

Israel VC Indicator Survey.

Expectations as of Quarter 1, 2006

Who is going to be the main player of the seed and pre-seed investments?

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, Spain, Belgium, Switzerland, the Netherlands, Italy, France, Australia, Hong Kong and China, India, Taiwan and Korea.

The results were collected from March 5th through March 21st, 2006 from 43 VCs in Israel, including all of the largest VCs in the country.

Introduction

2005 has been a stable and positive year for the international and Israeli high-tech industries. During the past few months Angels have begun returning to the scene, successful fund raising by incubator companies has been viewed, an increase in the number of Seed companies that have raised funds from VCs, and more. Due to the increase in available funds in the Israeli market, investments in Seed companies are expected to continue and VCs will become more active in their search for new investments.

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:

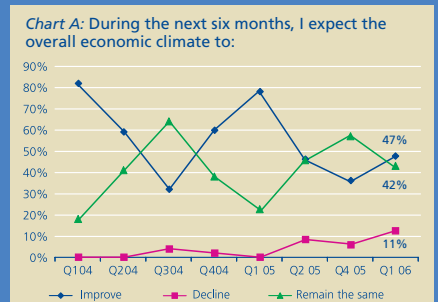
- Economic and market climate
- Deal activity
- Investment and Managerial focus

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 17th Deloitte - Brightman Almagor Israel VC Indicator Survey results for Q1 2006, include a comparison, where relevant, to responses from previous surveys. ●

Results

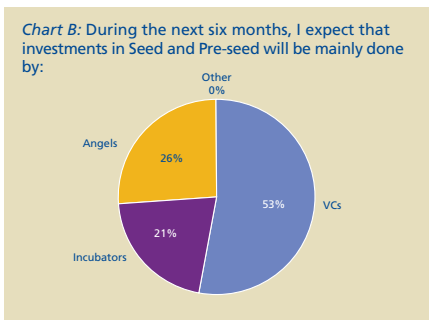
Although slightly lower investment levels during the past year in comparison to 2004, 2005 has been a good year for the Israeli high-tech industry. The results of first quarter of 2006 reflect continued optimistic; although moderate, expectations by the VC community regarding the months to come. An increase can be seen in the number of respondents that expect the overall economic climate to improve over the next six months (47% compared to 36% in Q4, 2005), but along with that, an increase can also be seen in the number of VC community members that expect a decline in the economic climate (11% compared to 6% in the previous quarter). (Chart A) ●



Insights

- With domestic events having minor affect on the local high-tech industry and no foreseen big changes in the global arena - Israeli VCs don't assume any dramatic changes will take place in the near future for better or for worse. The industry's expectations remain optimistic yet conservative, and it seems that despite the fact that the past two years have been good to the high-tech industry; the VC community remains level-headed and will not be part of the creation of a new "bubble".
- The acquisitions of startups by Internet heavyweights such as Yahoo and Google, have created a buzz among American VCs. As in the American market the Israeli VCs have begun to show interest in the Internet sector again and are actively searching for new investments, some of which will require their willingness to make some risky bets.
- Following the 1.2 billion dollars raised by the local VCs during 2005, the interest in Seed and Round A investments has grown. Furthermore, over the past year, foreign VCs have increased their activity in the Israeli market. Therefore, in light of growing competition, the VCs who have available funds will need to become more active in their search for new investments and entrepreneurs in order to attract, identify and obtain the best "deals".
- Although North American VC investments in cleantech have grown rapidly over the last few years, Israeli VCs haven't yet entered this field. Although there are some Israeli cleantech companies, most of them are early stage, usually have longer sale cycles and are not well experienced in dealing with venture capitalists. These characteristics and the lack of proven VC backed Israeli cleantech exits are still deterring Israeli VCs from investing in cleantech. Israeli VCs, being novices in cleantech investments, should place effort into researching the subject before allocating major investments to this opportunity area.
- VC leaders are showing increasing interest in seed and pre-seed investments and they are not alone. The incubators that were not well respected in the past are now gaining prestige, especially those incubators backed by VCs. They are operating on growing budgets (e.g. the IPO of Maayan) and may become key players in seed investments.

