

Israel VC Indicator Survey.

Expectations as of Quarter 3, 2007

Running too fast for an IPO



About

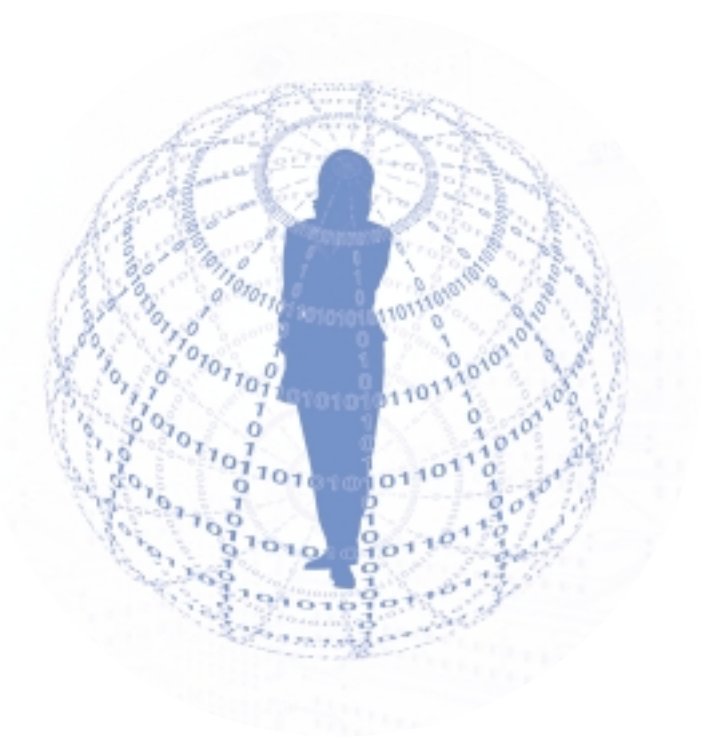
The purpose of the **Israel VC Indicator** is to identify trends within the venture capital arena. Its objective is to give a comprehensive picture of the expectations of the Israeli VC community for the next six to twelve months. The survey is designed to explore relevant key aspects, such as economic 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 22nd Deloitte Brightman Almagor Israel VC Indicator Survey results for Q3, 2007 include a comparison, where relevant, 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. The Global Survey 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 VC Indicator Q3, 2007 were collected from September 16th 2007 through to September 25th 2007. The responses were collected from venture capitalists in Israel, including replies from the major VCs in the country.

In this study we also included findings from Deloitte Global Trends in Venture Capital 2007 Survey, which was sponsored by Deloitte in cooperation with the National Venture Capital Association in the U.S., the Israel Venture Association and numerous other venture capital associations around the world. It surveyed venture capitalists in the Americas, Europe, the Middle East and Asia Pacific.



3rd Quarter, 2007 - Detailed Results



Highlights

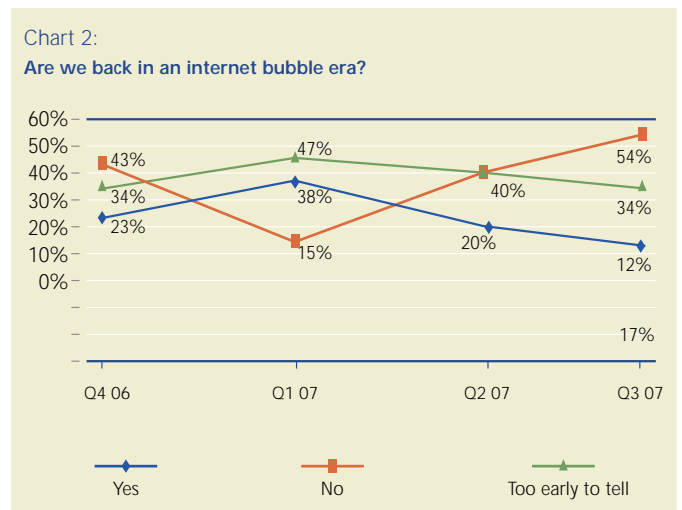
- There is a dramatic increase in the number of venture capitalists who believe the overall economic climate will worsen.
- VC community is convinced we are not in a new internet bubble as expectations for internet transaction mellow.
- Cleantech expectations remain high. Lack of investor knowledge is pointed at by VCs as a major impediment to its success in Israel.
- 81% of venture capitalists believe that Israeli companies who go public on the NASDAQ tend to do so too early.
- Venture valuations are expected by many respondents to remain the same or decrease.

