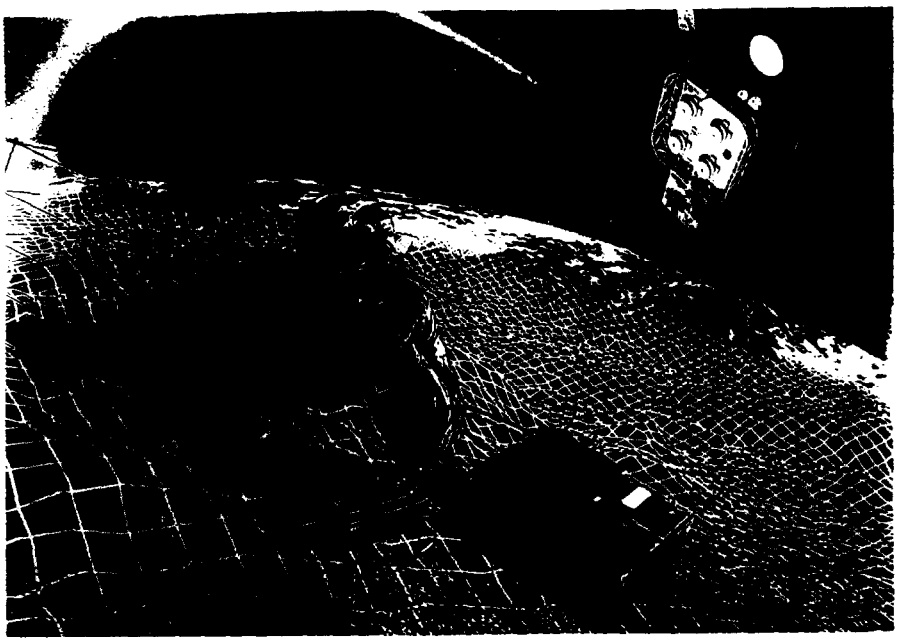
Partnerships. HAC is carrying out several successful partnerships with Raytheon that were entered into prior to the proposed merger.

For example, in 1996 a HAC-Raytheon team won a key study phase contract for the U.S. Army's Aerostat program, an over-the-horizon surveillance effort using high-altitude sensor technology.

And in Norway, HAC and Raytheon have teamed with Kongsberg Gruppen, ASA, to incorporate HAC's Advanced Medium Range Air-to-Air Missile (AMRAAM), along with the Hawk missile, in a new air defense system that will allow a single firing unit to launch either missile.

If the HAC-Raytheon merger occurs as expected, there will be many more opportunities for integrating the two companies' parallel operations, which should give the new company a considerable advantage in the marketplace.



HAC is a leading designer and manufacturer of military tactical communications, electronic combat and command and control products

Fielding Advanced Technologies at Low Cost

Today, crucial weapons and protective systems – aboard tanks, planes and ships and in the hands of soldiers themselves – must be made smarter by integrating next-generation electronics technologies, yet must be produced using low-cost manufacturing approaches. HAC excels at this.

In the United States, HAC is leading a team carrying out the Land Warrior™ contract to equip soldiers with an integrated system of 40 state-of-the-art components. The U.S. Army plans to order 34,000 units, and interest from U.S. allies is strong. The global market potential for revenue is in the billions of dollars.

To deliver the kind of value Land Warrior represents, and to achieve life-cycle cost containment in its programs, HAC is pursuing a multi-faceted approach.

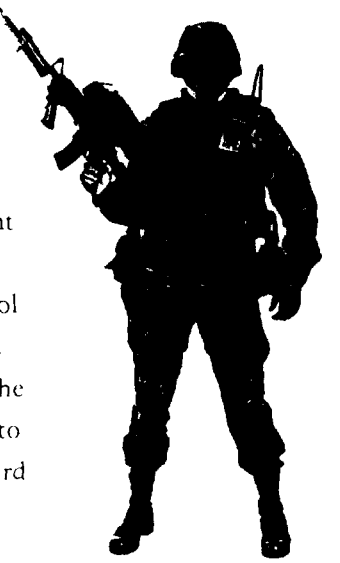
Acquisition reform is one way. For the U.S. Army's Fire Support Combined Arms Tactical Trainer (FSCATT) program, acquisition reform is helping HAC cut substantial time and cost during development, thereby lowering contract costs.

Other keys to HAC's ability to lower total life-cycle costs include: using today's most advanced electronics to achieve ten-fold improvements in performance-to-cost ratios; adopting commercial off-the-shelf technologies and common processes; leveraging all of these to build in high reliability from the start; and offering military customers up-front warranties on new systems, plus lifetime service contracts.

Innovative ways such as these to cut costs can be applied at every stage of building a weapons system. In a shrinking market driven by value, only companies that are able to consistently deliver on promises to be a low-cost manufacturer will succeed.

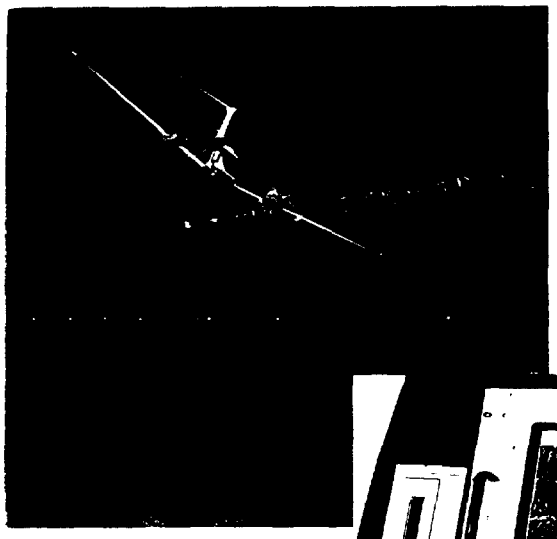
HUGHES AIRCRAFT

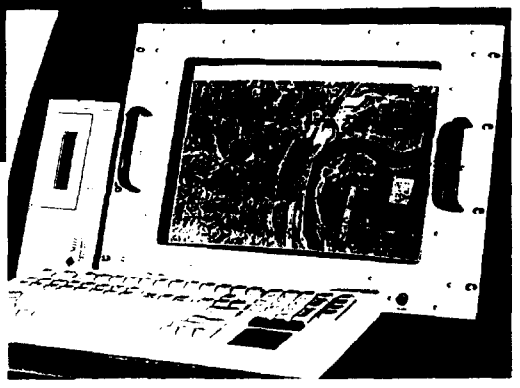
Land Warrior is the U.S. Army's first integrated fighting and support system for soldiers. HAC is the systems integrator for this new product line, which has 40 components.



Winning Domestic Contracts

Civil Aviation Expansion. Two major recent contract wins reinforce HAC's position as a significant participant in the air traffic control marketplace: a $483 million Federal Aviation Administration (FAA) award for improving the capability of the Global Positioning System to support navigation and landings; and an award of up to $1 billion, jointly won with





The Hughes Integrated Synthetic Aperture Radar is a system employing military reconnaissance technology that helps non-military agencies with such surveillance activities as monitoring the environment and catching smugglers

Raytheon, to provide HAC's TracView air traffic control stations as a backup to FAA and Department of Defense air traffic control terminals.

Core Market Contracts. Last year, HAC won numerous contracts from military customers in its traditional core markets, including more than $700 million in awards to build AMRAAM missiles for the U.S. Air Force and U.S. Navy, and Tomahawk and Standard Missiles for the U.S. Navy. HAC also won the engineering and manufacturing development contract for the AIM-9X missile. The initial AIM-9X contract is for $169 million, but the potential value of the program in sales to the U.S. Navy and Air Force and international customers over the next two decades is $5 billion.

Another key contract was HAC's more than $200 million share in a $641 million award to the Avondale Alliance to design, construct and support the U.S. Navy's next generation of amphibious ships. As systems integrator, HAC will be responsible for electronic systems over the 40-year life cycle of each ship. Because of the overwhelming importance of electronics to the operation and defense of modern high technology warships, this project points the way for HAC to take a leading role in future shipbuilding programs and retrofits of existing ships with the latest electronics.

Opening New Markets. Billions of dollars in business to perform military overhaul, repair and maintenance work previously exclusively done by government-run depots and terminals is being opened to industry. HAC is in the forefront of companies winning these "privatization" contracts. Last year, it won the largest such contract so far, an award with a potential value of $1.3 billion over five years for privatizing the Naval Air Warfare Center in Indianapolis.

In the growing U.S. government market for desktop computers, workstations and informa-

(Opposite Page) HAC's Advanced Oceanic Automation System for the Federal Aviation Administration will provide direct controller-to-pilot data-link communications, automatic position reporting and region-to-region flight information communications.

The Unit Training Device is a cost-effective way for the U.S. Air Force to provide continuing combat training. HAC is the second largest training and simulation systems provider in the world.

tion systems technology. HAC won three major contracts that could have combined revenues of $2 billion over their lifetimes. HAC is one of two firms chosen to supply the U.S. Air Force with approximately 37,000 workstations over five years at a total price of more than $950 million, along with $924 million worth of desktop computers. The U.S. Patent and Trademark Office selected HAC to provide up to $171 million worth of computers and peripheral equipment.

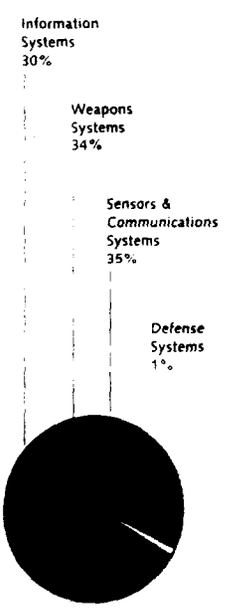
Winning Internationally

International new orders grew to $1.8 billion in 1996, led by several major contracts: $224 million from Norway for AMRAAM missiles, jointly for HAC and Raytheon; $262 million from the U.S. Air Force for operations, maintenance and training for Saudi Arabia's Peace Shield air defense system (which Hughes designed and built); $219 million in TOW missile awards from ten countries; and $126 million from GM's 22-nation European dealership network for training support in 17 languages.

A joint venture of HAC and Raytheon and several European companies has been awarded an $80 million contract related to the initial project definition stage of MEADS, the Medium Extended Air Defense System. MEADS is to be available by 2005 for use by U.S., German and Italian military units.

