GILAT SATELLITE NETWORKS LTD
Form 20-F
March 18, 2005

As filed with the Securities and Exchange Commission on March 17, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

Commission file number: 0-21218

GILAT SATELLITE NETWORKS LTD.

(Exact name of Registrant as specified in its charter)

ISRAEL
(Jurisdiction of incorporation or organization)

Gilat House, 21 Yegia Kapayim Street, Kiryat Arye, Petah Tikva, 49130 Israel
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act: **None**

Securities registered or to be registered pursuant of Section 12(g) of the Act:

Ordinary Shares, par value NIS 0.20 per share
(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock at the close of the period covered by the annual report:

22,312,487 Ordinary Shares, NIS 0.20 par value per share.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark which financial statement item the Registrant elected to follow:

Item 17 o Item 18 x

INTRODUCTION

We are a leading provider of products and services for satellite-based communications networks. Beginning January 1, 2005, we operate under two business units: (i) Gilat Network Systems, often referred to as GNS, which is a provider of network systems and associated professional services to service providers and operators and (ii) Spacenet, which provides managed services for enterprises and businesses through our U.S. Subsidiary, Spacenet Inc., for consumers through our U.S. subsidiary, StarBand Communications Inc. and for rural communities through Spacenet Rural Communications. In its most recent available report published in September 2003, Comsys, a specialized consulting company that analyzes the satellite communications industry, reported that Gilat is the second-largest manufacturer of very small aperture terminals, referred to in the network communications industry as VSATs. We were incorporated in Israel in 1987 and are subject to the laws of the State of Israel. Gilat s corporate headquarters, executive offices and research and development, engineering and manufacturing facilities are located at Gilat House, 21 Yegia Kapayim Street, Kiryat Arye, Petah Tikva 49130, Israel. Our telephone number is (972) 3-925-2000.

The name Gilat and the names TwoWay , OneWay , FaraWay ™, DialAw@y IP, SkySurfer, SkyWay , Skydata®, SkyEdge ", Clearlin SkyBlaster ", Skystar Advantage® and StarBand appearing in this annual report on Form 20-F are trademarks of Gilat and its subsidiaries. GSAT® is a registered trademark of GTECH Corporation (GTECH). See Item 4: Information on the Company Products and Services. Other trademarks appearing in this annual report on Form 20-F are owned by their respective holders.

Except for the historical information contained in this annual report, the statements contained in this annual report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our business, financial condition and results of operations. 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 Item 3: Key Information Risk Factors and elsewhere in this annual report.

We urge you to consider that statements which use the terms believe, do not believe, expect, plan, intend, estimate, anticipate and expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and are subject to risks and uncertainties. Except as required by applicable law, including the securities laws of the U.S., we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with U.S. generally accepted accounting principles, or U.S. GAAP. All references in this annual report to dollars or $ are to U.S. dollars and all references in this annual report to NIS are to New Israeli Shekels. The representative exchange rate between the NIS and the dollar as published by the Bank of Israel on March 16, 2005 was NIS 4.31 per $1.00.

As used in this annual report, the terms we, us , Gilat and our mean Gilat Satellite Networks Ltd. and its subsidiaries, unless otherwise indicated.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description

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PART I

ITEM 1: IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not Applicable.

ITEM 2: OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

ITEM 3: KEY INFORMATION

Selected Consolidated Financial Data

The selected consolidated statement of operations data set forth below for the years ended December 31, 2002, 2003 and 2004, and the selected consolidated balance sheet data as of December 31, 2003 and 2004 are derived from our audited consolidated financial statements that are included elsewhere in this Report. These financial statements have been prepared in accordance with U.S. generally accepted accounting principles or U.S. GAAP.

The selected consolidated statement of operations data set forth below for the years ended December 31, 2000 and 2001 and the selected consolidated balance sheet data as of December 31, 2000, 2001 and 2002 are derived from our audited consolidated financial statements that are not included in this Report.

The selected consolidated financial data set forth below should be read in conjunction with Item 5: Operating and Financial Review and Prospects and the Consolidated Financial Statements and notes thereto included in Item 18 in this annual report on Form 20-F for the year ended December 31, 2004.

	Year Ended December 31,				
	2000	2001	2002	2003	2004
STATEMENT OF OPERATIONS DATA:	**U.S. Dollars in thousands except per share data**				
Revenues:					
Products	$ 398,299	$ 279,297	$ 130,011	$ 120,776	$ 100,122
Services	106,263	106,732	78,744	69,401	141,376
	504,562	386,029	208,755	190,177	241,498
Cost of revenues:					
Products	265,259	194,374	73,182	75,560	52,184
Services	79,182	94,665	95,846	75,553	110,211
Write-off of inventories	-	59,790	20,107	6,434	2,000
	344,441	348,829	189,135	157,547	164,395
Gross profit	160,121	37,200	19,620	32,630	77,103
Research and development expenses, net	31,272	35,634	25,066	16,949	13,879
Selling, marketing, general and administrative expenses	82,444	121,486	86,227	71,720	69,174
Provision and write-off for doubtful accounts and capital lease receivables	3,654	134,614	34,714	1,383	717
Impairment of goodwill	-	50,580	13,049	5,000	-
Impairment of tangible and intangible assets	-	42,982	50,666	26,912	2,161
Restructuring charges	-	30,284	-	3,905	-
Gain from derecognition of liability	-	-	-	-	(245)
Operating income (loss)	42,751	(378,380)	(190,102)	(93,239)	(8,583)
Financial income (expenses), net	(1,289)	(21,334)	(21,324)	(3,256)	1,818
Gain from restructuring of debt	-	-	-	244,203	-
Other income (expense)	-	-	-	954	(274)
Write-off of investments in affiliated and other companies	(9,350)	(28,007)	(51,379)	3,300	-
Income (loss) before taxes on income	32,112	(427,721)	(262,805)	151,962	(7,039)
Taxes on income	2,003	974	929	9,690	4,429
Income (loss) after taxes on income	30,109	(428,695)	(263,734)	142,272	(11,468)
Equity in profits (losses) of affiliated companies	(950)	(252)	(29,334)	488	1,242
Acquired in-process research and development of an affiliated company	(10,000)	-	-	-	-
Minority interest in losses of a subsidiaries	276	5,889	3,517	871	164
Income (loss) from continuing operations, before cumulative effect of a change in an accounting principle	19,435	(423,058)	(289,551)	143,631	(10,062)
Gain (loss) from cumulative effect of a change in an accounting principle	-	-	(56,716)	-	611
Loss from discontinued operations	-	(6,054)	(1,937)	-	-
	$ 19,435	$ (429,112)	$ (348,204)	$ 143,631	$ (9,451)

	Year Ended December 31,				
Net income (loss)					
Net earnings (loss) per share from continued operation:					
Basic	$ 17.26	$ (362.21)	$ (245.59)	$ 12.09	$ (0.45)
Diluted	$ 16.13	$ (362.21)	$ (245.59)	$ 11.31	$ (0.45)
Basic and diluted net loss per share from cumulative effect of a change in an accounting principle	-	-	$ (48.10)	-	$ (0.03)
Basic and diluted loss per share from discontinued operation	-	$ (5.18)	$ (1.64)	-	-
Net earnings (loss) per share:					
Basic	$ 17.26	$ (367.39)	$ (295.33)	$ 12.09	$ (0.42)
Diluted	$ 16.13	$ (367.4)	$ (295.33)	$ 11.31	$ (0.42)
Weighted average number of shares used in computing net earnings (loss) per share:					
Basic	1,126	1,168	1,179	11,881	22,242
Diluted	1,205	1,168	1,179	12,819	22,242

BALANCE SHEET DATA:	As of December 31, 2000	2001	2002	2003	2004
	(U.S. Dollars In thousands)				
Working capital	$ 542,895	$ 249,572	$ 127,527	$ 74,490	$ 68,665
Total assets	1,252,332	858,623	474,214	401,956	391,448
Short-term bank credit and current maturities of long-term debt	14,819	29,888	10,023	4,770	13,028
Convertible subordinated notes	350,000	350,000	358,648	15,543	16,171
Other long-term liabilities	138,944	161,970	172,745	190,917	191,426
Shareholders' equity (deficiency)	$ 608,655	$ 177,320	$ (172,915)	$ 76,401	$ 68,019

Risk Factors

Risks Related To Our Business

Beginning January 2005, we are operating our business under two business units. It is not yet certain that this change in operation will be efficient or successful.

Beginning January 1, 2005, we began to operate under two business units: Gilat Network Systems and Spacenet. This division was made as part of the Company s new growth strategy aiming to increase sales for solution driven markets as well as the expansion of its operation business. While the intention is to enable and encourage each business unit to enhance its business strategy, it is possible that the division will cause competition within our company and lead to confusion in the market. In addition, as part of the changes to operations structure, we closed our offices in Sunrise, Florida and reduced staff in other offices. We may therefore experience difficulties meeting a high demand for services in the future or encounter problems in dealing with the increased demands of customers.

We have incurred major losses in recent years and may never achieve profitability.

We incurred a loss of approximately $348.2 million in 2002, a loss of approximately $100.6 million in 2003 (excluding the gain from restructuring of debt) and a loss of approximately $9.5 million in 2004. As of December 31, 2004, we had an accumulated deficit of approximately $648.4 million. We cannot assure you that we can operate profitably in the future. If we do not achieve profitability, the viability of our company will be in question and our share price will likely decline.

If commercial wireless communications markets fail to grow as anticipated, our business could bematerially harmed.

A number of the commercial markets for our products in the wireless communications area, including our broadband products, have only in recent years been developed. Because these markets are relatively new, it is difficult to predict the rate at which these markets will grow, if at all. If the markets for commercial wireless communications products fail to grow, or grow more slowly than anticipated, our business could be materially harmed. Conversely, to the extent that growth in these markets results in capacity limitations in the wireless communications area, it could materially harm our business and impair the value of our shares. Specifically, we derive virtually all of our revenues from sales of VSAT communications networks. A significant decline in this market or the replacement of VSAT technology by an alternative technology could materially harm our business and impair the value of our stock.

We have announced the introduction of the SkyEdge family of products and their acceptability in themarket cannot be determined as of yet.

In February 2004, we announced the launch of the SkyEdge family of products. The SkyEdge product family includes a series of VSAT products, all able to operate via a single hub, supporting communications services that customers such as enterprises, carriers, service providers and governmental customers require, from interactive data to broadband IP, public telephony and beyond. The unified platform supports a variety of applications and topologies including mesh, star and multi-star.

We cannot guarantee that this family of products will be accepted in the industry or that its performance will be as expected. The SkyEdge family of products have been beta tested by several customers and is commercially available. If the SkyEdge is not accepted by the market, then our business, financial condition and operating results could be adversely affected. In addition, we intend on releasing a DVB-RCS compliant version of the SkyEdge this year. Satlabs, the European organization that is to issue the certification for this standard of compliance is still determining which criterion will be used to base the standard certification. There can be no assurance that once completed, our products will be certified.

We face risks from the global slowdown.

The downturn in the global economy has had significant effects on markets that we serve, particularly satellite communications equipment manufacturers and network operators. This has had a negative effect on our revenues. Although there are indications that the downturn may be ending, we cannot predict whether the markets will fully recover or the downturn will continue for a long period of time. If the markets in which we operate do not fully recover, our ability to increase or maintain our revenues and operating results may be impaired.

Further, because global economic conditions and economies are extremely uncertain, it is difficult to estimate the growth in various parts of the economy, including the markets in which we participate. Because parts of our budgeting and forecasting are reliant on estimates of growth in the markets we serve, the current economic uncertainty renders estimates of future revenues and expenditures even more difficult than usual to formulate. The future direction of the overall domestic and global economies could have a significant impact on our overall financial performance and impair the value of our shares.