During 2006 investment levels are expected to further decline. 17% of the VC community expects a decrease in the number of companies that will raise new funds during this year in comparison to 2005, compared to only 2% in Q4 2005. Furthermore, only 57% of the respondents expect the number of companies to increase compared to 72% in Q4, 2005. On the bright side, investments in Seed companies which have increased during 2005 are expected to continue during 2006. With a number of VCs that have finished raising new funds and therefore searching for new investments, 32% of the respondents expect the majority of their new investments to be made in Seed companies compared to only 20% in the previous quarter. Furthermore, 53% of the VC community members expect that investments in Seed and Pre-seed companies will be done mostly by the VCs themselves. Only 26% expect these investments to be made mostly by Angels and 21% of the respondents expect that Seed and Pre-seed investments will be done mostly by incubators. The increase in Seed investments will result in the continued growth of the Israeli high-tech industry over the next few years. (Chart B)



In search for new investments it appears that the Internet sector is returning and will increase its attraction for VC investments, with the large majority of the respondents (80%) expecting so.

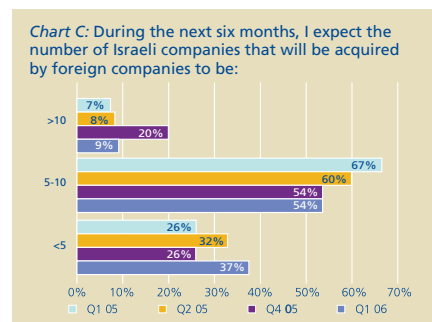
After many changes in the Israeli VC industry over that past couple of years (VCs have succeeded in raising new funds, more VCs expected to conclude the process during the year, new VCs that have appeared and VCs that have declared that they are not going to raise a new funds), the industry is expected to stabilize during 2006. Only 39% of the respondents expect the number of Israeli VCs to further decrease during the year (compared to 51% in Q4, 2005) and 52% expect the industry to remain the same.

Following the above, the majority of the VC community members (60%) expect to spend most of their time focusing on portfolio management (compared to only 48% in the previous quarter), 24% expect

the majority of their time to spent on new investments (mostly VCs who have concluded raising new funds), and only 16% expect to spend the majority of their time on raising new funds (compared to 22% in Q4, 2005).

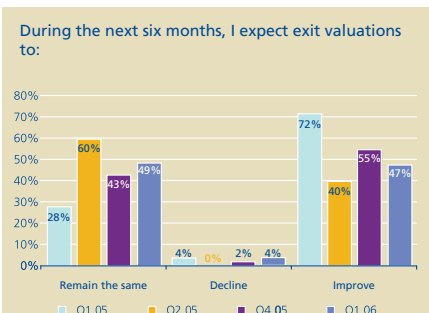
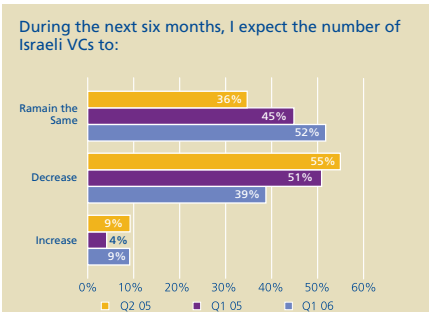
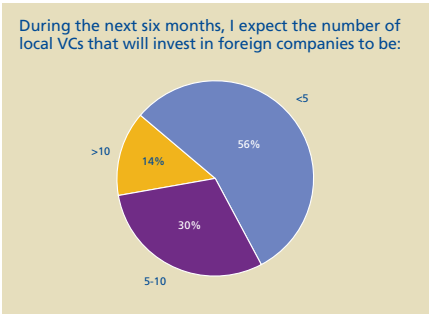
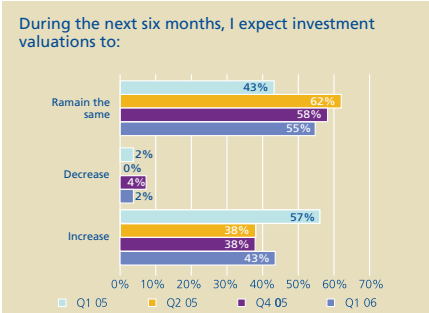
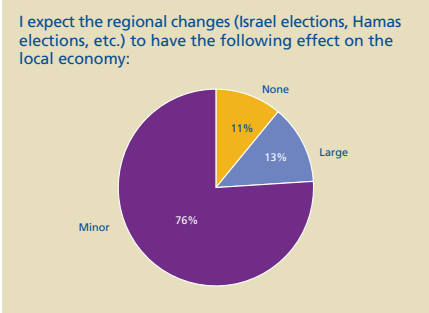
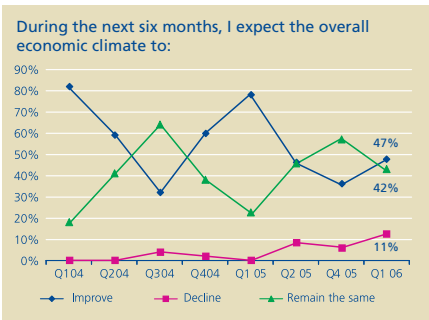
In regard to portfolio companies, 50% of the respondents expect the most pressing business issue confronting their portfolio companies to be an exit opportunity, and 24% expect it to be raising new funds (compared to 15% in the previous quarter).