Merging HAC with Raytheon

Assuming that HAC's strengths are combined with those of Raytheon later this year, the merger of the two companies will create a world leader in defense electronics. In the defense electronics sector alone, the new company would report 1996 pro forma combined revenues of $13 billion and a backlog of $18 billion. Its 127,000 employees and across-the-board excellence in a broad range of programs and technologies will make it a potent competitor to the giant combinations – like Lockheed Martin and Boeing – that have emerged from the defense industry's continuing consolidation.

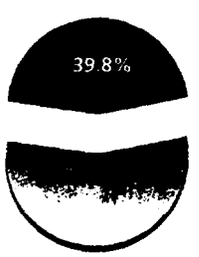


Percentage of 1996 Revenues by Business Unit

The following table sets forth selected pro forma data for the Aerospace and Defense Systems segment.

	Years Ended December 31*		
(Amounts in millions, except percentages)	**1996**	**1995**	**1994**
Revenues	$6,338.4	$5,945.4	$6,023.6
Revenues as a percentage of Hughes Revenues	39.8%	40.2%	42.7%
Net Sales	$6,331.5	$5,899.7	$6,007.3
Operating Profit (1)	694.7	688.0	663.6
Operating Profit Margin (2)	11.0%	11.7%	11.0%
Identifiable Assets at Year-End	$5,296.9	$5,369.7	$4,262.4
Depreciation and Amortization	157.6	132.0	158.5
Capital Expenditures	171.1	109.8	159.5

* The summary excludes purchase accounting adjustments related to GM's acquisition of Hughes Aircraft Company. Certain amounts for 1995 have been reclassified to conform with 1996 classifications.
(1) Net Sales less Total Costs and Expenses other than Interest Expense.
(2) Operating Profit as a percentage of Net Sales.



Percentage of Hughes Revenues

TELECOMMUNIC

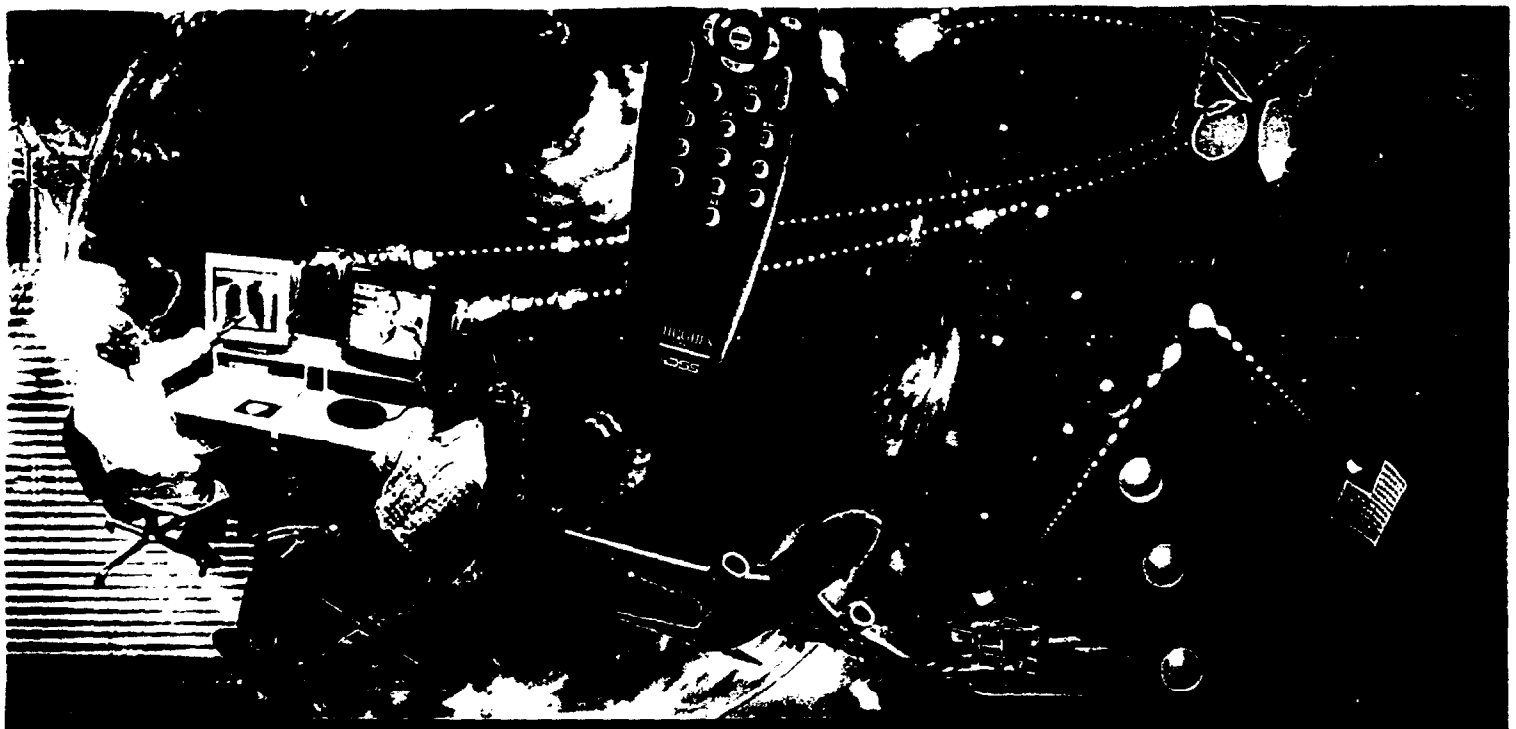
As the world's premier satellite builder and services provider, Hughes' Telecommunications & Space segment is shaping the global vision of telecommunications for the 21st century. It is breaking boundaries between satellite and cable, wireline and cellular, desktop computer and living room TV. The Wireless Expressway™ that Hughes is paving will transport us into an age of universal, mobile and interactive communications.

In today's global village, entertainment, personal communications and critical business information flow seamlessly across borders via a worldwide telecommunications infrastructure. Some 64 Hughes-built satellites help form the space-based portion of this great nexus. To meet tomorrow's challenge of Internet usage that is already growing 300 percent a year, Hughes is starting to manufacture satellites with throughput 150 times faster than conventional telephone lines.

In services, Hughes' market-leading DIRECTV already provides over 175 channels of in-home digital entertainment to more than 2.5 million U.S. subscribers. Hughes also has introduced this service in Latin America, and within a year, DIRECTV is expected to arrive in Japan.

Concurrently, Hughes is introducing mass-market business and consumer services for high-data-rate communications. DirecPC™ now provides instant Internet access and extremely fast download times. In the future, Hughes' proposed next-generation SPACEWAY™ service may enable computer users to exchange data, voice and video simultaneously, at high speed and in real time.

With the convergence of TV and computer technologies, soon, DIRECTV subscribers will be able to receive televised sports, news and enter-



ATIONS & SPACE

tainment on their computer, along with interactive and multimedia services, information, games and even software.

Satellite technology also offers unlimited potential for individuals to communicate on the move. Handheld mobile telephony, with full global roaming capability, should become available at the turn of the century with the launch of the Hughes-built 12-satellite ICO system.

In telecommunications and space, Hughes' strategy is two-fold. First, to maintain its edge in commercial satellite manufacturing, transponder sales and leasing, satellite-based and ground-based telecommunications networks, and direct-to-home television services. And second, to keep moving up the value chain, fully exploiting its satellite leadership with additional innovative, value-added, mass market global telecommunications services.

Hughes' core strengths in satellite manufacturing and operations provide strong competitive advantages as it moves into new high-growth service markets. Advantages include an ability to get to market first, recognized market leadership, superb technology, financial strength, management depth of experience, and vertical integration of Hughes' telecommunications businesses into a true one-stop service.

Last year, Telecommunications & Space segment revenues grew 33 percent to $4.1 billion. Given surging worldwide demand for communications and Hughes' growing strengths in the marketplace, the company expects its vision and strategy to continue yielding strong revenue and earnings growth.

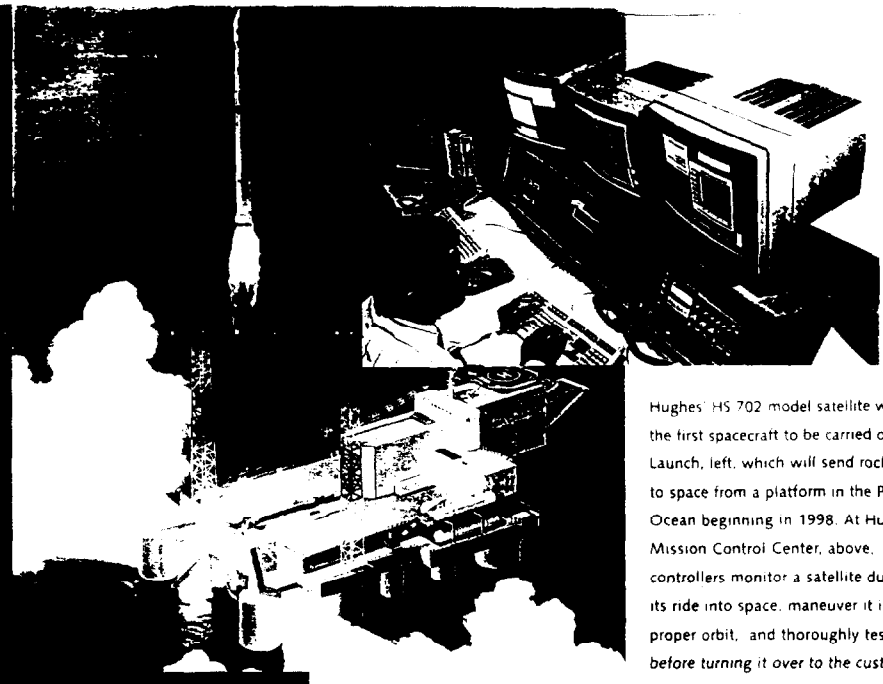
HUGHES SPACE & COMMUNICATIONS

Global demand for communications satellites is booming, and in 1996 Hughes Space & Communications (HSC), which manufactures commercial and government spacecraft, increased its revenues by 21 percent. The company maintained its leadership position by winning 50 percent of all commercial competitions. At the end of the year, HSC had a booked backlog with a value of $4.3 billion. To manage its increasing volume of business, in recent years HSC has streamlined its manufacturing process, and this has significantly increased employee productivity and reduced cycle time.

