

Israel VC Indicator Survey.

Expectations as of Quarter 4, 2009

Embracing a New Era
Moving East



About

The purpose of the Israel VC Indicator Survey is to identify trends within the venture capital arena. Its objective is to give a comprehensive picture of the Israel VC community expectations for the next six to twelve months. The survey is designed to explore relevant key aspects, such as economic and market conditions, deal activity and investment and managerial focus. The results produce a forward-looking measure of the overall sentiment in the Israeli venture capital community, which is extremely relevant to immediate deal flow.

The 31st Deloitte Brightman Almagor Zohar Israel VC Indicator Survey results for Quarter 4, 2009 include a comparison, to responses from previous surveys.

The VC Survey and Private Equity Surveys are a Deloitte initiative. The surveys have been conducted for some years, running concurrently in Israel, the United Kingdom, Germany, Spain, Portugal, Central Europe, Mexico, South Africa and India, to name but a few. Moreover, once a year, Deloitte also releases a Global VC Survey, whose purpose is to identify attitudes of venture capitalists and private equity investors regarding investing on a global basis and tracking long-term trends about the attitudes of international investing.

Responses for Israel VC Indicator Survey Quarter 4, 2009 were collected from December 15th, 2009 to December 23rd, 2009. The responses were collected from venture capitalists in Israel.

Deloitte TMT Business Development Team uses a variety of research and statistical tools to provide extensive and accurate analysis of the survey results. If respondents do not answer a question, the count for the question is adjusted accordingly. All charts presented in this report are sourced from the survey results.

4th Quarter, 2009

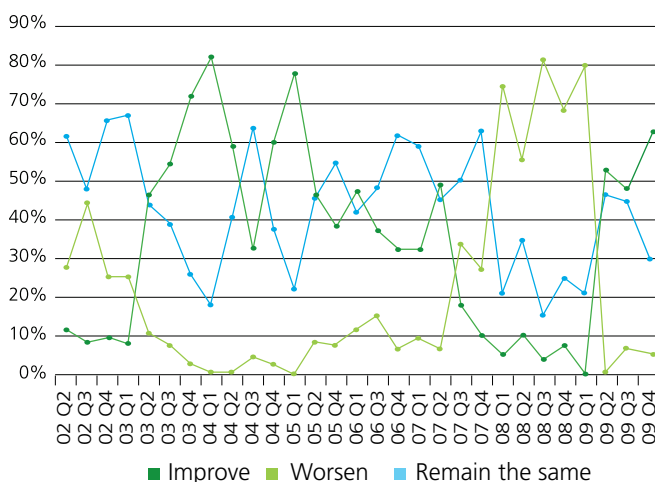
Highlights

- Additional positive sentiment with expectations to increase in M&A and deal flow.
- Opportunities for significant growth in Asia Pacific.
- Major increases in investment volume but mixed opinions regarding valuations.
- Cloud computing seems to be more than a buzzword.

Results

The general perception amongst respondents indicated a very large improvement in market sentiment (15%), in comparison to previous quarters; even though, some degree of trepidation is still evident. Taken as an aggregate, results indicate an impressive improvement in VC sentiment. Since the end of Q1 (2009) optimism began looming in on the VC markets and reflected the brink of a major market shift. The trend has gained traction in Q4, 2009, with 63% of surveyed participants believing economic climate is improving in comparison to 48% in Q3, 2009. The last 3 quarters of 2009, revealed that the average view for economic climate to improve was 55%, comparing to only 7% in the last three quarters of 2008. A 14% drop (QoQ) in forecasts for economic climate to remain the same, in parallel to a decrease of 1% of participants believing the market to worsen, also reveals a greater proportion of respondents expressing that the worst is behind them.