Results

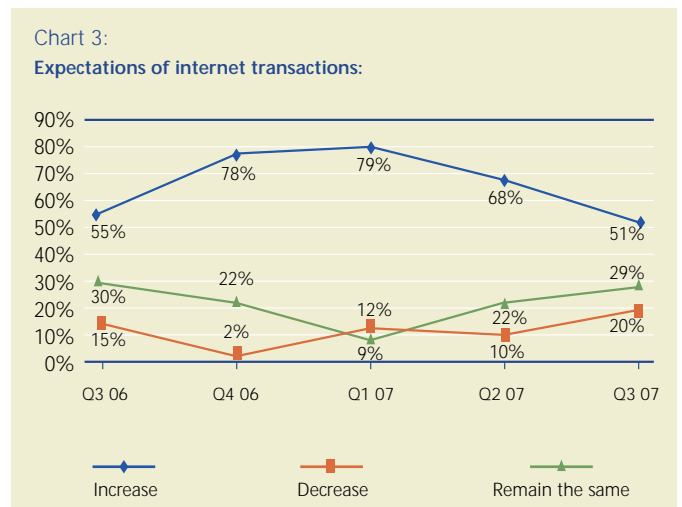
Venture Capitalists sentiment of the overall economic climate is somewhat depressed. There has been a downwards shift in economic expectation among respondents with 33% believing that the overall economic climate will worsen over the next six months (up dramatically from 6% in Q2, 2007). Simultaneously, only 17% of respondents believe that the economic climate will improve over the next six months (down from 49% in Q2, 2007). 50% of respondents predict no change in the overall economic climate. (Chart 1)



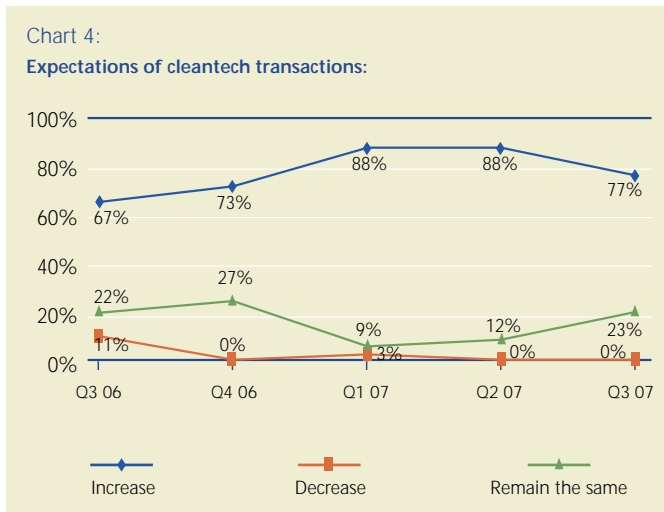
After displaying significant volatility in previous quarters, the Deloitte internet bubble index is beginning to stabilize with 54% of respondents saying we are not back in an internet bubble. Only 12% say we are back in a bubble, compared to 20% who thought so in Q2, 2007. 34% are still undecided saying it's too early too tell if we are in a new internet bubble. (Chart 2)



