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Brightman Almagor

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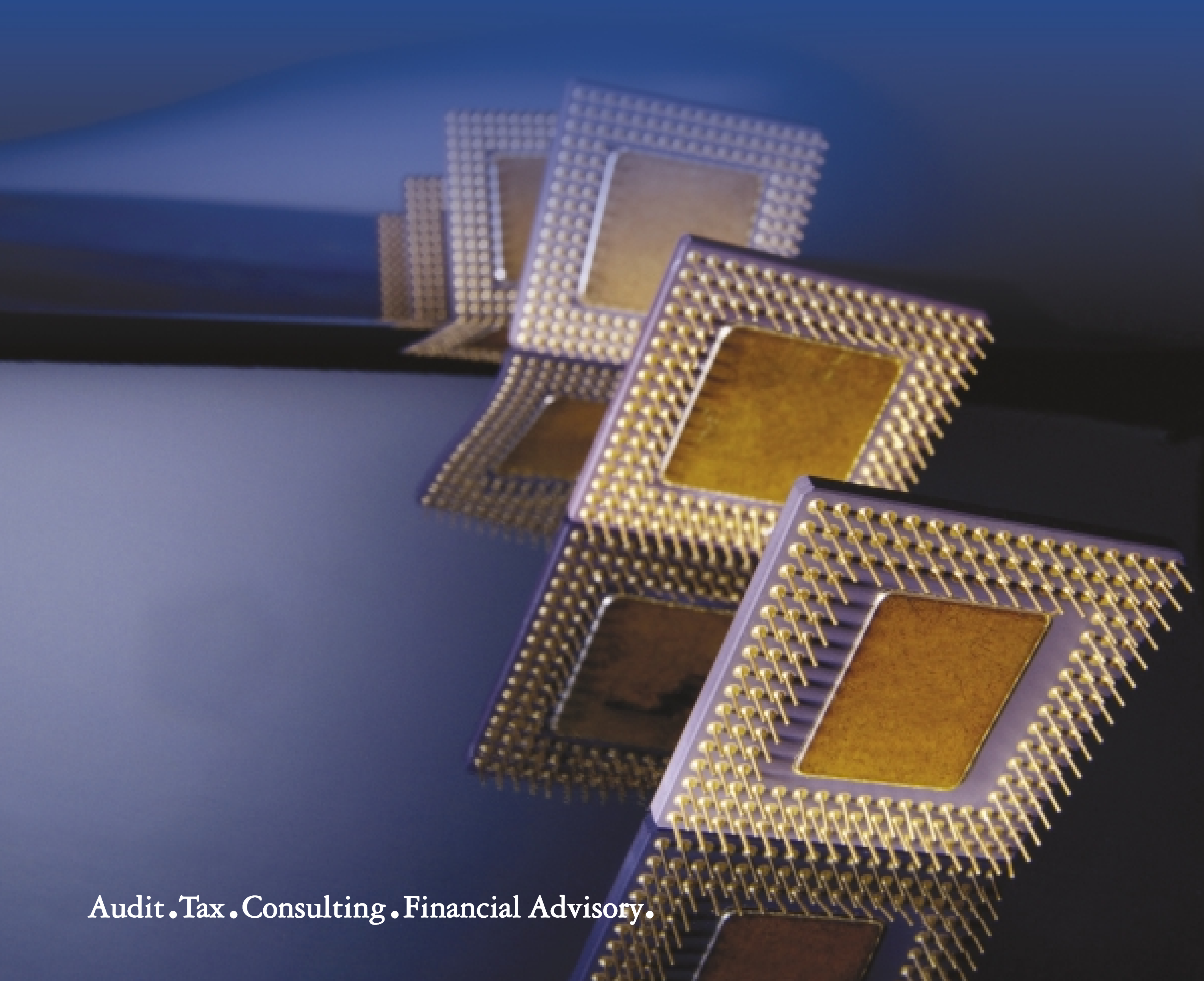
Technology, Media & Telecommunications

Israel VC Indicator Survey.