Trends and factors affecting the telecommunications industry are beyond our control and may resultin reduced demand and pricing pressure on our products.

There are trends and factors affecting the telecommunications industry which are beyond our control and may affect our operations. These trends and factors include:

- adverse changes in the public and private equity and debt markets and our ability, as well as the ability of our customers and suppliers, to obtain financing or to fund working capital and capital expenditures;
- adverse changes in the credit ratings of our customers and suppliers;
- adverse changes in the market conditions in our industry and the specific markets for our products;
- access to, and the actual size and timing of, capital expenditures by our customers;
- inventory practices, including the timing of product and service deployment, of our customers;
- the amount of network capacity and the network capacity utilization rates of our customers, and the amount of sharing and/or acquisition of new and/or existing network capacity by our customers;
- the overall trend toward industry consolidation and rationalization among our customers, competitors, and suppliers;
- increased price reductions by our direct competitors and by competing technologies;
- conditions in the broader market for communications products, including data networking products and computerized information access equipment and services;
- governmental regulation or intervention affecting communications or data networking;
- monetary stability in the countries where we operate; and
- the effects of war and acts of terrorism, such as disruptions in general global economic activity, changes in logistics and security arrangements, and reduced customer demand for our products and services.

Economic conditions affecting the telecommunications industry, which affect market conditions in the telecommunications and networking industry, in the United States and globally, affect our business. Reduced capital spending and/or negative economic conditions in the North America, Europe, Asia, Latin America and/or other areas of the world could result in reduced demand for or pricing pressure on our products.

Because we compete for large-scale contracts in competitive bidding processes, losing a relativelysmall number of bids could have a significant adverse impact on our operating results.

A significant portion of our sales revenue is derived from our being selected as the supplier of networks based on VSATs, under large-scale contracts that we are awarded from time to time in a competitive bidding process. These large-scale contracts typically involve the installation of between 2,000 and 10,000 VSATs. The number of major bids for these large-scale contracts for VSAT-based networks in any given year is limited and the competition is intense. Losing or defaulting on a relatively small number of bids each year could have a significant adverse impact on our operating results.

Many of our large-scale contracts are with governments or large enterprises in Latin America andother parts of the world; any instability in the exchange rates or in the political or economic situation orany unexpected unilateral termination, could have a significant adverse impact on our business.

In recent years, a significant portion of our revenues has been from large-scale contracts, including those in Peru, Colombia, and Brazil, China and Tibet. Agreements with the governments in these countries typically include unilateral early termination clauses and other risks such as the imposition of new government regulations and taxation that could pose additional financial burdens on us. In addition, the foreign exchange risks in these countries are often significant due to possible fluctuations in local currencies relative to the U.S. dollar. Any termination of business in any of the aforementioned countries or any instability in the exchange rates could have a significant adverse impact on our business.

In addition, in November 2002, we were awarded two large projects by the Colombian Government, including the installation and operation of 500 telecenters to provide Internet connectivity and telephony services in cities and towns throughout Colombia and a second 3,000-site public rural satellite telephony network. The total value of the contracts is approximately $65 million. If we do not meet certain minimum equity requirements, this customer may assert that we would be in breach of our contract with them. Any early unilateral termination by the Colombian Government could have a significant adverse impact on our operating results.

If we are unable to develop, introduce and market new products, applications and services on a costeffective and timely basis, our business could be adversely affected.

The network communications market, to which our services and products are targeted, is characterized by rapid technological changes, new product introductions and evolving industry standards. If we fail to stay abreast of significant technological changes, our existing products and technology could be rendered obsolete. Historically, we have enhanced the applications of our existing products to meet the technological changes and industry standards. For example, our initial product, the OneWay VSAT, which we introduced in 1989, was used primarily to facilitate one-way transmission of information. In 1992, we began marketing our TwoWay VSAT that enabled two-way communication. In 1999, we began marketing our SkyBlaster product that uses advanced technology to provide two-way high speed Internet access and video broadcasting via satellite. In February 2004, we announced the development of the SkyEdge product family. We cannot yet predict or guarantee the success of the SkyEdge family of products in the market.

To remain competitive in the network communications market, we must continue to be able to anticipate changes in technology and industry standards and to develop and introduce new products, applications and services, as well as enhancements to our existing products, applications and services. If we are unable to respond to technological advances on a cost-effective and timely basis, or if our new products or applications are not accepted by the market, then our business, financial condition and operating results could be adversely affected.

A decrease in the selling prices of our products could materially harm our business.

The average selling prices of wireless communications products historically decline over product life cycles. In particular, we expect the average selling prices of our products to decline as a result of competitive pricing pressures and customers who negotiate discounts based on large unit volumes. We also expect that competition in this industry will continue to increase. To offset these price decreases, we intend to rely primarily on obtaining yield improvements and corresponding cost reductions in the manufacturing process of existing products and on the introduction of new products with advanced features. However, we cannot assure you that we will be able to obtain any yield improvements or cost reductions or introduce any new products in the future. To the extent that we do not reduce costs or introduce new products in a timely manner, or our new products do not achieve market acceptance, it could materially harm our business and impair the value of our shares. In addition, our backlog has decreased significantly in 2004. If we are not able to generate a steady rate of long-term contracts in our backlog, our business could be materially adversely affected.

If we are not able to fill our backlog of orders, our business will be adversely affected.

At present, we have a backlog of orders, consisting of network service contracts, generally for three to five years, and of new orders for products and services. As of December 31, 2004 our backlog for equipment sales and for services under service contracts for our VSAT products was $191 million. If we are unable to satisfy the entire backlog of orders, we will not be able to fully recognize the revenues expected from this backlog and we could lose the contracts from which these backlog of orders arise, either of which could have a material adverse effect on our business. In addition, an inability to supply equipment and services could lead to our default on contracts and the subsequent exercise of performance guarantees by customers.

If we lose existing contracts and orders for our products are not renewed, our ability to generaterevenues will be harmed.

Our existing contracts could be terminated due, among others, to any of the following reasons:

- dissatisfaction of our customers with the services we provide or our inability to timely provide or install additional products or requested new applications;
- customers' default on payments due;
- our failure to comply with financial covenants in our contracts;
- customers' lack of confidence in our financial condition; or
- the loss of existing contracts or a decrease in the number of renewals of orders or of new large orders.

The termination or non-renewal of our contracts could have a material adverse effect on our business, financial condition and operating results. A vast majority of our business generated in 2004 was from recurring customers. If we are not able to gain new customers and retain our present customer base, our revenues will decline significantly. In addition, if we have a higher than anticipated subscriber churn for customers from StarBand and from Spacenet Inc., this could materially adversely affect our financial performance.

We are dependent upon a limited number of suppliers for key components to build our VSATs, and maybe significantly harmed if we are unable to obtain the hardware necessary for our VSATs on favorable termsor on a timely basis.

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 with respect to availability of components. However, we cannot assure you of the continuous availability of key components or our ability to forecast our component requirements sufficiently in advance. Our research and development and operations groups are continuously working with our vendors and subcontractors to obtain components for our products on favorable terms in order to reduce the overall price of our products. If we are unable to obtain the necessary volumes of components at desired favorable terms or prices, we may be unable to produce our products at desired favorable terms or prices. As a result, sales of our products may be lower than expected, which could have a material adverse effect on our business, financial condition and operating results.

The terms on which we are able to obtain components for our products are also affected by our relationship with our suppliers. In this regard, we entered into a non-exclusive Supply Chain Management agreement with Arrow/Rapac Ltd., or Arrow, a part of Arrow Electronics, Inc., to purchase certain components necessary for the manufacturing of our products as well as to provide comprehensive logistic services. The agreement is intended to ensure JIT (just in time) inventory and to reduce prices currently paid by us for components. In addition, regarding components purchased in bulk by Arrow for other customers, we are entitled to enjoy existing lower prices. Arrow is to purchase components on our behalf based upon rolling forecasts provided by us. While this agreement is intended to guarantee the supply of our products and reduce prices, it also increases our reliance on a single sub-contractor. Any inability on their part to substantively perform under the agreement could have an adverse effect on our operations.

We operate in the highly competitive network communications industry. We may be unsuccessful in competing effectively against many of our competitors who have substantially greater financial resources and experience.

We operate in a highly competitive industry of network communications, both in the sales of our products and our services. As a result of the rapid technological changes that characterize our industry, we face intense worldwide competition to capitalize on new opportunities, to introduce new products and to obtain proprietary and standard technologies that are perceived by the market as being superior to those of our competitors. Some of our competitors have substantially greater financial resources, providing them with greater research and development and marketing capabilities. These competitors may also be experienced in obtaining regulatory approvals for their products and services and in marketing them. Our relative position in the network communications industry may place us at a disadvantage in responding to our competitors pricing strategies, technological advances and other initiatives. At present our SkyEdge family line includes both proprietary and VSATs and a VSAT that is expected to be DVB-RCS compliant. Our principal competitors in the supply of VSAT networks are Hughes Network Systems, Inc., or HNS, ViaSat Inc., iDirect Technologies, EMS Technologies, Inc. and Nera ASA.

There are other manufacturers of products that compete with one or more of our products such as Alcatel Space, NDSatcom, Newtech and Polarsat. Another potential for product standardization in the VSAT industry is known as DOCSIS (Data Over Cable Service Interface Specification) for satellite communications. This concept is embedded in a product produced and sold by ViaSat directly in the international markets. In the United States, it has been reported that ViaSat delivers the same technology to the WildBlue consumer program that is reported to launch in 2004. This product is designed to be a low cost VSAT. If deployed, this standardization could pose a threat to the acceptance in the market of our current and future non-DOCSIS for satellite products and could have an adverse effect on the market price for VSATs industry-wide.

HNS introduced its own standard called IPoS (IP over Satellite) which relies on the installed base of their DirecWay System. If accepted by other companies in the industry, this could have an adverse affect on the acceptance of our products. HNS is also expected to launch their SpaceWay Ka satellite and program in the United States in two years which, if successful, could increase our competition in the enterprise market segment.

We also compete with various mobile satellite communications companies such as Iridium, Globalstar, Asia Cellular Satellite (known as ACeS) and Thuraya Satellite Communications Company and companies that offer communication network systems based on other non-satellite technologies such as terrestrial lines (including cable, DSL, fixed wireless, ISDN lines, cellular GPRS and fiber optics), frame relay, radio and microwave transmissions. These technologies can often be cheaper than VSAT technology in some applications while still providing a sufficient variety of the features required by customers.

Our actions to protect our proprietary VSAT technology may be insufficient to prevent others fromdeveloping products similar to our products.

Our business is based mainly on our proprietary VSAT technology and related products and services. We establish and protect proprietary rights and technology used in our products by the use of patents, trade secrets, copyrights and trademarks. We also utilize non-disclosure and intellectual property assignment agreements. Because of the rapid technological changes and innovation that characterize the network communications industry, our success will depend in large part on our ability to protect and defend our intellectual property rights. Our actions to protect our proprietary rights in our VSAT technology and related products may be insufficient to prevent others from developing products similar to our products. 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. If we are unable to protect our intellectual property, our ability to operate our business and generate revenues as expected may be harmed.

We depend on a single facility in Israel and are susceptible to any event that would adverselyaffect its condition.

Most of our laboratory 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. As discussed above, to remain competitive in the network communications industry, we must respond quickly to technological developments. Damage to our facility in Israel could cause serious delays in the development of new products and services and, therefore, could adversely affect our business. In addition, the particular risks relating to our location in Israel are described below.

Our international sales expose us to changes in foreign regulations and tariffs, political instability and other risks inherent to international business, any of which could adversely affect our operations.

