemable in full at 102% of the principal amount plus accrued and unpaid interest, setting the redemption price per $1,000 note at $1,020.72. All of the note holders opted to convert their notes into Gilat's ordinary shares prior to the redemption date and we consequently issued 1,785,695 ordinary shares to such holders.

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

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

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

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

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

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

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

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

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

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

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

Results of Operations of Gilat

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

Percentage of Revenues

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Variability of Quarterly Operating Results

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

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

Liquidity and Capital Resources

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

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

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

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

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

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

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

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

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

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

Acquisition of Spacenet

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

In-Process Research and Development.

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

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

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

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

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

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

Valuation Assumptions

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

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

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

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

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

Impact of Inflation and Currency Fluctuations

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

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

Effective Corporate Tax Rate

Israeli companies are generally subject to income tax at the rate of 36% of taxable income. However, substantially all of our production facilities in Israel have been granted Approved Enterprise status under the Law for Encouragement of Capital Investments, 1959, and consequently are eligible for certain tax benefits for the first several years in which they generate taxable income. We currently have nine Approved Enterprises, and have applied for approval for a tenth enterprise. Income derived from the nine Approved Enterprises is entitled to tax benefits for periods of 7 years (in the case of two of the enterprises) or 10 years (for the remaining seven enterprises), from the first year in which we generate income from the respective Approved Enterprise, on the basis of the nature of the incentives selected by us. The period of reduced tax for the tenth enterprise, if approved, is expected to be 10 years, although the terms of the approval may provide for a different period. The main tax benefits are a tax exemption for two or four years and a reduced tax rate of 15% to 25% for the remainder of the benefits period depending upon the level of foreign ownership of the company. As a result of these programs, our effective corporate tax rate was 0% in 1993, 2.1% in 1994, 0% in 1995, 1.5% in 1996, 0.8% in 1997, and 10.9% in 1999. The increase in 1999 was due mainly to one time charges associated with the restructuring and losses in subsidiaries for which no deferred income taxes were recorded. In 1998 we had a loss due to restructuring charges, write offs associated with restructuring and expenses related to acquired research and development. We anticipate that a substantial part of our income for 2000 will be tax-exempt, while the balance will be taxed at rates ranging from 15% to 36%.

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

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

Recently issued accounting pronouncements

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

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

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