Expectations as of Quarter 4, 2007

The 2008 Venture Capital Outlook



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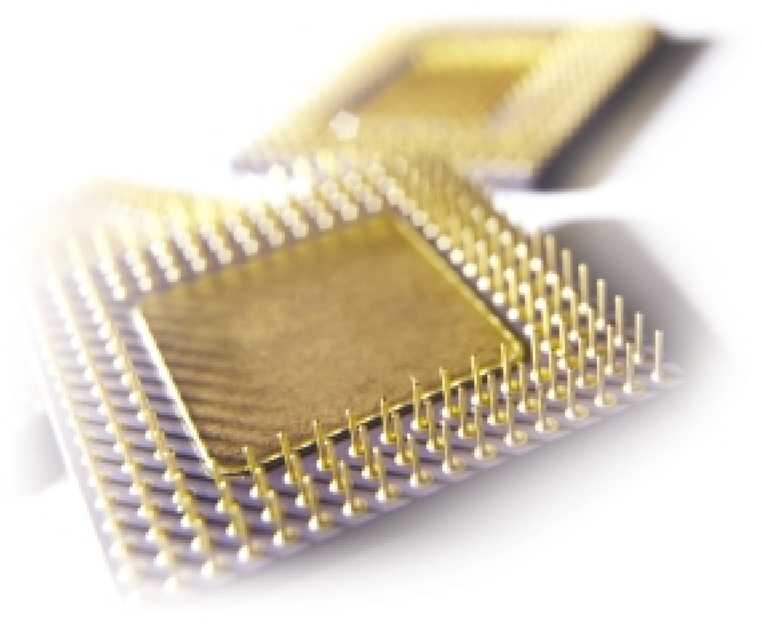
About

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 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 22nd Deloitte Brightman Almagor Israel VC Indicator Survey results for Q4, 2007 include a comparison, where relevant, 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. The Global Survey 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 VC Indicator Q4, 2007 were collected from December 10th 2007 through to December 16th 2007. The responses were collected from venture capitalists in Israel, including replies from the major VCs in the country.



4^{th} Quarter, 2007 - Detailed Results

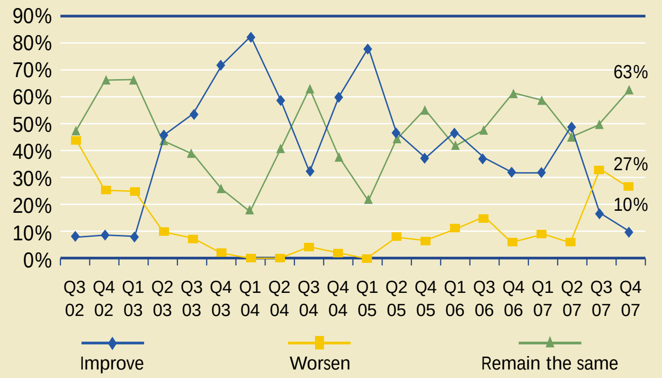
Highlights

- Expectations for overall economic climate improvement hit the lowest level since Q1 2003
- 50% of venture capitalists say there is a high probability for an economic slowdown in the U.S. during 2008
- Most venture capitalists believe that creating giant companies in Israel is not crucial for Israeli high-tech success
- There is complete agreement that Israeli Web 2.0 exits will continue during 2008
- Increasing government funding pointed to as a way of enhancing Israel's competitive advantage in the global cleantech market

