

# Israel VC Indicator Survey.

Expectations as of Quarter 2, 2011

## Bubble Trouble?



## 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 37th Deloitte Brightman Almagor Zohar Israel VC Indicator Survey results for Quarter 2, 2011 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's VC Indicator Survey Quarter 2, 2011 were collected from June 1st, 2011 to June 24th, 2011. 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.

# Second Quarter, 2011

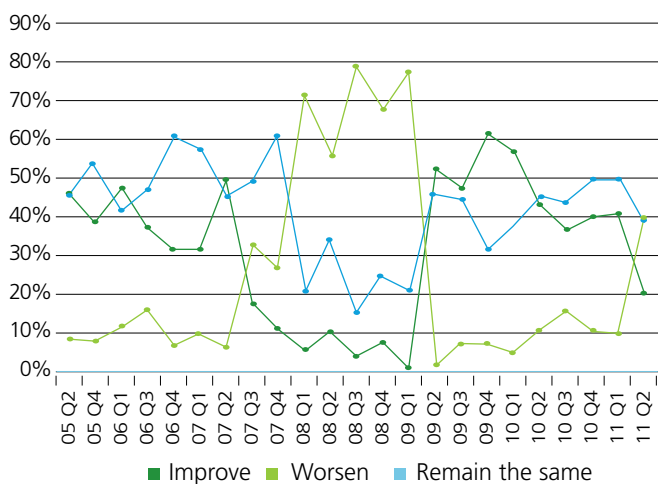
## Highlights

- Economic climate sentiment experiences a nasty spike in terms of negativity
- Internet poised to be spoiled from all the attention
- Shift to later stage investments becomes a scare
- Perception that LinkedIn, Facebook, Zynga, Twitter and Groupon are all overvalued
- Bubble #2 is a coin flip

## Results

Q2 2011 experiences a spike in negativity in terms of venture capitalist expectations of the overall economic climate during the next six months. The last time there was an increase of economic pessimism of this magnitude was prior to the latest global credit crunch. This negative shock translates to a 31% QoQ increase in venture capitalist expectations for the overall economic climate to worsen, in parallel to a 21% drop in expectations for economic improvement.

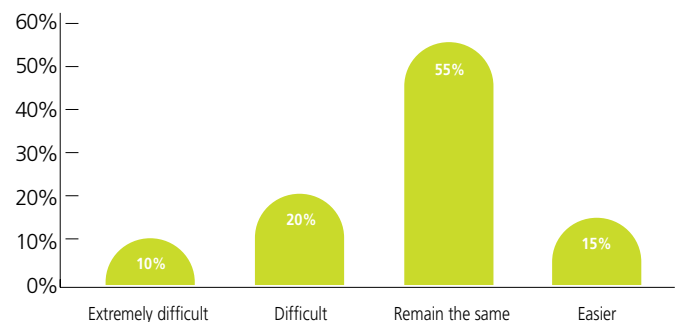
### During the next six months, I expect the overall economic climate to:



After Israel experienced one of its worst years in 2010 in terms of venture capital fund raising, surveyed participants project a continuation of cautious optimism regarding future fundraising activities. Despite roughly one in every two surveyed participants expecting fundraising activities to remain the same, 15% claim that it will become easier, translating into only a 3% QoQ climb. It is also important

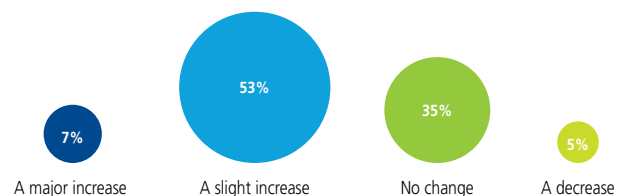
to point out that there is a 6% QoQ drop in venture capitalist expectations for VC fundraising activity to become difficult while respondents who believe this to be extremely difficult held at 10%.