While viewing various exit options for companies, only 63% of the respondents expect more than 5 Israeli to be acquired by foreign companies during the next six months, as opposed to 74% in the previous quarter, with only 9% of them expecting more than 10 companies compared to 20% in Q4, 2005. In addition, only 45% of the VC community members expect more than 5 companies to go public during the first half of 2006 (compared to 57% in Q4, 2005). (Chart C)

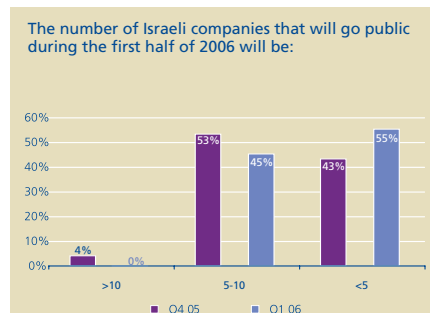
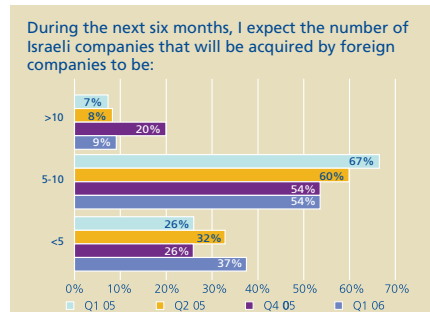
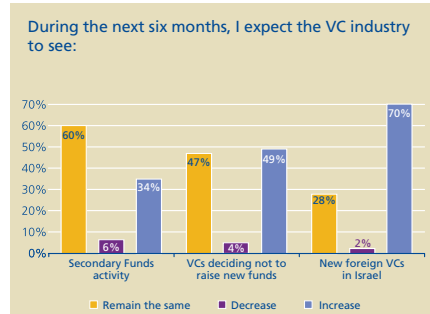
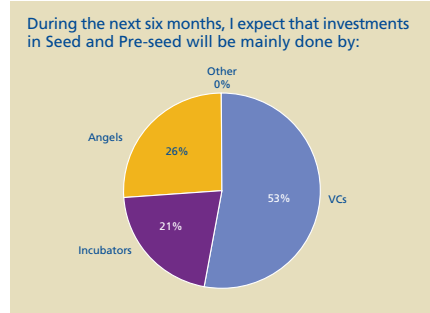
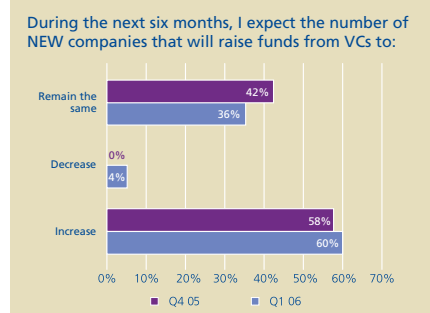
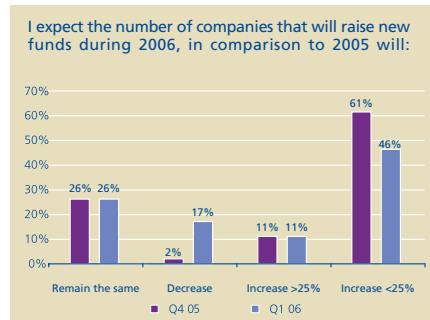


