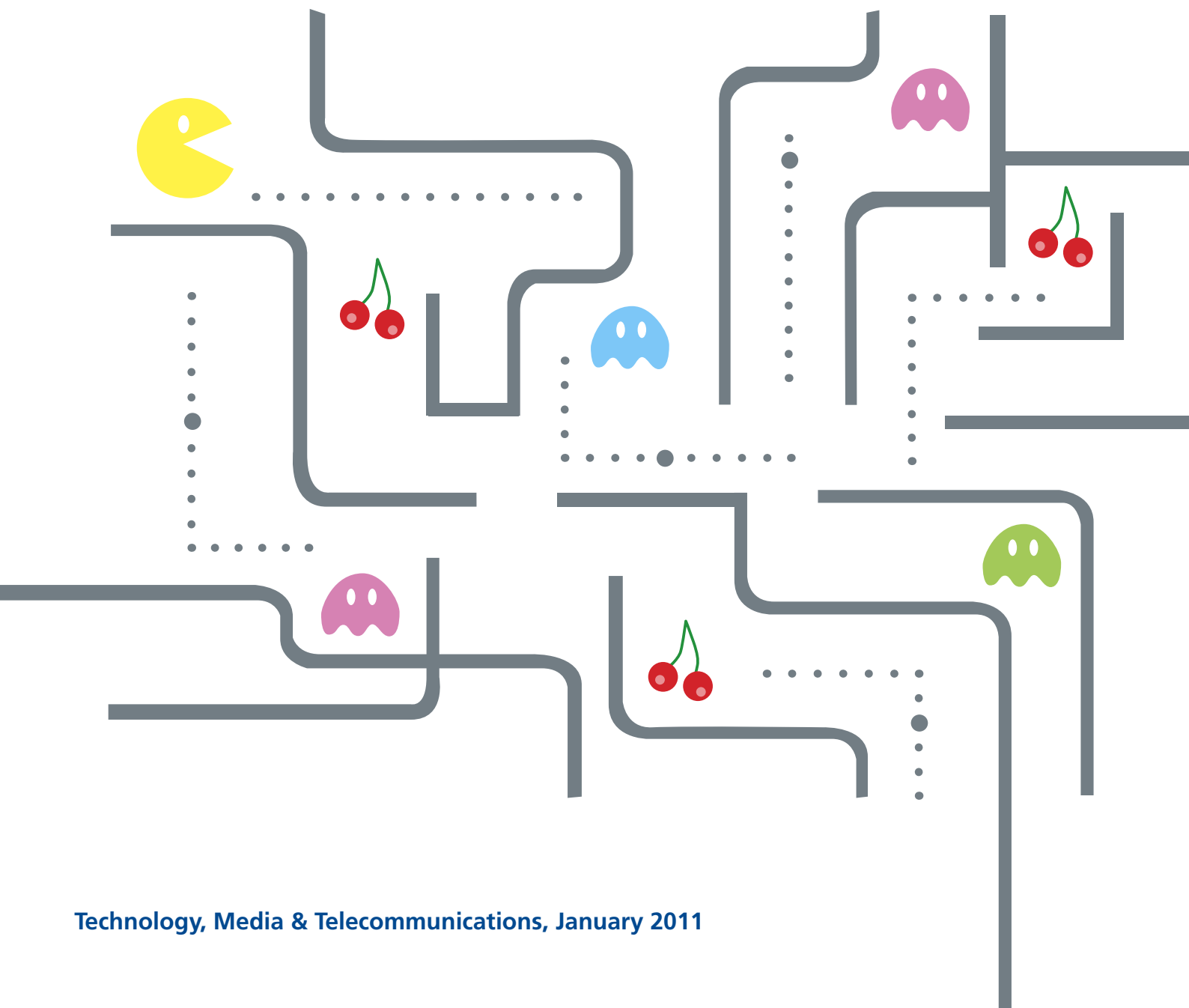


# Israel VC Indicator Survey.

Expectations as of Quarter 4, 2010

## Eat or Be Eaten...



## 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 35th Deloitte Brightman Almagor Zohar Israel VC Indicator Survey results for Quarter 4, 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 4, 2010 were collected from December 14th, 2010 to December 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.