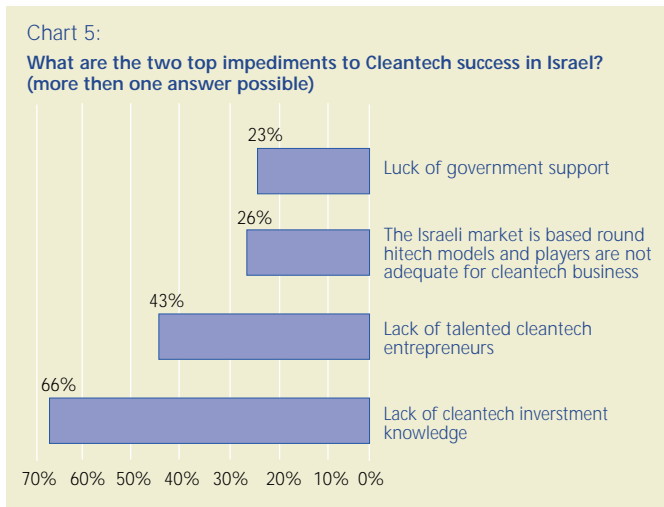
Expectations for an increase in internet transactions continue to mellow for the second quarter in a row and they are the weakest they have been in the last five quarters. 51% of respondents are expecting an increase in number of internet transactions over the next six months (compared to 68% and 79% in Q2, 2007 and Q1, 2007 respectively). The number of respondents who foresee a decline in internet transactions has doubled to 20% (compared to 10% in Q2, 2007). (Chart 3)



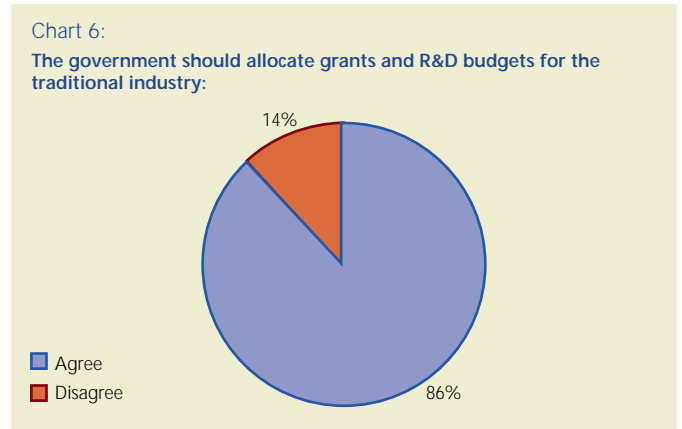
For the third quarter in a row, cleantech remains the favored sector for increased investment. Expectations of cleantech transaction increase continue to be high, 77% (slightly down compared with 88% in Q1, 2007 and Q2, 2007). In line with previous quarters not even one respondent expects cleantech transactions to decrease in the next six months. (Chart 4)



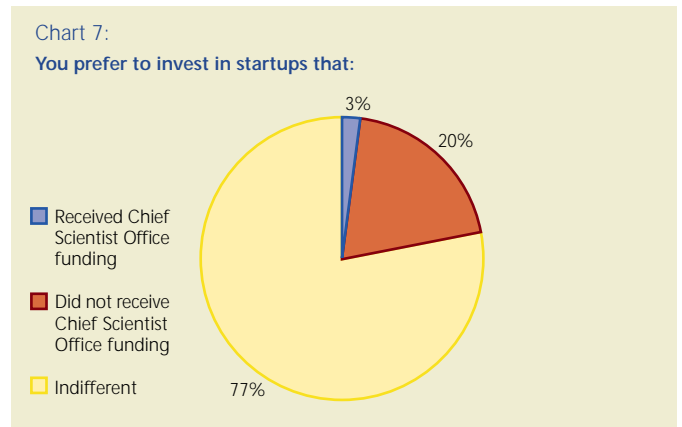
With expectations of cleantech transaction increase soaring but actual deals scarce, we asked the local venture capital community what they believed were the top impediments to cleantech success in Israel. 43% of respondents blame entrepreneurs, saying that the lack of talented Israeli cleantech entrepreneurs is a major obstacle for local cleantech companies' success. But the majority, 66% of respondents, says the blame is on the investors, saying that lack of cleantech investment knowledge is the top impediment to cleantech success in Israel. 26% said that the Israeli market is based round hi-tech models and players are not adequate for cleantech business. Only 23% named lack of government support as a major impediment. (Chart 5)