A key factor in HSC's continuing success is its leading-edge technologies, which have long set the company apart from follow-on competitors. During 1996, HSC completed development of the xenon ion thruster. This new electric propulsion system offers many performance improvements, including longer life and significant cost savings.

HSC's commercial customers can count on average satellite channel availability exceeding 99 percent, an outstanding record of reliability.

HSC's next generation satellite, the HS 702, will offer customers nearly twice the capacity and more than double the power of the most sophisticated satellite now in operation. The first HS 702 spacecraft, which is being built for Hughes Galaxy Communications, is expected to be launched in 1998.



Hughes' HS 702 model satellite will be the first spacecraft to be carried on Sea Launch, left, which will send rockets to space from a platform in the Pacific Ocean beginning in 1998. At Hughes Mission Control Center, above, controllers monitor a satellite during its ride into space, maneuver it into proper orbit, and thoroughly test it before turning it over to the customer.

PAS-5, built for PanAmSat Corporation, will be the first HS 601 HP (i.e., high-powered) model put into operation. It will be carried into space aboard a Proton rocket launched from Kazakhstan, Russia.

Hughes' pioneering technologies have broadened the scope of satellite-based telecommunications. For HSC, the expanding market is bringing greater opportunities – and more competition. The company is meeting this challenge with these main strategies: maintaining its number one position in commercial satellite manufacturing; and increasing both its U.S. government and international customer bases.

Maintaining Leadership in Satellite Manufacturing

Maintaining leadership means being the low-cost manufacturer; delivering spacecraft to meet customers' schedules; producing reliable satellites employing advanced technology; and assuring the availability of launch facilities.

Reducing Costs and Cycle Times. HSC delivered 11 satellites in 1996 and expects to deliver 24 more over the next two years. At year-end, its backlog stood at 37 satellites. To meet strong demand and also to lower costs, HSC has made its manufacturing facility more efficient. Since 1992, it has increased productivity by 47 percent.

These gains have helped HSC reduce cycle time by 30 percent over five years. Basic models of the HS 376 and HS 601 spacecraft now can be delivered in two years or less. In 1996, to meet customers' tight schedules, HSC deliv-

ered two HS 376 satellites within 14 months of being ordered.

Reliability Record/Technology Development. By early 1997, HSC had reached a new milestone: of the 120 commercial communications spacecraft it has launched in the past 32 years, 64 are still in service – and these have accrued 850 years in operation. Its nearest competitors' fleets each have accumulated only about a third as many years. In addition, more than 80 percent of the satellites have exceeded mission life by at least 10 percent.

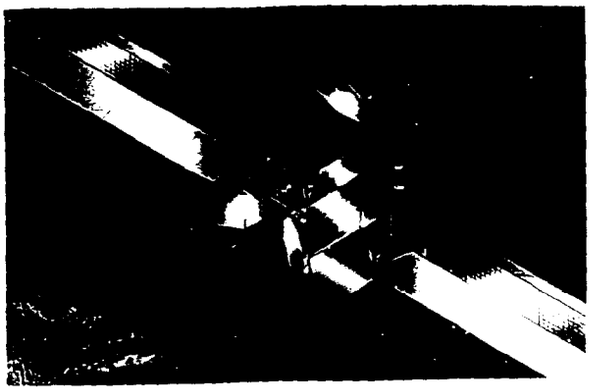
Hughes also is a spacecraft technology leader. Its continuing investment in technology development is dramatically improving the capabilities of satellite-based communications systems. For example, advanced solar technology, including new gallium arsenide solar cells developed by a Hughes subsidiary, will enable HSC's next-generation HS 702 satellite to have double the power of existing satellites. Another key Hughes technology is a digital processor that will operate as a "switchboard in the sky" for the wireless communications of future satellite-based systems.

Global Launch Commitments. To increase competitiveness, HSC must be able to offer customers launch options. HSC has been at the forefront in negotiating advance bookings for multiple launches. These commitments have helped increase competition in the launch industry, which is expected to result in more availability, greater reliability, lower costs, and the capability to launch larger satellites.

By early 1997, HSC had secured more than 40 future launch vehicles to be provided by companies in the United States, Japan, Kazakhstan and elsewhere.

Increasing U.S. Government and International Business

HSC has built numerous satellites for the Department of Defense and other agencies of the U.S. government. These customers represent about 50 percent of the company's business.



The HS 702 satellite model will provide more than double the power and nearly twice the capacity of existing body-stabilized satellites. Its on-board processing capability will allow the satellite to help reconfigure its own power, bandwidth and broadcast patterns to meet customers' expanding needs.

Seven ultra high-frequency (UHF) communications satellites have been built for the U.S. Navy, and three more are under construction, each incorporating a global broadcasting payload derived from Hughes' DIRECTV technology. And three satellites being built for the National Aeronautics and Space Administration will enable it to communicate with the space shuttle and other spacecraft in low-earth orbit.

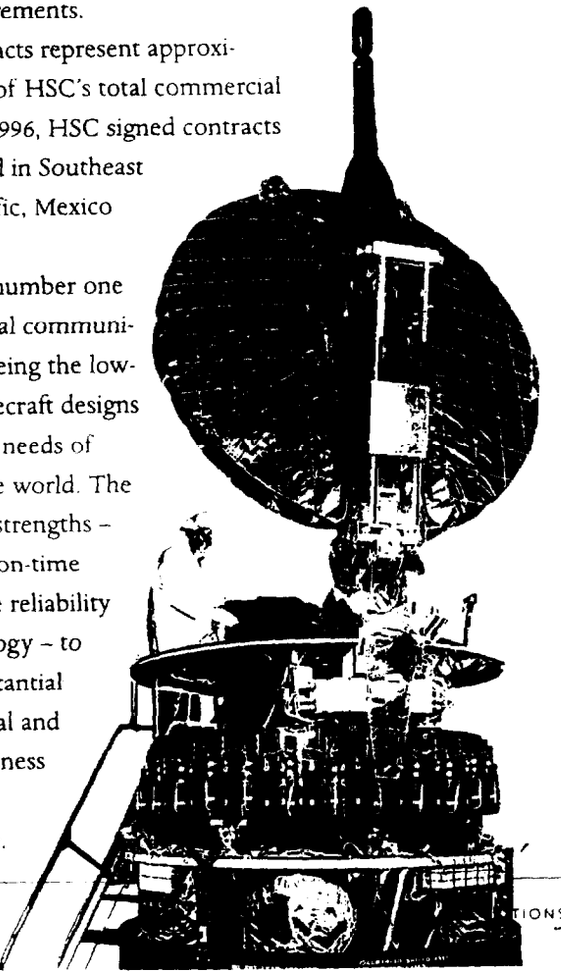
In 1996, HSC established a new unit, Hughes Government Services, that will help government customers acquire satellite services from various operators of commercial systems. Its goal will be to tailor end-to-end communications solutions matching each government customer's unique requirements.

International contracts represent approximately three-fourths of HSC's total commercial satellite business. In 1996, HSC signed contracts with companies based in Southeast Asia, Japan, Asia-Pacific, Mexico and Europe.

HSC maintains its number one position in commercial communications satellites by being the low-cost provider of spacecraft designs that meet the diverse needs of customers around the world. The company is using its strengths – efficient production, on-time delivery, performance reliability and superior technology – to continue to win substantial shares of international and U.S. government business in a competitive but growing marketplace.

HUGHES
SPACE & COMMUNICATIONS

Shown during construction is APSTAR 1A, an HS 376 spinning spacecraft model that was launched in mid-1996 and is now providing general communications services in Asia.



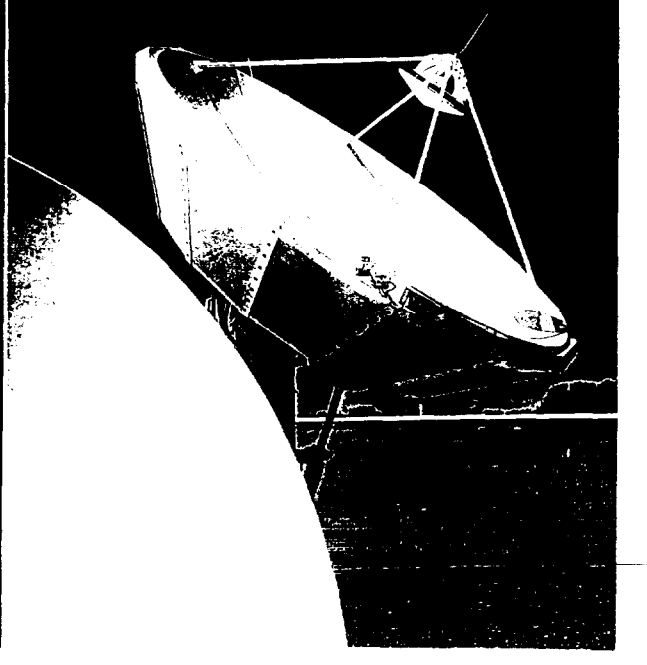
HUGHES NETWORK SYSTEMS

From the world's most prosperous countries to the world's developing countries, wireless communications systems are in great demand. Hughes Network Systems (HNS), a leading provider of satellite-based private business networks – or, very small aperature terminals (VSATs) – and terrestrial-based wireless communications equipment, increased its revenues by 18 percent in 1996. The company has a more than 60 percent share of the global VSAT market. Revenues from terrestrial-based wireless systems sales, the fastest growing segment of HNS' business, were up 25 percent, with the increase fueled by growth in fixed wireless systems for emerging countries.

HNS is working to increase its revenues from higher-growth-potential service businesses. One source of such service revenues is DirecPC, with its Turbo Internet™ offering – a fast-speed Internet communications service that the company has begun marketing worldwide. In addition, HNS is pursuing licenses to offer basic telephone services in two large regions of India.

Another growth opportunity will be supplying personal communications service (PCS) equipment. HNS has entered into strategic relationships with two companies that won PCS licenses for major U.S. markets – and will be providing equipment with a potential value of more than $1 billion.

For more than 25 years, HNS has been the world leader in satellite-based, digital networking. Antennas like these at a VSAT hub station are a key part of every HNS network.