### In the next six months, I expect VC fundraising activity to become:



VC manager's expectations regarding deal flow activity seemed to be infected by recent market jitters, given that currently 60% believe the deal flow to increase during the next six months, compared to the last three quarters. This is in contrast to 74% of respondents claiming deal flow activity to increase in Q1 2011. This relative pessimism towards deal flow is even more apparent due to the fact that 5% of surveyed participants forecast a decrease in activity to come within the next six months, the highest figure since Q2 2010.

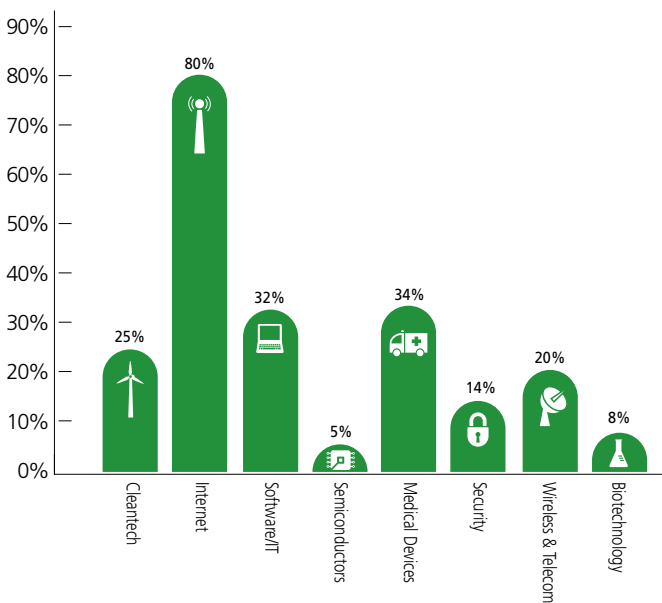
### I expect deal flow activity in the next six months, compared to the last three quarters, to show:



The hi-tech sector that venture capitalists believe will yield the most M&A activity within the next six months is the Internet sector (80%). This constitutes a 30% jump in M&A activity perceptions for the Internet sector since Q4 2010 and a 7% increase since the previous quarter. M&A activity expectations for the Medical Device sector

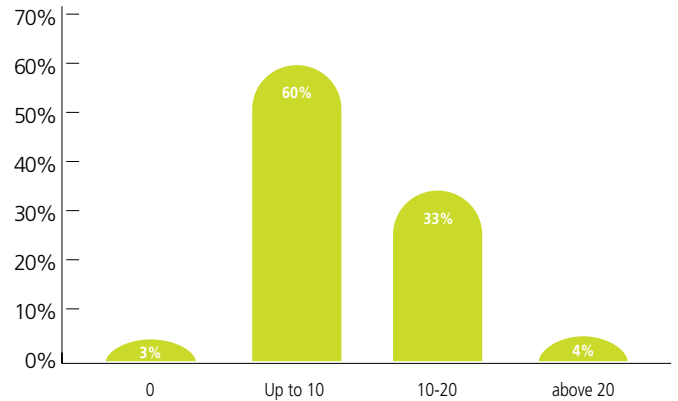
increased 10% QoQ. The Software/IT sector is also believed to experience much attention but expectations for M&A activity dropped by 10%. Whereas the Biotech and Semiconductor sectors are forecast to experience the least M&A activity (8% and 5%, respectively) during the next six months.