# Fourth Quarter, 2010

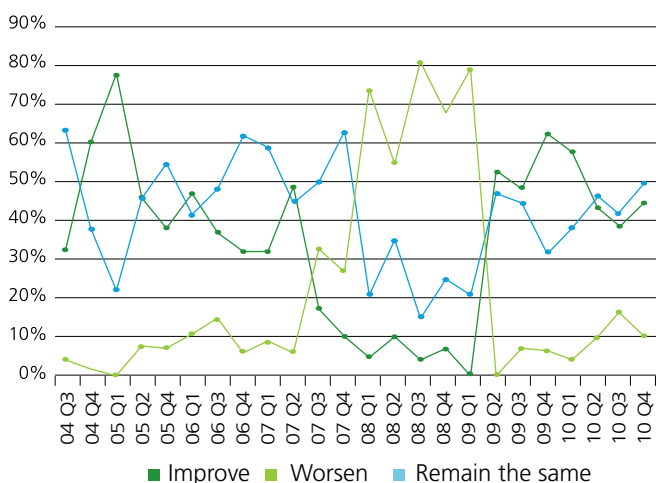
## Highlights

- Economic climate sentiment on the rise
- Israeli M&A activity forecasted to climb higher (with focus on the Internet and Medical Device sectors)
- Possible investment strategy shift to earlier stage companies
- Expectations for further future deployment of R&D outsourcing to the East
- Forecasts for improvements in exit valuations are at the highest since Q1, 2006

## Results

The general perception among venture capitalists indicates market sentiment improvement compared to last quarter. Such that, Q4 2010 experienced the first QoQ increase in the number of venture capitalists expecting improvements in the overall economic climate since Q4 2009. Additional optimism can be extrapolated through a 7% drop in surveyed participants expecting market conditions to worsen in the next six months. The number of respondents forecasting economic climate to remain the same went up by 6% QoQ.

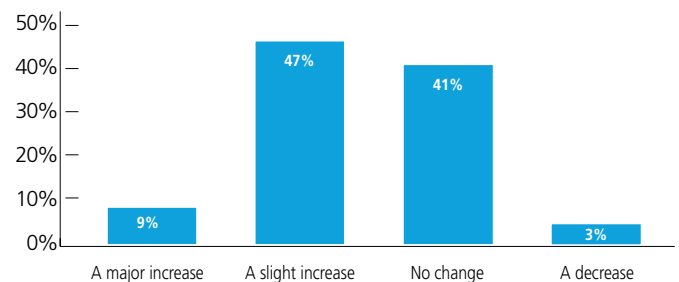
### During the next six months, I expect the overall economic climate to:



VC managers continue to be optimistic in regards to deal flow activity, such that 56% of respondents claim deal flow activity to increase. The positive sentiment towards deal flow is even more apparent due to the fact that only 3% of surveyed participants forecast a decrease in activity

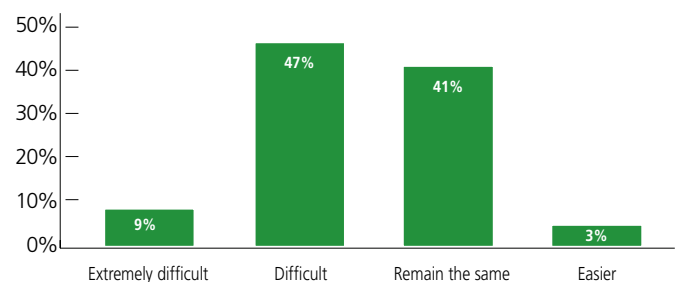
to happen within the next six months. This is in parallel to 41% of respondents forecasting deal flow to remain at current levels.

