

# Israel VC Indicator Survey.

Expectations as of Quarter 2, 2010

## Can Israel Decouple?



## 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 33rd Deloitte Brightman Almagor Zohar Israel VC Indicator Survey results for Quarter 2, 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 2, 2010 were collected from June 19th, 2010 to June 28th, 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.

# Second Quarter, 2010

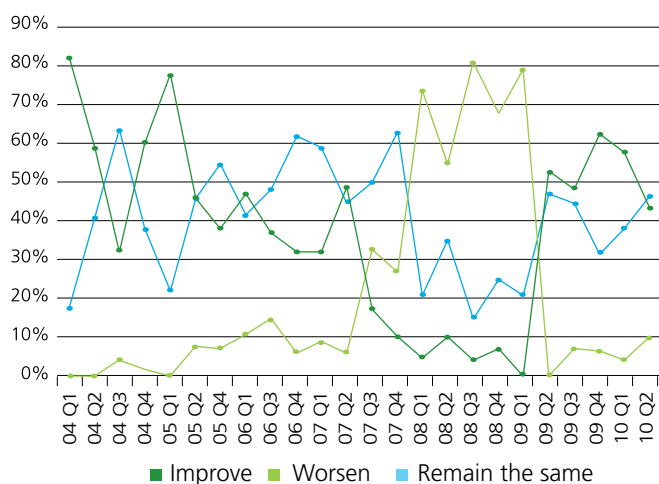
## Highlights

- Expectations regarding market improvements begin to decline
- Forecasts of new investments reflect cautious optimism
- Increasing optimism geared towards 2010 as the year to unfold as Israel's first IPO on NASDAQ
- Geopolitical issues raise concerns amongst venture capitalists
- Treasury Department should focus on encouraging
  - 1) Seed investments and on 2) encouraging Israeli institutions to take a larger role in high-tech investments

## Results

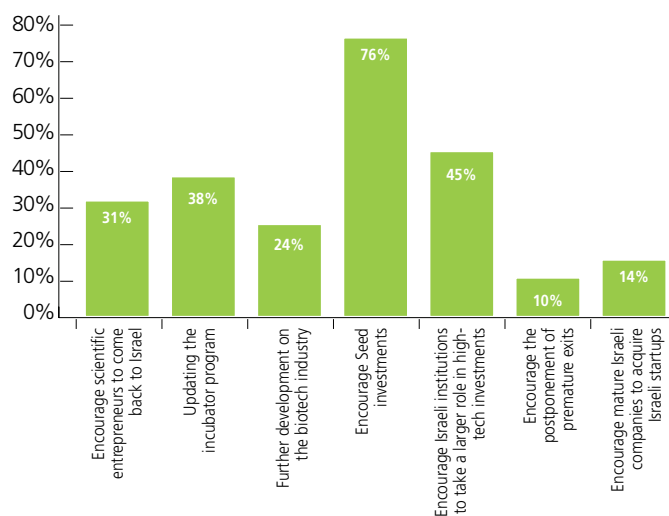
The general perception amongst venture capitalists indicates market sentiment improvement comparing to pre-crisis levels, however, this improvement has been faltering for two straight quarters. It is essential to note that Q1, 2009 economic climate improvement expectations were at a staggering low 0%, whereas in Q2, 2010, 43% of respondents expect the overall economic climate to improve. This is in parallel to only 10% of venture capitalists forecasting economic climate to worsen today in contrast to 79% in Q1, 2009. The number of respondents that forecast the economic climate to remain the same went up by 9% QoQ. At the same time, however, the number of those who believe that the economic situation will worsen has experienced the same 9% increase, revealing a greater proportion of respondents expressing a weakening belief in a strong recovery.

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



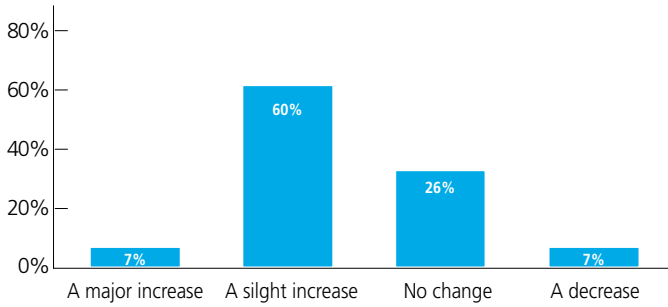
The survey also found that 76% of respondents believe that the Treasury Department's "Competitive Advantage" program to encourage the high-tech industry should focus on encouraging Seed investments. Whereas, 45% of respondents believe the Treasury Department should focus on encouraging Israeli institutions to take a larger role in high-tech investments. 38% of venture capitalists believe that their focus should be on updating the technological incubators program. A staggering low of 10% of surveyed participants believe that the Treasury should provide incentives for the postponement of premature exits in parallel to only 14% believing that the Treasury should encourage mature Israeli companies to acquire Israeli startups.

