

Israel VC Indicator Survey.

Expectations as of Quarter 3, 2010

Can the Treasury Push Hi-Tech Forward?



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 34th Deloitte Brightman Almagor Zohar Israel VC Indicator Survey results for Quarter 3, 2010 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 3, 2010 were collected from September 12th, 2010 to September 26th, 2010. 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.

Third Quarter, 2010

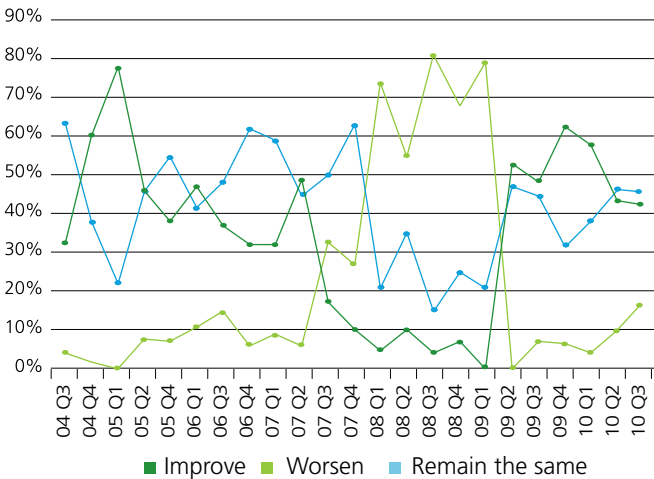
Highlights

- Further deterioration of economic climate sentiment
- Strong support geared towards Treasury's participation in taking on itself risk to a height of 20% of local investment in local VCs
- Majority of respondents claim that the Treasury's job should be to incentivize specific subsectors according to national priorities
- VC managers continue to be optimistic in regards to deal flow activity
- Venture Capitalists torn between whether or not Israel needs a "Nokia"

Results

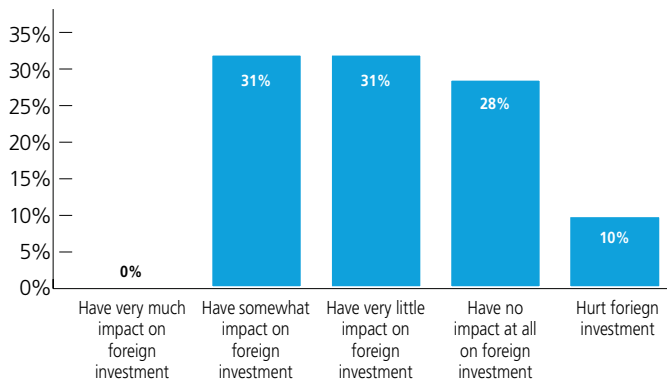
The general perception among venture capitalists indicates market sentiment improvement when compared to the levels seen during the "credit crunch". However, this improvement has made its fourth straight QoQ decline. Deterioration in overall economic climate started faltering subsequent to market improvement expectations in Q4, 2009 when it hit a staggering high 63%, constituting a 24% drop to date. Further deterioration is seen through 16% of venture capitalists forecasting economic climate to worsen during the next six months, the most pessimistic figure since Q1 2009. The number of respondents forecasting economic climate to remain the same declined by 2% QoQ.

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



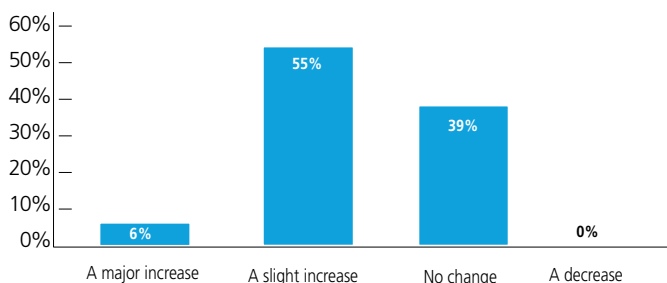
the aforementioned initiative will have somewhat of an impact on foreign investments, 31% believe it'll have very little impact, and one in ten venture capitalists forecast this initiative to hurt foreign investments. On the flipside, only around a quarter of surveyed participants believe this to have no impact on foreign investments.