DirecPC, HNS' satellite-based, fast-delivery information service, can transfer files simultaneously to multiple sites and download large software or video files in seconds to desk-top computers.

HNS is achieving double-digit annual revenue growth by providing innovative telecommunications products, systems and services in 60 countries. HNS' strategies are to increase revenues from services; build sales in core markets; and expand its market-driven technology portfolio.

Increasing Revenues from Services

HNS is pursuing its strategy of increasing revenues from services by building on its manufacturing strengths. DirecPC is one such service. DirecPC is a satellite-based, high-data-rate communications service that rapidly delivers software, multimedia communications, video and large documents from the Internet to personal computers. HNS is marketing the DirecPC service, and the equipment it manufactures, in North America, Europe and Asia. In the United States, CompUSA's retail stores began offering the DirecPC equipment to consumers nationwide in early 1997.

A new telecommunications venture in India is another potential source of service revenues. HNS and its local partners are pursuing government licenses to provide telephone service in the states of Maharashtra and Karnataka, with a combined 130 million households. Each state's telephone market size is comparable to that of a Regional Bell Operating Company in the United States.

Strengthening Leadership in Core Markets

HNS pioneered the development of satellite-based VSAT networks, and the company has maintained its worldwide leadership position. In the United States, the company solidified its market share in 1996 with installations of new or expanded VSAT business networks for Ford Motor Company, Mobil Oil and other large companies.

Internationally, HNS installed VSAT business networks that can simultaneously handle data, voice, fax and video services for customers in 49 countries during the year. In addition, the company installed 45 VSAT voice service networks in 17 emerging market countries. Among these was a VSAT system that established China's first nationwide paging network.

Wireless Equipment Market. HNS is a strong competitor in emerging markets because, unlike wireline equipment providers, it can provide a fixed wireless telephone system within months of signing a contract, and at a very competitive cost. In 1996, the company installed systems in Indonesia, the Czech Republic, Malawi, Vietnam and Brazil.

Mobile Cellular Market. Mobile communications is another prime market for HNS. An emerging high-potential segment in this market is PCS. Because of HNS' two large equipment supply agreements with NextWave Telecom, Inc. and Indus, Inc., the company is well positioned for future growth in PCS, which transmits an improved quality of voice communications as well as data to hand-held phones.

In May 1996, HNS completed its installation of a new generation cellular infrastructure for BellSouth's cellular system, which serves more than one million subscribers, using HNS technology that can operate in either analog or digital mode. The company has a valuable ongoing supplier relationship with BellSouth.

In countries around the world HNS' wireless systems provide basic telephone service. These systems are affordable alternatives to wireline systems which may be unavailable, overburdened or outmoded in emerging markets. In the home a Single Subscriber Unit mounts on a wall or window.

Expanding the Technology Portfolio

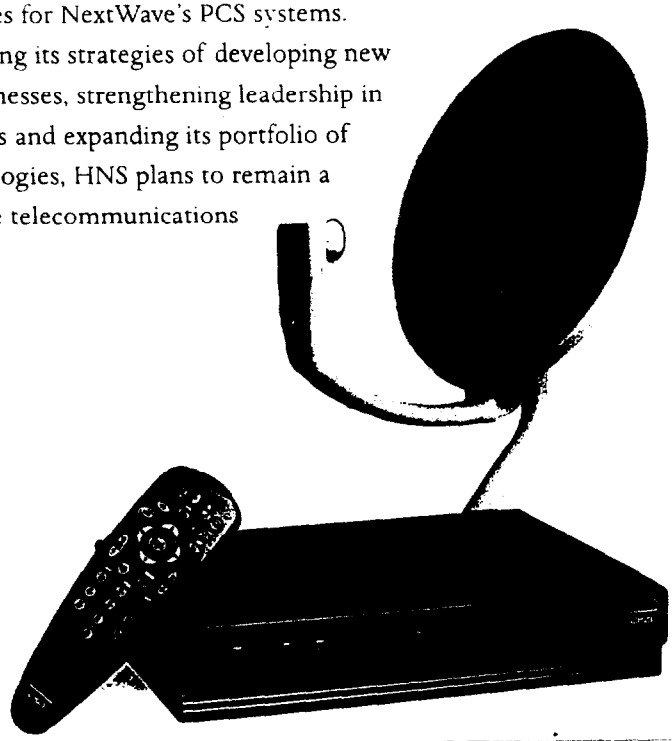
HNS makes development of new market-driven technologies a top priority. For example, the company's IS-136 TDMA (time division multiple access) digital transmission voice technology offers superior quality, and also allows cellular and PCS operators to provide identical features and seamless roaming between systems. HNS was first to introduce the technology and will supply it to Indus for its new PCS service.

However, because customers are demanding a complete spectrum of PCS technologies from suppliers, HNS is also licensing technology from other companies in order to rapidly expand its product portfolio. For example, HNS will use CDMA (code division multiple access) digital technology in the products it manufactures for NextWave's PCS systems.

By following its strategies of developing new service businesses, strengthening leadership in core markets and expanding its portfolio of new technologies, HNS plans to remain a leader in the telecommunications industry.

HUGHES
NETWORK SYSTEMS

HNS' own brand of DSS made its U.S. debut in 1996, and by year-end, the company had already shipped 170,000 units. The HNS system, including an 18-inch satellite dish, set-top receiving unit and remote control, receives programming from DIRECTV.



HUGHES GALAXY

Operating satellites is a fast-growing, high-margin business for Hughes Galaxy Communications. In 1996, it increased revenues by 20 percent and achieved an operating margin of more than 50 percent. Hughes Galaxy is the leading U.S. provider of satellite distribution services and enjoys a 44 percent share of the market. It leases transponders and sells services to dozens of major cable television systems, news and entertainment companies and private business networks.

Hughes Galaxy pioneered some of the industry's most innovative marketing programs: sales and leasing on a non-common carrier basis; pre-launch sales commitments; creation of cable, broadcast and other "neighborhoods" to attract customers with similar needs; and sales and leasing of backup transponder capacity.

Hughes Galaxy owns and operates 10 satellites with 283 transponders. The fleet's entire capacity was essentially sold out last year. But the company still expects continued robust growth in the future following completion of its merger with PanAmSat Corporation in mid-1997 and the launch of seven new satellites together this year and next. By the end of 1998, the new company's combined fleet is expected to offer customers 731 transponders aboard 21 satellites spanning the globe.

PanAmSat currently has four commercial satellites in orbit, and four more on order that will boost capacity in each global region.

Hughes Galaxy's strategy to build revenues and maintain its strong margins is fourfold: completing the PanAmSat merger; maintaining U.S. leadership; achieving growth in international markets; and offering customers valuable new satellite distribution services and applications.

Completing the PanAmSat Merger

In September 1996, Hughes announced an agreement to merge Galaxy with PanAmSat Corporation and form a new publicly traded company. PanAmSat's 1996 revenues were $247 million, more than double the previous year. It operates four satellites with 128 transponders and serves all of the world's seven continents.

When the merger is completed, Hughes will own 71.5% of the new company. The combined firms will operate as PanAmSat Corporation, and will own the world's largest, most cost-efficient private sector commercial satellite constellation. The company immediately will have 14 satellites in operation over the Atlantic, Pacific and Indian ocean regions, offering customers one-stop-shopping for global satellite communications services.

Maintaining U.S. Leadership

Expand Domestic Fleet. In 1996, two new satellites were added to the Galaxy® fleet, and an additional three are scheduled to be launched by 1998. These current and future satellites are targeted for support of Hughes' direct-to-home (DTH) service to Latin America and cable, news and business distribution services in the United States.

Customer Service. Last summer, Hughes Galaxy began using a state-of-the-art operations center in Long Beach, California. It enables operators to cut in half the time required to connect customers to Galaxy's satel-

lites. The new center also facilitates round-the-clock customer support, and its design will accommodate future growth.

Marketing Innovations. The company has pioneered the creation of satellite neighborhoods, a powerful concept that adds to its competitive advantage. For example, selected Galaxy satellites are cable television neighborhoods. Each one concentrates a broad range of cable programming on one satellite, thus appealing to many cable TV operators and, in turn, attracting business from additional cable customers who desire wide distribution of their programs. Hughes Galaxy also is extending the concept of neighborhoods to TV broadcasting, financial services and other customer categories.

Building International Sales

Even before the PanAmSat merger was announced, Hughes Galaxy was pursuing international growth. This effort was initiated with the 1996 launch of Galaxy 3R, whose services include the Latin American DTH market. By the year 2000, Hughes expects to launch an additional three satellites, which will provide video, audio and data distribution services in international markets.

However, Hughes Galaxy's efforts to build global sales will be greatly accelerated once the merger with PanAmSat is completed. PanAmSat brings an established international infrastructure, market access, additional orbital slots, an excellent reputation around the world, and a fleet covering 98 percent of the world's population.

Offering New Customer Services

The combined company's substantial number of orbital slots, including many in the new Ka-band frequency, will allow it to expand the wealth of communications services now available to customers. These include real-time global computer networking, tele-imaging, distance learning, digital libraries, desktop videoconferencing and telecommuting, and high-speed downloading from the Internet.

The coming generation of ever-more powerful satellites, like the HS 702, will enable the new PanAmSat to maximize spectrum use and increase applications, thus further boosting growth to businesses of all sizes, and even to individuals.

By delivering on its strategies to complete the PanAmSat merger, maintain U.S. leadership, build international sales, and continue serving customers with high-value applications, Hughes Galaxy expects to continue to achieve strong growth and profitability in the satellite transmission service business.

HUGHES
COMMUNICATIONS
GALAXY

The 10 satellites in Galaxy's fleet make it the leading provider of cable and broadcast television distribution in the U.S. market. Three large new satellites are on order.

At the Galaxy Network Operations facility in Long Beach, California, operators provide customers with easy, fast access to Hughes' satellite fleet.

DIRECTV

BEST BUY | CIRCUIT CITY | SEARS | RadioShack

DIRECTV, the first high-powered satellite-based DTH broadcast service in the United States, nearly doubled its subscriber base and achieved a 155 percent increase in revenues in 1996.

High quality – in customer service, programming selection and technology – is the DIRECTV hallmark. This is why the service has already garnered a more than 50 percent share of the DTH market in the United States. Also spurring subscriber growth is a strong distribution network of more than 26,000 outlets comprising the nation's leading consumer electronics retailers.