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



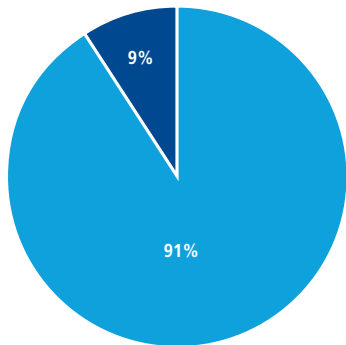
Surveyed participants differ significantly in their expectations regarding the future of fundraising activities. An absolute majority of 56% of respondents expect that venture capital fundraising will become more difficult whereas 41% claim that venture capital fundraising will remain the same. Only 3% of respondents expect VC fundraising to become easier.

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



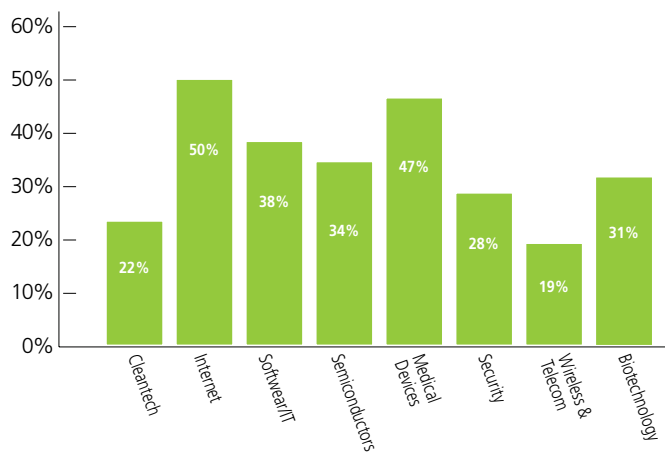
The strength of the VC recovery still remains to be a question; nonetheless, a staggering 91% of venture capitalists forecast M&A transactions in Israel to continue to ramp up in the next six months. Momentum in confidence of additional M&A activity reaching Israel has been spilling over since Q2 2010 when at that time 77% of surveyed participants claimed that merger and acquisition activity was ramping up.

**Do you believe that M&A transactions in Israel will continue ramping up in the next six months?**



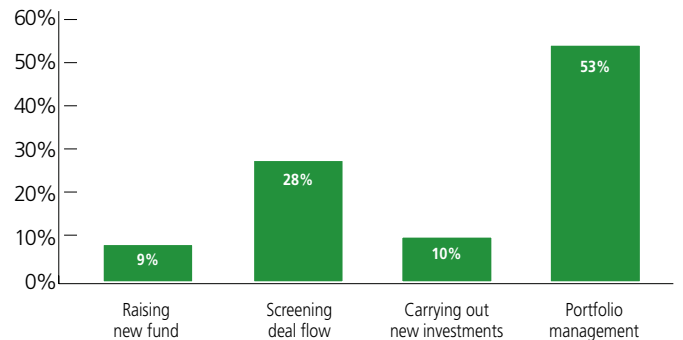
The hi-tech sector that venture capitalists believe will yield the most M&A activity within the next six months is the Internet sector (50%). Closely behind, with 47%, the Medical Device sector is also believed to experience much attention. Whereas, Cleantech and Wireless & Telecom sectors are forecasted to experience the least M&A activity (22% and 19%, respectively) in the next six months.