Chart 4: Do you believe the aforementioned initiative will:



VC managers continue to be optimistic in regards to deal flow activity, such that 61% of respondents claim deal flow activity to increase. The positive sentiment towards deal flow is even more apparent due to the fact that no surveyed participant forecasts a decrease in activity to come within the next six months. This is in parallel to 39% of respondents forecasting deal flow to remain at current levels.

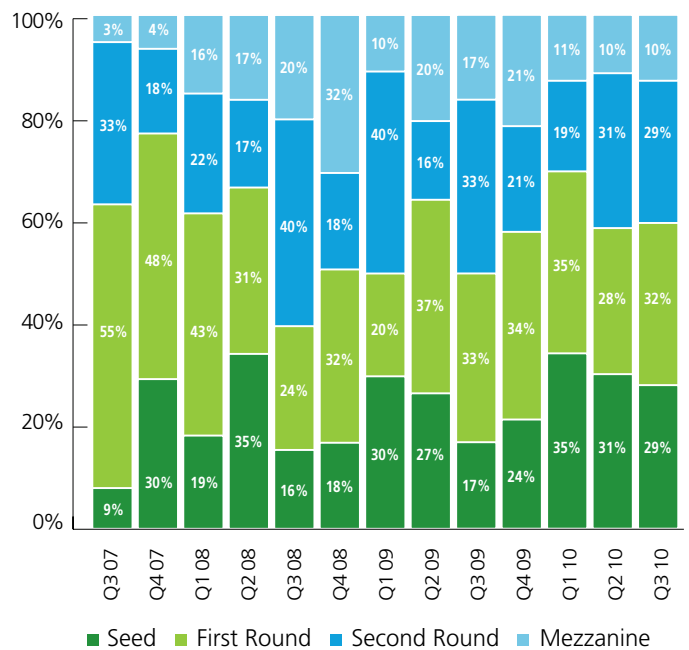
Chart 5: I expect deal flow activity during the next six months, comparing to the last three quarters, to show:



The segmentation of forecasted new investments reflects a continuation of cautious optimism, such that 29% of venture capitalists currently expect the majority of new investments to be made in Seed Round and 32% forecast new investments in Second Round. Early investments (Seed and First Round), constitute a 2% increase QoQ, however, 9% lower than the first quarter of 2010. Forecasts for new investments in Mezzanine Round

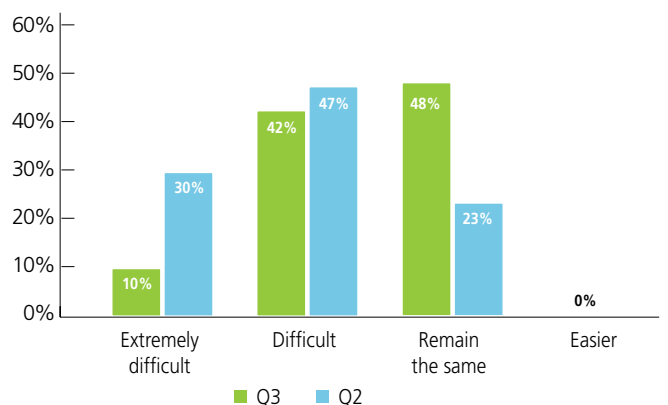
held stiff at 10%, bearing much resemblance to the rest of 2010. The general up leg seems to provide a clear indication that we are headed towards rosier times but it also remains evident that venture capitalists need an additional confidence boost before returning to pre-crisis levels.