**Chart 2: Which of the following incentive plants established by the Treasury Department do you feel are most important to tackle (you can choose more than one)?**



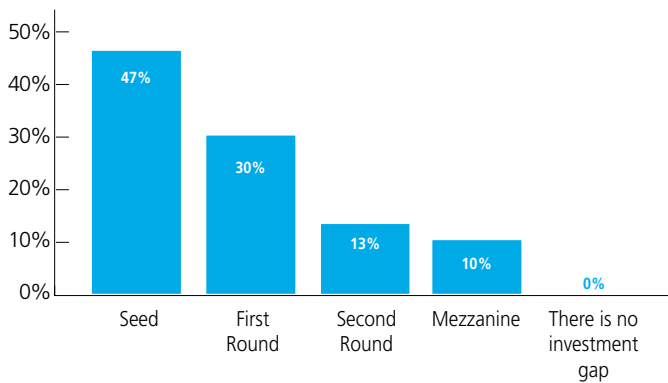
Optimism amongst VC managers continues to be felt towards deal flow activity; however, this optimism has begun to weaken with only 60% of respondents claiming deal flow activity to increase, in comparison to 72% in previous quarter. The positive sentiment towards deal flow is even more apparent due to the fact that only 7% of respondents forecast declines in activity while roughly a quarter of surveyed participants forecast deal flow to remain at current levels.

**Chart 3: I expect deal flow activity during the next six months, comparing to last three quarters, to show:**



It is interesting to note that there is a clear shift in the investment gap focused on earlier stages, whereby 77% of venture capitalists believe the gap is in Seed and First Round. 13% of respondents believe this gap to be in Mezzanine financing and no venture capitalist believes that there is no investment gap.

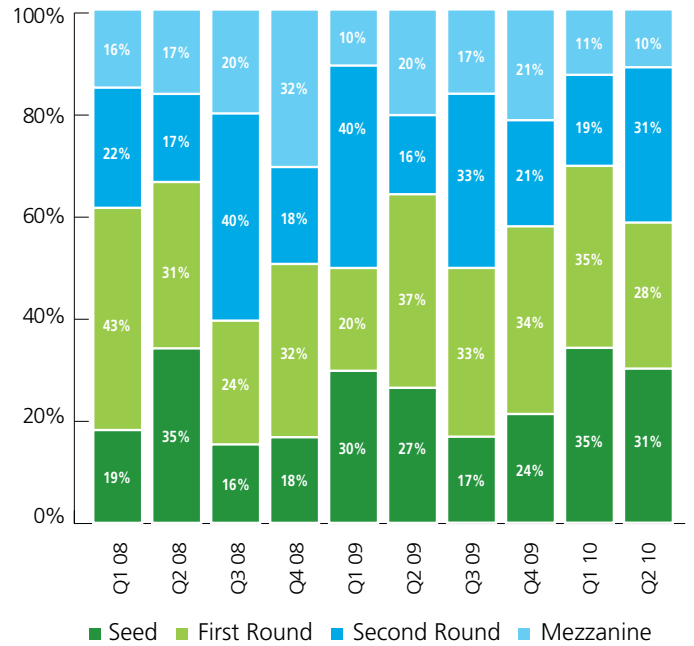
**Chart 4: What is the main investment gap in the Israeli start-up industry?**



The segmentation of forecasted new investments reflects cautious optimism in comparison to previous quarters. 31% of venture capitalists currently expect the majority of new investments to be made in the Seed and Second Round. This represents a 4% drop in Seed Investment expectations since the previous quarter; however, it is still the highest figure forecasted since Q2, 2008 (not including the previous quarter). 28% expect the majority of new investments to be made in First Round, and the remaining 10% of respondents expect to invest in the Mezzanine Round. Early investments (Seed and First Round) are beginning to reflect trends that dominated the venture capital industry before the "Credit Crisis". As can be seen in the end of 2007 and the beginning of 2008, where there was a much higher tendency to invest in