**In which hi-tech sector do you think there will be the highest M&A activity during the next six months?**



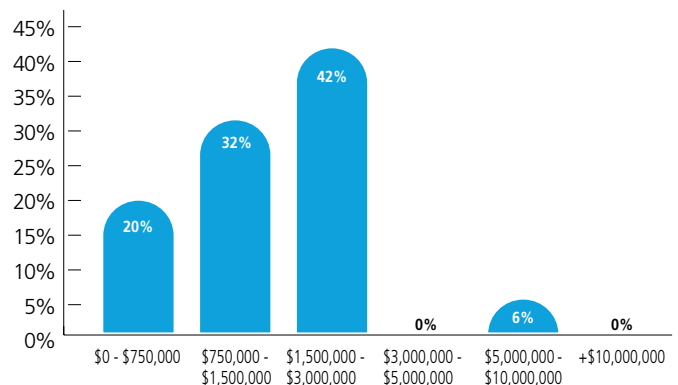
As "exits" will always be the name of the game in the VC world, it is of no surprise that VCs believe that we will continue to witness additional tech companies acquired, merged, IPOed, etc. Vast majority - 60% of surveyed venture capitalists expect to see 0 – 10 exits in the next six months and 33% expect to see 10 – 20 companies to exit during the next six months. Confidence on this front could be understood by an impressive 12% rise in venture capital "exit" sentiment shifted to believe that 10-20 technology companies will exit during the next six months.

**I expect to see \_\_\_\_ technology companies to exit during the next six months:**



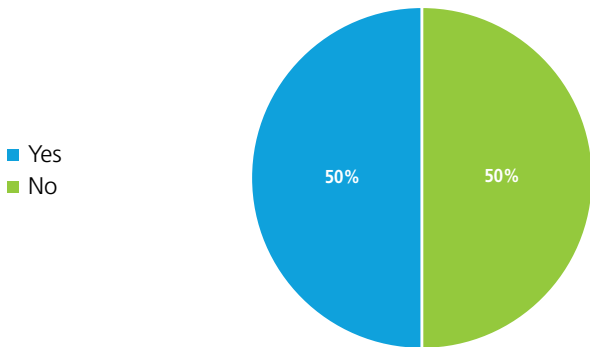
Currently, venture capitalists seem to be less eager to take risks as they shift to a more conservative mindset regarding future investments. It seems clear that venture capitalists expecting to invest in later stages resembles pre-crisis levels, revealing less of an inclination to invest in riskier assets. This relative risk aversion can be identified through a 36% fall in expectations for average investments per new company to reach \$1.5M. It is also important to point out that there is a 32% jump in surveyed respondents claiming that they expect their new investments to average \$1.5M - \$5M.

**Do you expect the average investment per new company your VC invests in to equal (in USD):**



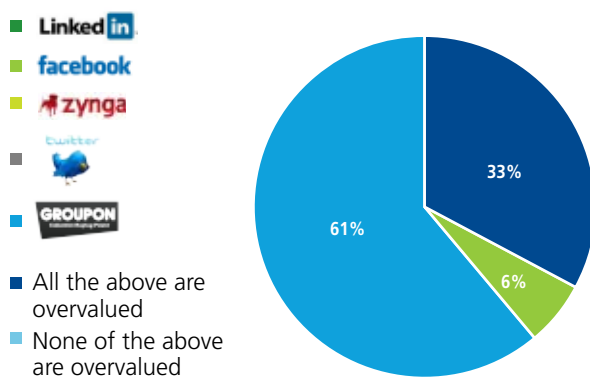
Now as after years in the doldrums, the IPO market for technology firms has suddenly sprung to life again in America and thus the question "are we headed for a second internet bubble" is debated throughout the global hi-tech arena. Skyrocketing valuations, increased focus on user traction and relatively weak revenue streams leaves us with the belief, hope and greed that dotcom companies will pave the way to grow beyond their potential but leaves Israel's venture capitalists torn between whether or not we are headed yet to another dotcom bubble burst.

**Do you believe that we are heading into a second dotcom bubble?**



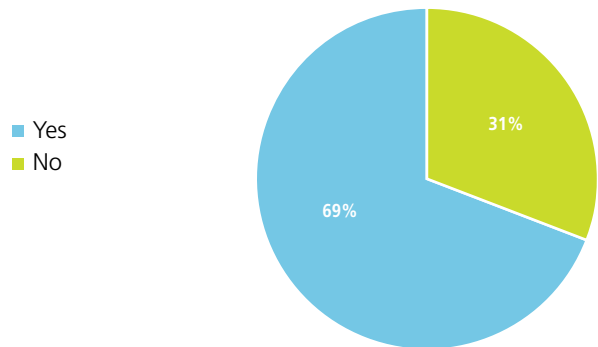
It is of no surprise that no surveyed venture capitalist believes that hi-tech companies such as LinkedIn, Facebook, Zynga, Twitter or Groupon are valued correctly when companies such as LinkedIn floated on the NYSE at \$8.8 billion valuation - 572 times its profits last year - at the end of the first day of trading. As web outfits including Groupon line up to join the IPO party at a rumored \$15bn valuation, while still bleeding red ink, should make more investors question whether they want to party with these "money printing machines".

