

Israel VC Indicator Survey.

Expectations as of Quarter 1, 2004

Back on track with the engines running

Introduction

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 Israel VC community for the next six to twelve months. The survey is designed to explore relevant key aspects, such as the economic and market climate, deal activity and investment and managerial focus.

The VC Survey is a Deloitte initiative, which is conducted on a quarterly basis concurrently in the UK, Canada, Israel, Germany, Austria, Switzerland, the Netherlands, Italy, Australia, Hong Kong and China, India, Taiwan and Korea.

The results were collected from February 11th through February 28th, 2004 from 48 VCs in Israel, including most of the largest VCs in the country.

This project is conducted by the Business Development Department within the TMT Group.

Optimism is skyrocketing among the members of the VC community. This is the fourth-consecutive quarter in which positive expectations are being expressed. This optimism is the strongest seen since the launch of this survey some two and half year ago. Furthermore, this time these expectations are starting to manifest.

The Israel VC Indicator Survey is a comprehensive picture of VCs expectations for the next six to twelve months and acts as an indicator of changing confidence levels in:

- Economic and market climate
- Deal activity
- Investment and Managerial focus

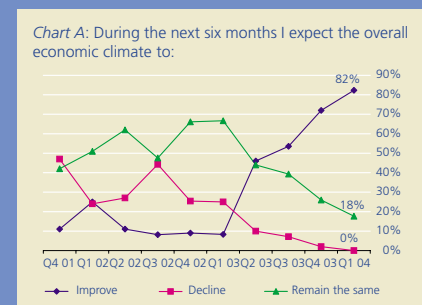
Results

This quarter's expectations represent a new peak of optimism. The positive trend line is impressive and is part of a shift that began a year ago and grew stronger each quarter. The VC community is totally united in its optimistic outlook on the economy with 82% of the respondents expecting the overall economic climate to improve over the next six months (compared to 72% in Q4, 2003 and 8% in Q1, 2003) while all the rest of them (18%) expect it to remain the same (compared to

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 10th Deloitte - Brightman Almagor Israel VC Indicator Survey results for Q1 2004, include a comparison, where relevant, to responses from previous surveys.

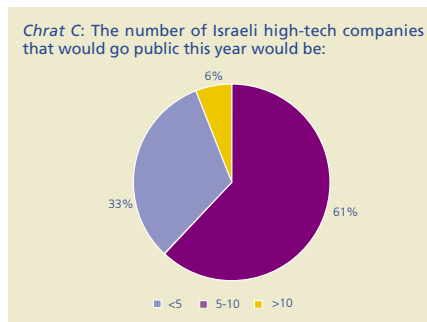
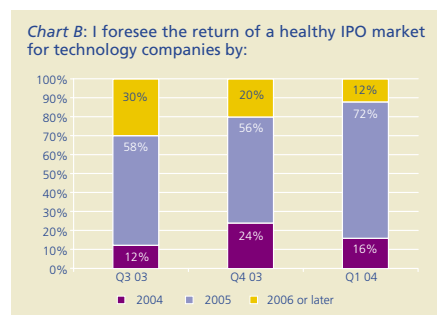
26% in Q4, 2003 and 67% in Q1, 2003). (Chart A)



The optimism glows from every corner: 58% of the respondents expect raising new funds by companies from VCs to be less difficult (compared to 41% in Q4, 2003 and 10% in Q1, 2003), whereas 40% expect it to remain the same (compared to 57% in Q4, 2003 and 62% in Q1, 2003) as they are nowadays. Furthermore, 57% of the respondents expect raising new funds by VCs to be less difficult, (compared to 16% in Q4, 2003 and 0% in Q1, 2003) whereas 41% expect it to remain the same (compared to 80% in Q4, 2003 and 45% in Q1, 2003).

A broader view of the trends of VCs planning their next capital raise provides a few interesting notions: only 6% (compared to 20% in Q4, 2003) of the respondents expect the impact of recent developments in the Israeli private equity landscape on VC's ability to raise capital from Israeli investors to be dramatic. 96% of the respondents expect that the portion of European Investors, in the new fund will increase (33%) or at least would remain the same (63%). As per the origin of the European investors in the new fund, the UK was cited by 47% of the respondents.

The public market plays a dominant role in the Venture Capital investment process. 72% (compared to 67% in Q4, 2003 and 55% in Q3, 2003) of the respondents expect that the recovery of public markets will be the most important factor in their decision to increase their investment levels. The linkage between VCs and public markets does not end here: 88% of the respondents foresee a return of a healthy IPO market for technology companies by 2004 (16%) or 2005 (72%) and the vast majority of the respondents (94%) feel that up to 10 Israeli high-tech companies would go public this year, (Charts B, C).



Yet when it comes to additional financing channels for Israeli high-tech, 92% of the VC community members defined the need for "Buy-Out" financing as low (24%) to medium (68%).