Chart 6: During the next six months, I expect the majority of my new investments to be made in:



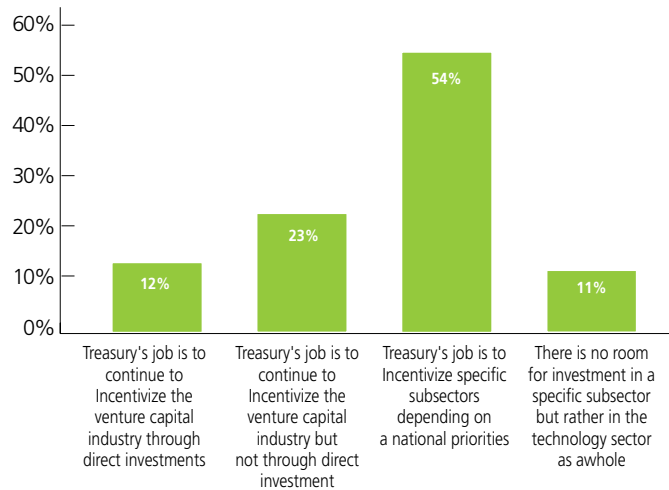
Surveyed participants are split between future fundraising activities. Such that a striking 52% of respondents claim that venture capital fundraising will become more difficult, whereas 48% claim that venture capital fundraising will remain the same. Some optimism can be found by a 20% QoQ drop in respondents believing fundraising to become extremely difficult, but on the flipside no respondent believes fundraising to become easier.

Chart 7: VC Fundraising activity will become:



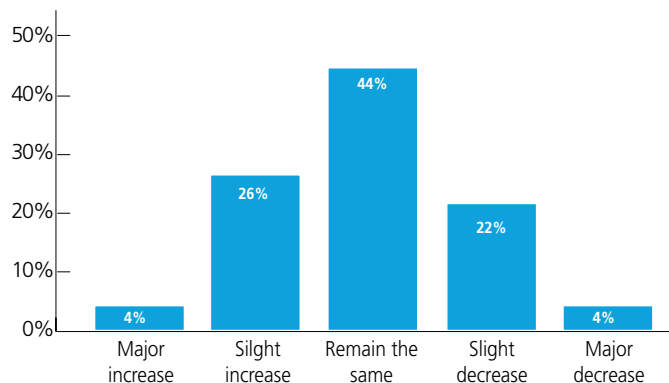
A majority (54%) of venture capitalists claim that the Treasury's job is to incentivize specific subsectors depending on national priorities. 23% of surveyed participants think that incentives shouldn't be made through direct investments, in contrast to 12% that believe it should. Only 11% of respondents believe there is no room for investments in a specific subsector but rather in the technology sector as a whole.

Chart 8: Which of the following statements do you agree with most bearing in mind that the Treasury recently announced a direct investment of \$24 million into each of the three Israeli-American VC biotech funds who will successfully raise \$76 million



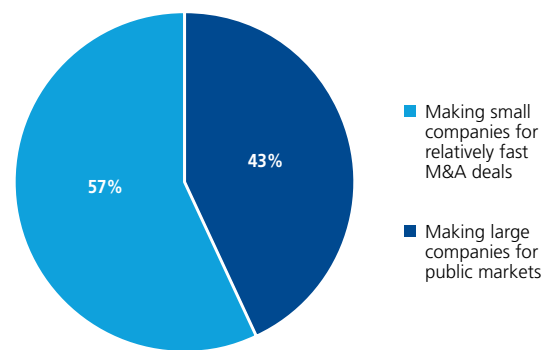
Additional sparks of cautious optimism emerge as 27% QoQ fewer venture capitalists expect a drop in assets under management in their projected fund size compared to current fund size. In addition, a majority of venture capitalists (44%) believe that AUM to remain the same.