In Latin America, DIRECTV anticipates strong demand, in part because an international partnership of prestigious communications companies is guiding the service's entry into the 22-country region, a complex task due to the wide variety of cultures. Another strong international partnership is working to assure that the DIRECTV debut in Japan is successful by carefully planning its marketing and distribution efforts, as well as by creating a programming line-up that is differentiated and will meet the tastes of the Japanese consumer.

DIRECTV delivers theater-quality video, CD-quality audio, more than 175 channels of excellent programming plus top-notch customer service.

Westin Hotels and Resorts is one of several major corporate hotel chains to offer DIRECTV programming as a free-to-guest, in-room service

DIRECTV is very popular with subscribers on two continents already and is about to debut on a third. Hughes is positioning DIRECTV to become the worldwide leader in the burgeoning satellite DTH business.

In the United States and Latin America, Hughes is marketing DIRECTV aggressively to build its subscriber base and is continuously increasing subscriber value with superior programming choices and unparalleled customer service. In Japan, the company is planning to use these strengths to grow quickly.

United States

DIRECTV leads the U.S. market, and by early 1997, the company was delivering over 175 video and audio channels to more than 2.5 million subscribers – a total that grows every day. To build its customer base, DIRECTV is delivering the programming customers demand, expanding its

A&E | CNBC | TNT | Discovery CHANNEL | THE HISTORY

marketing and distribution, and planning exciting new data services.

Programming Choices. American consumers demand many types of programming and excellent value at the same time. DIRECTV is delivering both. While offering viewers more sports and pay-per-view selections than competitors, DIRECTV continues to expand its programming line-up.

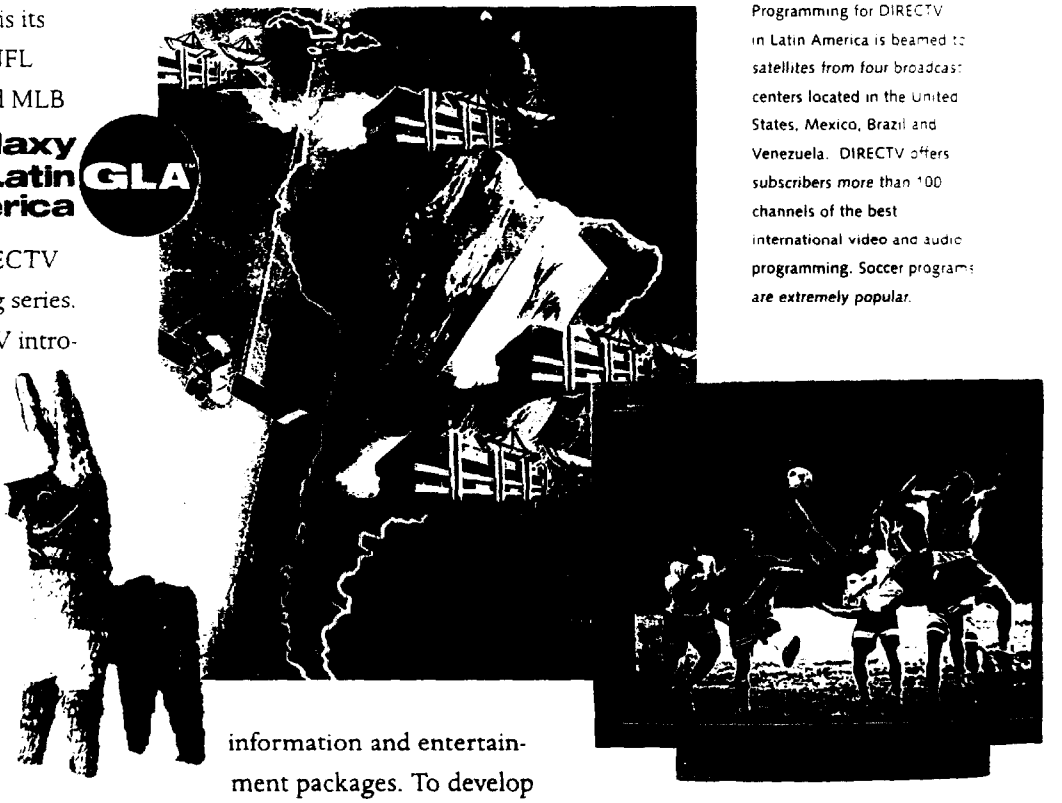
For example, in early 1997, DIRECTV added 14 new channels, including Trinity Broadcasting Network and Superstation WGN – the two channels most requested by its customers. Another differentiator for DIRECTV customers is its sports programming, which includes: NFL Sunday Ticket™, NBA League Pass℠ and MLB Extra Innings℠. In addition, DIRECTV is developing its own original programming, beginning with sports packages such as DIRECTV Ringside™, an exclusive monthly boxing series.

Marketing. In August 1996, DIRECTV introduced a $200 cash-back offer to new customers who purchased any brand of DSS equipment and a one-year subscription to a Total Choice™ programming package. This campaign made DSS equipment even more affordable and further stimulated sales.

Broader Distribution. DIRECTV has developed an unmatched network of licensed consumer electronics retailers who offer the DSS equipment. In addition, consumer electronics manufacturers including Hughes Network Systems market 11 DSS brands, such as RCA, Sony, Toshiba, Hitachi and Panasonic.

While single-family homeowners are the primary market for DIRECTV, the company is steadily developing other markets. In the multiple-dwelling-unit market, DIRECTV has already signed agreements with 65 system operators, including a provider of cable television services that has 50,000 units in the New York City metropolitan area. In the hotel market, the distribution of DIRECTV is also growing, in part through an agreement with On Command Video Corporation. By the end of 1996, DIRECTV was available in more than 100,000 hotel and resort guest rooms.

In the restaurant, bar and nightclub market, DIRECTV had signed nearly 9,000 establishments by year-end 1996. And, to stimulate sales in the office market, DIRECTV offers three information and entertainment packages. To develop the airline market, DIRECTV teamed with Hughes-Avicom International, Inc. to demonstrate live DIRECTV broadcasts on selected Delta Airlines flights.



Programming for DIRECTV in Latin America is beamed to satellites from four broadcast centers located in the United States, Mexico, Brazil and Venezuela. DIRECTV offers subscribers more than 100 channels of the best international video and audio programming. Soccer programs are extremely popular.

New Services. In 1996, DIRECTV announced an agreement with Microsoft Corporation for a new PC-based home entertainment service that will use the Microsoft Windows operating sys-

tem. Subscribers will be able to access not only all of the DIRECTV video programming but also interactive multimedia and data broadcast services. These include: selected World Wide Web sites; new multimedia magazines; financial, news, weather and sports tickers; data enhanced television programming; and games. DIRECTV is targeting the 1997 holiday shopping season for an introduction of these innovative services.

In 1996, DIRECTV not only succeeded in nearly doubling its U.S. subscriber base but also continued to receive an extraordinarily high 95 percent programming satisfaction rating from subscribers.

Latin America and the Caribbean

In mid-1996, DIRECTV became the first DTH service in Latin America and the Caribbean – a 22-nation region that has 90 million television households. Galaxy Latin America (GLA) is a partnership of Hughes and leading communications companies based in Venezuela, Brazil and Mexico. By early 1997, GLA was providing DIRECTV to eight Latin American nations representing more than 70 percent of the potential market. GLA offers approximately 70 video channels and 30 audio channels of international programming in Portugese, Spanish and English.

With the launch of GLA's next, more powerful satellite in the fall of 1997, programming is expected to expand to more than 100 video channels, plus at least 40 channels of highly popular pay-per-view movies and sports.

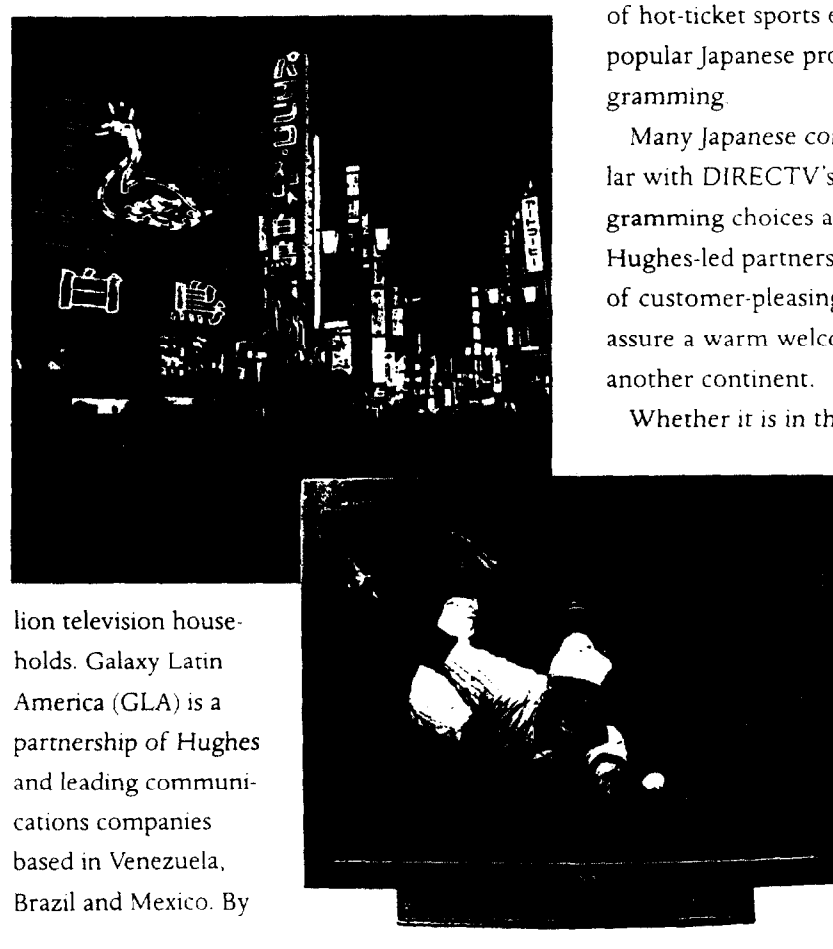
Japan

Within a year, a partnership of Hughes and leading Japanese companies is expected to make DIRECTV available to Japan's 44 million television homes, a market that has few viewing choices and is ripe for high-quality video and audio offerings as well as data offerings. DIRECTV Japan will offer up to 100 channels of hot-ticket sports events, blockbuster movies, popular Japanese programming, and audio programming.