The winds of optimism bring new tidings to entrepreneurs that are thinking of embarking on new venture. 26% of the respondents expect the majority of their new investments to be made in "seed" stage companies (compared to 23% in Q4, 2003 and 20% in Q3, 2003), while 36% of the respondents expect the majority of their new investments to be made in "2nd round" stage companies (compared to 40% in Q4, 2003 and 42% in Q3, 2003).

As per the origin of the companies VCs intend to invest in, 76% of the respondents expect the number of transactions made by Israeli VCs in foreign high-tech companies (i.e.: without any relation to Israel) will remain the same as they are at present. Yet, of those investments in foreign high-tech companies, 71% of the respondents expect that up to 20% will be in European entities and 29% expect the proportion to be 20% to 50%.

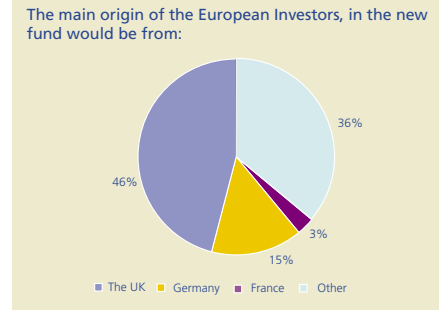
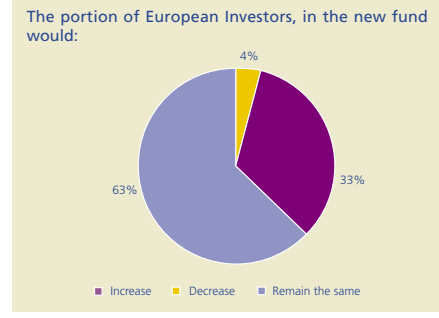
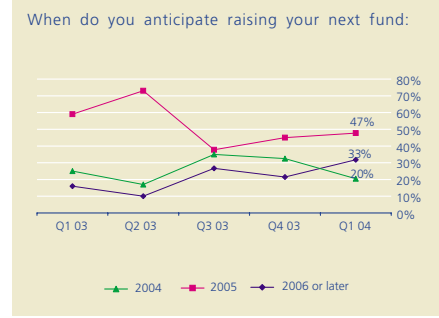
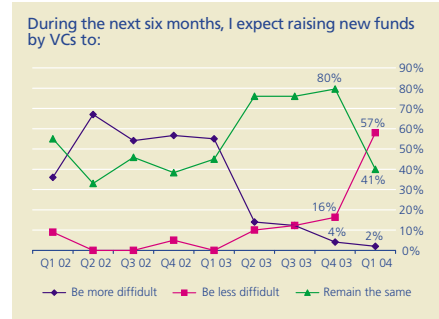
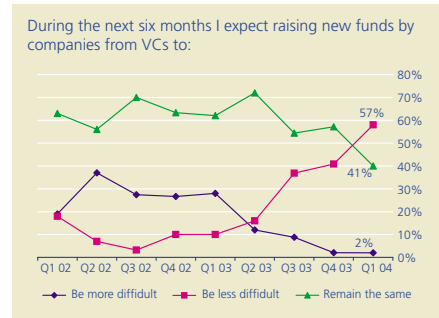
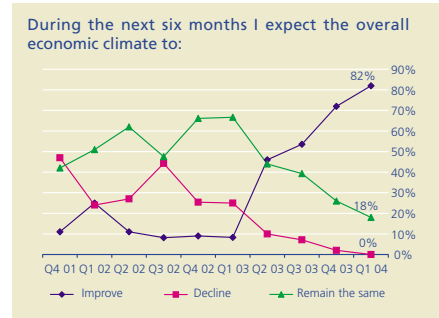
The Internet/e-commerce sector still attracts a great deal of interest: 94% (compared to 85% in Q4, 2003) of the respondents expect that sector to demonstrate an increase in the number of transactions during the next six months. The optimism is overall and includes all sectors: there was no sector in which more than 10% of the respondents expected transactions in the next six months to show a decrease ●