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

- imposition of governmental controls, regulations and taxation which might include a government s decision to raise import tariffs or license fees in countries in which we do business;
- government regulations that may prevent us from choosing our business partners or restrict our activities. For example, a particular Latin American country may decide that high-speed data networks used to provide access to the Internet should be made available generally to Internet service providers and may require us to provide our wholesale service to any Internet service providers that request it, including entities that compete with us. If we become subject to any additional obligations such as these, we would be forced to comply with potentially costly requirements and limitations on our business activities. This could result in a substantial reduction in our revenue;
- political instability in countries in which we do or desire to do business. For example, economic instability in Indonesia has led to a decrease in the value of the Indonesian Rupiah. If such decrease continues, this could adversely affect the ability of the Indonesian market to finance VSAT projects. We also face similar risks from potential or current political and economic instability in countries such as Russia, Kazakhstan, Angola, India and Kenya;
- trade restrictions and changes in tariffs which could lead to an increase in costs associated with doing business in foreign countries;
- difficulties in staffing and managing foreign operations that might mandate employing staff in the United States and Israel to manage foreign operations. This change could have an adverse effect on the profitability of certain projects;
- longer payment cycles and difficulties in collecting accounts receivable;
- seasonal reductions in business activities;
- foreign exchange risks due to fluctuations in local currencies relative to the dollar; and
- relevant zoning ordinances that may restrict the installation of satellite antennas that might also reduce market demand for our service. Additionally, authorities may increase regulation regarding the potential radiation hazard posed by transmitting earth station satellite antennas emissions of radio frequency energy that may negatively impact our business plan and revenues.

Any decline in commercial business in any country can have an adverse effect on our business as these trends often lead to a decline in technology purchases or upgrades by private companies. We expect that in difficult economic periods, countries in which we do business will find it more difficult to raise financing from investors for the further development of the telecommunications industry. Any such changes could adversely affect our business in these and other countries.

We may face difficulties in obtaining regulatory approvals for our telecommunication services,which could adversely affect our operations.

Our telecommunication services require licenses and approvals by the Federal Communications Commission, or FCC, in the United States, and by regulatory bodies in other countries. In the United States, the operation of satellite earth station facilities and VSAT systems such as ours are prohibited except under licenses issued by the FCC. We must also obtain approval of the regulatory authority in each country in which we propose to provide network services or operate VSATs.

The approval process can often take a substantial amount of time and require substantial resources. For instance, Spacenet Services License Sub, Inc., our indirect wholly owned subsidiary, obtained authorization from the FCC to provide two-way data communications services on a specific frequency band six months after Spacenet Services License Sub filed the required regulatory application. Moreover, the license for Spacenet Services License Sub required approximately four months of technical and legal preparation to complete the application.

In addition, any approvals that are granted may be subject to conditions that may restrict our activities or otherwise adversely affect our operations. Also, after obtaining the required approvals, the regulating agencies may, at any time, impose additional requirements on our operations. We cannot assure you that we will be able to comply with any new requirements or conditions imposed by such regulating agencies on a timely or economic basis.

Our lengthy sales cycles could harm our results of operations if forecasted sales are delayed or donot occur.

The length of time between the date of initial contact with a potential customer or sponsor and the execution of a contract with the potential customer or sponsor may be lengthy and vary significantly depending on the nature of the arrangement. During any given sales cycle, we may expend substantial funds and management resources and not obtain significant revenue, resulting in a negative impact on our operating results.

Possible need for additional funds.

We are currently very thinly capitalized. As such, we may be required to raise additional funds to finance our business. Our cash and cash equivalents at December 31, 2004 were approximately $75.8 million. If we are unable to raise additional funds, we may fail and our inability to obtain adequate capital would limit our ability to continue our operations. There can be no assurance that we will be able to raise necessary funds or that we will be able to do so on terms acceptable to us. Any such additional funding may result in significant dilution to existing shareholders.

Our operating results may vary significantly from quarter to quarter and these quarterly variations in operating results, as well as other factors, may contribute to the volatility of the market price of our shares.

Our operating results may vary significantly from quarter to quarter. 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; and
- the changes in the competitive environment in which we operate.

The quarterly variation of our operating results, may, in turn, create volatility in the market price for our shares. Other factors that may contribute to wide fluctuations in our market price, many of which are beyond our control, include, but are not limited to:

- 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 earnings releases of our competitors; and
the general state of the securities markets (with particular emphasis on the technology and Israeli sectors thereof).

In addition to the volatility of the market price of our shares, the stock market in general and the market for technology companies in particular have been highly volatile and at times, thinly traded. Investors may not be able to resell their shares following periods of volatility.

We may at times be subject to claims by third parties alleging that we are infringing their intellectual property rights. We may be required to commence litigation to protect our intellectual property rights. Any intellectual property litigation may continue for an extended period and may materially adversely affect our business, financial condition and operating results.

There are numerous patents, both pending and issued, in the network communications industry. We may unknowingly infringe a patent. We may from time to time be notified of claims that we are infringing on the patents, copyrights or other intellectual property rights owned by third parties. While we do not believe that we have in the past or are at present infringed on any intellectual property rights of third parties, we cannot assure you that we will not, be subject to such claims.

In addition, we may be required to commence litigation to protect our intellectual property rights and trade secrets, to determine the validity of and scope of the proprietary rights of others or to defend against third-party claims of invalidity. An adverse result in any litigation could force us to pay substantial damages, stop designing or manufacturing, using and selling the infringing products, spend significant resources to develop non-infringing technology, discontinue using certain processes or obtain licenses to use the infringing technology. In addition, we may not be able to develop non-infringing technology, nor might we be able to find appropriate licenses on reasonably satisfactory terms. Any such litigation could result in substantial costs and diversion of resources and could have a material adverse effect on our business, financial condition and operating results.

Potential product liability claims relating to our products could have a material adverse effect onour business.

We may be subject to product liability claims relating to the products we sell. Potential product liability claims could include those for exposure to electromagnetic radiation from the antennas 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. However, 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.

Our insurance coverage may not be sufficient for every aspect or risk related to our business.

Our business includes many risks, only some of which are covered by our insurance. For example, in many of our satellite capacity agreements, we do not have a back up for satellite capacity, nor do we have indemnification or insurance in the event that our supplier s satellite malfunctions or is lost. In addition, we are not covered by our insurance for acts of fraud or theft. Our business, financial condition and operating results could be materially adversely affected if significant costs resulting from these exposures are incurred.

We are involved in litigation alleging violations of the federal securities laws that may have anadverse effect on our business.

On May 13, 2003, a complaint was filed with the United States District Court for the Eastern District of New York against the Company and certain of its officers and directors asserting claims under Section 10(b) of the Securities Exchange Act of 1934. The complaint was the result of the court-ordered consolidation of nine separate similar actions filed in March 2002 in the United States District Courts. In addition, a request was made to file a class action lawsuit in the Tel Aviv, Israel, District Court, but this action was stayed pending the outcome of the class action proceedings in the United States. The Complaint asserts the claims of purchasers of our securities from February 9, 2000 and through May 29, 2002, and alleges violations of the federal securities laws and claims that we issued material misrepresentations to the market. We have filed a motion to dismiss the complaint which is pending. We believe that the allegations against us and certain of our current and former officers and directors are without merit and intend to contest them vigorously. However, these legal proceedings are in the preliminary stages and we cannot predict their outcome. The litigation process is inherently uncertain. If we are not successful in defending these legal proceedings, we could incur substantial monetary judgments or penalties in excess of available insurance coverage or result in damage to our reputation, and whether or not we are successful, the proceedings could result in substantial costs and may occupy a significant amount of time and attention of our senior management.

Our senior management and board of directors have made changes to our business plan and business strategy, which may not prove successful for us.

Our senior management and board of directors conducted a review of our company and our business. This review included various factors that may affect our economic viability and profitability, such as our business model, our corporate structure, our cost structure, the inter-company relationships and organization of our subsidiaries, and other business considerations relevant to our business plan and business strategy. The results of this review have caused management to make certain business strategy decisions regarding our products and services and the way in which we compete in the market. There can be no assurance given that our management team will be able to successfully implement our business plan.

In the past twelve months we have lost key management, directors and technical personnel. The loss of these employees may have an ongoing adverse effect on the business of the Company.

During 2004, we lost certain key management, including the CEO and President of our Company. The changes in management could materially adversely affect our business, financial condition and operating results.

We face competition for personnel, particularly for employees with technical expertise. Our business, financial condition and operating results could be materially adversely affected if we cannot hire and retain suitable personnel.

The implementation of SFAS No. 123R, which required us to record compensation expense in connection with equity share based compensation, would reduce our profitability significantly.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), which is a revision of SFAS No. 123. Generally, the approach in SFAS 123(R) is similar to the approach described in Statement 123. However, SFAS No. 123 permitted, but not required, share-based payments to employees to be recognized based on their fair values while SFAS No. 123(R) requires, as of the third quarter of 2005, all share-based payments to employees to be recognized based on their fair values. SFAS No. 123R also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The adoption of SFAS No. 123R may have a significant effect on our results of operations. In addition, such adoption could also limit our ability to continue to use stock options as an incentive and retention tool, which could, in turn, hurt our ability to recruit employees and retain existing employees.

Risks Related To The Shares And Our Capital Structure

Our share price has been highly volatile, has experienced a significant decline, and may continueto be volatile and decline.

The trading price of our shares has fluctuated widely in the past and may to continue to do so in the future as a result of a number of factors, many of which are outside our control. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market prices of many technology companies, particularly telecommunication and Internet-related companies, and that have often been unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations could adversely affect the market price of our shares. In the past, following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. Securities class action litigation could result in substantial costs and a diversion of our management s attention and resources.

We have never paid cash dividends and have no intention to pay dividends in the foreseeable future.

We have never paid cash dividends on our shares and do not anticipate paying any cash dividends in the foreseeable future. We intend to continue retaining earnings for use in our business, in particular to fund our research and development, which are important to capitalize on technological changes and develop new products and applications. In addition, the terms of some of our financing arrangements restrict us from paying dividends to our shareholders.

Our principal shareholder is also a major creditor of the Company.

Our principal shareholder, Bank Hapoalim B.M., has provided us with a substantial loan. The bank agreed to amend the terms of such loan in April 2004. Bank Hapoalim B.M. has a representative on our board of directors and has a right (as do any of our shareholders that meet the shareholding threshold) to appoint one director to our board of directors at every annual general meeting of our shareholders, as long as its holdings of our shares does not fall below the threshold set forth in our amended articles of association. The interests of Bank Hapoalim as a major creditor of our company may conflict at times with the interests of our other shareholders.

Our ordinary shares are traded on more than one market and this may result in price variations.

Our ordinary shares are traded primarily on the Nasdaq National Market and on the Tel Aviv Stock Exchange. Trading in our ordinary shares on these markets is made in different currencies (US dollars on the Nasdaq National Market, and New Israeli Shekels on the Tel Aviv Stock Exchange), and at different times (resulting from different time zones, different trading days and different public holidays in the United States and Israel). Consequently, the trading prices of our ordinary shares on these two markets often differ. Any decrease in the trading price of our ordinary shares on one of these markets could cause a decrease in the trading price of our ordinary shares on the other market.

Risks Related To Regulatory Matters

We may be subject to Israeli tax payments that we had not anticipated or taken into account.

In 2003 and 2004, we received initial tax assessments for the tax years 1998-2001 for approximately $45 million plus $7 million in penalties based on various claims of the Israeli Tax Authorities. In January 2005, we received a final tax assessment for the tax year 1998 for approximately $0.5 million including penalties reduced from $10.5 million in the initial assessment. We intend to vigorously defend ourselves in this action, but we cannot be certain as to the outcome of these claims. In addition, the claims made by the tax authorities may also be made for the years 2002-2004. Any such claims, if substantiated and proven, could have a significant adverse effect on our financial condition. In addition, the Israeli Tax Authorities and the tax authorities in the jurisdictions in which we operate might raise additional claims, which might result in payment of additional taxes.