Results

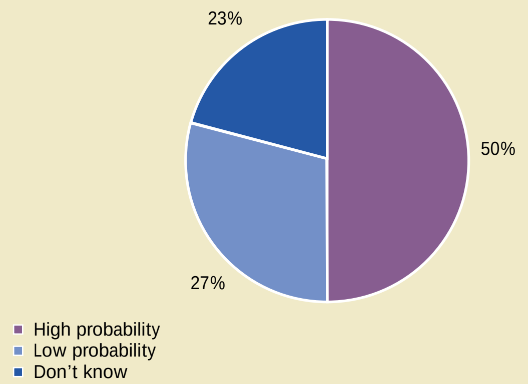
Venture capitalist sentiment of the overall economic climate is negative. The downwards shift in economic expectation amongst respondents that begun in Quarter 3 continued into Quarter 4, with 27% believing that the overall economic climate will worsen over the next six months (similar to 33% in Q3, 2007). At the same time, only 10% of respondents believe that the economic climate will improve over the next six months (down from 17% in Q3, 2007), the lowest expectation for improvement since Quarter 1, 2003. 63% of respondents predict no change in the overall economic climate.

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



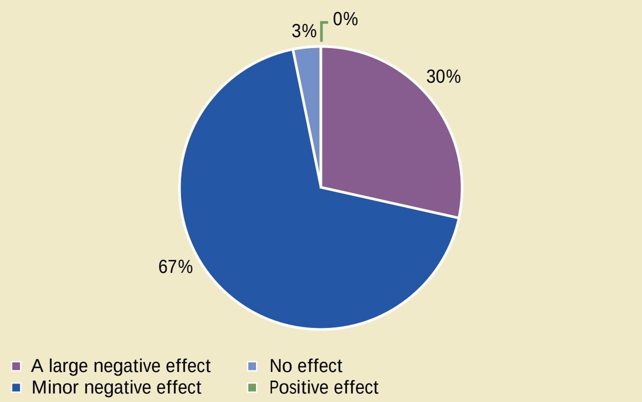
No doubt that the overall pessimistic sentiment is largely influenced by concerns of an economic slowdown in the U.S. 50% of venture capitalists believe that we will see such a slowdown during 2008, 27% deem such a scenario to have a low likelihood.

Chart 2:
Are we likely to see an economic slowdown in the U.S. during 2008?



The implication of a U.S. recession on the Israeli high-tech industry would be negative. Most venture capitalists, 67%, expect such an American recession to have only minor negative effect on the Israeli high-tech industry. 30% of respondents expect that it would have a large negative effect. Only 3% believe it would have no effect on the local high-tech industry.

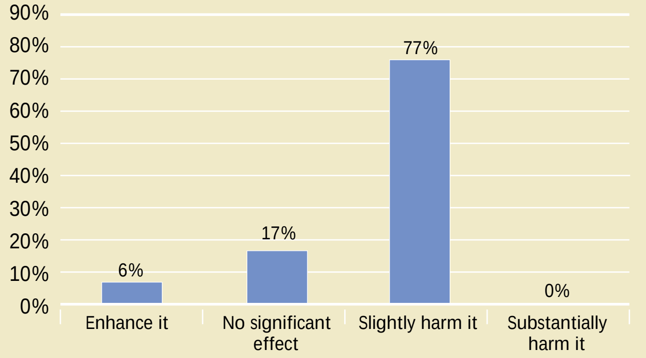
Chart 3:
The effect of a U.S. recession on the Israeli high-tech industry would be?



The overwhelming majority, 77%, say that the weakening of the U.S. dollar only slightly harms the Israeli high-tech industry. No respondents stated that it substantially harms the Israeli high-tech industry. 17% Say it would have no significant effect and 6% even think the weakening of the dollar would enhance the Israeli high-tech industry.

chart 4:

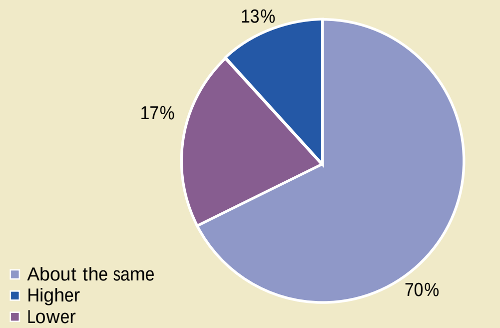
The weakening of the US dollar would have the following effect on the Israeli high-tech industry:



70% expect Israeli high-tech company capital raised in 2008 to be at around the same level of capital raised during 2007. 17% think that it will be lower compared to 2007, 13% believe that it will be higher.