Insights

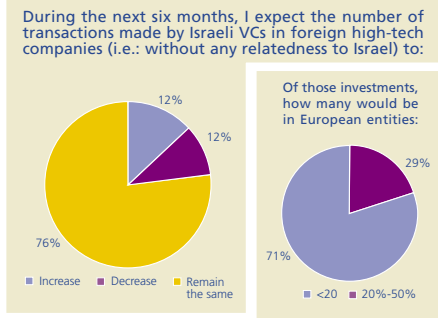
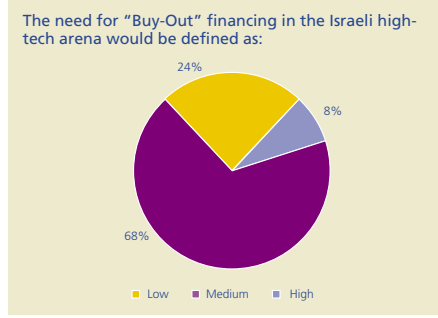
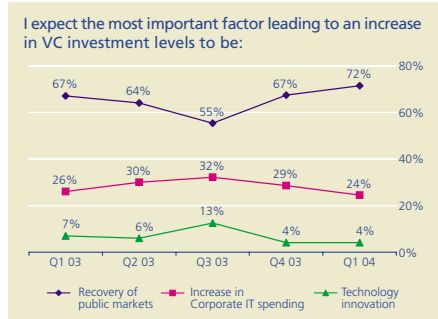
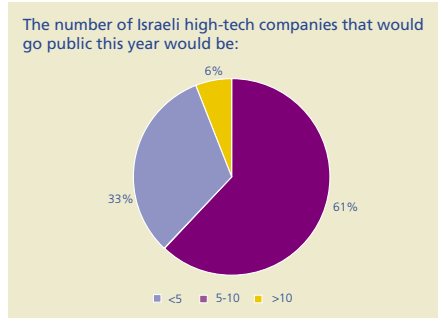
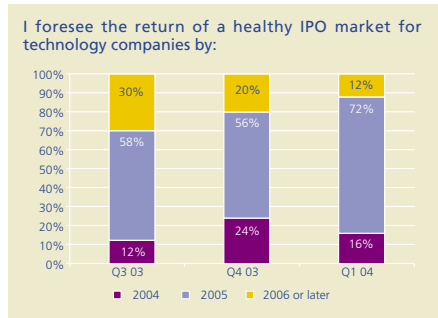
- The Israeli VC arena - in terms of the number of players and their nature - has changed tremendously since the days of "The Bubble". When it comes to raising new funds, it is even more interesting - those for whom "Venture Capital" is their "Profession" rise above and separate from the pack.
- The presence of institutional investors in VCs is already on the rise. We believe that the Ministry of Finance's consent to permit institutional investors to charge management fees on funds invested in VC's as well, will provide an additional and meaningful boost to the industry in the future.
- As part of the whole maturing process the marketplace is going through, there's room and relevancy for all types of PE financing: early-stage, Buy-Outs, PIPEs, Secondary etc.
- Foreign VC's and other foreign investors are once again scouting here. The renewed interest demonstrates both optimism and new craving along with acknowledgment as to the quality of Israeli ventures. Yet, it has additional ramifications: valuations will increase and the whole pace of the investment process will quicken. However, since we all remember the days of "The Bubble" and it's consequences, this time we believe that there will be greater caution and rationalism.
- With all the optimism being expressed so strongly, we must not forget the government's role. Though it has done quite a bit in terms of putting the economy back on track and supporting the industry, there's still a great deal more to be done. Supporting technological R&D, Export, etc., is vital if we want to see Israel's true growth engine - the High-Tech industry - lead us to prosperity.

Detailed Results, 1st Quarter, 2004

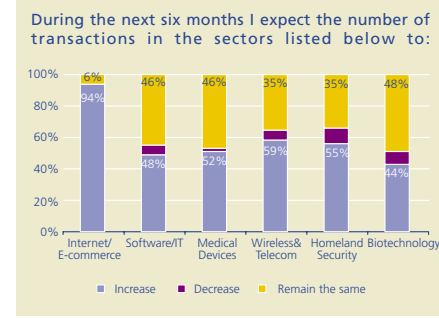
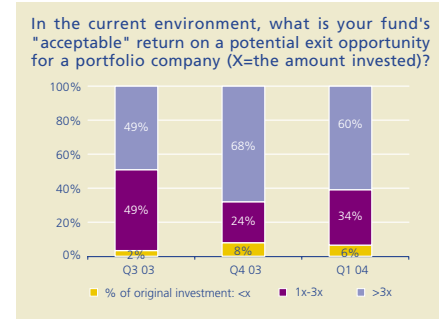
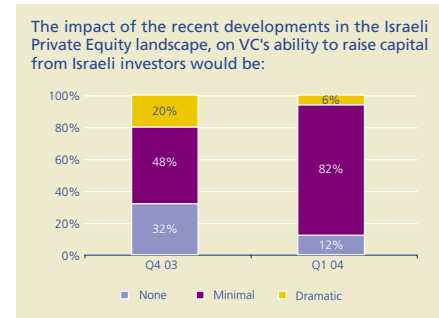
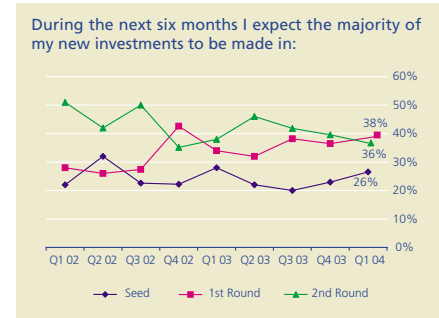
Economic Activity



Deal Activity



Investment & Managerial Focus



“82% of the respondents expecting the overall economic climate to improve over the next six months.”

For more information...

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