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בריטמן אלמגור

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Technology, Media & Telecommunications

Israel VC Indicator Survey.

Expectations as of Quarter 4, 2006

Not in a bubble, yet

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 VC Survey is a Deloitte initiative, which is conducted on a quarterly basis concurrently in the UK, Canada, Israel, Germany, Austria, Spain, Belgium, Switzerland, the Netherlands, Italy, France, Australia, Hong Kong and China, India, Taiwan and Korea.

Responses were collected from December 25th 2006 through to January 1st 2007 from venture capitalists in Israel, including replies from the major VCs in the country.

Introduction

The Israel VC Indicator Survey is a comprehensive picture of VCs expectations for the next six to twelve months and acts as an indicator of changing confidence levels in:

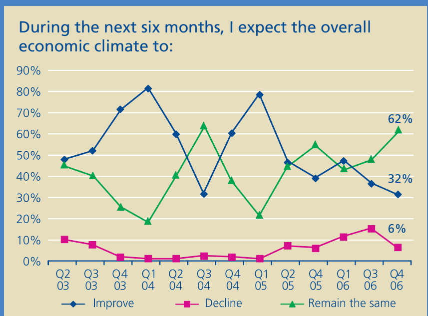
- Economic and market climate
- Deal activity
- Investment and Managerial focus

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 19th Deloitte Brightman Almagor Israel VC Indicator Survey results for Q4 2006 include a comparison, where relevant, to responses from previous surveys

Results

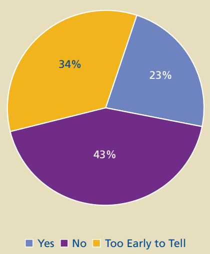
The results of the survey for the fourth quarter of 2006 reflect the stability of the Israeli economy. With the Tel Aviv Stock Exchange continuing to rise in 2006 and as the Shekel continues to strengthen against the dollar only 6% of respondents expect the overall economic climate to worsen (compared to 15% in Q3, 2006). A solid 62% believe that we will see no change and 32% expect the overall economic climate to improve (*Chart A*).



53% expect Israeli high tech capital raised in 2007 to be at around the same level as it was during 2006. 36% believe it will be higher, 11% think it will be lower compared to 2006.

No doubt that the high tech buzz word of 2006 was Web 2.0. New websites are popping up like mushrooms after the rain and internet deals are making headlines. Among Israeli venture capitalists there are more who believe that we are not back in a new internet bubble era, than those who believe that we are. Yet, the results are inconclusive, 43% say we are not in a bubble, 23% think we are in a bubble and as many as 34% of the respondents are undecided and say that it is too early too tell whether this is a new bubble *(Chart B)*.

Chart B: Are we back in an inernet bubble era:



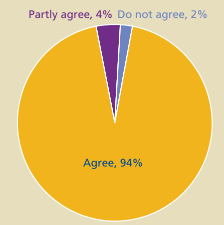
The Tel Aviv Stock Exchange was up for the fourth consecutive year in 2006. The TA100 index gained 12%, yet only 9% of the respondents believe that in the medium-term VC funds will provide returns that will under perform the TA100 Index (compared to 23% in Q3 2006). 71% believe VC funds will outperform the TA100 Index (compared to 58% in Q3 2006). 20% think that the funds will perform in line with the TA100 index.

Less venture capitalists expect the majority of their new investments to be made in seed stage - 20% compared to 27% in Q3 2006 and lower than the last four year average of 23.5%. On the other hand, the number of respondents that will invest mainly in first round have almost doubled to 45% compared to 23% in Q3 2006. The reason could be the rise in the amount of internet transactions which are usually financed at seed stage by angels rather than by VCs.

The indications are that the understanding and attitude of institutional investors in Israel towards the VC industry are improving. 54% of those surveyed agree (compared to 34% in Q3 2006). The US remains the main source for raising funds with 62% of the respondents intending to turn to the States for capital. The remaining respondents are split almost equally between Israel (11%), Europe (11%) and the rest of the world (16%). Venture lending is on the rise in the local VC market, 72% expect an increase in that activity in the next six months (compared to 63% in Q3 2006).

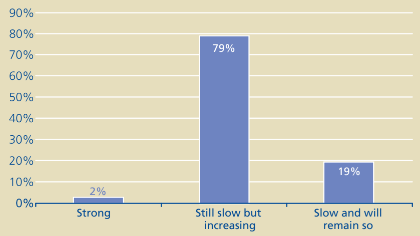
A lot of venture capitalists, 69%, believe that more startups should strive for an IPO and becoming long term sustainable companies, 31% oppose. But almost all of them (94%) agree that at least during the next six months M&A shall continue to be the main exit vehicle for Israeli companies. Four Israeli companies went public on Nasdaq during 2006. 67% of respondents believe that in 2007 we will see more IPOs, between six to ten. 33% think less than 5 companies will go public on the Nasdaq stock market *(Chart C)*.