Chart 5:

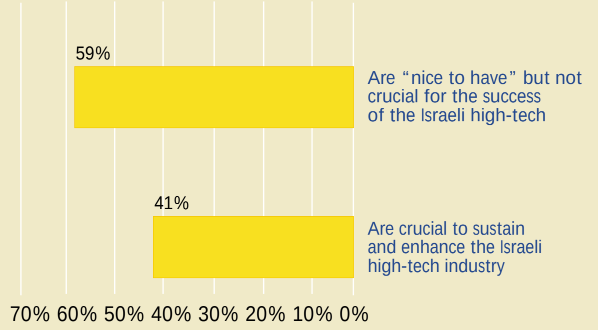
Compared to 2007 I expect Israeli high-tech companies capital raised in 2008 to be:



In the on going discussion on the creation and existence of giant companies in Israel, the VC community is fairly divided on the subject. 59% of respondents say that giant companies are "nice to have" but not crucial for the success of the Israeli high-tech. 41% say that giant companies are crucial to sustain and enhance the Israeli high-tech industry.

Chart 6:

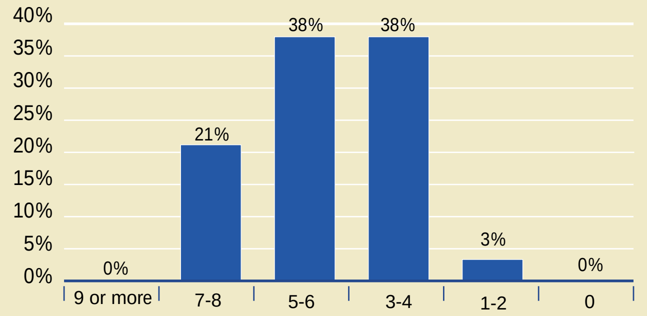
Craeting giant companies in Israel:



During 2007 only six Israeli companies went public on NASDAQ and most venture capitalists foresee that 2008 will not bring more IPOs. 38% estimate that only three or four Israeli companies will go public on NASDAQ during 2008 another 38% estimate the number would be five or six companies, 21% say it would be seven or eight companies.

chart 7:

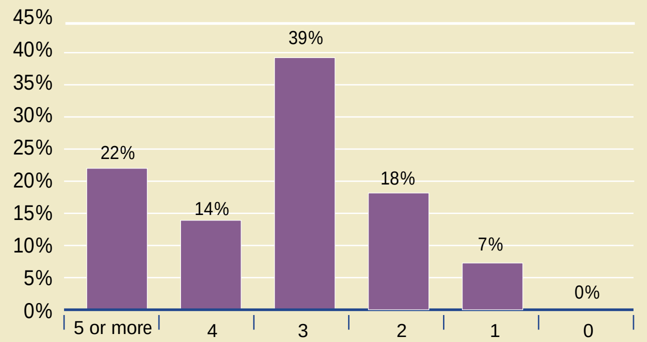
The number of Israeli companies that will go public on NASDAQ during 2008:



With the first Israeli web 2.0 exit in 2007 the general notion among venture capitalists is that we will see more web 2.0 exits during 2008. 22% of respondents expecting at least five web 2.0 exits, 14% expecting four exits and 39% expecting three exits. Not even one respondent expects no Israeli web 2.0 exits in 2008.