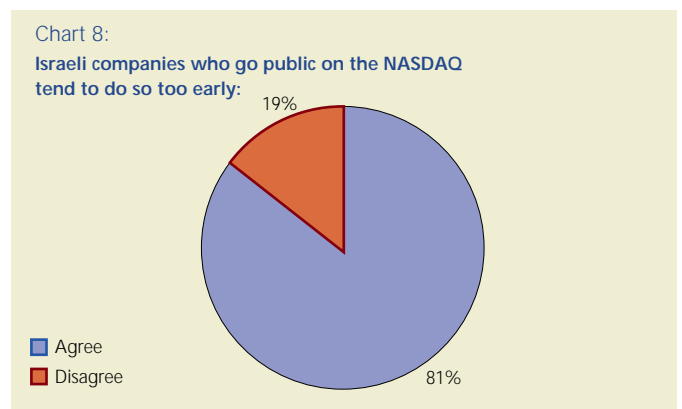
86% of respondents agree that the government should allocate grants and R&D budgets for the traditional industry. Only 14% disagree with that. (Chart 6)



As for government involvement through Chief Scientist Office funding, most venture capitalists, 77%, are indifferent to investing in startups that received or did not receive such funding. (Chart 7)



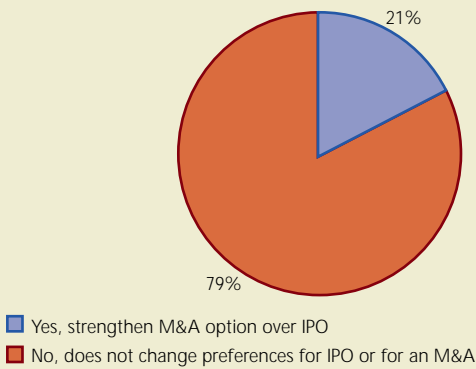
A significant proportion of respondents, 81%, believe that Israeli companies who go public on NASDAQ tend to do so too early. Only 19% disagree with that. The outlook of respondents is very much in line with the drop in share price of most Israeli companies that went public on the NASDAQ during 2007. (Chart 8)





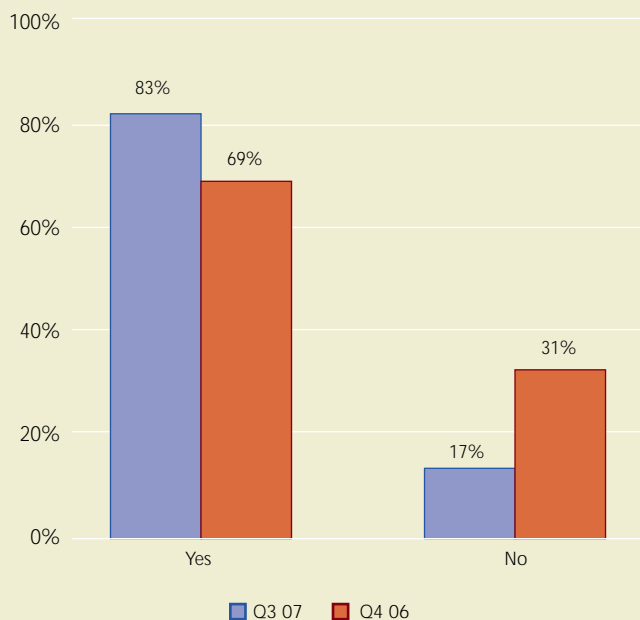
The poor stock performance of recently IPOed Israeli companies on NASDAQ does not deter most venture capitalists from pursuing an IPO exit strategy. 79% of respondents say that the poor performances did not make them, nor they are planning to, change their exit policy preferences for IPO or for an M&A deal. It is worth noting that a non negligible share of respondents, 21%, says that the poor performances have caused them to change their exit policy preferences strengthening the M&A option over IPO. (Chart 9)