Detailed Results, Quarter 1, 2006

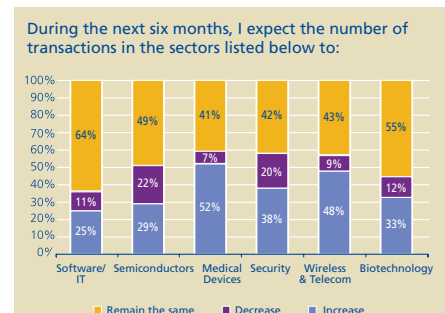
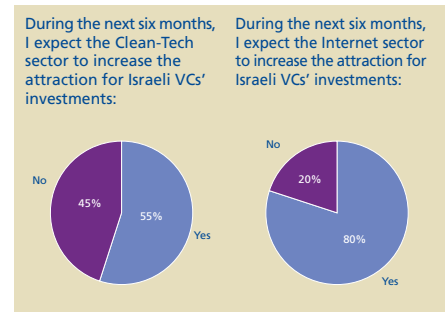
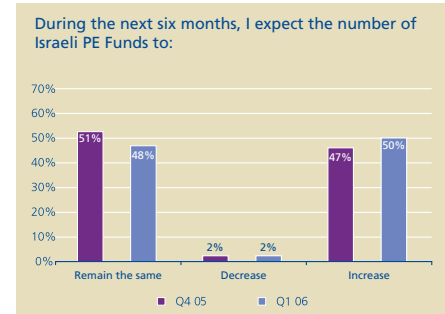
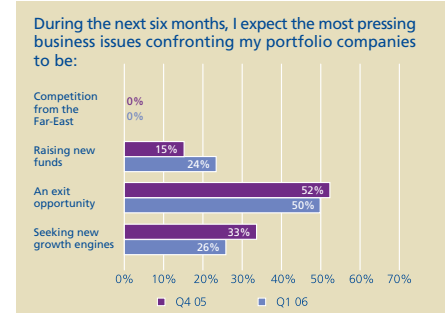
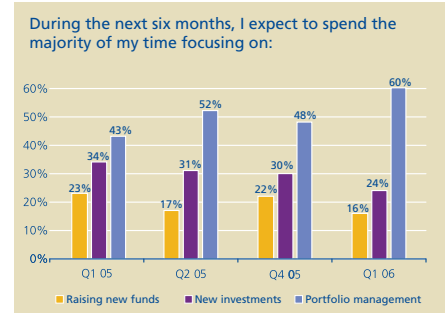
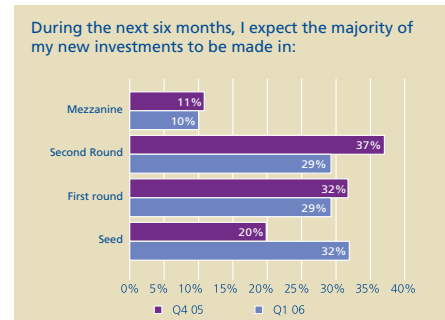
Economic Climate



Deal Activity



Investment & Managerial Focus



Contacts

We welcome suggestions for issues to be addressed in future Israel VC Indicator Surveys.

For more information about this survey or the special services offered by Deloitte Brightman Almagor or its affiliates, to VCs and how we can assist deal initiation and the execution process, please contact us as follows:

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