Many Japanese consumers are already familiar with DIRECTV's reputation for broad programming choices and excellent value, and the Hughes-led partnership is developing an array of customer-pleasing programs that should assure a warm welcome for DIRECTV on yet another continent.

Whether it is in the United States, Latin America or Japan, DIRECTV intends to aggressively grow its subscriber base and continuously increase subscriber value with outstanding programming choices and unrivaled customer service.

DIRECTV. JAPAN



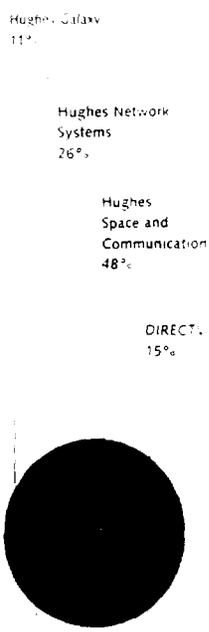
In Japan, DIRECTV is preparing a very competitive programming line-up. On the roster are sports – especially baseball – and movies.

TELECOMMUNICATIONS & SPACE: LOOKING AHEAD

Hughes' leadership in growing new businesses like DIRECTV and DirecPC lends confidence to the company's pursuit of future satellite-based global business opportunities. One example is its proposed SPACEWAY system, which may offer customers an array of multimedia services beginning at the turn of the century. The state-of-the-art HS 702 satellites that Hughes would use will incorporate technologies such as onboard digital processing, flexible antenna coverage and intersatellite links to provide excellent customer service and value.

Assuming that the transactions announced in January 1997 are completed (see page 28 for further details), the company's telecommunications and space businesses will derive a double benefit. First, a sharpened management focus on this high-potential area; and second, substantial additional financial resources to fund growth opportunities.

In future years, Hughes expects to achieve rapid growth by building upon its leadership in satellites and digital wireless systems. It also will seek growth in new telecommunications services and continue moving toward realizing its vision of a global Wireless Expressway that will bring people everywhere closer together through universal, mobile and fully interactive communications.



Percentage of 1996 Revenues by Business Unit

The following table sets forth selected pro forma data for the Telecommunications and Space segment.

	Years Ended December 31*		
(Amounts in millions, except percentages)	**1996**	**1995**	**1994**
Revenues	$4,114.9	$3,092.7	$2,596.2
Revenues as a percentage of Hughes Revenues	25.9%	20.9%	18.4%
Net Sales	$3,992.2	$3,075.8	$2,633.8
Operating Profit (1)	259.8	189.2	271.0
Operating Profit Margin (2)	6.5%	6.2%	10.3%
Identifiable Assets at Year-End	$4,406.7	$3,820.0	$3,217.8
Depreciation and Amortization	194.8	178.3	140.8
Capital Expenditures (3)	449.8	436.5	399.3

* The summary excludes purchase accounting adjustments related to GM's acquisition of Hughes Aircraft Company. Certain amounts for 1995 have been reclassified to conform with 1996 classifications.
(1) Net Sales less Total Costs and Expenses other than Interest Expense.
(2) Operating Profit as a percentage of Net Sales.
(3) Includes expenditures related to telecommunications and other equipment amounting to $187.9 million, $274.6 million and $255.8 million, respectively.

Percentage of Hughes Revenues

RESEARCH & DEVELOPMENT

In 1996, Hughes Research Laboratories (HRL) focused on creating more robust space-based systems for telecommunications and defense. To meet both commercial and government demand for a highly advanced – yet cost-efficient – global space-based communications architecture, HRL devoted significant attention to four critical areas: (1) ion propulsion; (2) microelectronics; (3) Internet access via satellite; and (4) micromechanical sensors.

Until now, commercial satellites have been thrust into space using liquid-fueled engines that add considerable mass. By developing an electronic xenon ion propulsion system (XIPS), HRL has reduced a satellite's propellant requirements to one-tenth of current mass.

The first XIPS-propelled commercial satellite will be the Hughes-built PAS-5, scheduled for launch in 1997.

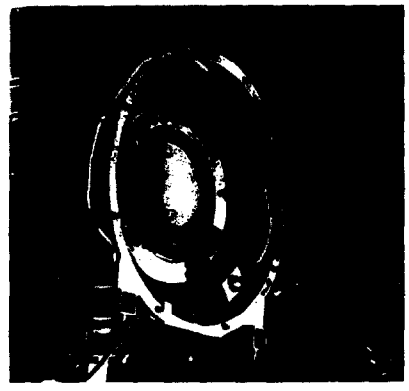
One way to improve the cost-efficiency of the overall satellite system is to reduce the size and cost of the ground equipment that receives the satellite signal. HRL's microelectronics group is developing advanced receivers that combine on a single chip both analog-to-digital converters and low-noise amplifiers.

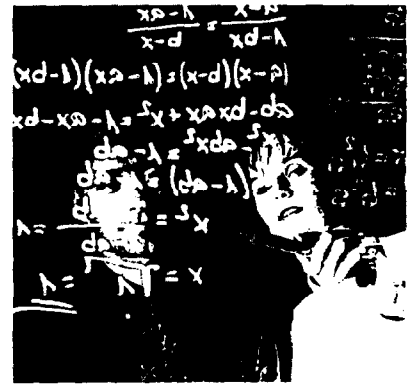
In addition to enhancing transmission quality, digital technology reduces the weight and power consumption of both satellites and ground terminals. Low-noise amplifiers, in turn, increase antenna sensitivity, enabling use of a smaller, less-expensive ground terminal – like the 18-inch DIRECTV dish or a handheld mobile phone.

More powerful and efficient satellites, along with low-cost, high-performance user terminals, are two necessities for universal Internet access. A third is open standards. HRL is working to establish new algorithms that will enable true global interconnectivity.

Concurrently, HRL is designing a flow congestion control algorithm for unimpeded interactive multimedia exchange by satellite. This will facilitate new, real-time global video, voice, and data collaborations in business, education, and medicine.

In the area of space-based defense communications, speed is the single-most crucial requirement for detecting incoming threats and improving reaction times. Motion-detecting sensors called micromechanical accelerometers help satellites detect such threats. In 1996, HRL conducted pioneering research in "tunneling-effect" fabrication technology – yielding a superior micromechanical accelerometer.





The blue glow comes from ions accelerated from the discharge chamber of the Xenon Ion Propulsion System, a thruster that will keep Hughes-built satellites in their proper orbital locations. At HRL, where the system was created, the qualification thruster is undergoing life tests.

Just as human brainwaves leap across synapses to speed communication, the HRL-patented tunneling device allows current to flow between two unconnected pieces of metal. Satellites stabilized by radiation-hardened, tunneling-effect accelerometers can more quickly detect the launch, position, and velocity of incoming missiles or torpedoes.

Assuming that the transactions announced in January 1997 are completed (see page 28 for further details), HRL will be jointly owned by Hughes Electronics and Raytheon Company.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion excludes purchase accounting adjustments related to General Motors' acquisition of Hughes Aircraft Company (see Supplemental Data beginning on page 47).

Statements made concerning expected financial performance, ongoing financial performance strategies, and possible future action which Hughes intends to pursue to achieve strategic objectives for each of its three principal business segments (including the planned transactions described below) constitute forward-looking information. The implementation of these strategies and of such future actions and the achievement of such financial performance are each subject to numerous conditions, uncertainties and risk factors, and, accordingly, no assurance can be given that Hughes will be able to successfully accomplish its strategic objectives or achieve such financial performance. The principal important risk factors which could cause actual performance and future actions to differ materially from the forward-looking statements made herein include economic conditions, product demand and market acceptance, government action, competition, ability to achieve cost reductions, GM's global sourcing strategy with respect to automotive electronics, General Motors' North American Operations (GM-NAO) volumes, technological risk, interruptions to production attributable to causes outside Hughes' control, and the receipt of various approvals with respect to the planned transactions.

GENERAL

On January 16, 1997, GM and Hughes announced a series of planned transactions designed to address strategic challenges and unlock stockholder value in the three Hughes business segments. The transactions would include the tax-free spin-off of the Hughes defense business to holders of GM's $1-⅔ par value and Class H common stocks, followed immediately by the tax-free merger of that business with Raytheon Company (Raytheon). The spin-off is not being proposed in a manner that would result in the recapitalization of Class H common stock into $1-⅔ par value common stock at a 120% exchange ratio, as currently provided for under certain circumstances in the General Motors Restated Certificate of Incorporation, as amended. At the same time, Delco Electronics, the automotive electronics subsidiary of Hughes, would be transferred from Hughes to GM's Delphi Automotive Systems unit. Finally, GM's Class H common stock would be recapitalized into a tracking stock linked to the telecommunications and space business of Hughes. After the spin-off and tax-free merger of the Hughes defense business with Raytheon, there would be outstanding two classes of Raytheon/Hughes defense common stock: Class A common stock, approximately 103 million shares of which would have been distributed to GM's $1-⅔ par value and Class H stockholders in the spin-off, and Class B common stock which would be exchanged for Raytheon common stock on a one-for-one share basis in the merger. The common stock of the Hughes defense business that would be distributed to GM common stockholders would represent approximately 30% of the stock of the combined company. The distribution of stock in the Hughes defense business to holders of GM Class H and $1-⅔ par value common stock would be in a ratio that would be determined by GM's Board of Directors to be fair to both classes of stockholders and would reflect: (1) a pro rata spin-off of the Hughes defense business to holders of GM Class H and $1-⅔ par value common stock; (2) a partial reallocation of the Hughes defense business from holders of GM $1-⅔ par value common stock to holders of Class H common stock in exchange for the derivative interest in the earnings of Delco currently held by the Class H stockholders; and (3) other effects of and factors relating to the planned transactions. Such a distribution ratio will be set by

GM's Board of Directors at a time closer to GM's distribution of the solicitation statement/prospectus pursuant to which GM stockholders will be asked to approve the transactions.