**Which hi-tech company do you believe is currently most overvalued?**



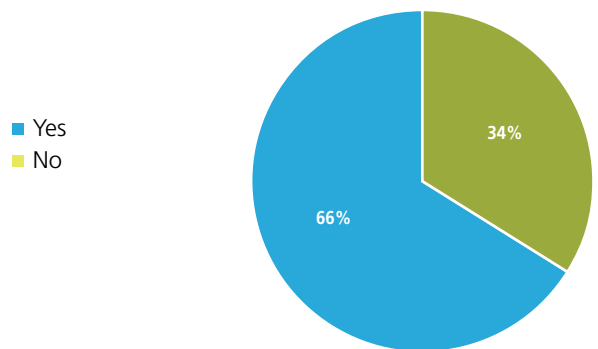
Despite presumed economic wariness emerging, venture capitalists seem to be relatively optimistic regarding future fund raising activity. Such that, 56% of surveyed respondents expect their VCs next fund to undergo an increase in AUM, whereas only 9% forecast a decrease in assets under management.

**Should the Treasury provide additional incentives for early stage hi-tech companies in Israel?**



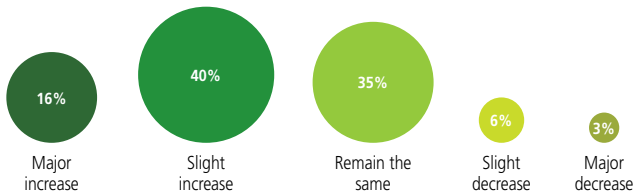
Only 31% of venture capitalists support the Treasury's involvement in incentivizing early stage hi-tech companies in Israel. This compares to a significant 69% who do not believe the Treasury is taking an active enough role in helping companies in this stage of their life cycle.

**Do you believe that an Israeli startup can become one of the next major global internet companies during the next 5 years?**



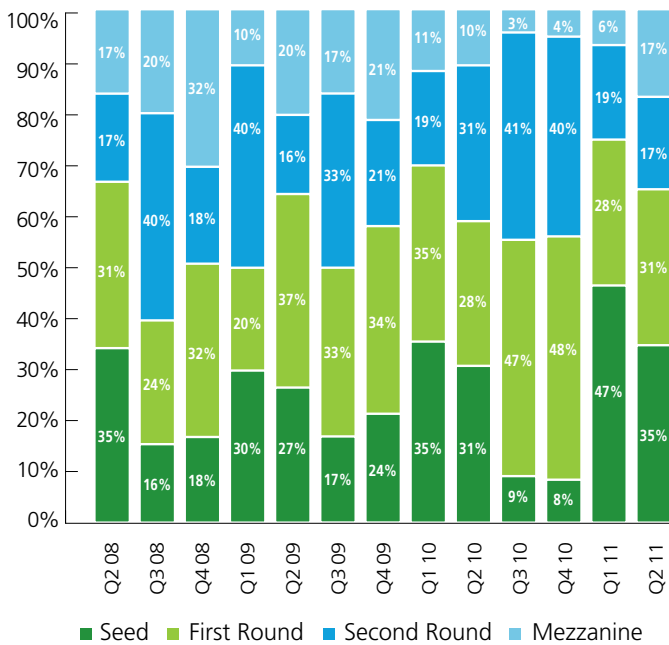
In the recent past much attention has been focused on the size of "exits" in Israel. Israel has produced countless mini-exits in the internet space but two-thirds of surveyed participants believe that Israel will fail to produce a mega-internet company. Israel's hope to one-day produce a major global Internet company seems bleak to the majority but there is still one in three venture capitalists who believe this to be in our not so distant future.