We have historically relied, and in the future intend to rely, upon tax benefits from the state of Israel on our taxable income. The termination or reduction of these tax benefits would significantly increase our costs and could have a material adverse effect on our financial condition and results of operations.

Under the Israeli Law for Encouragement of Capital Investments, 1959, some of our Israeli facilities qualify as Approved Enterprises. As a result, we have been eligible for tax benefits for the first several years in which we generated taxable income. Our historical operating results reflect substantial tax benefits, including tax exemptions and decreased tax rates up to December 31, 2000. In, 2002, 2003 and 2004, we recorded substantial losses for tax purposes and a decrease in revenues and therefore could not realize any tax benefits. The Israeli government has shortened the period for which tax exemptions are applicable to Approved Enterprises from four to two years. This change only applies to our last four Approved Enterprises and to any future Approved Enterprises, if any. Our financial condition and results of operations could suffer if the Israeli government terminated or reduced the current tax benefits available to us.

In addition, in order to receive these tax benefits, we must comply with two material conditions. We must invest specified amount in property and equipment in Israel, and finance a portion of these investments with the proceeds of equity capital we raise. We believe we have complied with these conditions, but we have not received confirmation of our compliance from the government with respect to some of the approved enterprises. If we have failed or fail in the future to comply in whole or in part with these conditions, we may be required to pay additional taxes and would likely be denied these tax benefits in the future, if and when we are profitable, which could harm our financial condition and results of operations. We are currently negotiating the approval of our Tenth Approved Enterprise with the Israeli government. If we fail to receive such approval, we will be required to pay substantial additional taxes, which may negatively affect our results of operations and financial condition.

We benefit from Israeli Government grants. The termination or reduction of these grants could have a material adverse effect on our ability to develop new products and applications.

Research and development grants from the Office of the Chief Scientist of the Israeli Ministry of Industry and Commerce, or the Chief Scientist during 2002, 2003 and 2004 amounted to approximately $3.6 million, $3.5 million and $2.2 million, respectively. These grants enable us to develop new technologies to use in new products and applications. However, they also impose certain restrictions on us, as discussed below. Israeli authorities have indicated that the grant program may be reduced in the future. The termination or reduction of these grants to us could have a material adverse effect on our ability to develop new products and applications, which could harm our business.

The transfer and use of some of our technology and its production is limited because of the research and development grants we received from the Israeli Government to develop such technology. Such limitations may restrict our business growth and profitability.

Our research and development efforts associated with the development of our OneWay VSAT product and our DialAw@y IP product and our SkyBlaster product have been partially financed through grants from the Chief Scientist. We are subject to certain restrictions under the terms of the Chief Scientist grants. Specifically, the products developed with the funding provided by these grants may not be manufactured, nor may the technology which is embodied in our products be transferred outside of Israel without appropriate governmental approvals and/or fines. These restrictions do not apply to the sale or export from Israel of our products developed with this technology. These restrictions could limit or prevent our growth and profitability.

Compliance with changing regulation of corporate governance and public disclosure may result inadditional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission regulations and Nasdaq Stock Market rules, are creating uncertainty for companies such as ours. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest reasonably necessary resources to comply with evolving standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities, which could harm our operating results and business prospects.

Risks Related To Doing Business In Israel

Political and economic conditions in Israel may limit our ability to produce and sell our products.This could result in a material adverse effect on our operations and business.

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and most of our research and development and manufacturing facilities. Political, economic and security 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. Major hostilities between Israel and its neighbors 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.

Since October 2000, there has been substantial deterioration in the relationship between Israel and the Palestinian Authority that has resulted in increased violence. The future effect of this deterioration and violence on the Israeli economy and our operations is unclear. Ongoing violence between Israel and the Palestinians as well as tension between Israel and the neighboring Syria and Lebanon may have a material adverse effect on our business, financial conditions or results of operations.

Generally, male adult citizens and permanent residents of Israel under the age of 51 are obligated to perform up to 36 days of military reserve duty annually. Additionally, these residents may be 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 reserve service is difficult to predict.

In addition, in recent years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Our operations could be adversely affected if the economic conditions in Israel continue to deteriorate. In addition, due to significant economic measures proposed by the Israeli Government, there have been several general strikes and work stoppages in 2003 and 2004, affecting all banks, airports and ports. These strikes have had an adverse effect on the Israeli economy and on business, including our ability to deliver products to our customers. Following the passage by the Israeli Parliament of laws to implement the economic measures, the Israeli trade unions have threatened further strikes or work-stoppages, and these may have a material adverse effect on the Israeli economy and on us.

You may not be able to enforce civil liabilities in the United States against our officers and directors.

Most of our executive officers are non-residents of the United States. A significant portion of our assets and the personal assets of most of our directors and executive officers are located outside the United States. Therefore, it may be difficult to effect service of process upon any of these persons within the United States. In addition, a judgment obtained in the United States against us, and most of our directors and executive officers, including but not limited to judgments based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States.

Generally, it may also be difficult to bring an original action in an Israeli court to enforce liabilities based upon the U.S. federal securities laws against us and most of our directors and executive officers. Subject to particular time limitations, executory judgments of a United States court for liquidated damages in civil matters may be enforced by an Israeli court, provided that:

- the judgment was obtained after due process before a court of competent jurisdiction, that recognizes and enforces similar judgments of Israeli courts, and according to the rules of private international law currently prevailing in Israel;
- adequate service of process was effected and the defendant had a reasonable opportunity to be heard;
- the judgment and its enforcement are not contrary to the law, public policy, security or sovereignty of the State of Israel;
- the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties;
- the judgment is no longer appealable; and
- an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the foreign court.

Furthermore, if a foreign judgment is enforced by an Israeli court, it will be payable in Israeli currency.

Current terrorist attacks in Israel and globally may have a material adverse effect on our operating results.

Terrorist attacks, such as the attacks that occurred in New York and Washington, D.C. on September 11, 2001, terrorist attacks in Israel and other acts of violence or war may affect the markets on which our shares trade, the markets in which we operate, and our operations and profitability. We cannot assure you that there will not be further terrorist attacks against the United States or Israel, or against American or Israeli businesses. These attacks or subsequent armed conflicts resulting from or connected to them may directly impact our physical facilities or those of our suppliers or customers. Furthermore, these terrorist attacks may make travel and the transportation of our supplies and products more difficult and more expensive and ultimately affect the sales of our products in the United States and overseas. Also, the ongoing armed conflicts around the world such as in Iraq could have a further impact on our sales, our profitability, our supply chain, our production capability and our ability to deliver product and services to our customers.

Our operating results would be adversely affected if inflation in Israel is not offset on a timelybasis by a devaluation of the new Israeli shekel (NIS) against the U.S. dollar.

Our international sales expose us to fluctuations in foreign currencies. Most of our sales are denominated in U.S. dollars. When the Israeli inflation rate exceeds the rate of the NIS devaluation against foreign currencies, 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.

The rights and responsibilities of our shareholders are governed by Israeli law and differ in somerespects from the rights and responsibilities of shareholders under U.S. law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company s articles of association, increases in a company s authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote or to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

Israeli law may delay, prevent or make difficult a merger with or an acquisition of us, which couldprevent a change of control and therefore depress the price of our shares.

Provisions of Israeli law may delay, prevent or make undesirable a merger or an acquisition of all or a significant portion of our shares or assets. Israeli corporate law regulates acquisitions of shares through tender offers and mergers, requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. These provisions of Israeli law could have the effect of delaying or preventing a change in control and may make it more difficult for a third party to acquire us, even if doing so would be beneficial to our shareholders. These provisions may limit the price that investors may be willing to pay in the future for our ordinary shares. Furthermore, Israeli tax considerations may make potential transactions undesirable to us or to some of our shareholders.

Under current Israeli law, we may not be able to enforce covenants not to compete and therefore maybe unable to prevent our competitors from benefiting from the expertise of some of our former employees.

We currently have non-competition clauses in the employment agreements of nearly all of our employees. The provisions of such clauses prohibit our employees, if they cease working for us, from directly competing with us or working for our competitors. Recently, Israeli courts have required employers, seeking to enforce non-compete undertakings against former employees, to demonstrate that the competitive activities of the former employee will cause harm to one of a limited number of material interests of the employer recognized by the courts (e.g. the confidentiality of certain commercial information or a company s intellectual property). In the event that any of our employees chooses to go and work for one of our competitors, we may be unable to prevent our competitors from benefiting from the expertise of our former employees obtained from us, if we cannot demonstrate to the court that harm would be caused to us.

Assistance from the United States.

Israel receives significant amounts of economic assistance from the United States, averaging approximately $3 billion annually over the last several years. We cannot assure you that U.S. economic assistance will continue at or near amounts received in the past. If U.S. economic assistance is eliminated or reduced significantly, the Israeli economy could suffer material adverse consequences which could have a material adverse impact on our financial condition and results of operations.

ITEM 4: INFORMATION ON THE COMPANY

History and Development of the Company

We are a leading provider of products and services for satellite-based communications networks. Beginning January 1, 2005, we operate under two business units: (i) Gilat Network Systems, which is a provider of network systems and associated professional services to service providers and operators and (ii) Spacenet, which provides managed services for enterprises and businesses through our U.S. Subsidiary, Spacenet Inc., for consumers through our U.S. subsidiary, StarBand Communications Inc. and for rural communities through Spacenet Rural Communications. In its most recent available report published in September 2003, Comsys, a specialized consulting company that analyzes the satellite communications industry, reported that Gilat is the second-largest manufacturer of very small aperture terminals, referred to in the network communications industry as VSATs. We were incorporated in Israel in 1987 and are subject to the laws of the State of Israel. Gilat s corporate headquarters, executive offices and research and development, engineering and manufacturing facilities are located at Gilat House, 21 Yegia Kapayim Street, Kiryat Arye, Petah Tikva 49130, Israel. Our telephone number is (972) 3-925-2000.

Gilat 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 applications and establishing strategic alliances primarily with major telecommunications companies and equipment suppliers. We have also broadened our marketing strategy by providing a full range of VSAT services and by emphasizing 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 Inc. 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 including from our OneWay and Skystar Advantage products. By an agreement in 1992, COMSAT RSI, Inc. became our joint venture partner to develop, manufacture and market two-way rural telephone VSAT products. We began marketing the FaraWay VSAT in 1994. We began marketing the DialAw@y IP VSAT, another rural telephony product outside of the scope of that joint venture, at the end of 1996. Additionally, we began marketing the SkySurfer VSAT in 1997 and the SkyBlaster VSAT in 1999.

In 1999, we began marketing our SkyBlaster VSAT product. The SkyBlaster product is a two-way IP-based product with which broadband Internet services via satellite are provided. One of the first SkyBlaster products developed was the 360 model, designed for consumers and home offices and small business users. In 2001, we completed development of the SkyBlaster 360E, a two-way satellite-based communication geared toward the enterprise, small business, SME and SoHo markets, that enables broadband networking between a central hub and up to thousands of locations. The SkyBlaster 360E was launched in 2002 and then renamed the SkyStar 360E. Approximately 119,000 units of the SkyStar 360E have shipped to date.

In February 2004, we introduced our SkyEdge family of products which offer a comprehensive satellite communications platform to deliver data, voice and video services over a single, powerful system. The SkyEdge family of products was beta tested in the third quarter of 2004 and became available for commercial distribution in the last quarter of 2004.