Chart 9:
Considering the drop in share price of most Israeli companies that went public on the NASDAQ during 2007 - have, or do you plan, to change your exit policy:



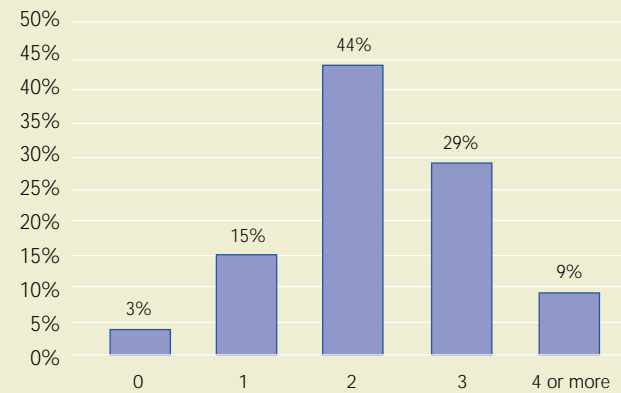
More respondents this quarter, 83%, than Q4, 2006, 69%, think that more Israeli startups should strive for an IPO and becoming a long-term sustainable company. (Chart 10)

Chart 10:
Should more startups strive for an IPO and becoming a long-term sustainable company?



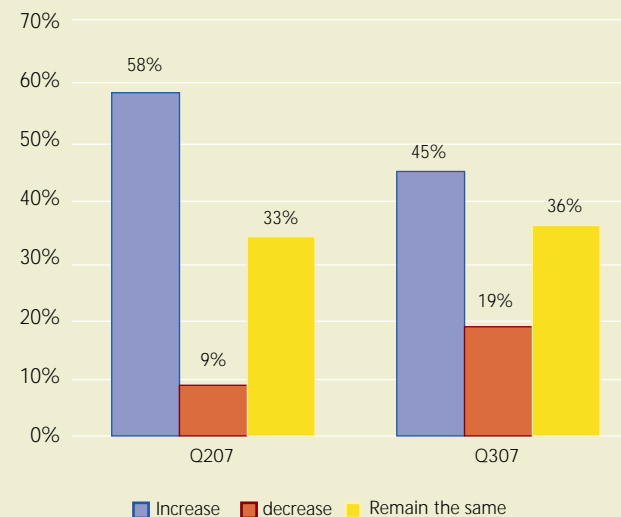
38% of venture capitalists believe Q4, 2007 will have extensive Israeli IPO activity on NASDAQ, with 29% expecting three IPOs and 9% foreseeing at least four IPOs. 44% of respondents expect two Israeli companies going public on NASDAQ on Q4, 2007. 15% are expecting only one IPO and 3% believe that not even one Israeli company will go public on NASDAQ until the end of 2007. (Chart 11)

Chart 11:
The number of Israeli companies that will go public on NASDAQ during Q4 will be:



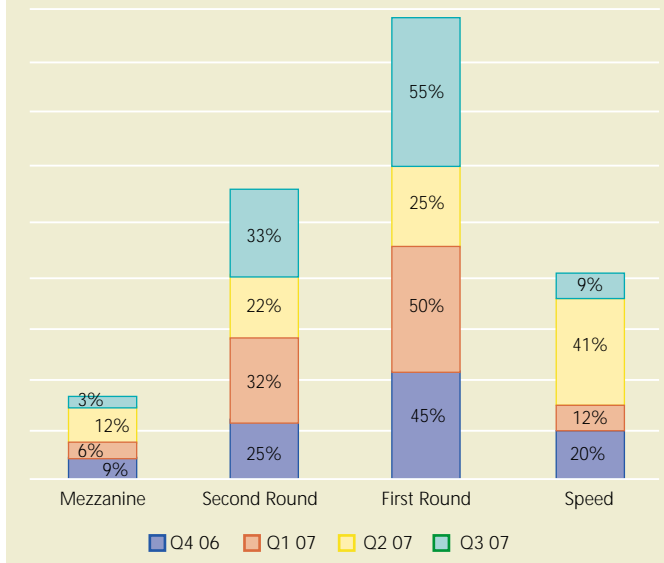
Less venture capitalists expect angel investments to increase during the next six months, 45%, compared to 58% in Q2, 2007. 19% expect to see a decrease in angel investments (compared to 9% in Q2, 2007). (Chart 12)

Chart 12:
During the next six months, I expect to see angel investment:



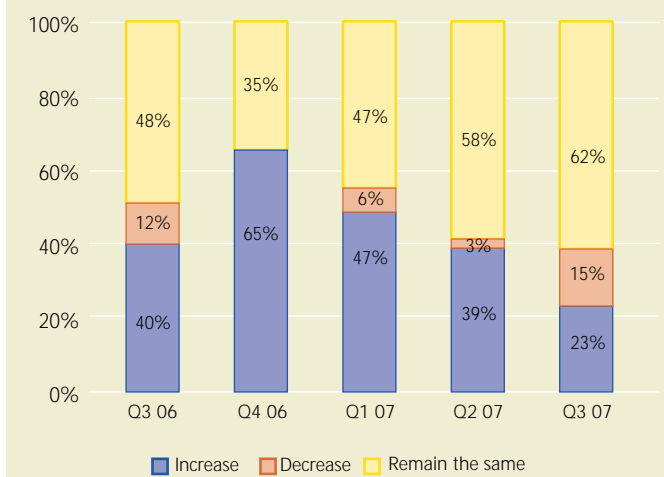
Most venture capitalists, 55%, expect that, during the next six months, the majority of their new investments will be made in first round funding. 33% expect to invest mainly in second round and 9% in seed round. (Chart 13)

Chart 13:
During the next six months, I expect the majority of my new investments to be made in:



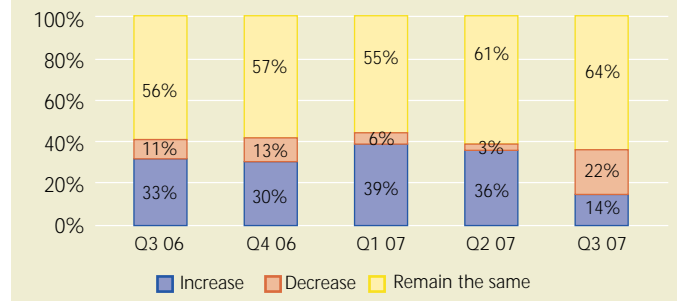
62% of respondents believe that investment valuations will remain the same during the next six months. Only 23% expect investment valuations to increase, compared to 39% in Q2, 2007 and the lowest since first posting this question on Deloitte Israel VC Indicator in Q4, 2004. The number of venture capitalists expecting a decrease in investment valuations is also relatively high, 15%, the highest percentage since Q4, 2004 and compared to only 3% in Q2, 2007. (Chart 14)

Chart 14:
During the next six months, I expect investment valuation to:



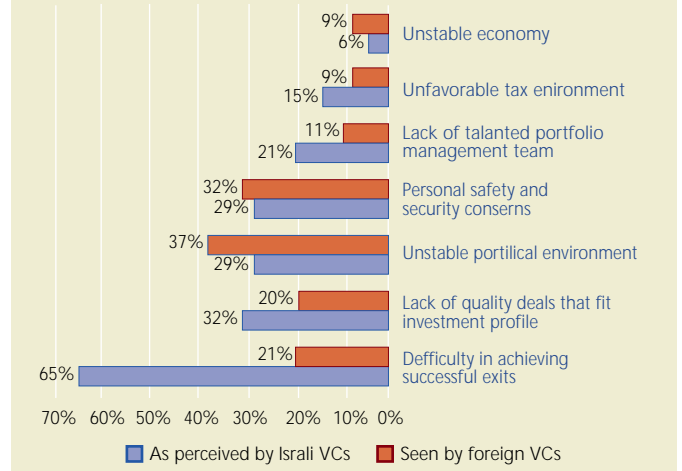
Low expectations are also noted for exit valuations during the next six months. Only 14% of respondents expect exit valuations to increase compared to 36% in Q2, 2007 and the lowest since first posting this question on Deloitte Israel VC Indicator in Q4, 2004. 22% foresee that exit valuations will decrease, this being the highest percentage since Q4, 2004 and compared to only 3% in Q2, 2007. (Chart 15)

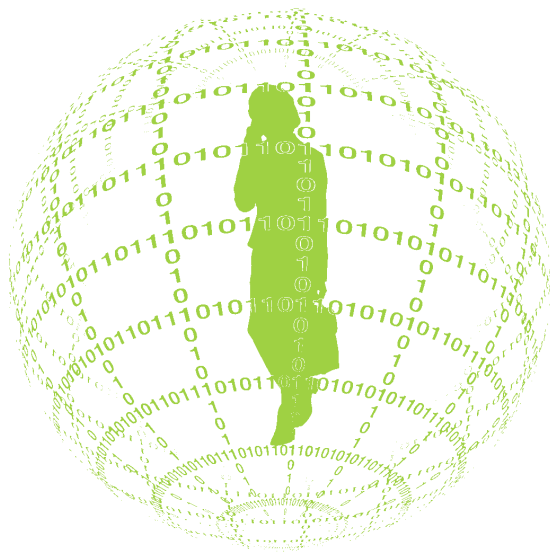
Chart 15:
During the next six months, I expect investment valuation to:



In the recent Deloitte Global VC Survey foreign venture capitalists were asked what are the top impediments to investing in Israel. In this edition of the Israel VC Indicator Survey we asked the local VC community what are the top impediments to investing in Israel, as perceived by foreign VCs. The top two impediments to investing in Israel for foreign VCs were an unstable political environment, 37%, and personal safety and security concerns, 32%. However, Israeli respondents perceived these two impediments to carry less weight amongst foreign VCs than the Global Survey would otherwise indicate. Difficulty achieving successful exits, 65%, and lack of quality deals that fit investment profile, 32%, were ranked by Israeli venture capitalists as the top two impediments to investing in Israel, as perceived by foreign VCs. (Chart 16)

Chart 16:
What are the top impediments to investing in Israel, as perceived by foreign VCs? (more than one answer possible)





Insights

Investments in the internet sector are beginning to stabilize. On one hand VCs do not think we are in a new internet bubble, on the other hand expectations for transaction increase have mellowed and some VCs are beginning to wonder if the internet startups investment valuations during the recent year were not too high. Venture capitalists continued, but more moderate, interest in internet startups reflects their confidence that these startups will be strong performers in the future. It also reflects that VCs are no longer caught up in the internet hype rather are taking a more rational and healthy look at this sector.

The hype surrounding cleantech in Israel continues to increase. And yet one thing is missing – deals. Significant investments have been few and far between. One of the major causes for the gap between the markets expectations and actual investments is lack of cleantech investment knowledge. Venture capitalists are now looking to try their fortune in cleantech. The common denominator of the know-how in leveraging innovation in high-tech and in cleantech looks all too appealing. But, when scrutinizing the cleantech sector more closely, investors are looking at projects that require different scales and timeframes of investment. Not only that, but they often do not understand the sales cycle well enough to be prepared to commit funds. VCs still have a lot of study to do and different investment models for cleantech companies should be considered.