**Do you believe that your VCs next projected fund size compared to the current fund size (AUM) will undergo a:**



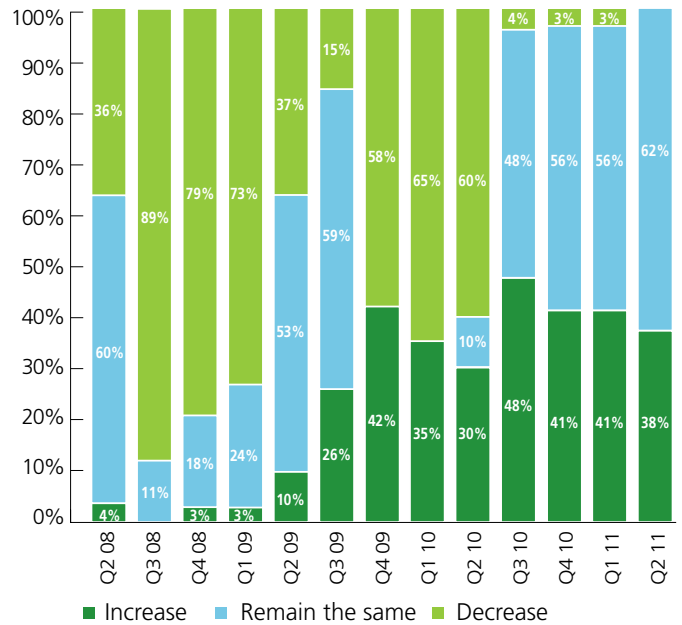
The segmentation of forecasted new investments reflects a relative jump in pessimism. Our survey shows that 31% of venture capitalists currently expect the majority of new investments to be made in Seed, reflecting a 16% QoQ drop. Early investments (Seed and First Round) experienced a 7% drop QoQ. This was after Q1 2011 experienced the highest early investment expectations since Deloitte Brightman Almagor Zoar recorded investment stage investment expectations (Q1 2003).

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



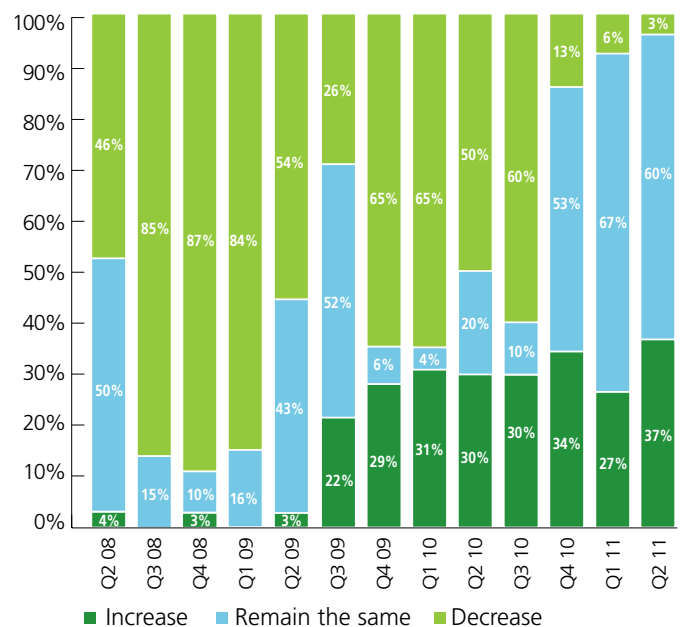
In similarity to last quarter's surveyed responses - venture capitalists are split apart on the path that exit valuations are going to take during the next six months. This is evident from the fact that all venture capitalists are still virtually torn between whether they believe exit valuations are to improve or to remain the same. Despite of what may be seen as general confusion about future exit valuation expectations, no surveyed respondents believe this to decrease during the next six months.