The SkyEdge product family consists of the *SkyEdge System* (the hub), and five VSAT products including:

SkyEdge Pro *Multi-service VSAT,* supporting interactive data, mesh telephony, broadband IP and video, with plug-in card architecture expanding the VSAT capabilities.
SkyEdge IP *IP Router VSAT*, supporting interactive, broadband IP, VoIP and multicasting applications.
SkyEdge Call *Telephony VSAT*, supporting thin-route telephony applications.
SkyEdge Gateway *Trunking Solutions VSAT,*providing mesh trunking solutions supporting digital telephony and IP data on demand trunking applications.
SkyEdge DVB-RCS *Enhanced Standard VSAT,* fully supporting the DVB-RCS standard. Being much more than only a return link standard, this dual mode VSAT provides an end-to-end standard solution for a satellite network operator with an arsenal of additional access schemes, embedded software and enhanced IP acceleration features for full flexibility and support in a complex IP environment. This VSAT has dual-mode capability to operate with the SkyEdge proprietary hub or the SkyEdge DVB-RCS hub.

In addition to our VSAT product line, in 2004 we released an integrated solution to support global systems for mobile communications, also known in the industry as GSM. This solution, called the SkyAbis, enables transmission communication between GSM cellular base stations and the base-station controller.

In October 2002, to permit completion of a detailed restructuring arrangement and the submission to holders of our 4.25% Convertible Subordinated Notes due 2005, or the old notes, and certain other creditors, we filed with the Israeli Court a petition under Section 350 of the Israeli Companies Law 1999 (known as the Companies Law) for a stay of proceedings on actions by holders of the old notes and our bank lenders. In March 2003, after negotiating with both the holders of the old notes and our major creditors, we received the approval of the Israeli courts, and completed a plan of arrangement, or the arrangement with our bank lenders, holders of the old notes and certain other creditors. Pursuant to the arrangement, our old notes were cancelled and the holders of the old notes were issued a combination of 4.00% Convertible Notes due 2012, referred to herein as the new notes, and ordinary shares. Additional new notes and ordinary shares were also issued in exchange for a portion of our bank debt and debt to another financing creditor. The arrangement reduced our debt by approximately $309 million, secured new agreements with our banking creditors, and significantly reduced overall financing costs. As part of the arrangement, we entered into a new agreement with SES Americom, our major supplier of satellite transponder capacity.

In October 2003, we distributed an offering circular to the holders of our new notes and offered to exchange the new notes for our ordinary shares at a conversion rate of $8 per share. In November 2003, we accepted approximately $73.7 million of the new notes for exchange and issued an additional 9,208,270 ordinary shares.

As of December 31, 2004, 22,312,487 of our ordinary shares were outstanding.

Financing Transactions. In February 2000, we completed a private offering of $350 million of convertible subordinated notes due 2005. The notes were convertible into ordinary shares at a conversion price of $3,723.6 per share. In March 2003, pursuant to the arrangement, we cancelled these notes and issued to the holders of these notes an aggregate of (i) 10,104,195 ordinary shares; and (ii) $83.3 million in principal amount of 4.00% convertible notes due 2012 or, the new notes. In November 2003, we offered holders of the new notes the opportunity to exchange the Notes for ordinary shares at a rate of $8 per share. More than $73 million of the new notes were exchanged for 9,208,270 of our ordinary shares, including new notes held by Bank Hapoalim as described below. See Item 5: Operating and Financial Review and Prospects Commitments and Contingencies.

In December 2000, we entered into a facility agreement with Bank Hapoalim, under which we borrowed $108 million to finance our general corporate activities including our working capital. The loan bore interest at LIBOR plus 0.8% per annum and the principal was repayable in six semi-annual payments commencing June 2002. In June 2002, we paid part of the initial payment due of $6 million in principal. In March 2003, as part of the Arrangement, we amended our agreement with Bank Hapoalim. The loan was again amended in April 2004. Please see Item 5: Operating and Financial Review and Prospects Commitments and Contingencies.

In September 2001, Bank Leumi lent us $30 million to be repaid in a single installment on April 5, 2003. The loan is secured by a lien on our buildings in Petah Tikvah, Israel. In March 2003, as part of the arrangement, the terms of the loan made by Bank Leumi were revised. For more details on the arrangement, see Item 5: Operating and Financial Review and Prospects Commitments and Contingencies.

Capital Expenditures and Divestitures. In 2002, 2003 and 2004, Gilat s property and equipment purchases amounted to approximately $9.7 million, $14.7 million and $6.2 million respectively. These amounts do not include classification of inventory to property and equipment made during 2002, 2003 and 2004 in the amount of approximately $3.8 million, $6.8 million and $21.7 million respectively. For more details, see Item 4 Property and Equipment. In 2004, we completed the sale of our Argentina subsidiary, Servicio Satelital S.A. to a third party.

VSAT Industry Background

A VSAT network consists of:

several dozen to several thousand VSAT remote sites with small antennas;

a large central earth station called a hub, which includes a large antenna and base band equipment which enables the connection of all the VSATs in the network; and

the capability to communicate with a specified satellite.

A VSAT includes an indoor unit and an outdoor unit (see figure below). The indoor unit usually fits on a desktop (much like a modem) and contains the technology that enables communication between the user s equipment and the satellite. The outdoor unit includes a small antenna, usually two to six feet in diameter, that can be mounted on a user s roof, ground or wall and electronic equipment that transmits and receives signals to and from a satellite transponder. A transponder is the technical term for the space on a satellite designated to communicate with a specific user s equipment.

The control station or hub, which enables the connection of all VSATs into a VSAT network, consists of a large dish antenna (4.5 to 11 meters) and radio frequency electronics equipment to allow signals to be transmitted between the hub and the satellite transponder. A hub also includes electronic equipment to provide for satellite communications, protocol support and network management functions. Protocol is a technical term, which refers to the standards and methods by which computers communicate with one another.

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

The current generation of high power satellites is known as Ku-band satellites, because they use the Ku-band frequencies. This type of frequency band together with the sophisticated VSAT earth stations is particularly well suited to provide high-speed business communications services as well as broadband web-based services. The use of the Ku-band frequencies (as opposed to the C-band used by older generations of satellites) offers reduced interference with ground communications. This enables satellites to use the higher broadcasting power necessary to support VSAT earth stations and makes it cost-effective to transmit to or among numerous locations. With increasing satellite power and the latest generation of VSAT software, VSAT earth stations are becoming smaller and less expensive, reducing overall network costs. Our technology is compatible with both Ku-band and C-band satellites. In addition, special extended C-band and extended Ku-band satellites are also supported by our technology, where needed.

Our Market

The networks we establish are primarily used for:

internet-basednetworking applications such as networks within corporations (known as corporate intranets), corporate training and other corporate applications which enable the transmission of audio and video by high-speed Internet connections (known as broadband), as well as consumer broadband Internet uses;

on-line data delivery and transaction-oriented applications including point-of-sale (for example, credit and debit card authorization), inventory control and real time stock exchange trading; and

bundled telephone and internet access service in areas that are underserved by the existing telecommunications services or in remote locations without service, some of which are maintained by us.

Satellite-based communications networks such as those Gilat has developed offer several advantages over ground-based communication facilities. Among these advantages are the following:

ubiquitous reach, providing equal access to users in urban and remote areas under a single tier network;

fixed transmission costs, insensitive to distance or the number of receiving stations;

a persistent "always on" connection to the Internet without the need to dial up to an internet service provider;

cost savings over competing technologies such as ground telephone lines and digital subscriber lines (commonly known as DSLs) in remote areas and suburbs;

independence from telecommunication companies and other network providers;

less terrestrial infrastructure thus making satellite-based technology less susceptible to local disasters such as fires and earthquakes that adversely affect ground-based communication;

consistent and rapid response time in comparison to dial-up lines;

Internet acceleration technologies, enhancing user experience and improving satellite communication effectiveness;

rapid installment of networks and flexibility in their configuration, integration and location; and

a versatile platform, which allows for the provision of multiple applications solutions and services.

Gilat Networks Systems (GNS)

We provide VSAT communication solutions to service providers in each of the following three markets, as detailed herein:

VSAT-Based Products for Large Corporations and Government Entities

VSAT and other satellite technology is particularly well suited to data networks which need to (i) reach many locations over vast distances simultaneously; (ii) solve a last mile or congestion problem, allowing high bandwidth access in areas currently limited to slow connections like copper wire; (iii) transmit to remote locations and to emerging markets where the terrestrial telecommunications infrastructure is not well developed; (iv) rapidly provide services across a large geographic area served by multiple terrestrial providers; and (v) provide private, controlled and secured networks for a wide range of centrally-controlled applications. Due to the above advantages, corporate and government users are increasingly realizing the benefits of VSAT networks. Additional uses of the VSAT-based data networks for businesses include lottery card transactions (whereby chosen lottery numbers of consumers are transmitted via VSATs located in various stores and stations to a control hub), retailer and manufacturer inventory control and utilities monitoring and control systems for power lines and pipe lines. Other uses include hybrid solutions that combine our VSAT technology with other communication technologies, either wireless or land, producing added solutions to a customer. Some applications include back-up services, broadcasting and multicasting, and transportable and mobile solutions.

VSAT-Based Bundled Telephony and Internet-access Products

In a large number of remote, rural and urban areas, primarily in developing countries, there is limited or no telephone or Internet service due to inadequate ground telecommunications infrastructure. In these areas, VSAT networks are able to utilize existing satellites to rapidly provide high quality cost-effective telecommunications solutions. In contrast to ground-based networks, VSAT networks are simple to reconfigure or expand, relatively immune to difficulties of topography and can be located almost anywhere. Additionally, VSATs can be installed and connected to a network in a matter of hours without the need to rely on local infrastructure and seldom require maintenance.

As a result of the above advantages, the market for VSAT-based bundled services of fixed telephony and Internet access products is growing. This market consists of public telephone operators that need to fulfill service obligations worldwide, large companies that require private networks to provide inter-office communications between branch offices and corporate headquarters, and service providers targeting rural and residential areas in developing countries that do not have a ground-based telecommunications infrastructure. A new solution that we introduced into this market is a cost effective transmission product for global system mobile (GSM) cellular operators that deploy cellular base-station infrastructures to remote areas.

VSAT-Based Broadband and Internet Products for Small Businesses, SMEs, SoHos and Consumers

The term broadband services refers to networks that provide high-capacity, high-speed transmission of data. Satellite broadband networks allow for multimedia transmissions and can provide high-speed always on accelerated Internet connectivity. A multimedia transmission (also known as multimedia streaming) is a distribution process that allows simultaneous broadcasting and playback of video and audio content. The terrestrial Internet infrastructure was not designed to support the traffic load created by broadcasting full motion video or high-fidelity audio. Currently, there are three terrestrial means of providing broadband services to consumers: cable, DSL and fixed wireless.

Our Products and Services

We currently offer VSATs to the three markets described above, each of which is generally incorporated into a VSAT network consisting of a remote terminal linked to a central hub or gateways or via a satellite. In the year 2004, we offered the following satellite networks, VSATs and services, as described below.

SkyEdge Product Family

In February 2004, we introduced our new SkyEdge product family. The family consists of the SkyEdge system which is the hub, and five VSAT products including SkyEdge Pro, SkyEdge IP, SkyEdge Call, SkyEdge Gateway and SkyEdge DVB-RCS. These enhanced VSAT platforms support the same markets as our existing products and also cover new areas, such as the DVB-RCS standard and applications and solutions based on the SkyEdge products, such as the SkyAbis. Unlike our previous products, the SkyEdge products all operate on a single hub.