Chart 8:

I expect the number of Israeli web 2.0 exits during 2008 to be:

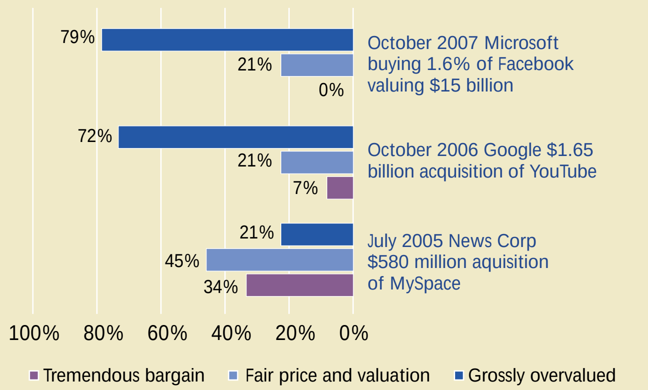


To see how many web 2.0 "believers" there are in the local VC community we requested evaluation of the three major web 2.0 deals in the United States namely MySpace, YouTube and Facebook. The lower the deal valuation, and earlier the transaction had been made, the better respondents viewed the deal. July 2005 News Corp $580 million acquisition of MySpace was described by 34% as a tremendous bargain, 45% think it was a fair price and valuation and only 21%

say it was grossly overvalued. October 2006 Google $1.65 billion acquisition of YouTube is described as a tremendous bargain by only 7%, 21% think it was a fair price and valuation and 72% say it was grossly overvalued. As for October 2007 Microsoft buying 1.6% of Facebook valuing the site at $15 billion, 79% say that it was grossly overvalued, 21% think that it was a fair price and valuation and not even one respondent said it was a tremendous bargain.

Chart 9:

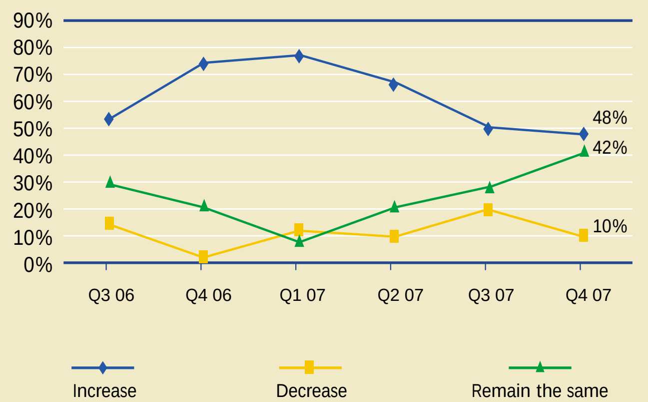
How would you describe these transactions?



For the third consecutive quarter expectations for an increase in internet transactions get lower and they are the weakest they have been in the year and a half. 48% of respondents are expecting an increase in number of internet transactions over the next six months (compared to 51% and 79% in Q3, 2007 and Q2, 2007 respectively). The number of respondents who foresee a decline in internet transactions has dropped to 10% (compared to 20% in Q3, 2007).

Chart 10:

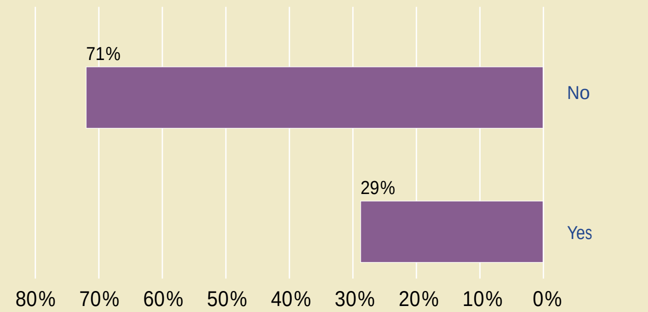
Expectations of internet transactions:



In Israel VC Indicator Survey of Quarter 2, 2007 66% of respondents said that water technologies is the cleantech sector in which Israel will excel. Meanwhile according to the NVCA most U.S. cleantech venture capital investments were made in the field of solar energy in the first 9 months of 2007, and the next biggest fields were alternative energy, power supply and recycling. In light of the U.S. cleantech investment distribution we asked the Israeli venture capitalists whether Israel has made a mistake by focusing its cleantech industry on water? While 71% said it did not, a notable 29% thought that it was a mistake to focus cleantech efforts on water technologies.