**In which hi-tech sector will M&A activity be highest in the next six months?**



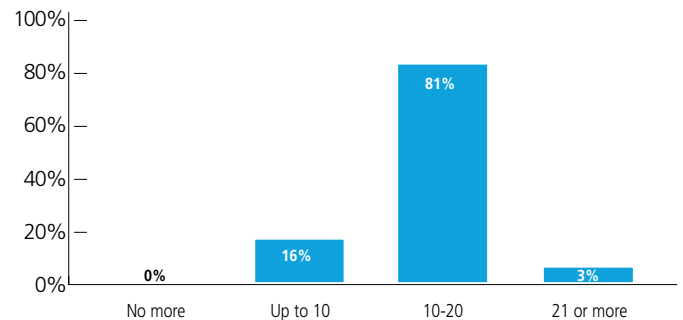
53% of surveyed participants expect to allocate a majority of their time to Portfolio Management, identical to the results recorded in the previous quarter. Additional fragility in the VC industry can be understood through the fact that only one out of ten respondents believes to carry out new investments during the next three months, a 7% slide since Q3 2010.

**Where do you expect to spend the majority of your time to be focused on during the next three months?**



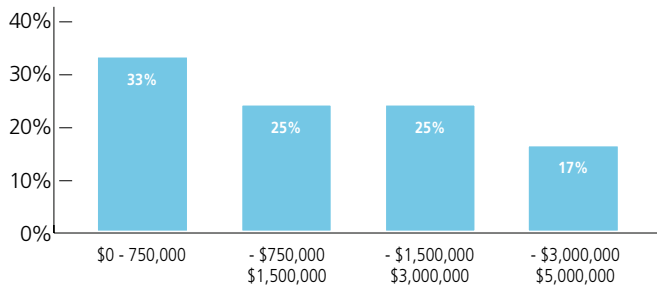
As "exit" is the name and the goal of the game in the VC world, it is of no surprise that VCs believe they will continue to witness additional tech companies being acquired, merge, go public, etc., however in limited nature. 97%, an overwhelming majority, of surveyed venture capitalists expects to see up to 20 during the next six months.

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



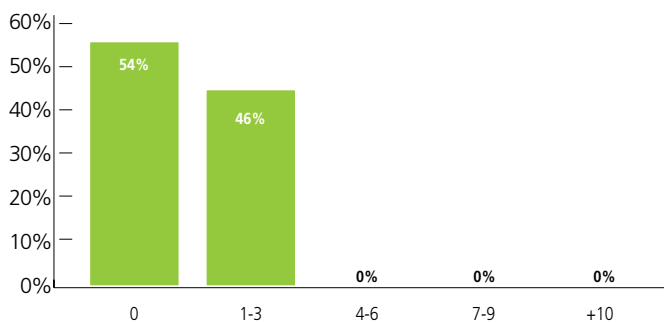
VC expectations regarding the average investment size per new company in the next six months could be perceived as a potential shift in investment strategy. 58% of venture capitalists expect to invest up to \$1.5M whereas a surprisingly lower number (42%) claim that their average new investment will equal \$1.5M – \$5M. This could reveal initial signs of VCs hunger for taking on additional risk by shifting to earlier stage investments.

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



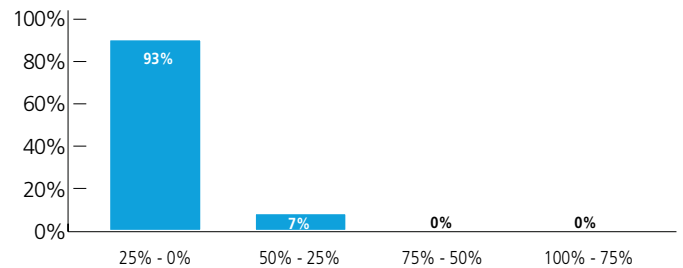
Expectations regarding the number of companies in their VCs current portfolios to conduct R&D activities in the East (China, India, etc.) are almost evenly split up into two halves. The majority (54%) expects the number of those companies to be zero, while 46% expect the number to be somewhere between one and three. It is interesting to see that no venture capitalists expect more than four companies in their current portfolio to have R&D operations in the East.