The SkyEdge s modular and flexible hardware enables customers to expand the capabilities of their system as the need arises, using embedded software and hardware architecture with plug-in cards architecture that enable a large range of applications and solutions. The unified platform supports a variety of topologies, including mesh, star and multi-star, which empower operators and service providers with a true competitive advantage. From carrier-grade native voice to VoIP and video conferencing, the system s flexible architecture enables superior performance and heightened user satisfaction. SkyEdge s centralized NMS features hub partitioning for shared hubs, allowing for efficient allocation of resources. Unique NMS utilities facilitate administrators tasks while guiding them through common processes and better preparing them for system and VSAT modifications. Since all software is embedded into the VSATs, there is no need for external boxes. All software can be fully managed, easily controlled and updated remotely from the NMS.

SkyEdge Highlights

Unites data and telephony applications over a single VSAT platform
Universal service platform
Standard DVB-RCS and Gilat's multi-service technologies on one system
Provides customer-oriented service diversity
Flexible, modular, scalable
Cost-effective, lower maintenance, operation and support costs
Saves resources/space segment optimization
Secure, redundant and centrally-controlled
Advanced, simple-to-operate NMS

Key Features

Data Support. SkyEdge features a wide-ranging solution with extensive IP capabilities for full flexibility and support in a complex IP environment. It also supports all data and IP multicast applications, interactive broadband IP, and legacy protocols.

Full Telephony and managed VoIP Capabilities. SkyEdge contains all of Gilat s satellite telephony innovations: toll quality voice, fax and in-band data support; mesh call routing, payphone support; advanced signaling support allowing for supplementary features; numbering schemes that conform with PSTN conventions; highly efficient space segment utilization; and fully-managed, low cost public telephony.

Embedded VPN. Gilat s VPN Inside processor is an integral part of the VSAT, enabling accelerated VPN and is easily managed from the NMS. Everything is onboard no external box is necessary.

Embedded IP & HTTP Acceleration. The network receives a dramatic improvement in IP application performance and Web browsing. Moreover, all software conveniently resides inside the VSAT, not on the client s PC.

Enhanced DVB-RCS Support. Standard DVB-RCS and multi-service VSATs can operate on the same network providing unparalleled advantages including flexible and tailored services for supporting diverse markets and applications. In addition to the DVB-RCS standard access scheme, operators receive an arsenal of additional access schemes, embedded software and enhanced IP acceleration features. SkyEdge utilizes highly efficient outbound supporting additional modulation and coding technologies. A scaleable outbound range provides a major advantage for small-scale networks wanting a minimal initial investment and seamlessly growing to accommodate large networks.

Architecture

Members of SkyEdge Family

The family consists of the *SkyEdge System* and five VSAT products currently under development including:

SkyEdge Pro *Multi-service VSAT,* supporting interactive data, mesh telephony, broadband IP and video, with plug-in card architecture, expanding the VSAT capabilities.
SkyEdge IP *IP Router VSAT*, supporting interactive, broadband IP, VoIP and multicasting applications.
SkyEdge Call *Telephony VSAT*, supporting thin-route telephony applications.
SkyEdge Gateway *Trunking Solutions VSAT,*providing mesh trunking solutions supporting digital telephony and IP data on demand trunking applications.
SkyEdge DVB-RCS *Enhanced Standard VSAT,* fully supporting the DVB-RCS standard. Being much more than only a return link standard, this dual mode VSAT provides a unique real end-to-end standard solution for a satellite network operator with an arsenal of additional access schemes, embedded software and enhanced IP acceleration features for full flexibility and support in a complex IP environment. This VSAT has a dual-mode capability, to operate with the SkyEdge proprietary hub and the SkyEdge DVB-RCS hub.

Our Legacy Products

Legacy Products by VSAT Market Type

Type	Products/Application	
Data Network Applications for Enterprises	Skystar Advantage - Interactive Data Multiple Protocols	Skystar 360E- Two-way Internet Access for Small Offices and Home Offices Enterprises
Bundled telephony and Internet Applications	FaraWay - Corporate Telephony	DialAw@y IP - Rural Telephony and Internet Solution
Broadband SME, SoHo & Consumer Applications		SkyBlaster 360 - Two-way Internet Access for Consumers

Data Delivery VSATs for Enterprises

Skystar Advantage is a private VSAT network designed for data, multimedia and voice applications, providing highly reliable communication between a central hub and almost any number tens or thousands of geographically dispersed sites. Skystar Advantage integrates the features of several different applications into a single platform. The same network can be used for interactive data and voice, as well as for multicasting multimedia over an Internet service provider. Its modular 3-slot plug-in card enables a service operator to customize for each remote site according to their specific and changing needs.

Gilat s Skystar Advantage is already implemented in numerous markets, such as: Internet access, banking, multimedia, Supervisory Control and Data Acquisition, or SCADA a technical term for computer systems that collect and summarize data from up to thousands of computers into reports for operators and management, retail and gas stations. The applications currently served by the Skystar Advantage include credit and debit card authorization for retail sales, point-of-sale information and ATM networks, on-line recording and validation of lottery tickets, prescription verification, review of customers profiles, inventory control and delivery scheduling at the manufacturing level, supervisory control and data acquisition networks for oil and gas pipelines, on-line remote stock exchange trading for brokers, distance learning and Internet access. Additional voice channel add-ons are available, as are video and audio broadcasting applications.

Skystar Advantage Network Architecture

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

The Skystar Advantage s modular configuration includes intrinsic flexibility with three indoor unit slots for plug-in cards. This architecture enables field upgradability by the addition of plug-and-play cards, which are able to support a variety of interfaces and applications such as LAN (local area networks), Universal Serial Bus port (USB port), a standard port used in PCs to connect a computer with external applications such as modems, VSATs and digital cameras, serial ports that are used as standard interface to many devices, such as ATM s and lottery machines, and video and voice cards.

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

Our Skystar Advantage VSAT product utilizes a patented technology that enables us to use low-cost outdoor unit hardware and allows the VSAT network to handle momentary peak traffic loads without any significant degradation of response time.

Features. The Skystar Advantage VSAT now offers a feature enabling Internet connectivity and additional voice channel capability, enabling voice communication between the hub site and a remote location. A VSAT network incorporating our Skystar Advantage VSAT product can offer features including: low-cost terminal equipment; rapid response time; high network availability; small antenna size which allows for easy installation and maintenance; very low transmission error rate; high hardware reliability; a variety of customer interfaces such as local area networks, or LAN (e.g., Token-Ring and Ethernet); support for commonly used data communications protocols, including and, if required, simultaneously X.25, SDLC, TCP/IP IP routing, MPEG1, MPEG2 and video; easy integration of additional value-added services such as data, audio and video broadcasting, and modular design that enables easy and staged network expansion.

Skystar 360E VSAT. The Skystar 360E VSAT offers two-way satellite based communication-enabling broadband and digital video broadcast applications. The Skystar 360E is designed for networking between a central hub and tens of thousands of locations across wide geographical areas. The Skystar 360E is to be used by companies that control their own dedicated hub or that work with shared hub operators. Applications for companies using the Skystar 360E include the following:

Enterprises Two-way interactive Internet Protocol communications, reliable software distribution, Internet and Intranet access, which means communicating between and among VSATs, video conferencing, corporate training and voice over IP enabling an integrated telephony and data solution over the same platform;

Retail Businesses credit, debit and check authorizations, point-of-sale transactions, inventory management and check authorizations, point-of-sale transactions, inventory management and hotel and airlines or other reservations systems;

Banking and Financial Services stock market and financial transactions, ATM s, financial data broadcasts and a electronic or floorless stock exchange; and

Government Uses education networks for schools, lottery transactions, long-distance training and SCADA line monitoring.

Skystar 360E Network Architecture

Architecture. The Skystar 360E star network consists of a central hub, many VSAT terminals based in remote locations, and a satellite channel. The hub consists of base band equipment and a radio frequency terminal. Each remote terminal is composed of a small outdoor antenna, an outdoor unit and an indoor unit. The indoor unit is a stand-alone box that connects to the user s PC via an Ethernet LAN.

At the hub, the base band equipment controls the satellite transmission and interfaces with the customer s data equipment. An advanced, user friendly NMS provides centralized monitoring and control, using statistics, alarms, network configuration and report generation. Corporate content is sent from the company s headquarters to the hub where it is uploaded and distributed to remote locations via satellite. Information can be sent to a single location, a group of locations or all locations. Delivery confirmation and other data, including file uploads, are sent back to headquarters via the satellite return channel.

Key Features

Star Topology The Skystar 360E is designed to support connectivity from a central hub to many remote locations.

DVB Outbound The Skystar 360E outbound carrier complies with DVB standards.

Superior Inbound Coding Intelligent coding algorithms and modulation techniques enable efficient usage of satellite bandwidth.

Stand Alone Remote Unit Client software is already embedded in the box. There is no need for external software for terminal operation.

Extensive Internet Protocol Capabilities The Skystar 360E can function in a variety of Internet Protocol environments and supports a wide range of Protocols and applications.

Centralized Network Management Network management is carried out from the hub. Remote terminals can be monitored from a central location.

Rapid Deployment Terminals can be set up easily across multiple locations.

Proven Technology Gilat s interactive VSAT terminals have already been installed and are operating successfully in thousands of locations worldwide.

VSATs as Telephony Products

FaraWay VSAT. Gilat and COMSAT RSI were parties to a joint venture for the development of the FaraWay VSAT, a satellite telephony VSAT, which provides voice and data services via satellite to remote locations and other areas that lack adequate telecommunications infrastructure. FaraWay VSATs provide:

a reliable telecommunications network (with fax, telephone and data capabilities) for corporate, governmental and business users in developing countries that have minimal or no telecommunications infrastructure;

multi-channel toll-quality telephone or digital trunking service to geographically isolated rural residential areas in developing countries; and

cost-effective telephone and data service that can be installed quickly for remote installations (e.g., oil and gas exploration sites, small rural government agencies, public call offices and new factories).

Architecture. The FaraWay telephony product employs a unique VSAT architecture and satellite access scheme. As illustrated above, the product architecture permits connections to either private telephone equipment, pay telephones, private or public switches connecting the product to a single telephone line or a public switch connecting the product to many lines and data terminals, as well as to any combination of this equipment. High-speed data links can be established on a permanent basis or on demand, in a full mesh configuration.

The remote terminal of the FaraWay includes a dish antenna (typically 1.8 to 3.7 meters in diameter), an outdoor unit and an indoor unit. The indoor unit connects directly to subscribers telephone equipment central office or data networks. The FaraWay hub, which may be connected to a public switch telephony network, or PSTN, or data networks, such as Internet access or connection to other servers), includes a large dish antenna (typically 3.7 to 13 meters in diameter), radio frequency electronics, a network resource and call-processing controller, and a Network Management System, or NMS, which includes call accounting files. The network resource controller assigns satellite frequencies to the equipment at both ends of the communication link; the NMS monitors and controls the overall network and also provides data for external network billing; and the traffic terminal provides the hub s interface to the public switch, voice or data network.

Features. The FaraWay VSAT offers a cost-effective, flexible solution for connecting multiple telephone and data lines from a public switch or ISP connection to a local switch or directly to subscribers premises via satellite and to support voice, fax and high data rate applications. The product features include: Ku-band and C-band and extended Ku-band and C-band frequency operation; flexible interfaces and telephony signaling support; support of up to 330,000 calls per hour; ITU-approved 16 and 8 kilobit per second voice encoding and bit pipe data links up to 5Mbps (via High Rate Module).

DialAw@y IP VSAT. Our DialAw@y IP VSAT product is intended to provide inexpensive, toll quality telephone service including voice and fax communication bundled simultaneously with high speed Internet access. This product is targeted for small businesses and villages in remote or urban areas lacking an adequate telephone infrastructure. The product has many applications:

Public Telecommunications - offering telecommunication services to remote locations such as: public call offices, pay phones, pre-paid services and "always-on" internet access;

Private Telephones offering telephone, fax and Internet access for small offices and home offices, referred to in the industry as small office/home office users, remote businesses, farms and remote tourist sites;

Standalone Phones for emergency or rescue operations, rural roads and remote highways and as back up for ground-based telephony networks.