The spin-off of the Hughes defense business and merger with Raytheon would have an indicated total value of $9.5 billion to GM and its common stockholders based on stock prices as of the announcement date. That value would consist of a combination of approximately $4.7 billion of total debt obligations of the Hughes defense business at the time of the merger, and $4.8 billion of indicated value of Hughes defense stock to be distributed to common stockholders (after giving affect to the merger based on the market price of Raytheon common stock as of the announcement date of $47.00). The merger terms provide that the total debt of the Hughes defense business will be adjusted to reflect variations in the average market price of Raytheon stock, subject to specified limits, so that the two components of value will total $9.5 billion so long as such market price is in a range of between $44.42 and $54.29 per share. Substantially all of such debt would be incurred immediately prior to the spin-off, with the proceeds used principally to fund the telecommunications and space business of Hughes.

Consummation of the transactions described previously is subject to various contingencies, including regulatory clearances and approval by GM common stockholders. Additional information regarding these planned transactions is included in Note 18 to the Consolidated Financial Statements. These planned transactions had no impact on 1996 financial results.

The planned transactions described previously are intended to result in the achievement of several strategic objectives. The merger of the Hughes defense business with Raytheon would create a stronger defense electronics company which would be able to more effectively compete for new business in an industry where significant consolidation is occurring. At the same time, the integration of Delco Electronics and Delphi Automotive Systems would combine advanced electronics capability with components and systems expertise, and would be expected to result in reduced costs. Hughes Electronics would continue to hold and operate the telecommunications and space business. This would allow Hughes management to focus on this business segment and the capital infusion would allow it to take advantage of growth opportunities in this very competitive industry. The strategy of this business is to continue to expand its offerings from being primarily a supplier of hardware to becoming a provider of hardware and video, voice, and data services worldwide. This strategy requires significant current and future investment in order to maintain and enhance the segment's competitive position with respect to existing products and to take advantage of the growth opportunities presented, as well as the formation of strategic alliances to compete in the very competitive global marketplace.

RESULTS OF OPERATIONS

Revenues. Hughes reported record revenues of $15,917.9 million in 1996, a 7.5% increase over 1995. Revenues in 1995 were $14,807.9 million, an increase of 5.0% compared with 1994 revenues of $14,099.4 million. The increase in 1996 revenues was largely the result of continued growth in the Telecommunications and Space segment and increased revenues in the Aerospace and Defense Systems segment, partially offset by lower Automotive Electronics revenues caused in part by work stoppages at various GM production locations during the year. 1995 revenue growth was driven by the Automotive Electronics and Telecommunications and Space segments. (Pro forma segment information is presented on page 39).

TELECOMMUNICATIONS AND SPACE - Revenues in the Telecommunications and Space segment were $4,114.9 million in 1996, a 33.1% increase over 1995, and $3,092.7 million in 1995, a 19.1% increase over 1994 revenues of $2,596.2 million. The increases in both years were primarily due to continued expansion of the DIRECTV® subscriber base, increased sales of commercial satellites and cellular communications equipment, and increased video distribution revenues from Galaxy® satellite transponders.

AUTOMOTIVE ELECTRONICS - Revenues in the Automotive Electronics segment decreased 3.8% in 1996 to $5,350.8 million from $5,561.3 million in 1995. The decline was principally due to a decrease in GM vehicles produced in the United States and Canada (excluding joint ventures) primarily related to the United and Canadian Auto Workers' (UAW and CAW, respectively) strikes offset, in part, by an increase in Hughes-supplied electronic content in these vehicles from $888 per vehicle to $906 per vehicle and an increase in international and non-GM-NAO sales from $841 million in 1995 to $1,010 million in 1996. Revenues increased $339.6 million, or 6.5%, in 1995 from $5,221.7 million in 1994. 1995 revenue growth was attributed to an increase in Hughes-supplied electronic content in GM vehicles produced in North America to $888 in 1995 from $857 in 1994, and an increase in sales to international and non-GM-NAO customers to $841 million in 1995 from $672 million in 1994. Vehicle production remained relatively unchanged between 1994 and 1995.

AEROSPACE AND DEFENSE SYSTEMS - Aerospace and Defense Systems segment revenues were $6,338.4 million in 1996, a 6.6% increase from 1995 revenues of $5,945.4 million. The growth was primarily attributable to additional revenues resulting from the December 1995 acquisition of Hughes Defense Communications (formerly Magnavox Electronic Systems Company) and the build-up of newer programs including Desktop V, Wide Area Augmentation System and Land Warrior. 1995 revenues decreased $78.2 million, or 1.3%, from 1994 revenues of $6,023.6 million. The decline was principally due to lower production rates on several missile programs, partially offset by the additional revenues related to the 1995 acquisition of CAE-Link Corporation.

OTHER INCOME - Included in revenues is other income of $173.8 million, $93.6 million, and $37.1 million for 1996, 1995, and 1994, respectively. 1996 includes the $120.3 million pre-tax gain from the sale of a 2.5% equity interest in DIRECTV to AT&T. 1995 and 1994 included pre-tax charges of $40.0 million and $35.0 million, respectively, for the estimated losses on disposition of certain non-strategic business units. Also included in 1995 was $35.9 million of revenue earned for providing services to GM.

Operating Profit. Operating profit was $1,594.3 million in 1996, $1,667.3 million in 1995, and $1,630.4 million in 1994. Operating profit margins, as a percentage of net sales, were 10.1%, 11.3%, and 11.6%, in 1996, 1995, and 1994, respectively. The decline in profitability in 1996 compared to 1995 was primarily attributable to the lower GM production volumes related to the UAW and CAW strikes and continued price reductions in the Automotive Electronics segment offset in part, by the increased profitability in the Telecommunications and Space segment. Also offsetting the 1996 decline in profitability were the reduced operating losses at Hughes-Avicom International, Inc. Operating profit improved in 1995 largely due to a continued emphasis on cost reduction efforts, most notably in the Automotive Electronics and Aerospace and Defense Systems seg-

ments and the overall growth in revenues, partially offset by a planned increase in operating expenses associated with DIRECTV. The 1995 operating profit margin decline was attributable primarily to the DIRECTV operating expense increase which more than offset the margin improvements in the two other segments.

TELECOMMUNICATIONS AND SPACE - Operating profit for 1996 was $259.8 million, a 37.3% increase from $189.2 million reported in 1995. The 1996 increase was largely a result of the revenue increases previously discussed and reduced mobile telephony satellite development costs offset, in part, by operating losses related to the start of service by the Company's DIRECTV business in Latin America. Operating profit in 1995 decreased 30.2% from 1994 operating profit of $271.0 million. The 1995 decline in operating profit was principally due to increased operating expenses associated with the expansion of DIRECTV and increased development costs on a geostationary satellite mobile telephony product line. Operating profit margins were 6.5% in 1996, 6.2% in 1995, and 10.3% in 1994. After 1996, operating profit margins in the Telecommunications and Space segment are expected to increase as DIRECTV's subscriber base grows.

AUTOMOTIVE ELECTRONICS - In 1996, operating profit was $654.0 million compared with $869.0 million in 1995. The decline was mostly due to the reduced production volumes, continued price reductions resulting from competitive pricing in connection with GM's global sourcing initiative, and the impact from continued investment in international expansion. 1995 operating profit increased $74.2 million, or 9.3%, as compared to 1994 operating profit of $794.8 million. The improvement in profitability in 1995 was attributable not only to increased revenues, but also an aggressive cost reduction program.

As the principal supplier of automotive electronics to General Motors' North American Operations unit (GM-NAO), Hughes' sales of automotive electronics will continue to be heavily dependent on General Motors production of vehicles in North America, the level of Hughes-supplied electronic content per GM vehicle, the price of such electronics, and the competitiveness of Hughes' product offerings. In this regard, it is anticipated that competition through GM's global purchasing process will negatively impact Hughes' sales to GM-NAO and result in a decline in the portion of GM-NAO automotive electronics supplied by Hughes. The segment's strategy is to aggressively reduce costs in order to minimize the effect of continuing price reductions and to manage the loss of GM-NAO market share by offering competitive products which increase electronic functionality through a focus on safety, security, communications, and convenience. The segment will also seek to improve its systems capability and cost competitiveness both internally and by developing key design, manufacturing, and marketing alliances and other relationships with mechanical and electrical automotive component suppliers.

The international market for automotive electronic products is also highly competitive. The segment has refined its strategy for this market to focus on profitable growth as well as increased market share, and accordingly, will seek to enhance the cost competitiveness of its international operations.

The competitive environment described above is making it increasingly difficult to maintain the level of operating profit margins realized in this segment in the past. Beyond 1996, operating margins are expected to be lower than recent historical levels as price and volume declines associated with GM's global sourcing initiatives more than offset Hughes' ability to achieve cost reductions. In response to the

increased pressure on margins and to enhance future competitiveness, management will take action to reduce the cost structure of the business. As a result of the factors described above, the operating margin is expected to decline further in 1997 to low double digits, and then show modest improvement in 1998 and 1999.

Aerospace and Defense Systems - Operating profit was $694.7 million in 1996 compared to $688.0 million in 1995 and $663.6 million in 1994. The operating profit margin for 1996 declined to 11.0% from 11.7% in 1995 primarily due to a continued shift from production programs to engineering and development programs, and growth in information systems and services revenues. The operating profit margin for 1995 increased to 11.7% from 11.0% largely due to a provision taken in 1994 for certain air traffic control contracts, partly offset by reduced revenues in 1995. Future operating profits could be adversely impacted by further reductions in the U.S. defense budget.

Costs and Expenses. Selling, general, and administrative expenses were $1,505.6 million in 1996, $1,234.2 million in 1995, and $1,018.3 million in 1994. The increases were principally due to the continued expansion of DIRECTV, both in the U.S. and internationally, and increased international sales activities at Delco Electronics.

The effective income tax rate was 34.5%, 36.8%, and 34.7% in 1996, 1995, and 1994, respectively. The decrease in the effective income tax rate in 1996 was due primarily to the favorable resolution of certain tax contingencies while the effective income tax rate in 1994 was favorably impacted by the recognition of capital loss carryforward benefits.

Earnings. Hughes' 1996 earnings were $1,151.2 million, or $2.88 per share of GM Class H common stock, compared with 1995 earnings of $1,107.8 million, or $2.77 per share, and 1994 earnings of $1,049.2 million, or $2.62 per share. Earnings in 1994 included the unfavorable effect of an accounting change for postemployment benefits. Excluding the accounting change, Hughes' earnings in 1994 would have been $1,079.6 million, or $2.70 per share.