**How many companies in your VCs current portfolio do you expect to conduct R&D activities in the East (China, India, Etc.):**



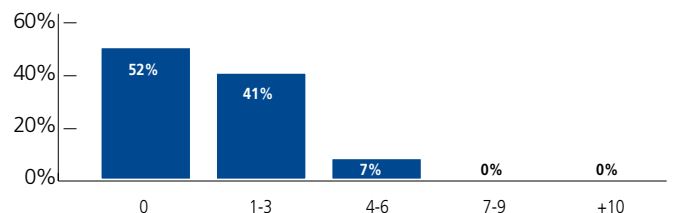
After seeing the data from previous graph, it is of no surprise that a striking 93% of venture capitalists claim that companies in their current portfolio with R&D operations in the East comprises 0% – 25% of their current fund, whereas the remaining 7% claim that this constitutes 25% - 50%.

**In terms of the amount that you stated in the previous question, what is a rough estimate to the percent that this constitutes of your current fund:**



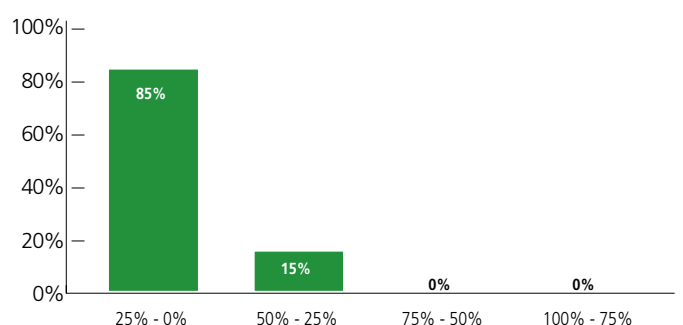
As an aggregate, venture capitalists believe that more companies in their VCs next portfolio will conduct R&D activities in the East than their current portfolio. Such that, all surveyed respondents expect up to three companies in their VCs current portfolio to conduct R&D activities in the East, this compares to 7% of venture capitalists claiming that they will already have four to six companies in their next portfolio.

**How many companies in your VCs next portfolio do you expect to conduct R&D activities in the East (China, India, etc.):**



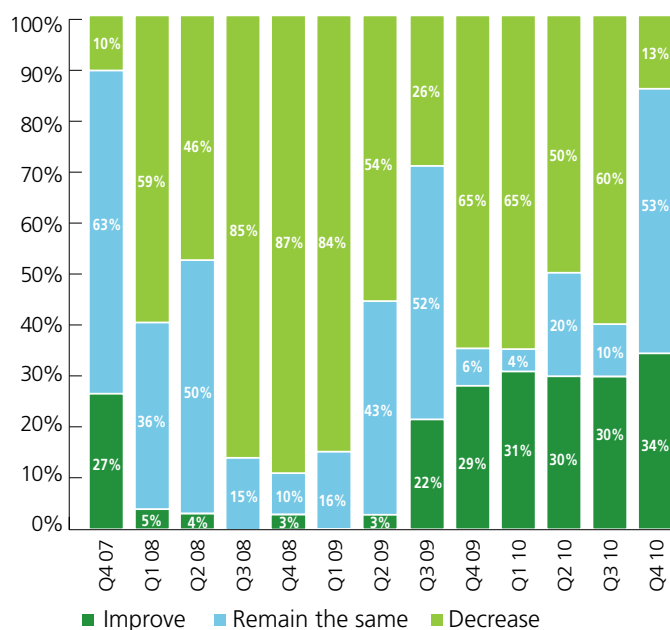
As aforementioned, a greater amount of surveyed venture capitalists believe that their VCs next portfolio will consist of more companies conducting R&D activities in the East than their current portfolio. This translates into an additional 8% of surveyed participants expecting a heftier 25% - 50% of their next portfolio to utilize the benefits of the East over the patriotism of using local R&D.