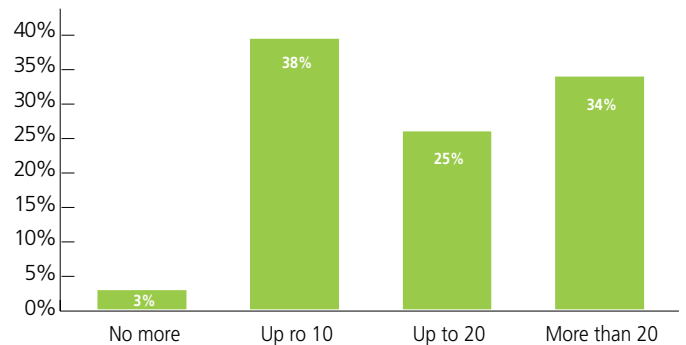
Chart 1: During the next six months, I expect the overall economic climate to:



Even though there is much optimism expressed relating to economic climate, there is still a long way to go before we can attain a growth phase resulting in no additional ceased operations. This was revealed by only a small

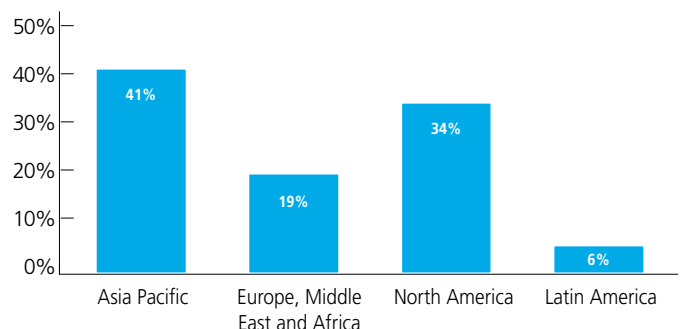
portion of respondents (3%) forecasting that no more tech companies will shutdown in the next six months. This divergence expressed between improvement in economic climate and ceased operations sheds light that fear for further market turbulence still exists. 41% of respondents feel that there will be up to ten tech company's shutdown; whereas 59% forecast more than ten tech companies to cease operations within the next six months.

Chart 2: I expect to see _____ technology companies shutdown (ceased to operate) during the next six months:



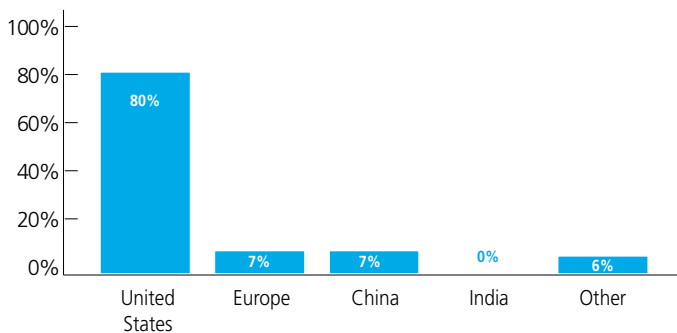
It is clear that respondents feel that the best opportunity for significant growth over the next five years will be in Asia Pacific (41%) or North America (34%), combined reaching a significant 75%. 19% of respondents chose Europe, Middle East and Africa, whereas a staggering low of 6% forecast Latin America to represent the best opportunity for their portfolios.

Chart 3: Which geographic markets represent the best opportunity for significant growth for your portfolio over the next five years?



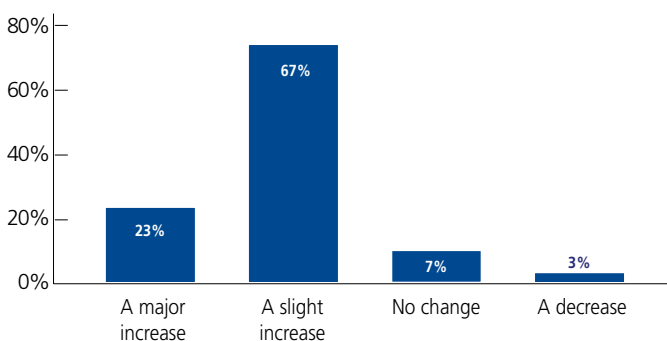
Venture capitalists forecast superior opportunities in Asia Pacific, and closely behind is North America. However, in regards to portfolio competition, United States is still by far the most dominant player in terms of being a source of innovation, with a clear majority of 80%. Europe and China paired with a low 7% each, and India had zero respondents believing that portfolio competition was imminent in their neck of the woods.