Backlog. The 1996 year-end backlog of $15,100 million increased from $14,929 million at the end of 1995, primarily due to record backlog in the Aerospace and Defense Systems segment. 1995 year-end backlog increased from the $13,210 million at the end of 1994, primarily due to increased satellite orders in the Telecommunications and Space segment. A portion of the backlog is subject to appropriation decisions by the U.S. Government subsequent to award. In addition, Hughes' contracts with the U.S. Government are subject to termination by the Government either for its convenience or for default by Hughes. Sales to the U.S. Government may be affected by changes in acquisition policies, budget considerations, changing concepts in national defense, spending priorities, and other factors that are outside of Hughes' control.

Special Provision for Restructuring. In 1992, Hughes recorded a special charge of $749.4 million (after-tax), for the restructuring of Hughes' operations. The special charge comprehended a reduction of Hughes' worldwide employment, a major facilities consolidation, and a reevaluation of certain business lines that no longer met Hughes' strategic objectives. Restructuring costs of $92.4 million, $208.8 million, and $228.3 million were charged against the reserve during 1996, 1995, and 1994, respectively. In addition, in 1994, the restructuring reserve was increased by $35.0 million, primarily due to changes in the estimated loss on disposition of a subsidiary. The remaining liability at December 31, 1996 of $42.0 million relates primarily to reserves for excess

facilities and other site consolidation costs. Approximately $40.7 million of this amount will require future cash outflows. It is expected that these costs will be expended predominantly during the next year.

Accounting Changes. Effective January 1, 1996, Hughes adopted Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, and as permitted by this standard, will continue to apply the recognition and measurement principles of Accounting Principles Board Opinion No. 25 to its stock options. Hughes has calculated the pro forma effects of applying SFAS No. 123 and determined that such effects are not significant in relation to reported net income and earnings per share.

Effective January 1, 1996, Hughes also adopted SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. This Statement establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used, and for long-lived assets and certain identifiable intangibles to be disposed of. The adoption of this new accounting standard did not have a material effect on Hughes' consolidated operating results or financial position.

Effective January 1, 1994, Hughes adopted SFAS No. 112, Employers' Accounting for Postemployment Benefits. The Statement requires accrual of the costs of benefits provided to former or inactive employees after employment, but before retirement. The unfavorable cumulative effect of adopting this Standard was $30.4 million, net of income taxes of $19.2 million, or $0.08 per share of GM Class H common stock. The charge primarily related to extended disability benefits which are accrued on a service-driven basis.

LIQUIDITY AND CAPITAL RESOURCES

Cash and Cash Equivalents. Cash and cash equivalents were $1,161.3 million at December 31, 1996, an increase of $21.8 million from December 31, 1995. Operating activities generated cash of $1,199.4 million as Hughes achieved another year of record earnings. Additional cash was provided by proceeds from the sale and leaseback of satellite transponders with General Motors Acceptance Corporation, and proceeds from the sale of a minority interest in DIRECTV of $137.5 million. The increases in cash were offset by the cash used to fund capital expenditures, repay notes and loans payable and pay dividends to General Motors.

In 1995, cash and cash equivalents decreased $362.3 million to $1,139.5 million at December 31, 1995, from $1,501.8 million at December 31, 1994. Operating activities generated cash of $986.2 million, however, cash used to fund capital expenditures, pay dividends to General Motors, and acquire new businesses more than offset the cash generated by operating activities.

In the third quarter of 1996, Hughes reported that cash flows in 1997 and beyond were expected to be negatively impacted by a change in the credit terms between Hughes and GM-NAO for purchases of automotive electronics. With the announcement of the planned transactions in January 1997, (see Note 18 to the Consolidated Financial Statements), implementation of the change in credit terms has been deferred pending the consummation of such planned transactions.

Liquidity Measurement. As a measure of liquidity, the current ratio (ratio of current assets to current liabilities) was 1.69 at December 31, 1996, 1.58 at December 31, 1995, and 1.76 at December 31, 1994. The increase from 1995 to 1996 was principally due to the repayment of certain notes and loans payable.

The decrease from 1994 to 1995 was principally due to the decrease in cash described above and increases in the notes and loans payable balance, primarily caused by a loan related to an acquisition. (See Note 13 to the Consolidated Financial Statements.)

Property and Equipment. Property, net of accumulated depreciation, increased $147.4 million in 1996 while telecommunications and other equipment, net of accumulated depreciation, decreased $41.6 million, primarily due to the sale and leaseback of GIIIR which more than offset additional expenditures related to the Galaxy satellite fleet.

Expenditures for property and equipment were $652.3 million in 1996 compared with $545.7 million and $490.5 million in 1995 and 1994, respectively. Management anticipates that capital expenditures in 1997 will increase approximately $100 million over 1996 and will be financed primarily from cash provided by operating activities.

Telecommunications and other equipment expenditures were $187.9 million in 1996 compared with $274.6 million and $255.8 million in 1995 and 1994, respectively. Management anticipates that telecommunications and other equipment expenditures in 1997 will increase significantly compared with 1996 and will be financed primarily from cash provided by operating activities.

TELECOMMUNICATIONS AND SPACE - Capital expenditures, including expenditures related to telecommunications and other equipment, increased to $449.8 million in 1996 from $436.5 million in 1995 and $399.3 million in 1994. The 1996 capital expenditures increase reflects additions to the Galaxy satellite fleet and construction of the California Broadcast Center, an uplink facility that supports Hughes' DIRECTV business in Latin America. The increase in 1995 was due primarily to additions to the Galaxy satellite fleet.

AUTOMOTIVE ELECTRONICS - Capital expenditures decreased to $196.0 million in 1996, compared with $264.7 million in 1995, and $166.4 million in 1994. The decrease in the 1996 capital spending reflects the impact of delays in engineering capital expenditures and the higher than normal level of expenditures in 1995. The increased capital spending in 1995 reflects expenditures for additional program requirements related to new product changes associated with the 1996 model year combined with a decrease in tooling cost recoveries.

AEROSPACE AND DEFENSE SYSTEMS - Capital expenditures in the Aerospace and Defense Systems segment for 1996, 1995, and 1994 were $171.1 million, $109.8 million, and $159.5 million, respectively. The 1996 increase relates to capital expenditures to support expanding business requirements. The 1995 decrease was due to the high level of expenditures in 1994 related to the consolidation of facilities in an effort to increase the operational efficiencies of manufacturing and engineering activities.

Debt and Capitalized Leases. Long-term debt and capitalized leases were $34.5 million at December 31, 1996, a decrease from $258.8 million at December 31, 1995, and $353.5 million at December 31, 1994, reflecting scheduled principal repayments and the reclassification of certain amounts to current liabilities. The ratio of long-term debt and capitalized leases to the total of such debt and pro forma stockholder's equity decreased to 0.5% in 1996 from 4.4% in 1995 and 6.6% in 1994.

As discussed further, additional debt will be incurred in conjunction with the PanAmSat merger. It is anticipated that a portion of this debt would be repaid from cash expected to be received pursuant to the planned transactions. (See Note 18 to the Consolidated Financial Statements.)

Other Balance Sheet Items. In evaluating both its pension and retiree medical liabilities, Hughes recognizes the impact of changes in long-term interest rates by adjusting the discount rate used in determining the actuarial present values of the projected benefit obligations. In 1996, the weighted-average discount rate for Hughes' non-automotive pension obligations increased from 7.25% to 7.5% and the weighted-average discount rate for Hughes' other postretirement benefits increased from 7.25% to 7.56%.

Acquisitions and Divestitures. In December 1996, Hughes announced that it had reached an agreement to acquire the Marine Systems Division of Alliant Techsystems, Inc. for $141.0 million in cash. The Marine Systems Division is a leader in lightweight torpedo manufacturing and the design and manufacturing of underwater surveillance, sonar and mine warfare systems. The acquisition was completed in the first quarter of 1997.

In September 1996, Hughes and PanAmSat Corporation entered into an agreement to merge their respective satellite services operations into a new publicly-held company. Hughes would contribute its Galaxy satellite services business in exchange for a 71.5% interest in the new company. Current PanAmSat stockholders would receive a 28.5% interest in the new company and $1.5 billion in cash. Such cash consideration and other funds required to consummate the merger are expected to be funded by new debt financing totaling $1.725 billion. This debt financing is expected to be provided by Hughes, which currently intends to borrow such funds from General Motors.

For accounting purposes, this transaction would be treated as a partial sale of the Galaxy business by Hughes and would result in a one-time, nonrecurring gain. The amount of this gain depends on several variables, but is expected to be between $400 and $600 million before tax. PanAmSat is a leading provider of international satellite services. The transaction, which is contingent upon receiving certain regulatory approvals, is expected to close during the second quarter of 1997.

In March 1996, Hughes sold a 2.5% equity interest in DIRECTV, a wholly-owned subsidiary of Hughes, to AT&T for $137.5 million, with options to increase their ownership interest under certain conditions. The sale resulted in a $120.3 million pre-tax gain which is included in other income.

In February 1995, Hughes completed the acquisition of CAE-Link Corporation, an established supplier of simulation, training, and technical services, primarily to the U.S. military and NASA, for $176.0 million. In December 1995, Hughes acquired Magnavox Electronic Systems Company, a leading supplier of military tactical communications, electronic warfare, and command and control systems, for $382.4 million

During 1995, Hughes divested several non-strategic enterprises resulting in aggregate proceeds of approximately $127.2 million and a net gain of approximately $21.9 million. Also in 1995, Hughes recorded a $40.0 million charge for the estimated loss on disposition of a business unit and completed the divestiture of Hughes LAN Systems, for which a pre-tax charge of $35.0 million was taken in 1994.

Dividend Policy. As discussed in Note 7 to the Consolidated Financial Statements, it is GM's current policy to pay aggregate annual cash dividends on the GM Class H common stock approximately equal to 35% of the Available Separate Consolidated Net Income of Hughes for the prior year. In January 1997, the Board of Directors of GM increased the quarterly dividend on GM Class H common stock from $0.24 per share to $0.25 per share. It is anticipated that if the previously described Hughes transactions are consummated, the General Motors Board of Directors will adopt a