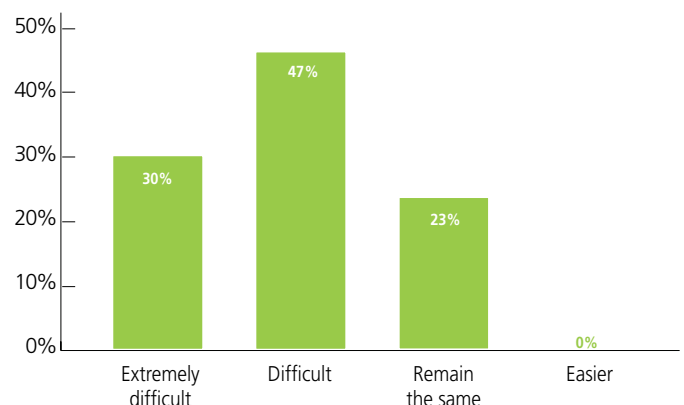
earlier stages. The evident up leg seems to provide a clear indication that we are returning to pre-crisis levels but not necessarily at the rate expected originally.

**Chart 5: During the next six months, I expect the majority of my new investments to be made in:**



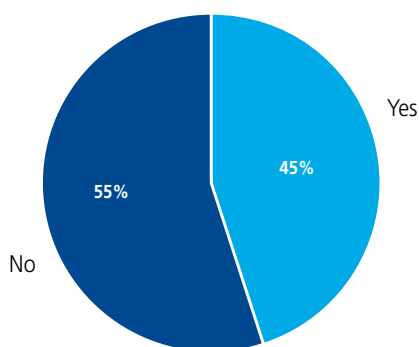
A striking 77% of respondents claim that venture capital fundraising will become more difficult; whereas only 23% claim that venture capital fundraising will remain the same. In addition, not one surveyed participant believes that the capital raising process will become easier. What is more daunting is that these figures have become more dismal, reflecting a strong deterioration in optimism regarding venture capital fundraising activity.

**Chart 6: VC Fundraising activity will become:**



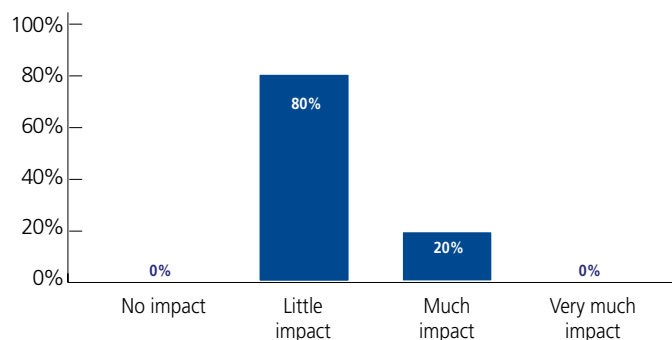
Recent events in the political arena, led by the confrontation aboard a Turkish vessel headed for Gaza, raised concerns amongst venture capitalists. Nearly half of respondents (45%) forecast this conflict to have negative affects on venture capital fund raising.

**Chart 7: Will recent tensions Israel faces due to the confrontation aboard a Turkish vessel headed for Gaza negatively effect venture capitl fund raising?**



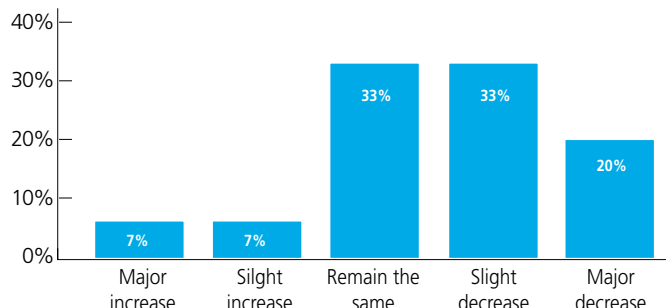
All venture capitalists forecast that heavily indebted European countries will negatively impact venture capital fund raising in Israel. The silver lining is that four out of every five surveyed participants (80%) believe this impact to be a minor one, with only 20% stating the opposite.