Chart 4: Where do you think the majority of your portfolio competition is based?



The wide spread optimism amongst VC managers is felt in perceptions towards deal flow activity in the next six months. An impressive 90% forecast an increase, of which roughly a quarter believe the increase to be a major one. The apparent positive sentiment towards deal flow can also be identified through only 3% of respondents forecasting declines in activity.

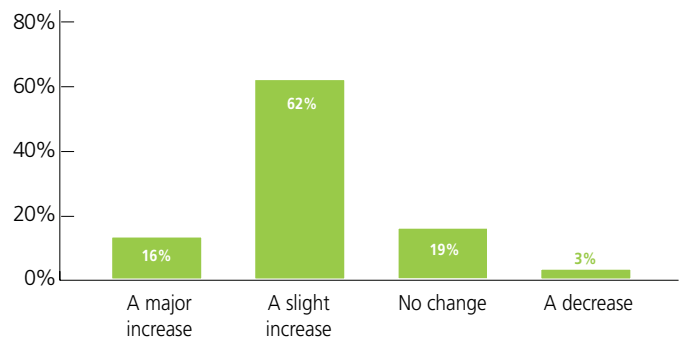
Chart 5: I expect deal flow activity during next six months, comparing to last three quarters, to show:



The positive market sentiment shined in expectations towards investment volume. Whereby, 78% of surveyed participants forecast a slight or major increase in volume of investment transactions, versus only a fraction of

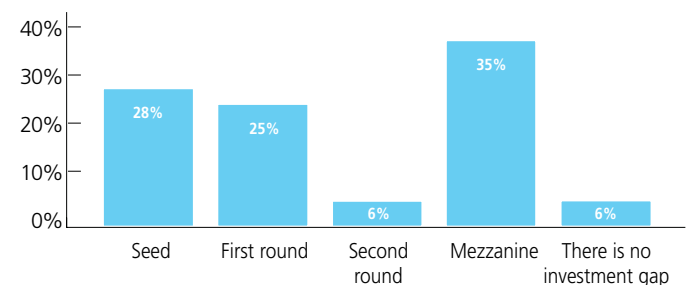
respondents (3%) claim a decrease being imminent. Nevertheless, a relatively hefty 19% of respondents project investment transaction volume to remain the same.

Chart 6: During the next six months, I expect the volume of investment transactions to show:



Owing to the results, it can be learnt that there is no clear agreement amongst our respondents relating to the central investment gap in the Israeli start-up industry. Only 6% of the respondents claim that venture capital financing has no investment gap, but this is a drop of 9%, since Q3, 2009. 6% of respondents claim that Second Round financing will hold the largest investment gap, which incidentally dropped (9%) since Q3, 2009. The remaining opinions were dispersed relatively evenly amongst the main investment gap alternatives. Such that 28% feel the main gap is in the Seed Stage, 25% in the First Round, and 35% in the Mezzanine Stage.