Chart 11:

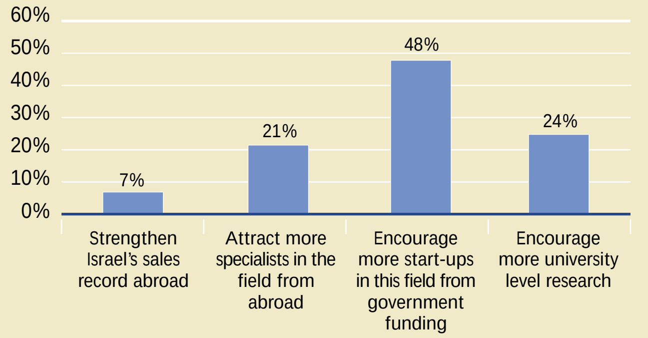
Do you think that Israel has made a mistake by focusing its cleantech industry on water?



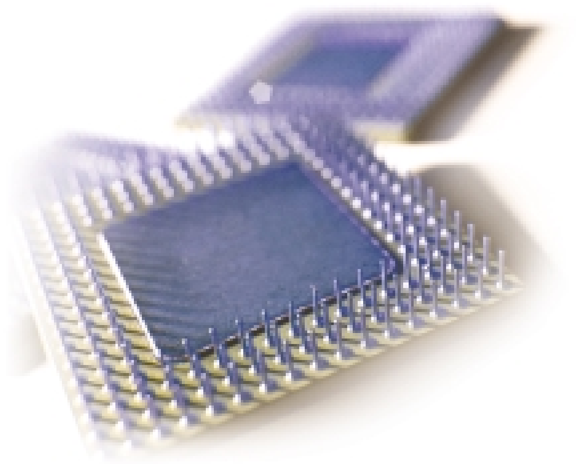
According to the NVCA, of the 168 U.S. VC cleantech deals made in the first 9 months of 2007, only one was an investment into Israel. More U.S. deals were made in India, the U.K., Canada and Germany. We asked what Israel has to do to increase its competitive advantage. Almost half, 48%, of the respondents said that Israel should encourage more start-ups in this field to receive government funding. 24% said that Israel should encourage more university level research. 21% said that Israel should attract more specialists in the field from abroad. 7% said that Israel should strengthen its sales record abroad.

chart 12:

What do you think Israel has to do to increase its cleantech competitive advantage?

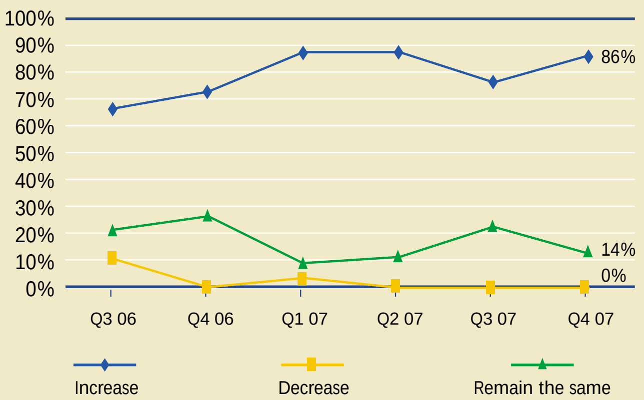


For the fourth quarter in a row, cleantech remains the favored sector for increased investment. Expectations of cleantech