**Chart 8: European heavily indebted counties will have \_\_\_\_\_ on venture capital fund raising.**



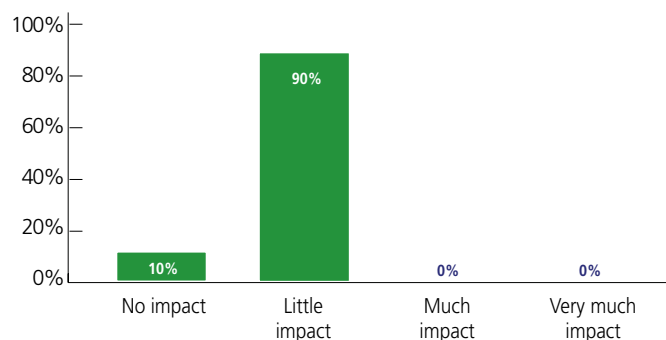
A further indication of Israeli venture capital market pessimism was reflected by the fact that 53% of venture capitalists expect a drop in assets under management (AUM), whereas, only 14% of respondents expect an increase in AUM. Additional pessimism geared towards projected fund size can be understood by 35% consider no improvement.

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



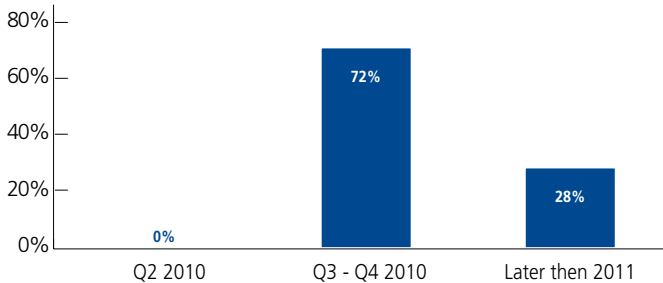
90% of survey respondents believe that the boycott imposed on Israeli products by countries such as Sweden, Norway and Turkey may negatively affect revenues of companies which receive venture capital funding. No surveyed participant believes that these renewed geopolitical tensions will bear a significant impact. Now the remaining question is whether continuous strains on past geopolitical issues coupled with current tensions could take its toll on the economy and political momentum, and quite possible spillover to one of Israel's major growth engines, the high-tech sector?

**Chart 10: Acording to you, the new wave of boycotts from countries such as Sweden, Norway, Turkey, Etc. of Israeli products and companies will have \_\_\_\_\_ on revenues of venture backed companies.**



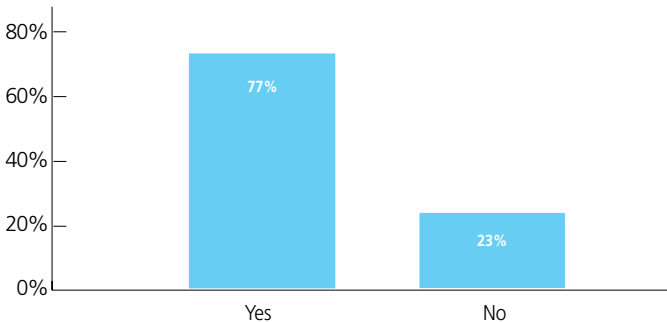
Expectations regarding the strength of the VC recovery still remain a question; nonetheless, there was a significant increase in optimism pertaining to Israel embarking on its first IPO on the NASDAQ since July, 2007 (Voltaire). This was easily understood by an impressive 72% of respondents believing for this to occur by the end of this year. Despite the evident increase in NASDAQ IPO optimism there is still roughly one quarter of venture capitalists who believe an IPO on the NASDAQ will occur only later than 2011.

**Chart 11: When do you believe we'll see the next Israeli IPO on the NASDAQ?**



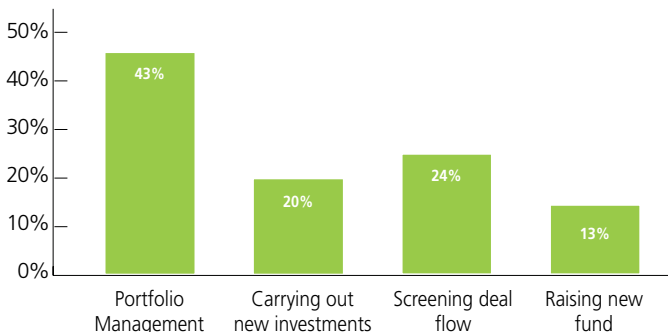
Additional optimism was unveiled by the fact that 77% of surveyed participants claim that merger and acquisition activity is ramping up. Despite being only 1% higher than the previous quarter and 15% lower than the last quarter of 2009, recent numbers clearly reflect the apparent turnaround since the inception of market turmoil.