Chart 9: Projected fund size compared to current fund size (by AUM):



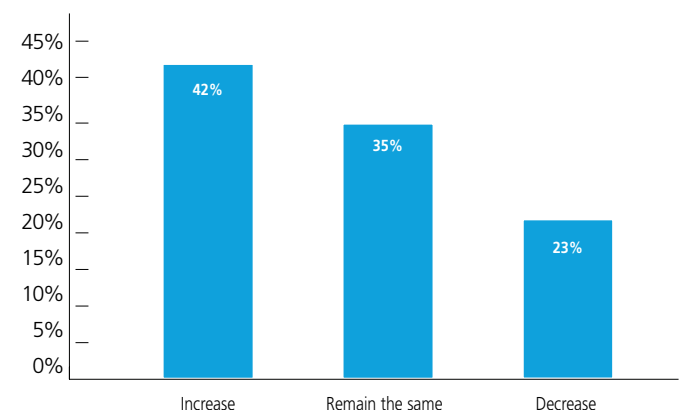
Israelis frequently look to Finland and ask, "Where's our Nokia, why hasn't Israel produced a technology company as large and successful as Nokia?" Despite this debate receiving more attention in the recent past, venture capitalists are still torn between whether VCs in Israel should focus on making large companies for public markets or making small companies for relatively fast M&A deals. Such that, 43% believe VCs focus should be on making large companies for public markets, while a slightly higher percent (57%) deem focus should be on making small companies for relatively fast M&A deals.

Chart 10: Do you believe VCs in Israel should focus on making large companies for public markets or making small companies for relatively fast M&A deals?



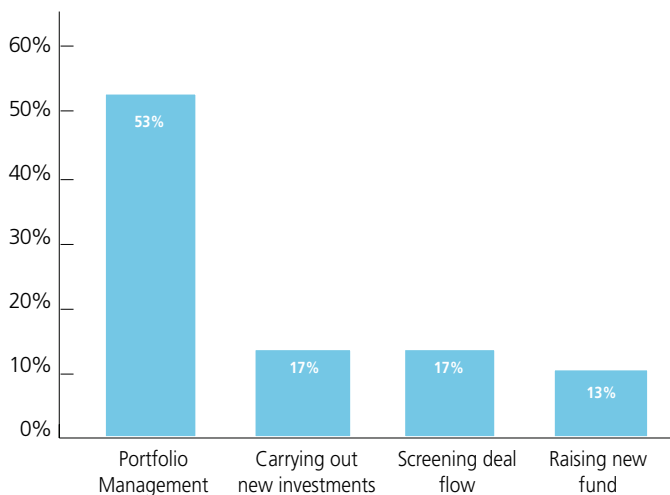
A hefty 77% of respondents claim that average venture capitalist fund multiples to remain the same or increase in the next 12 months, whereas only a quarter of venture capitalists claim there will be a decrease.

Chart 11: Do you believe the average venture capital fund multiple will increase, decrease or remain the same in the next 12 months:



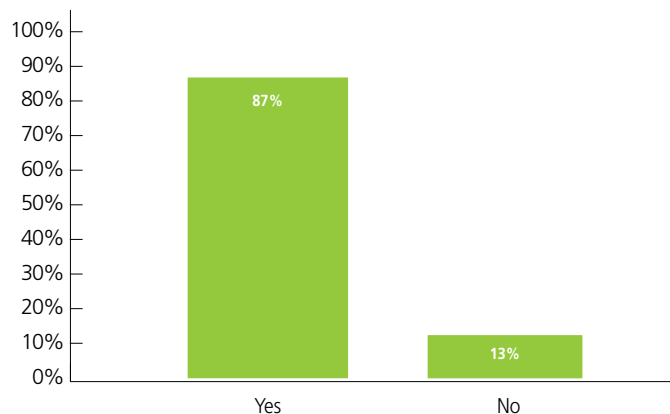
According to venture capitalists, 53% of them expect to allocate a majority of their time to Portfolio Management, translating into a 10% QoQ increase. In conjunction with the aforesaid, faltering optimism can be noted by a 7% increase in deal flow screening which could be attributed to the increase in expected time allocated towards Portfolio Management. Perpetual signs of instability in the market continue to shed clear indication to why only 17% of venture capitalists time is expected to be spent on carrying out new investments, a drop of 3% QoQ.