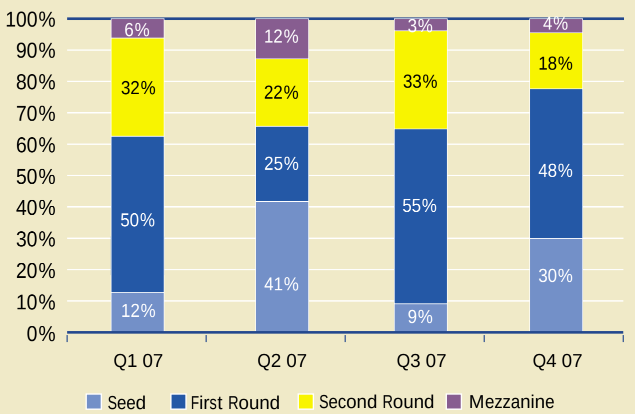
transaction increase continue to be high, 86% (compared with 77% in Q3, 2007 and 88% in Q2, 2007). In line with previous quarters not even one respondent expects cleantech transactions to decrease in the next six months.

Chart 13:
Expectations of cleantech transactions:



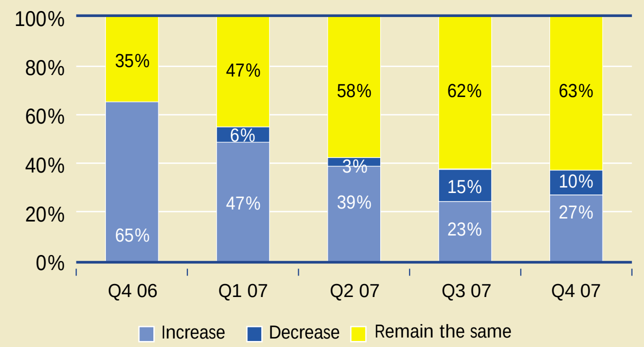
Almost half of venture capitalists, 48%, expect that, during the next six months, the majority of their new investments will be made in first round funding. 30% expect to invest mainly in seed round and 18% in second round.

Chart 14:
During the next six months, I expect the majority of my new investments to be made in:



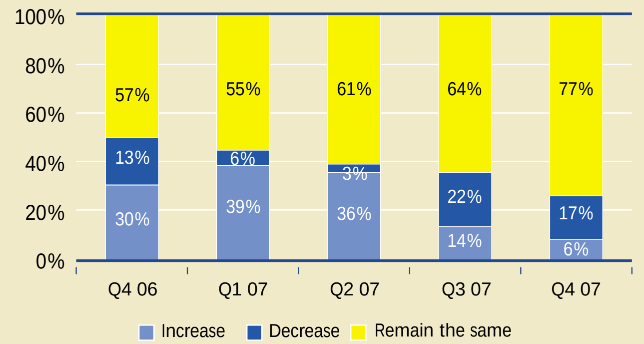
The pessimistic sentiment trend which begun in Q3, 2007 in both investment and exit valuations continues in Q4, 2007 as well. 63% of respondents believe that investment valuations will remain the same during the next six months. Only 27% expect investment valuations to increase, compared to 23% in Q3, 2007 and 39% in Q2, 2007. The number of venture capitalists expecting a decrease in investment valuations is also relatively high, 10%, compared to 15% in Q3, 2007 and compared to only 3% in Q2, 2007.

Chart 15:
During the next six months, I expect investment valuation to:



Low expectations are also noted for exit valuations during the next six months. Only 6% of respondents expect exit valuations to increase compared to 14% in Q3, 2007, 36% in Q2, 2007 and the lowest since first posting this question on Deloitte Israel VC Indicator in Q4, 2004. 17% foresee that exit valuations will decrease compared to 22% in Q3, 2007 and compared to only 3% in Q2, 2007.