C or Ku

The DialAw@y has been designed to offer subscriber or pay telephone and public call offices with up to six lines. Our rural telephony product can operate in a mesh configuration, in which the remote terminals communicate with one another in single satellite hop (meaning that the connection between the terminals passes only once through the satellite), or multi-star configuration, which involves several interconnection points to the public network. At the same time the DialAw@y IP offers always on high speed two-way Internet access. We believe that the cost benefits of the product meet the telephony needs of the targeted non-urban telephony users, as well as such users current and future needs for Internet access.

Architecture. As illustrated above, a DialAw@y IP network consists of a central hub, PSTN and ISP gateways, satellite channels and remote terminals. A remote terminal consists of a small outdoor antenna (typically 0.98 to 1.2 meters), an outdoor unit and our indoor unit with one to six telephone lines. The hub consists of a radio frequency terminal and baseband equipment. The radio frequency terminal incorporates a large dish antenna (typically 3.7 to 11 meters) and radio frequency electronics equipment (up and down frequency converters, low noise amplifiers and high power amplifiers). The baseband includes a Hub Satellite Processor handling the satellite communications, a Hub Voice Processor be connected to the PSTN using a digital E1 line, a Hub Internet Processor connected to an internet service provider, and an NMS. The NMS monitors and controls all the remote terminals and the hub equipment. The hub design permits easy incorporation of new features. The hub station is the point of presence for Internet traffic, which means that it is the gateway to the user s connection to the Internet. Telephony traffic can be also routed to regional gateways, which can utilize satellite or terrestrial infrastructure.

Features. Our DialAw@y IP VSAT product offers full support of telephone line services, including flexible adjustment to various payphones, an integrated telephony prepaid platform, high speed Internet access, full mesh architecture, call data processing, low cost, simple installation and operation, high hardware reliability, remote control and monitoring; and low power consumption.

VSATs for Consumers

SkyBlaster 360 VSAT. The SkyBlaster 360 provides two-way connectivity, with both directions of connectivity via satellite. The SkyBlaster 360 is designed for consumers and home offices and small business offices that want high bandwidth services and do not have a terrestrial high-speed infrastructure available to them. Our VSAT technology is ideal in outside metropolitan centers because geographic distances do not hinder our ability to provide the high-speed infrastructure that is unavailable otherwise. The SkyBlaster 360 consists of a DVB receiver and a satellite transmitter as a return channel. The VSAT is in the form of a stand-alone external modem. The external modem is substantially easier to install than the personal computer card used in previous models.

The consumer-friendly external modem (approximately 12 inches x 12 inches x 4 inches wide) sits near a user s personal computer and provides two-way connectivity for Internet access as well as for content delivery and other multicast and interactive applications.

The SkyBlaster 360 features adaptable capacity of up to 52.5 megabits per second, or Mbps, downstream and 307.2 kilobits per second, or Kpbs for the return channel. It can be used with either an Ethernet connection or a USB port**,** and is compatible with Windows 98SE, Windows Me, Windows 2000 and Windows XP.

The SkyBlaster 360 enables reliable, high-speed, bandwidth-intensive content delivery applications including the following:

Consumer Internet access;

High-speed Intranet and Extranet. Extranet enables sources outside an enterprise such as suppliers, access to only select portions of a network and Internet connections;

High-speed Internet access;

Business TV such as conferences, classes and seminars; and

Interactive learning that enables companies to conduct a single class to employees located throughout a single continent.

Architecture. A SkyBlaster 360 star network consists of a central hub, many VSAT terminals, and a two-way satellite channel. The hub consists of base-band equipment and a radio frequency terminal. Each remote terminal is composed of a small outdoor antenna, an outdoor unit and an indoor unit. The indoor unit is a stand-alone box that connects to the user s PC.

At the hub, the base-band equipment controls the satellite transmission and interfaces with the Internet and various servers. An advanced, user friendly Network Management System provides centralized monitoring and control of the entire system including statistics, alarms, status reports, network configuration and trouble-shooting of all the hub components and remote VSATs. Content from the Internet or from the various servers at the hub is transmitted from the hub to the remote stations. Information can be sent simultaneously to a single location, which is referred to as unicasting, a group of locations, which is referred to as multicasting, or all locations, which is referred to as broadcasting. Delivery confirmation and other data, including file uploads, are sent back to headquarters via the satellite return channel.

Key Features

Star Topology Specially designed to support connectivity from a central hub to thousands of remote locations.
DVB-S Outbound The outbound carrier is DVB-S (MPE) compliant and is scalable from 2.5Mbps to 52.5Mbps. It can also be multiplexed into an existing Direct to Home (DTH) carrier.
Stand Alone VSAT The VSAT houses the transmitter and receiver. A USB or 10 base-T Ethernet interface connects the VSAT to the PC.
Centralized Network Management Network management is carried out from the hub. Remote terminals can be monitored from a central location.

Extensive IP capabilities The VSAT can function in a variety of IP environments and supports a wide range of IP protocols and applications.
Rapid Deployment Any site within the satellite footprint can be immediately connected to the network. The unique design allows a single team to install up to three remote sites per day.
Proven Technology Gilat s VSAT terminals have already been installed and are operating successfully in thousands of locations worldwide.
Host Software Performance enhancing client applications implemented on the PC accelerate traffic at both the TCP and HTTP layers.

Spacenet

Spacenet acts as an operator of communications networks for the provision of telephony, data and Internet services to customers, who are at present primarily in the Americas. The charges to customers for networking services vary with the type of operations provided, the length of the contract, the amount of satellite capacity and the types of technologies and protocols employed. The business is divided as follows:

The enterprise provides satellite-based, enterprise-grade broadband wide-area networking solutions for a broad range of commercial organizations and small business customers, primarily in North America.
The consumer market, which provides broadband Internet access via satellite to residential, SoHo in North America.
The rural market, which provides satellite-based rural telephony and internet access solutions to remote areas in Latin America.

In our two primary geographic markets, North America and Latin America, we provide full network services through our network management centers, or NMC, in addition to product sales. We offer a full spectrum of services, from installation and maintenance services to comprehensive satellite communication service offerings in which we package the VSAT system with installation, network operations, maintenance and access to satellite transponder capacity. Our services include the following, as further detailed below:

network analysis,
network implementation,
shared hub services,
network operations,
value-added services,
managed network services,
maintenance,
customer technical services,
provision of telephony services, and
access to satellite capacity.

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

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

Many of the activities for installing a VSAT network take place at the customer s facilities, such as site survey, site preparation and installation of ground, roof, or wall-supported mounts with lightning protection, connection of the outdoor unit and the indoor unit to the antenna and intra-facility link or cable, powering up the system, pointing the antenna, initializing the VSAT and confirming proper operation with the hub, connecting the VSAT with the customer s local equipment, and providing an orientation to the local customer personnel. A typical installation can be completed in four to six hours.

Hub installation services vary depending on whether the customer s network involves a private hub or use of one of our shared hub facilities in McLean, Virginia, Chicago, Illinois, Atlanta, Georgia, Colombia or Peru.

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

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

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

Value-Added Services. We provide a wide range of developed and third-party value-added network services for our customers to increase their network connections. Value-added services are applications, managed or coordinated by us, providing added functionality to customers over their Gilat network connection. Our value-added services currently include licensed in-store music delivered to customer sites over their Gilat network connection, unicast/multicast delivery of distance learning/videoconferencing content, and credit/debt transaction processing support via the VSAT link, with more services expected to be added in 2005. Rural operation services include prepaid voice, prepaid IP and voice mail services.

Managed Network Services. We also offer managed network services, which allow customers to outsource their IT functionality to us on a consultant services basis. These services leverage our experience providing enterprise network solutions customized to each customer s specific applications, topology and usage profiles, bringing us into a more consultative professional services role and enabling us to add more value to the customer relationship.

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

Our maintenance services are supported by our internal logistics and repair organization, which is responsible for stocking parts in warehouses in the United States and Latin America.

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

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

Spacenet Inc.

Our U.S. subsidiary. Spacenet Inc., provides satellite-based, enterprise-grade broadband wide-area networking solutions for a broad range of commercial organizations throughout North America. These networks are provided to a wide range of business and corporate enterprises that require hundreds or sometimes thousands of VSATs with high-speed Internet access and other communication applications via VSATs. Most service contracts through Spacenet Inc. are for three to five year periods and enterprises pay on a per site, per month basis in addition to upfront installation and hardware and software fees. Major customers of Spacenet Inc. include the United States Postal Service, GTECH, Dollar General, Countrywide, Valero, Rent-Way and Kroger. In 2002, Spacenet Inc. expanded its market to include an off the shelf service known as Connexstar, a satellite network solution product for small to mid-sized enterprises. This business offers standard pre-packaged services, hardware and software for businesses that want business connectivity for as few as one location and up to hundreds of locations. Today, Connexstar off the shelf VSAT services represent the majority of new business generated by Spacenet Inc.. In 2004, Spacenet Inc. broadened its service portfolio to provide hybrid VSAT/terrestrial networks to customers where VSAT technology cannot provide a complete solution. In 2002, 2003 and 2004, Spacenet Inc. s revenues accounted for approximately one-half, one-third and one-quarter of our total revenues respectively.

Spacenet Rural Communications

We provide satellite-based rural telephony and internet access solutions to remote areas in both Colombia and Peru. Outside dense urban areas, telephone and Internet access communications infrastructure is costly and difficult to set up. Gilat s service offering provides governments with an affordable way to bridge the gap between urban and rural areas, providing high-speed Internet connectivity, phone and fax service using our satellite-based technology.

To meet these needs, we have developed the following product portfolio:

Hub operation, which includes handling a network operation and engineering services.

Maintenance of remote sites, technical support, preventive and corrective maintenance, planning and management of network operativeness, creation or improvement of the distribution network for payment means.

BOT (Build, Operate, Transfer) in which we assume full responsibility for the design, construction and operation of a telecommunications project, and then transfer the knowledge of the operation and after a time pass it on to the client.

Rendering of pre-payment and post-payment voice public services, preferably by public telephones or public telephone booths.

Provision of connection to Internet with high velocity services for small and medium companies.

National and international long distance call services.

These applications enable us to provide the following services:

Isolated Public Telephones with one line and the gradual increase of the number of lines, as needed, feeding options through alternative power sources, pre- and post-payment service. The telephones can be used for general public use as community phones, for emergency or rescue measures and on long highways.

Public Call Offices which typically offer several voice lines in the same premises, enabling telephone, fax and Internet services.

Telecenters which offer both voice and Internet services with multiple telephone lines, personal computers providing communities with Internet, telephones, facsimiles, carrier and scanner and printing of documents.

Through four contracts awarded to us by Peru s National Program for Rural Telecommuncations Projects, Fonde de Inversion en Telecomunicaciones del Peru (FITEL), we have deployed fixed satellite telephony and Internet access in Peru a public call office network, serving approximately 6,000 communities, and providing rural satellite telephony and Internet service to twenty percent of Peru s population. The solution includes: (i) bundled service of high-speed Internet access and toll-quality telephony service on a single, low-cost platform; and (ii) VSAT satellite communications equipment that can be deployed without reliance on terrestrial infrastructure, even in the most remote locations. The FITEL telephony network operated by us provides citizens with quality, affordable phone, fax and Internet services.

In Colombia, we have provided telecommunications services since 2000. At present, we operate approximately 11,535 remote locations. The services provided include public telephone services in call offices and isolated telephone booths and telecenters of both voice and Internet services. The services are provided under three government subsidized projects awarded to us in the past five years.