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



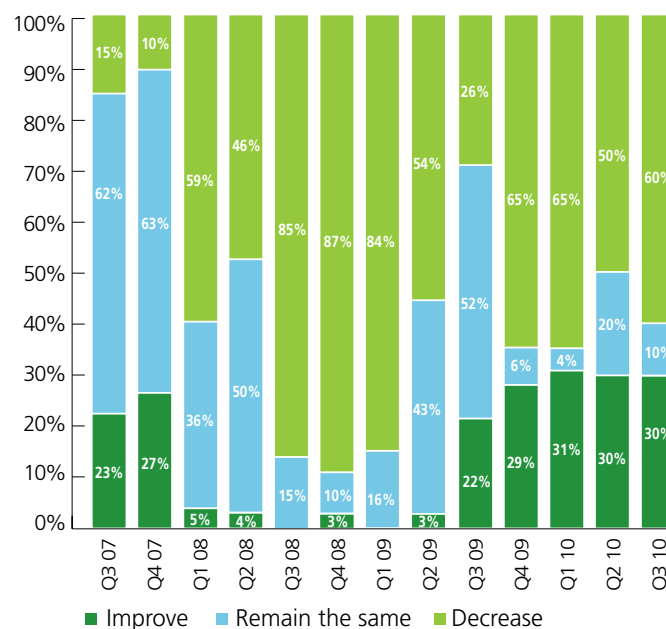
Expectations regarding the strength of the VC recovery still remain to be a question; nonetheless, a staggering 87% of venture capitalists forecast the recent surge in foreign hi-tech M&A activity to reach Israel within the next 12 months. Momentum in M&A confidence reaching Israel has been spilling over since Q2 2010 when at that time 77% of surveyed participants claimed that merger and acquisition activity was ramping up.

Chart 13: Do you believe the recent surge in foreign hi-tech M&A activity will reach Israel within the next 12 months?



This quarter's investment valuation expectations for the next six months bear much similarity to all surveyed results since late 2009. Currently, 60% of respondents believe a decrease to come within the next six months, whereas 30% of venture capitalists believe investment valuation expectations are poised to increase. The remaining 10% forecast investment valuation to remain the same. The 10% QoQ upswing in expectations for investment valuation to falter in the next six months provides additional signs of market wariness.

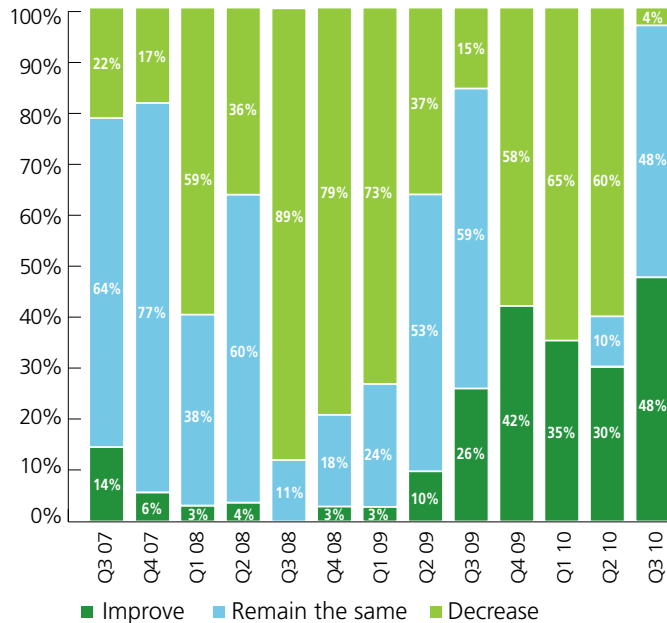
Chart 14: During the next six months, I expect investment valuations to:



Venture capitalists are split apart on their forecasts regarding their exit valuation expectations. An even 48% of venture capitalists are torn between exit valuations to improve or remain the same. Despite of what may seem as general confusion about future exit valuation expectations, forecasts indicating improvement are the highest since Q4, 2005.