**Chart 12: I believe M&A transactions are ramping up?**



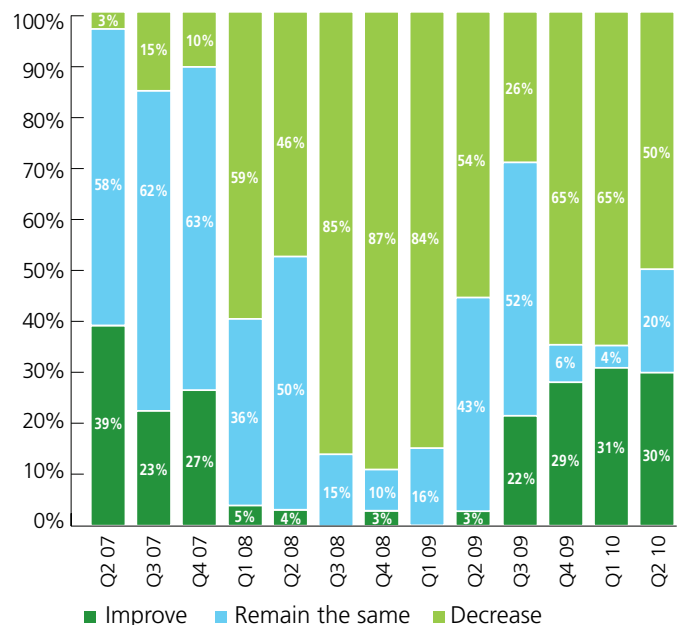
According to venture capitalists, 43% of them expect to allocate a majority of their time to Portfolio Management, translating into a 13% decrease since Q4, 2009. In conjunction with the aforesaid, cautious optimism can be noted through a 20% increase in deal flow screening which could be attributed to a significant portion of the drop in Portfolio Management. Despite this, perpetual instability continues to shed clear indication to why only 20% of venture capitalist's time is expected to be spent on carrying out new investments.

**Chart 13: During the next three months, I expect to spend the majority of my time focusing on:**



Investment valuations paint a rosier picture for the venture capital investment environment. Such that, investment valuation expectations are poised for a 30% increase, the highest level since Q2, 2007 (not inclusive of Q1, 2010 where venture capitalists forecasted an almost equivalent 31% increase in investment valuations). Additional optimism can be extrapolated through a 15% QoQ decrease in respondents who expect investment valuations to decrease and a 16% QoQ increase in venture capitalists who forecast investment valuations to remain at current levels.

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



A continued disparity in exit valuations conveys some confusion as to where venture capitalists feel to be headed. However, a clear deterioration in terms of exit valuation expectations continues, such that 60% of venture capitalists forecast a drop, 30% forecast an increase, and 10% expect exit valuations to remain the same.

## Insights

Recent events in the political arena, led by the confrontation aboard a Turkish vessel headed for Gaza raised concerns amongst venture capitalists, whereby nearly half of respondents (45%) forecast this conflict to have negative affects on capital raising. Additional geopolitical as well as economic strains affecting Israel were caused by boycotts which were unleashed on Israel as a result of recent tensions with its neighbors.

90% of survey respondents believe that the boycott imposed on Israeli products by countries such as Sweden, Norway and Turkey may negatively affect revenues of companies which received venture capital funding. Israel's history has showed that specific geopolitical tensions play a small role in Israel's high-tech industry in the long-run. However, the impact of continuing strains on past geopolitical issues could take its toll on the economy and political momentum, and quite possible spillover to one of Israel's major growth engines, the high-tech sector.