Marketing and Distribution

We use both direct and indirect sales channels to market our products, solutions and services. Our GNS equipment sales division has marketing activities organized geographically, with groups, subsidiaries or affiliates covering all regions of the map. Our sales teams are comprised of account managers and sales engineers, who are the primary account interfaces and work to establish account relationships and determine technical and business requirements for the network. These teams also support the other distribution channels with advanced technical capabilities and application experience. Sales cycles in the VSAT network market are lengthy and it is not unusual for a sale to require 18 months from initial lead through signing of the contract. The sales process includes several network design iterations, network demonstrations, and in some cases special software development, integrations with third party equipment for complete solution offerings, which is completed before contract signing. For VSAT networks sold as a complete service offering, the sale cycle is typically shorter and can be as low as 90 days from the initial lead through the signing of the contract. Some of the larger government bids in Latin America include service provision for up to ten years.

The following table sets forth our revenues by geographic area for the periods indicated below as a percent of our total sales and includes countries in which revenues exceeded 10% in any of the reporting years:

	Years Ended December 31,		
	2002	2003	2004
United States	52.8%[1]	35.8%[1]	39.1%
South and Central Latin America (except Brazil)	14.9%	22.8%	27.8%
Asia	11.8%	15.4%	13.3%
Brazil	4.5%	11.0%	8.8%
Africa	8.3%	8.4%	5.8%
Europe	7.0%[1]	4.7%[1]	4.8%[1]
Other	0.7%	1.9%	0.4%
Total	100.0%	100.0%	100.0%

[1] Includes revenues from related parties of 3.2%, 4.0%, and 1.2% for the years ended December 31, 2002, 2003 and 2004, respectively.

Strategic Alliances, Joint Ventures and Acquisitions

We have acquired certain entities and established certain key strategic marketing relationships and joint ventures, including the following:

Spacenet Inc. On December 31, 1998, we completed the acquisition of Spacenet Inc., a company engaged in providing VSAT-based network services, from SES Americom (formerly known as GE Americom) and certain affiliates. Prior to the acquisition, Spacenet Inc. was our single largest customer. Spacenet Inc. purchased our VSAT products in order to incorporate them into its VSAT-based network service offerings.

As part of the Spacenet Inc. acquisition, we entered into several significant agreements with SES Americom. See Item 7: Major Shareholders and Related Party Transactions Related Party Agreements . The acquisition of Spacenet Inc. has enabled Gilat to expand from primarily manufacturing and selling VSAT equipment to becoming a provider of complete end-to-end telecommunications and data networking solutions based on VSAT satellite earth stations.

StarBand. In March 2000, we established a joint venture named StarBand Communications Inc.(formerly known as Gilat-to-Home, Inc.) with MSN, EchoStar and ING, to provide broadband Internet access via satellite to residential, SoHo and small business customers in North America. MSN and EchoStar originally invested $50 million each and ING has invested $25 million in cash in StarBand in exchange for both senior convertible preferred and common shares, of the outstanding capital of StarBand. Following an additional investment by EchoStar, Gilat, through Spacenet Inc., owned approximately 35.0% of StarBand s outstanding shares.

On May 31, 2002, StarBand filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Since that time, we provided to StarBand approximately $14 million of debtor in possession financing, the majority of which has been in the form of transponder capacity, and additional financing of approximately $11.2 million. In November 2003, StarBand emerged from bankruptcy and we currently hold 49% of StarBand. Upon StarBand s emergence from Chapter 11, and in consideration for the 49% shares issued to Gilat at that time, we forgave approximately $84 million of debt provided by us to StarBand and we entered into three agreements with StarBand: (i) the restated master agreement for the supply of equipment and services upon the terms described above; (ii) a note and loan agreement providing for repayment of $14 million of debtor in possession financing supplied by us to StarBand during Chapter 11 proceeding, bearing 3.5% annual interest and with quarterly payments to be made between March 31, 2004 and December 31, 2008 and principal payments to be made between March 31, 2006 and December 31, 2008; and (iii) a financing agreement for the provision of a up to $7.5 million in revolving financing and trade credit, subject to various restrictions and reductions, through the end of 2009. As of December 31, 2004, StarBand is consolidated into our financial statements. Please see Item 8 Significant Changes .

Deterministic Networks Inc. In July 2000, we acquired all of the shares of Deterministic Networks, Inc. (Deterministic), a privately held company based in California. Deterministic is a supplier of policy-based networking products and toolkits to several major technology companies, providing quality of service, network management and Internet security capabilities that enhance the products and services of its customers. In exchange for Deterministic s stock, the shareholders of Deterministic received 10,921 of our ordinary shares then valued at approximately $7.8 million. A total of $7.2 million of this price was attributed to goodwill which was amortized at an annual rate of 20% through December 2001, with the balance impaired in 2002 and recorded as a cumulative effect of change in accounting principle in the first quarter of 2002. Currently, Deterministic has approximately ten employees and continues to develop software-networking products.

rStar. In January 2001, following a tender offer, we became the owners of 51% of the outstanding shares of rStar (a then publicly traded company on NASDAQ) at a cost of approximately $51 million. In May 2001, rStar issued and delivered to Gilat 19,396,552 shares of rStar Common Stock, in full satisfaction of rStar s outstanding capital lease obligations to Spacenet Inc. in the amount of approximately $45 million, which resulted in Gilat increasing its share holdings in rStar to approximately 66%. In August 2002, we completed a transaction in which we acquired additional shares of rStar, increasing our ownership interest to approximately 85%. As part of this transaction, we sold to rStar the exclusive rights in certain Latin American countries (i) to implement, operate and market broadband Internet access services and voice services to residential consumers and SoHo subscribers, (ii) to provide a bundled product with direct-to-home television service using a single satellite dish, and (iii) to provide such new technologies and products related to the foregoing as Gilat may in the future develop or make available to StarBand, which shall be offered to rStar upon commercially reasonable terms. Under the acquisition agreement, rStar purchased the outstanding capital stock of StarBand Latin America in exchange for 43,103,448 shares of rStar common stock. StarBand Latin America was created to provide, through local subsidiaries, two-way always on, high-speed Internet access and telephony to residential and SoHo customers in Latin America.

In December 2003, we entered into an agreement with certain rStar stockholders to acquire an additional 9.3% of rStar shares for $0.60 per share in cash. In April 2004, immediately following such transaction, , we effected a short-form merger and acquired the shares held by all other rStar stockholders.

Satlynx S.A. In April 2002, together with SES Global SA (formerly known as SES Finance SA), we announced the formation of a new company that provides two-way satellite broadband communications services to enterprises, consumers and SoHo users throughout Europe. We and SES Global contributed cash and in kind contributions, which included existing facilities, transponder capacity, hubs, terminals, other technology and technical as well as marketing assistance. Gilat transferred six of its European subsidiaries (in Italy, Germany, the Czech Republic, England, Holland and France). As a result, substantially all of the service-providing business of Gilat in Europe was transferred to this joint venture. The transaction between Gilat and SES Global was completed on May 24, 2002. In June 2003, and in March 2004, Alcatel Space and Skybridge (Alcatel subsidiaries) invested in Satlynx cash and in-kind contributions. The future of Satlynx is contingent upon its ability to raise additional financing.

Backlog

The 2004 year-end backlog for equipment sales and revenues from multi-year service contracts for our VSAT products was approximately $191 million, from approximately $243 million at the year-end 2003. Approximately $24 million of the backlog is for equipment sales, and $167 million for network operations. Backlog is not necessarily indicative of future sales. Many of our contracts can be terminated at the convenience of the customer. In addition, some of our contracts may include product specifications that require us to complete additional product development. Any inability to meet the specifications could lead to a termination of the related contract. In addition, our backlog has decreased significantly in the past year. If our backlog continues to decrease and we do not increase our short-cycle sales, our business could be adversely affected.

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. Our patent portfolio includes 48 patents issued (22 U.S. and 26 foreign patents), 22 U.S. patent applications pending and nine foreign applications pending. All of the patents and applications that were developed and/or owned by our subsidiaries have been formally transferred to the parent company and are now controlled by us. In addition, we have filed patent applications with respect to our SkyEdge family of products that will be released to the market soon, as well as patents concerning a range of other inventions. As part of our patent program, Gilat intends to file additional patent applications on an ongoing basis.

We believe that our patents are important to our business. We also believe 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, subcontractors and certain customers and other business partners. 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.

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.

Customers

Gilat s products are purchased by a wide spectrum of customers, including government operators, service providers large retail, small and medium enterprises, small consumer-oriented businesses, including retail and consumer distribution, convenience stores, restaurants and hospitality establishments, gas stations, hotels, brokerage, banking and financial services providers, communications companies, lotteries, automotive and governmental institutions. We sell our products, both equipment and in some instances services, directly to these customers or indirectly through resellers. In general, networks for these customers range from approximately 100 to 10,000 sites, although some customers have satellite data networks considerably smaller and others, considerably larger than this range. For example, GTECH, a lottery provider in the United States, has deployed more than 25,000 Skystar Advantage VSATs around the world. In Peru, Gilat has deployed 6,000 Dialaw@y IP VSATs providing telephony and Internet services. In Brazil, StarOne, the largest satellite ISP from enterprise to consumer customer, is using Skystar Advantage, SkyBlaster 360 and Skystar 360E in more than 10,000 sites. In South Africa, Gilat has been contracted to deploy up to 26,000 Skystar 360E Broadband VSATs over the next five years. In China, the two western provinces, Xinjiang and Tibet, have more than 3,000 Dialaw@y IPs for rural telephony. In Australia, Optus has selected Gilat to supply an additional 2,500 Skystar 360E for broadband applications. In Kenya, the Dialaw@y IP platform will be used to modernize the Kenyan postal offices throughout the country.

Competition

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

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

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

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

Our principal competitor in the supply of VSAT satellite networks is Hughes Network Systems (HNS) which offers a full line of VSAT products and services and which obtains most of its satellite capacity on the satellite system operated by its affiliates Hughes Galaxy and PanAmSat. In competing with HNS, we emphasize particular technological features of our products and services, our ability to customize networks and perform desired development work, the quality of our customer service and our willingness to be flexible in structuring arrangements for the customer. In addition, we face increased competition for all of our product lines from ViaSat, Inc. and iDirect Technologies.

The satellite market is leaning toward a standard technology. Several technologies have emerged as possible candidates. The only open standard at this point in time is DVB-RCS. There are several manufacturers providing and supporting this standard which has been established primarily in Europe. Other companies offer technologies that can be standardized such as DOCSIS by ViaSat and IPoS by HNS.

We may experience increased competition in the future from existing or new competitors in the hardware, services and the consumer broadband spheres that may adversely affect our ability to continue to market our products and services successfully. We believe that we have been able to compete successfully with larger telecommunications companies in part by entering into strategic joint development and marketing relationships with major companies such as SES Global, by developing new products such as the SkyEdge and by emphasizing low-cost product and service features and functions that meet the needs of customers in the markets in which we compete. See Item 4: Information on the Company Patents and Intellectual Property.

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

We also compete with other companies that offer communications networks and services based on other technologies (e.g., ground-based lines and frame relay, radio transmissions, point-to-point microwave) that can be competitive in terms of price and performance with our products. For example, there is a competing technology for a unidirectional VSAT system that uses a lower-cost remote terminal but requires more satellite space segments capacity than our unidirectional VSAT products. See Item 3: Key Information Risk Factors; Competition in the network communications industry.

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 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, or 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 guarantee 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. In certain countries, there are maximum tariffs and fees set by the regulatory authority maximizing the fees that can be charged for use of telephony services we provide.