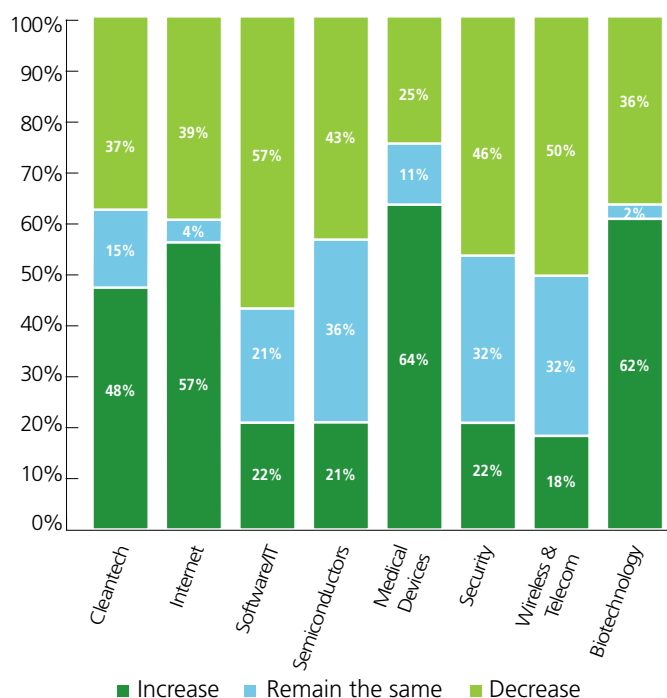
Insights

Chart 15: During the next six months, I expect exit valuations to:



The medical device sector continues to shine with 64% forecasting this sector to project the highest number of transactions during the next six months. In addition, Biotechnology and the Cleantech sectors are also perceived with interest, such that 62% and 57% (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 telecommunications (18%) and semiconductor (21%).

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



The general perception among venture capitalists indicates market sentiment improvement compared to levels seen during the "credit crunch". This improvement, however, has been losing steam for four straight quarters. Despite high-tech proving relatively resilient to the global chaos, the Treasury has taken increasing interest in aiding the backbone of Israel's economy. Support for such actions can be extrapolated through 70% of venture capitalists supporting the Treasury's new planned initiative to encourage Israeli institutional investors to invest in local venture capital funds by the state's participation in taking on itself part of the risk. Additional actions are being administered through the Treasury's proposed initiative to provide a direct investment of \$24 million into each of the three Israeli-American VC biotech funds who will successfully raise \$76 million.

The Treasury's recent announcements of its efforts to further stimulate Israel's high-tech industry came as Israel embarked on its first IPO on the NASDAQ since July 2007, in parallel to a flurry of M&A activity emerging both in the USA and Europe. Despite the strength of the VC recovery still remaining a question, a staggering 87% of venture capitalists forecast the recent surge in foreign hi-tech M&A activity to reach Israel within the next 12 months. Thus it seems that whether Israel will have a "Nokia" or not somewhere in the future, M&A activity is on the verge of exploding.

VC managers continue to be optimistic in terms of deal flow activity, such that 61% of respondents claim deal flow activity to increase. The positive sentiment towards deal flow is even more apparent due to the fact that no surveyed participant forecasts declines in activity to come in the next six months. But it seems that stimuli from the Treasury is arriving just in time as 53% of venture capitalists expect to allocate a majority of their time to Portfolio Management, whereas only 17% towards carrying out new investments. Thus it seems evident that for Israel to not only aid the coming wave of exits but help facilitate the next wave, the Treasury has to stick to its guns and provide the necessary stimuli not just to its next potential "Nokia" but to its economic backbone.