**In terms of the amount that you stated in the previous question, what is a rough estimate to the percent that this constitutes of your next estimated fund:**



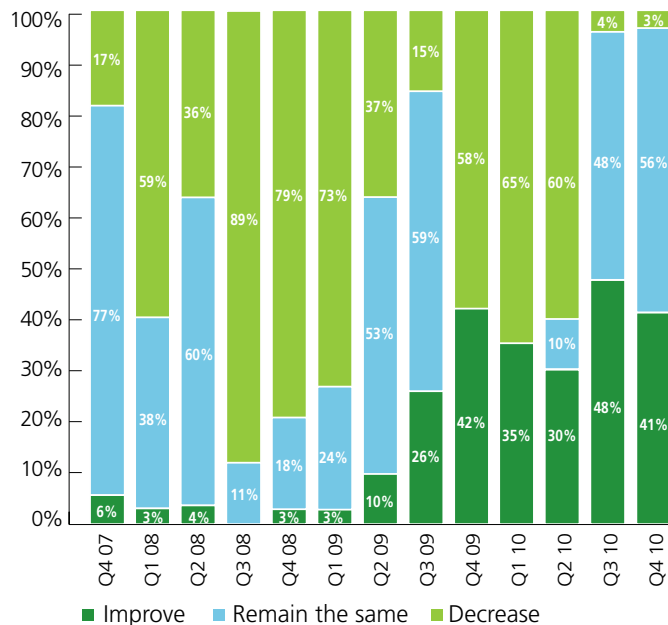
This quarter's investment valuation expectations for the next six months clearly show a drop in the number of venture capitalists expecting investment valuations to decrease. This is understood through only 13% of respondents expecting investment valuations to decrease which is the lowest level recorded since Q4 2007. Further optimism can be extrapolated through 34% expecting improvement in investment valuations, constituting the highest figure since Q2 2007. Much of the shift in responses can possibly be attributed to a significant 53% of venture capitalists claiming investment valuations to remain the same, which provides comfort that the worst may be behind us in terms of decreasing investment valuations.

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



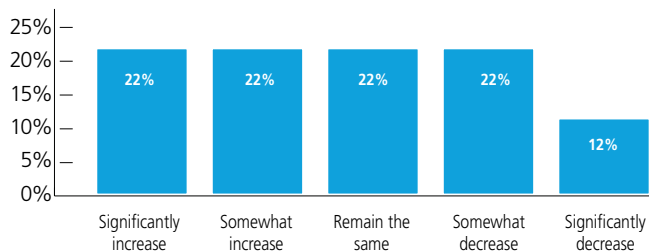
Bearing much similarity to last quarter's surveyed responses, venture capitalists are split apart on their expectations of what path exit valuations are going to take during the next six months. This is evident from the 97% of venture capitalists that are still virtually torn between exit valuations to either improve or to remain the same. Despite of what may be seen as a slight uncertainty about future exit valuation expectations; forecasts indicating improvement are the third highest since Q1, 2006.

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



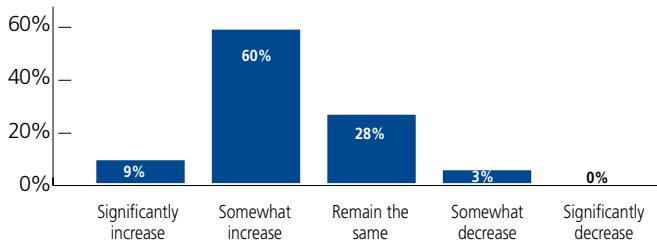
There is a lack of consensus in expectations regarding revenues in companies in their last fund to increase or decrease in 2011 compared to 2010. Slightly larger number (44%) of surveyed participants expects next year revenues to grow whereas 36% forecast revenues to diminish.