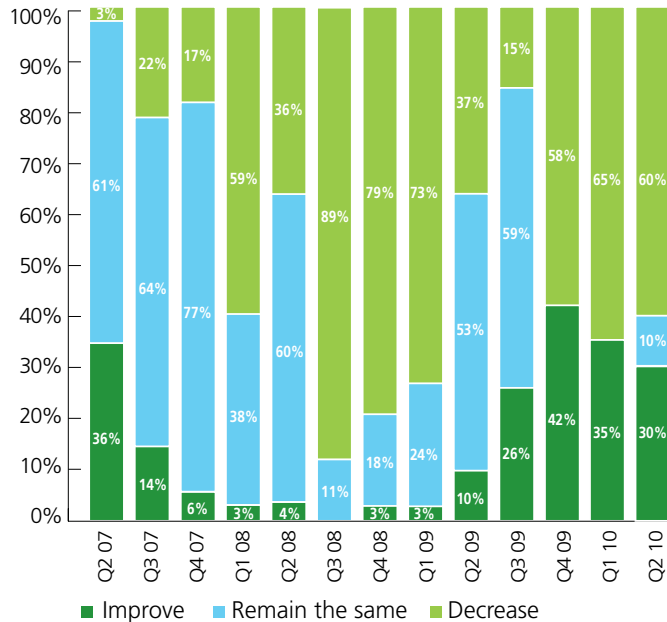
The survey revealed that venture capitalists are expressing cautious optimism in terms of Israel's economic climate, such that 43% of respondents expect economic improvement in contrast to 58% of respondents in previous quarter. Much of the reason for a moderation in venture capital economic sentiment can be associated with financial difficulties encountered by several Euro zone countries. 20% of venture capitalists forecast these difficulties to translate into a large impact on venture capital fundraising.

Additional concerns regarding the process of raising venture capital were reflected in the fact that 77% of venture capitalists expect fundraising activities to become more difficult. It should be noted that not one surveyed participant believed that the capital raising process will become easier.

Expectations associated with the strength of the VC recovery still remain a question; nonetheless, there was a significant increase in optimism pertaining to Israel embarking on its first IPO on the NASDAQ since Voltaire's exit in 2007. This was easily understood by an impressive 72% of respondents believing for this to occur by the end of this year. Additional optimism was found through 77% of surveyed participants claimed that merger and acquisition activity is ramping up.

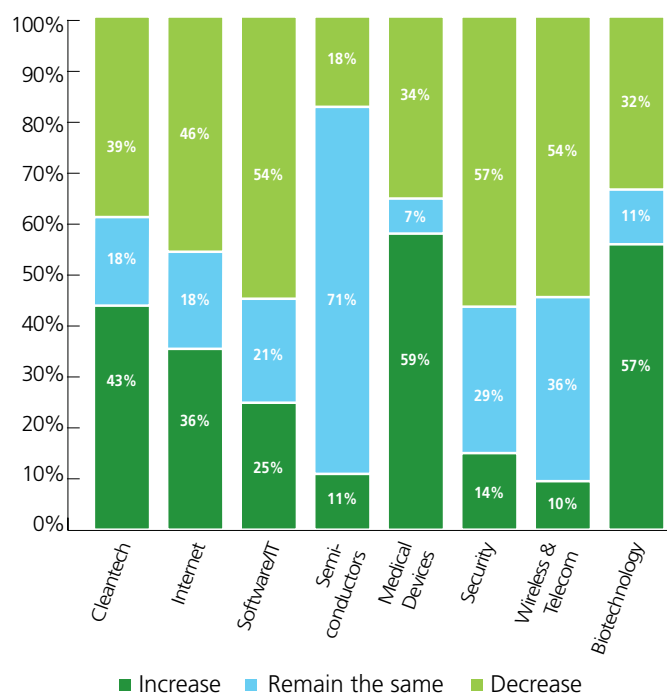
The survey also found that 76% of respondents believe that the Treasury Department's "Competitive Advantage" program to encourage the high-tech industry should focus on encouraging Seed investments and 45% of respondents believe the Treasury Department should focus on encouraging Israeli institutions to take a larger role in high-tech investments. 38% of venture capitalists believe that their focus should be on updating the technological incubators program. The continuous shocks felt in the market place experienced in the last decade indicate that there is a real need for increased government involvement in order to ensure the much needed long-term stability in the high-tech sector. Furthermore, more resources should be allocated towards companies at early stages to encourage innovation and entrepreneurship in order to maintain Israel's strong technological positioning in the world.

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



The medical device sector continues to shine with 59% forecasting this sector to project the highest number of transactions during the next six months. In addition, Biotechnology and the Cleantech sectors were also perceived with interest, such that 43% 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 (10%) and semiconductor (11%).

**Chart 16: 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. You are welcome to send your suggestions to Rony More at [romore@deloitte.co.il](mailto: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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