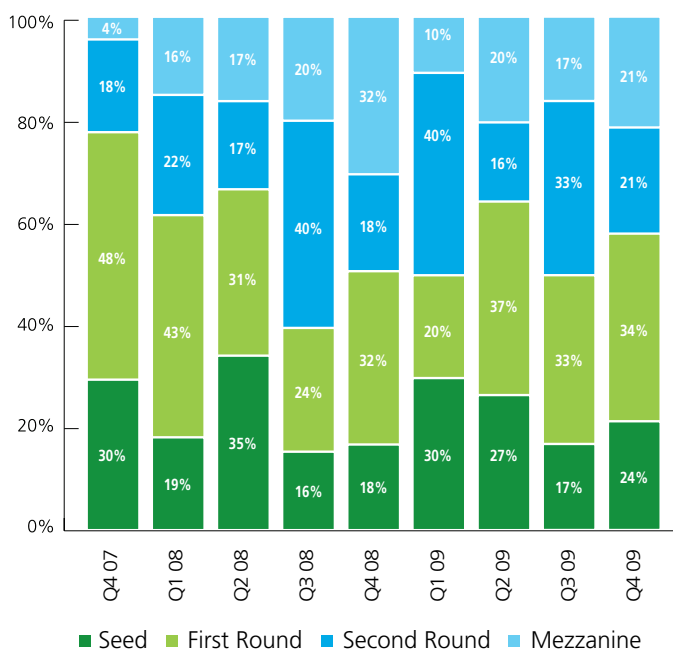
Chart 7: What is the main investment gap in the Israeli start-up industry?



The segmentation of new investments reflects increased optimism in comparison to previous quarters. Such that 24% of respondents expect to focus a majority of their new investments in Seed Stage, equivalent to a jump of 7%, in comparison to the previous quarter. 34%

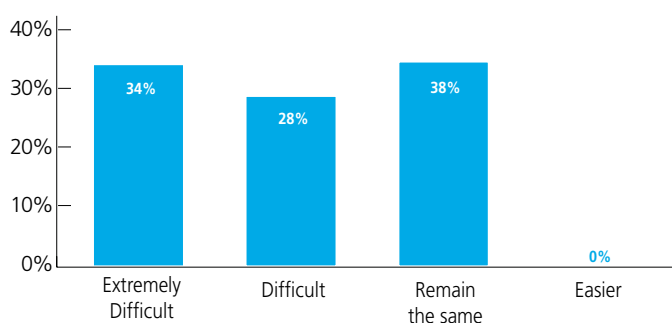
expect the majority of new investments to be made in First Round, and the remaining 42% of respondents expect to invest in later stages. Early investments (Seed and First Round) reflect little correlation to the trends that controlled the venture capital industry before this "Credit Crunch". As can be seen in the end of 2007 and the beginning of 2008, where there was a much higher tendency to invest in earlier stages. Nonetheless, the evident up leg seems to provide a clear indication that we are returning to pre-crisis levels.

Chart 8: During the next six months, I expect the majority of my new investments to be made in:



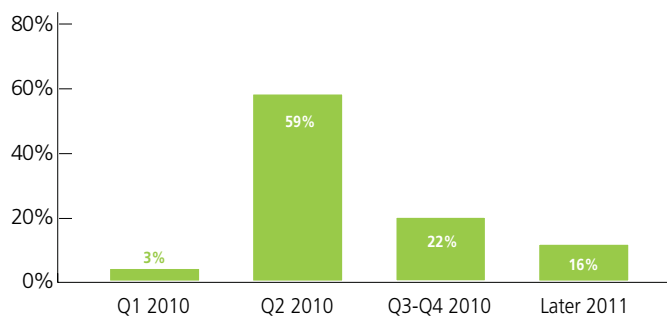
Despite much optimism in terms of most factors affecting venture capitalists, an imposing 62% of respondents claim that fundraising will become more difficult. What is more daunting is that 38% claim that it will remain the same, while in parallel no venture capitalist believe that fundraising will become easier.

Chart 9: VC Fundraising activity will become:



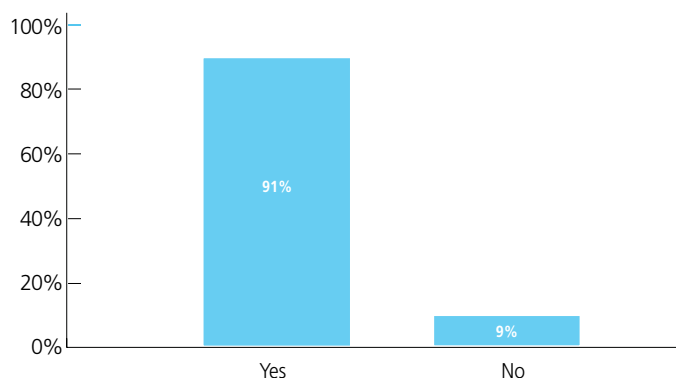
Waning pessimism seems to be creeping in, with a significant majority of 59% of respondents claiming that the next IPO on the NASDAQ will be in Q2, 2010. It is essential to note that Israel has not contributed to any IPOs on the NASDAQ since July, 2007 (Voltaire) and the probability for such an event being imminent seems to be increasing. An inspiring jump since the previous quarter of 29% of respondents forecasting Q2, 2010 to be the quarter which embarks Israel's first IPO since 2007, indicates that venture capitalists are seeing more light at the end of the tunnel.

Chart 10: When do you believe we will see the next Israeli IPO on the NASDAQ?



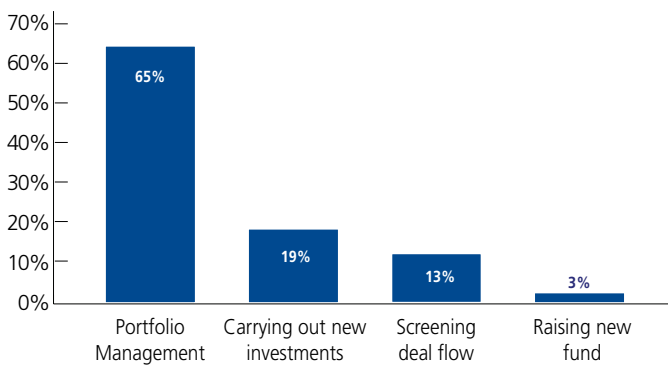
A robust percentile (91%) of respondents claim that M&A transactions are ramping up. This notion clearly reflects the apparent market improvement which seems to be paving the way for increases in such transactions. (Chart 11)

Chart 11: I believe M&A transactions are ramping up?



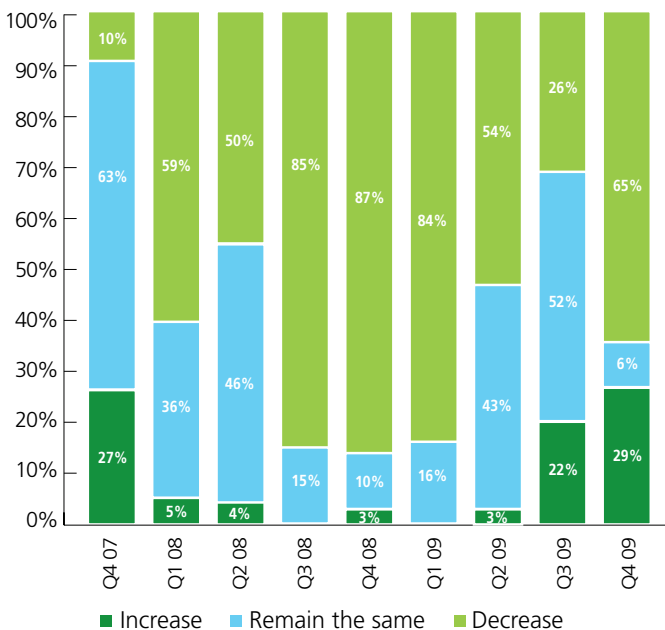
According to venture capitalists, 65% of them expect to allocate a majority of their time to Portfolio Management. Despite increased optimism, perpetual instability sheds clear indication to why only 19% of venture capitalists time is expected to be spent on carrying out new investments. On the flipside, screening deal flow increased 7% from Q3, 2009.