The people in the Israeli high-tech sector are probably the ones least calling and demanding governmental help. The overwhelming majority of venture capitalists agree that the government should allocate grants and R&D budgets for the traditional industry rather to the high tech industry. Most VCs are indifferent to investing in startups that received or did not receive funding from the Chief Scientist Office. And even with the new evolving cleantech sector there are not many VCs calling for increased government support. Hi-tech continues to be self reliant sector that leads, rather than being led by, the Israeli economy.

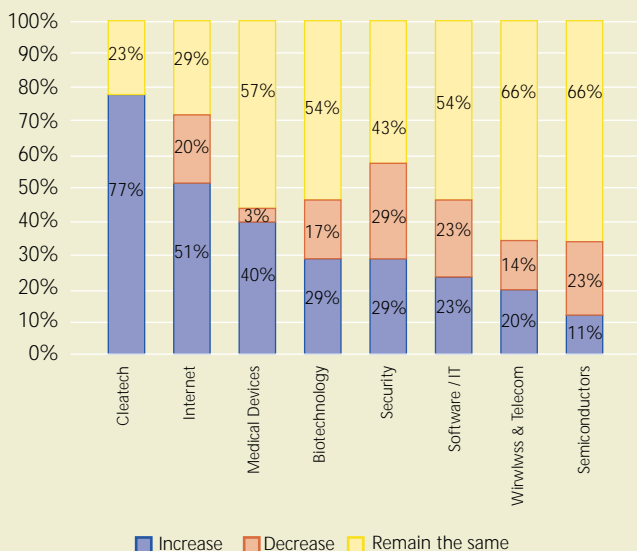
Most venture capitalists believe that Israeli companies who go public on NASDAQ tend to do so too early. Good market conditions for an IPO namely market appetite for new floats and increased interests in the company's field, are not enough. Revenue growth history, earnings and promising prospects are key factors to consider when assessing a company for listing.

This survey's findings show change in VCs sentiment into a more pessimistic trend in both investment and exit valuations. With venture valuations on the rise for a quite some time more venture capitalists are worried that we are in a much-hyped market. These fears are accompanied with a negative shift in overall economic climate expectation and might point out that it is time to be a bit more careful and cautious in the coming months.

Although the Israeli VC community has been working closely with the global VC industry for many years it still has misperceptions regarding what is keeping foreign VCs from investing in Israel. While most Israeli venture capitalists think the top impediments to investing in Israel are specifically high tech industry related, it transpires that that the foreign VCs are mainly deterred by safety and security concerns as well as the unstable political environment of Israel. As self reliant as it would be the high tech industry still depends on the general situation in Israel to draw more foreign investments.

The highest expectations of transaction increase are, once again, in cleantech. 77% of respondents expect an increase of transactions in this sector. The internet sector continues to be a hot area of investment activity. However, optimism has decreased substantially from Q2, 2007. Only 51% of respondents believe the number of transactions in this sector will increase over the next six months, compared to 68% in Q2, 2007. The medical devices sector is still among the most positive sectors, 40% expect transaction increase and only 3% expecting a decrease. Expectations in the semiconductors sector are the weakest (for the fourth consecutive quarter), with only 11% who foresee an increase in transactions, 66% say the number of semiconductor sector transactions will remain the same, 23% say it will decrease. (Chart 17)

Chart 17:
During the next six months, I expect the number of transactins in the second listed below to:



Contacts

We welcome suggestions for issues to be addressed in future Israel VC Indicator Surveys. You are welcomed to send them to Gil Shterzer at gshterzer@deloitte.co.il

For further information about this survey's results, the special services offered by Deloitte Brightman Almagor and its affiliates to VCs, how we can assist with deal initiation and the execution process, please contact Our **Deloitte's TMT industry specialists:**

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