Chart 16:
During the next six months, I expect exit valuation to:

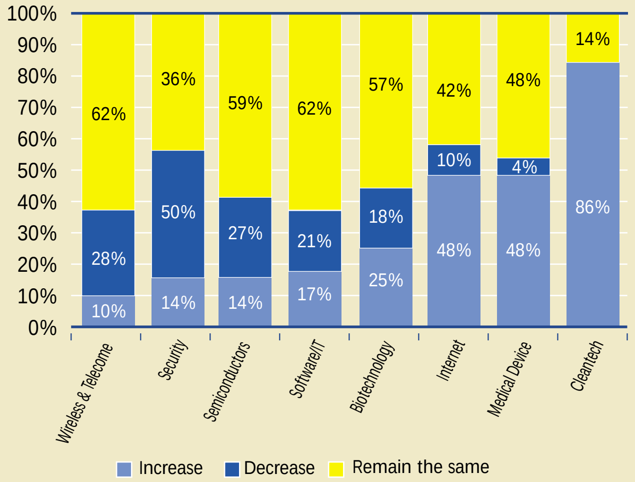


The highest expectations of transaction increase are, once again, in cleantech. 86% of respondents expect an increase of transactions in this sector. The medical devices sector continues to be among the most positive sectors and with

8% up from Q3, 2007 it is second in expectations of transaction increase along with the internet sector, both with 48%. The weakest expectations are for the security sector and for the wireless and telecom sector. Security sector with 14% who foresee an increase in transactions and 50% who foresee a decrease along with wireless and telecom sector with only 10% expecting an increase in transactions.

Chart 17:

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



Insights

Concerns of a U.S, economic slowdown are already heightened. Sub-prime market losses, the rising cost of energy and other indicators suggest that the U.S. is headed for a recession and the negative impact on the Israeli economy and high-tech market will be unavoidable. This has resulted in overall economic climate expectations remaining grim, with either economic stand still or deterioration predicted, much depending on whether the U.S. recession will have a large or only minor negative effect on Israel.

The American venture backed IPO market has performed well in 2007 and is expected by many to continue its recovery during 2008, despite the anticipated economic slowdown. For Israeli companies it was a very quite year on NASDAQ with only six IPOs and the VC community's expectations are that the number of Israeli IPOs on NASDAQ during 2008 will be about the same. Unviable exits through IPOs drive down the value of the alternate exit root, M&A transactions. VCs should put more thought on how to drive their portfolio companies for successful IPOs, this will lead to M&A valuation to rise.

There are a growing number of Israeli venture capitalists who understand the evolution the internet is going through and are able to evaluate the new business models it brings with it. MySpace and YouTube acquisitions and even the Facebook Microsoft deal are perceived by these venture capitalists as good deals. This is good news for internet entrepreneurs. 2007 was a good year for the Israeli internet industry but both venture capitalists and entrepreneurs should be aware that a U.S. economic slowdown, even if hitting traditional sectors harder than the technology and internet sectors, could affect the web as well. The internet, revolving around advertising money, could be largely affected by traditional companies cut in online advertising budgets. An economic recession would also cut the online shopping spending, another important revenue channel for internet companies.

Most venture capitalists polled believe that despite the overwhelming U.S. investment in the energy sector, the focus on water in Israel is not a mistake. Demand for water is expected to be driven by economic growth and population increases, trends which are common in emerging economies. The long-term outlook for water supply is ominous but the potential value in the opportunity appears to be as significant as the problem. The local emphasis on water provides Israel with a competitive advantage in this growing sector and investors seem to recognize and value this.

As venture capital globalization spreads and the dominance of U.S. economy weakens it is time for Israel to look beyond the U.S. to countries that traditionally were not major business partners of the Israeli high-tech industry and venture capital community. The growing markets in Asia and the close-to-home European market should be getting more attention.

Contacts

We welcome suggestions for issues to be addressed in future **Israel VC Indicator Surveys.** You are welcomed to send them to Gil Shterzer at gshterzer@deloitte.co.il

Please contact us for further information about: this survey's results, the special services offered by **Deloitte Brightman Almagor** and its affiliates to VCs, how we can assist with deal initiation and the execution process.

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