Chart 12: During the next three months, I expect to spend the majority of my time focusing on:



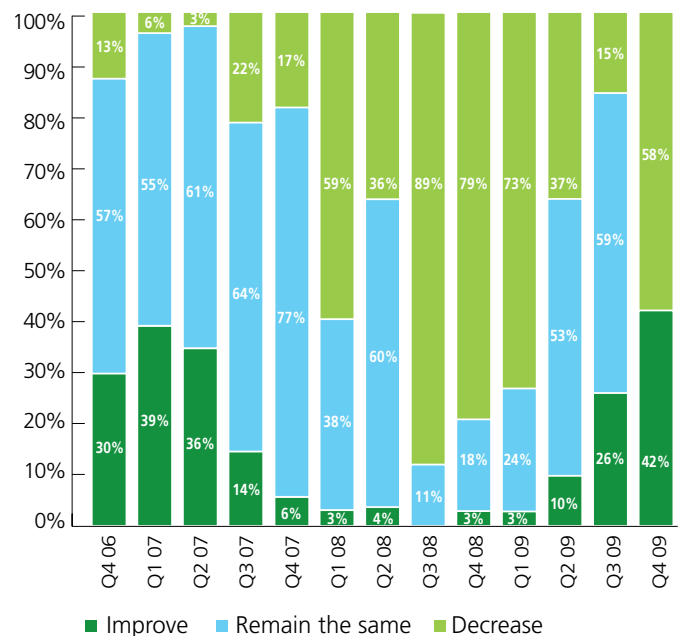
Today's growing positive sentiment (indicated throughout a vast majority of the answers), investment valuations paint a slightly more concerning picture in terms of investments. Investment valuation expectations are poised for higher valuations by 7% (QoQ) of respondents, however, a whopping 29% (QoQ) of venture capitalists claim decreases in valuations, whereas only 6% assert valuations to remain unchanged.

Chart 13: During the next six months, I expect investment valuations to:



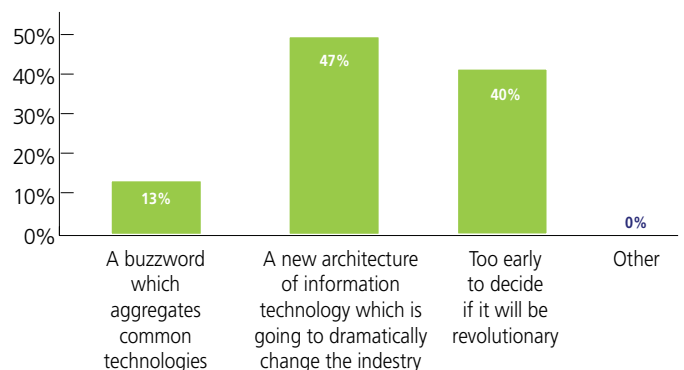
Exit valuations provide similar signs of a collage of trepidation and emergence of venture capital optimism. Exit valuations expectations, suggest that 58% forecast decreases in valuations in the next six months, comparing to only 15% in Q3, 2009. However, a noteworthy 42% claim improvements are around the corner, comparing to only 26% in Q3, 2009. Despite the apparent increased divergence, the 42% claim in improvements in terms of exit valuations is the highest level seen since Q1, 2006.

Chart 14: During the next six months, I expect exit valuations to:



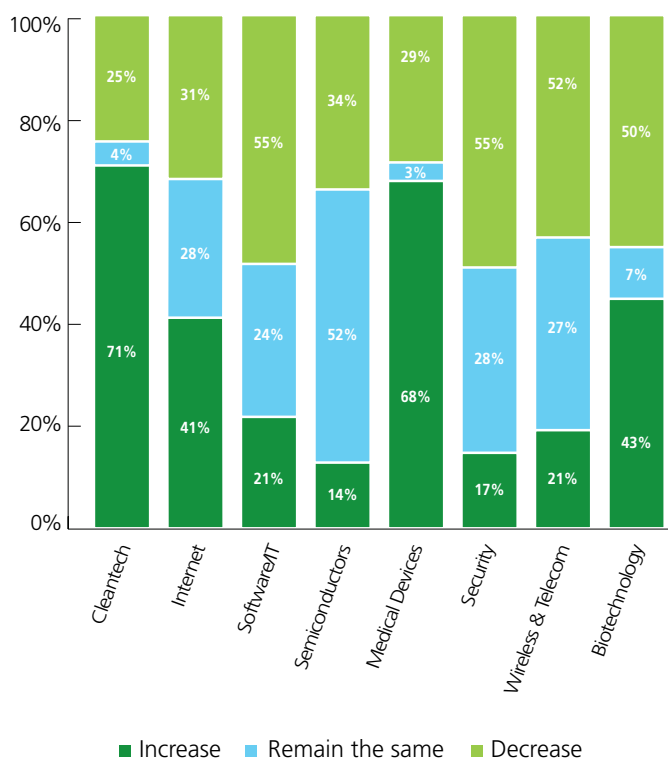
The consensus of cloud is rather polarized, even though 13% of respondents believe that cloud computing is just a buzzword. The polarization is extrapolated through 47% of respondents agree that cloud computing is a new architecture of information, while 40% claim that it is still too early to decide whether cloud computing will be revolutionary.

Chart 15: Cloud computing is:



In concurrence with the entire duration of the crisis, expectations for transaction growth in Cleantech have grown immensely. 71% of respondents claim that Cleantech will project the highest number of transactions during the next six months. Improvements in terms of transactions were also evident in the Biotechnology and Medical device sectors (43% and 68%, respectively). According to respondents, the Semiconductor sector is forecasted to demonstrate the sharpest decline in transactions which has been a consistent notion for the past several quarters.

Chart 16: During the next six months, I expect the number of transactions in the sectors listed below to:



Insights

The continued improvement in venture capital sentiment in Israel seems to be gaining momentum when comparing Q4, 2009 to previous quarters. Despite some degree of suspicion still evident, the general perception amongst respondents indicates significant improvement regarding market perceptions and overall transaction volume. This trend, which has been gaining traction since the end of Q1, 2009 has been rising steadily with surveyed data reflecting improving economic climate amongst 63% of respondents, in comparison to a staggering low of 0% in Q1, 2009.

In addition, waning pessimism relating to IPO's seems to be creeping in, with an inspiring jump of 29% (59% in Q4, 2009 vs. 30% in Q3, 2009) of respondents forecasting Q2, 2010 to be the quarter which embarks Israel's first IPO since 2007. Looking forward, we can expect a continuation of improvement in terms of VC sentiment which should alleviate many challenges that venture capitalists still face today, such as fundraising (62% claim fundraising will become more difficult).

Cloud computing seems to be more than just a buzzword. The consensus of cloud is rather polarized, with 47% agreeing that cloud computing is a new architecture of information which is going to dramatically change the industry, whereas 40% claim that it is still too early to decide if cloud computing will be revolutionary. Thus, the future for scalable and virtualized resources over the web seems to still be up for grabs.

The United States prove to continue to be the dominating force concerning portfolio competition. Being considered the innovation source to a hefty majority of venture capitalists in Israel provides much of the understanding to why 34% of surveyed data also reflects North America being considered the best opportunity for significant growth. However, increased attention should be directed to Asia Pacific, since 41% of respondents see it as the geographic region with best opportunities for portfolio growth. As an aggregate, three-fourths of surveyed venture capitalists suggest that these two engines encapsulate the majority of opportunities. While venture capitalists concede to the possibility of these two opportunity engines comprise the vast majority of investment prospects, the continuation of stronger growth in the east, in parallel to slower growth in the west, points to further shifting of power.

Contacts

We welcome suggestions for issues to be addressed in future Israel VC Indicator Surveys. You are welcome to send your suggestions to Rony More at romore@deloitte.co.il

Please contact us for further information about the results of this survey, the special services offered by Deloitte Brightman Almagor Zohar and its affiliates to VCs, and assistance with deal initiation and the execution process.

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