Chart C: M&A will be the main exit vehicle for Israeli companies in the next six months:



Cleantech is making headlines but the deal flow is not strong, only 2% sense that actual cleantech deal flow is strong. The majority of respondents, 79%, say cleantech deal flow is slow but increasing. 19% believe that in spite of the many headlines in the papers cleantech deal flow will remain slow *(Chart D)*.

Chart D: In light of the anticipated increase in cleantech transactions, you sense that the actual deal flow is:



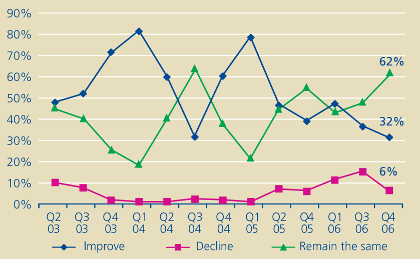
As mentioned above, the actual deal flow is not yet strong but 73% of respondents expect the number of cleantech transactions to increase during the next six months (compared to 67% in Q3 2006), there were no respondents who believe that it will decrease. The leading sector in which expectations are for transactions to increase is the internet, with 76% of respondents expecting an increase (compared to 55% in Q3 2006). Expectations in the semiconductors sector are the weakest, with only 15% who foresee an increase in transactions, 65% say the number of semiconductor sector transactions will remain the same, 20% say it will decrease.

Insights

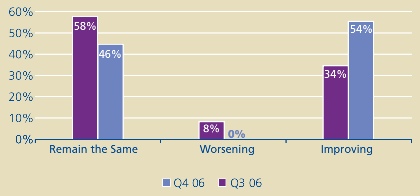
- It does not seem that we are entering another internet bubble, at least not for now. Why not? First of all it's much cheaper to start these days - initial investments are small. Since feedback on success is fast - capital sunk into failed startups will not be huge. Marketing and development expenses are significantly lower than in the dotcom era, which means burn rate is lower and there is no need for a quick infusion of growth capital.
- Venture capitalists expect investment valuations to increase. A lot of VC money is chasing too few interesting companies. When the deal flow quality is not good enough, the competition for good deals means that many startups will get funded at higher valuations.
- The continued growth in M&A activity shown in 2006, and forecasted for 2007, is perceived by venture capitalist to be moving at a healthy steady pace. Thus, expectations for the coming months are that exit valuations will remain about the same.
- Venture capitalists came under fire in recent weeks. Their criticizers have been claiming that VCs are pushing their portfolio companies for quick exits rather than trying to help the startups grow into long-term sustainable companies. Surprisingly an overwhelming majority of the VC Indicator respondents said that more companies should strive for an IPO rather than seeking an acquisition exit. Add that to the expected easing of Sarbanes Oxley compliance rules for small companies and we might just see more Israeli companies going public on Nasdaq.
- Cleantech continues to generate a lot of buzz in the press and among venture capitalists. Though, as of now, there are not many actual transactions that are taking place. It seems that not too many in the VC industry know how to deal with cleantech startups and on the other hand, not too many cleantech entrepreneurs are familiar with the VC world. The industry as a whole still has some studying to do before buzz translates into transactions.

Detailed Results, Quarter 4, 2006

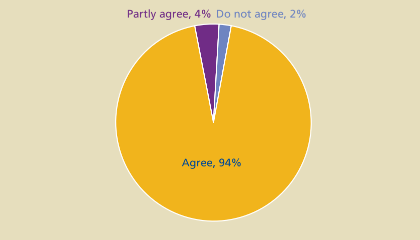
During the next six months, I expect the overall economic climate to:



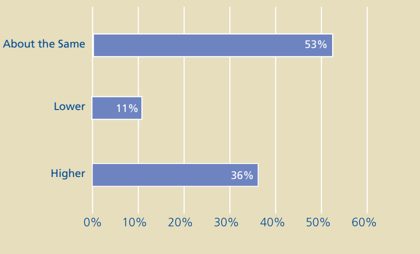
I feel that the understanding and attitude of institutional investors in Israel towards the VC industry are:



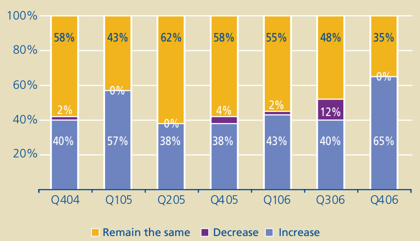
M&A will be the main exit vehicle for Israeli companies in the next six months:



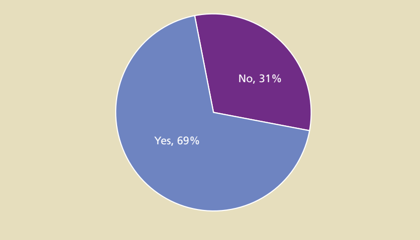
Compared to 2006 I expect Israeli high-tech capital raised in 2007 to be:



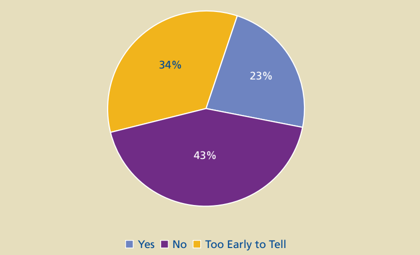
During the next six months, I expect investment valuations to:



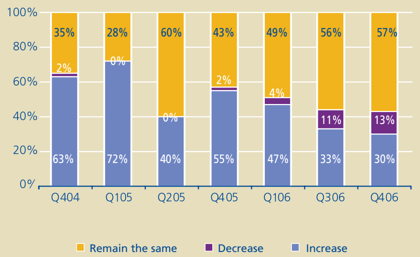
Should more startups strive for an IPO and becoming a long-term sustainable company:



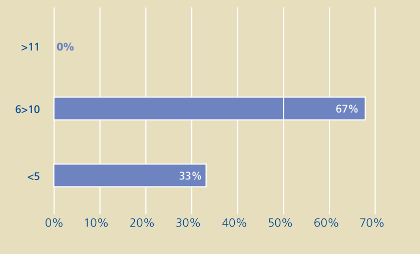
Are we back in an inernet bubble era:



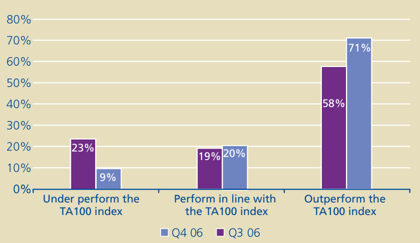
During the next six months, I expect exit valuations to:



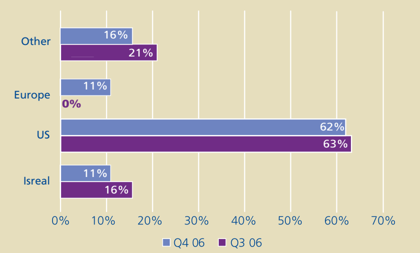
The number of Israeli companies that will go public on Nasdaq during the coming year:



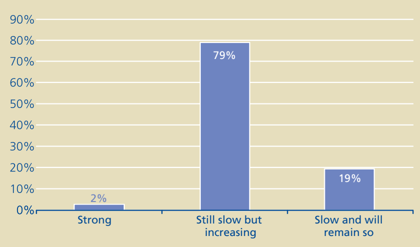
My current medium-term view is that VC funds will provide returns that will:



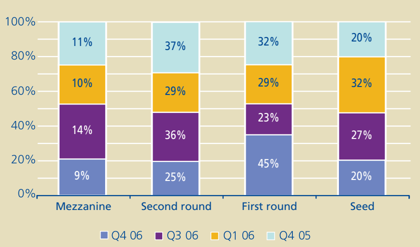
If I intend to raise funds within the next 6 months, the capital would be raised form:



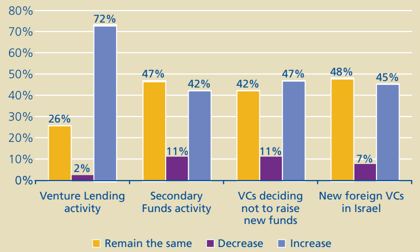
In light of the anticipated increase in cleantech transactions, you sense that the actual deal flow is:



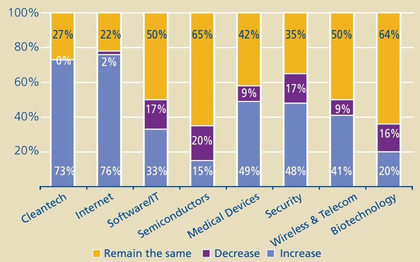
During the next six months, I expect the majority of my new investments to be made in:



During the next six months, I expect the VC industry to see:



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



Contacts

We welcome suggestions for issues to be addressed in future Israel VC Indicator Surveys.
Comments or suggestions can be sent to: gshterzer@deloitte.co.il

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