**Do you expect revenues in companies in your last fund to increase or decrease in 2011, compared to 2010?**



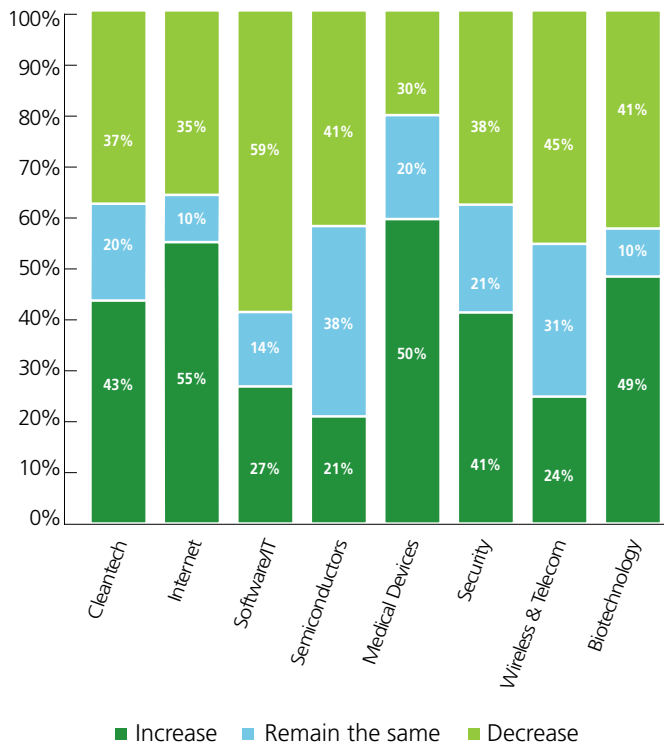
One of this survey's highlights is that 97% of venture capitalists forecast companies in VCs current fund to expand their workforce in 2011 versus 2010. Such that 9% expect this increase to be significant, 60% forecast a small increase and 28% expect the workforce to remain the same while only 3% expect a decrease.

**Do you expect the workforce of the companies in your last fund to increase or decrease in 2011, compared to 2010?**



Out of the eight tested sectors, the Internet sector shines the brightest with 55% forecasting this sector to project the highest number of transactions during the next six months. In addition, Medical Device and Biotechnology sectors are also perceived with much interest, such that 50% and 49% (respectively) of respondents expect these sectors to have the highest amount of transactions. The sectors perceived to result in the least amount of transactions in the next six months are Telecommunications (24%) and Semiconductor (21%).

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



## Insights

Venture capitalist perception regarding market sentiment indicates improvement compared to Q3 2010, but for this sentiment to continue its climb up into the new year, the economy will need some additional pushing. A staggeringly high 91% of venture capitalists forecast M&A transactions in Israel to continue to ramp up in the next six months. This provides the much needed evidence that M&A activity could be one of the main drivers that both support and drive the economy into higher levels.

Venture capitalists claim that the Internet and Medical Device sectors will be at the forefront of this M&A expansion. As global M&A activity rises globally and continues to spill into Israel, more and more companies will have to, put simply, "eat or be eaten". But to increase appetite for further consolidation, companies will have to continue to grow both in terms of revenues and workforce. If this plays out as aforementioned, venture capitalists will be correct in their assessment for higher exit valuations, but in turn will make prowling the Israeli hi-tech sector for companies on fire sales that much more difficult.

VC managers continue to be optimistic in regards to deal flow activity, such that 56% of respondents claim deal flow activity to increase. The positive sentiment towards deal flow is even more apparent due to the fact that only 3% of surveyed participants forecast a decrease in activity to come within the next six months. This is in parallel to 41% of respondents forecasting deal flow to remain at current levels. But despite this noticeable forecast for further increases in deal flow activity, still 53% of surveyed participants expect to allocate a majority of their time to Portfolio Management, identical to last quarter's result. Additional fragility in the VC industry can be understood through the findings that only one out of ten respondents believes that they will carry out new investments during the next three months, a 7% slide since Q3 2010.

Overall and in conclusion, to much extent these results indicate that for Israel's VC industry to prove itself as fully recovered, the Israeli hi-tech sector will first have to go through a much anticipated food fest of M&A activity.

# 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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