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



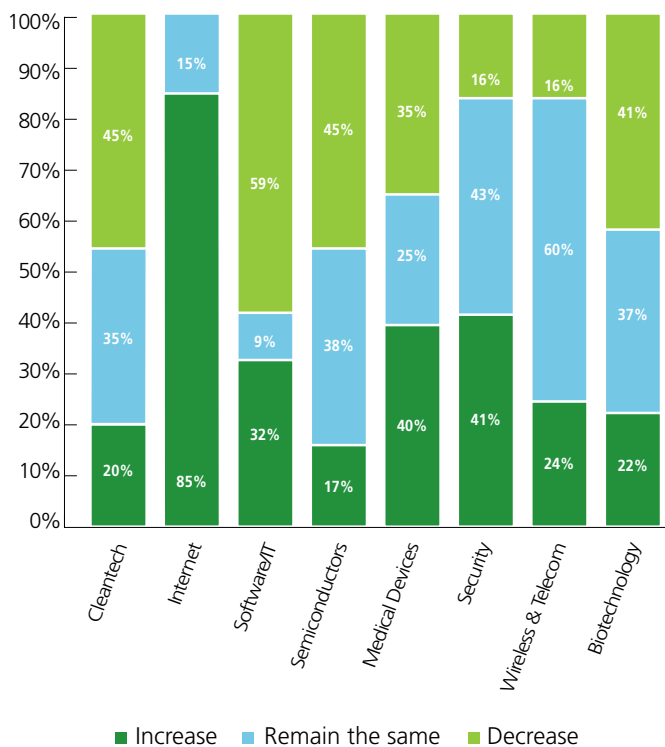
This quarter's investment valuation expectations for the next six months clearly show a drop in venture capitalist expectations pertaining to investment valuations to decrease. This is understood through only 3% of respondents expecting investment valuations to decrease, the lowest level recorded since Q2 2007. Despite a majority of venture capitalists (60%) still on the fence regarding investment valuations during the next six months, there is a 10% QoQ rise in expectations for an increase in investment valuations.

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



The Internet sector shined even brighter with a whopping 85% forecasting this sector to project the highest number of transactions during the next six months. This compares to an also very high 80% in Q1 2011, where the Internet sector was also considered to be the sector which will be the center of attention during the next six months. In addition, Clean Tech and Security sectors are also perceived with much interest, such that 45% and 41% (respectively) of respondents expect these sectors to have the highest amount of transactions. The sectors perceived to result in the least amount of transactions are Biotechnology (22%) and Semiconductor (17%).

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



## Insights

Venture capitalists perception regarding market sentiment indicates a sudden emergence of suspicion to what lies ahead. Such that, the last time there was an increase of economic pessimism of this magnitude was prior to the financial tsunami that drowned global markets in fear of apocalypse. Time will tell whether this is the reemergence of economic bedlam or just venture capitalists belief that there will be some severe headwinds before we get back to calmer waters. Either way, even after Israel experienced one of its worst years in 2010 in terms of venture capital fund raising, surveyed participants in Q2 2011 are still cautious regarding their future fundraising activities. This poses a sincere threat to the industry as a whole and is thus presumably an additional burden weighing down VC sentiment.

VC manager's expectations regarding deal flow activity seem to be also infected by recent market jitters, given that 14% less venture capitalists believe this to increase in the next six months in comparison to Q1 2010. But despite the propensity for a global "lost decade" scenario on the rise, the Internet sector seems to be the catalyst for hope and promise. This is extrapolated by surveyed participant's indication that the Internet sector will shine even brighter with a whopping 85% forecasting this sector to project the highest number of transactions during the next six months.

All surveyed venture capitalists currently claim that hi-tech companies such as LinkedIn, Facebook, Zynga, Twitter and Groupon are overvalued due to the overwhelming attention and focus that user traction has received rather than bottom-line earnings. But even though many of these companies continue to bleed red ink, and the ride can get bumpy at times, they possess the necessary hold over the masses to lead our world to a much needed paradigm shift...

