

The Israel VC Indicator is a survey that is meant 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 & Touche initiative being conducted on a quarterly basis, concurrently in US's Silicon Valley, the UK, Canada, Israel, Germany, Austria, Switzerland, the Netherlands, Italy, Australia, Hong Kong and China.

The results were collected from May 19th through May 30th, 2003, from 46 VCs in Israel, including most of the largest VCs in the country.

This project is conducted by the Business Development department in the TMT Group

A Shift in the Wind

Introduction

For the first time in over a year and a half positive signs are emerging and a change in atmosphere with positive expectations can be felt in the VC community. However, these signs are being treated very cautiously and it will still take a while before they will actually be seen (if at all) in the market. Although many VCs are actively seeking new investments, investment levels and the number of quarterly deals still remain steady and relatively low. Hopefully these brighter expectations will evolve in to positive trends.

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:

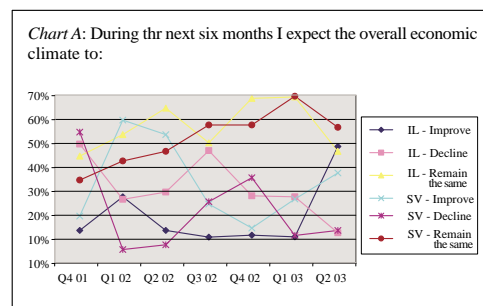
- Economic and market climate
- Deal activity
- Investment and Managerial focus

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 7th Deloitte & Touche – Brightman Almagor Israel VC Indicator Survey results for Q2 2003, include a comparison, where relevant, with responses from the previous quarters surveys in Israel and with the results of the Q2 2003 VC Confidence Survey which is conducted by Deloitte & Touche on a quarterly basis in the Silicon Valley.

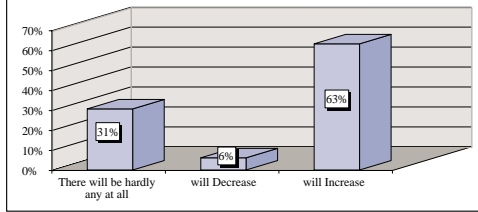
Results

This quarter's results indicate a brighter outlook and the first signs of recovery in over a year. 46% of the respondents expect the overall economic climate to improve during the next six months compared to 8% in Q1, 2003 and only 10% expect a decline compared to 25% in the previous quarter. These expectations are similar to those of the Silicon Valley VC community who has shown optimistic expectations since last quarter (35% expect an improvement in the overall economic climate compared to 25% in Q1, 2003). (Chart A)



Additional indications to an increasing positive outlook can be seen in the VCs expectations regarding foreign investments in Israel and raising new funds. It seems that the end of the war in Iraq, together with general sentiment of improvement being felt in the public markets in the US lately have resulted in some optimistic expectations in the Israeli VC community. 63% of the respondents expect foreign investments in Israeli companies to increase during the next six months. Furthermore, only 12% of the VC community members expect raising new funds by companies from VCs to be more difficult than it is today (compared to 28% in Q1, 2003). This definitely reflects a change in atmosphere! (Chart B, see next page)

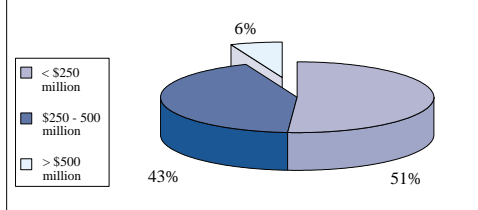
Chart B: Due to the local situation and to the end of the war in Iraq, I expect that during the next six months foreign investments in Israeli companies:



Raising new funds for the VCs themselves is also expected to be slightly simpler, with 10% of the respondents expecting it to be less difficult than it is today (compared to 0% in Q1, 2003) and only 14% expecting it to be more difficult (compared to 55% in Q1, 2003). Despite this encouraging expectation, the majority of the VC community (73% compared to 59% in Q1, 2003) still anticipates that they will only raise their next fund during the year 2005.

Those VCs that are looking to raise new funds should note that it seems that the difficulties that the VCs have encountered during the past two years throughout the world in raising new funds, and the fact that some of the funds raised between 1999 and 2000 have been returned to the LPs, coincides with the fact that the vast majority of the Silicon Valley respondents (94%) indicate that the optimal fund size in the current environment is less than \$500 million, with 51% of the same group indicating that \$250 million is the optimal fund size. *(Chart C Silicon Valley)*

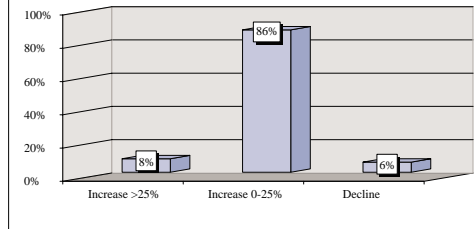
Chart C Silicon Valley: What is the optimal fund size, given the current pool of investable private companies, assuming traditional investment horizons?



As in last quarter, the majority of the VC community members (64% compared to 67% in Q1, 2003) still expect the most important factor that will lead to an increase in VC investment levels to be the recovery of public markets and only 30% expect it to be an increase in corporate IT spending. 86% of the respondents expect the value of NASDAQ to increase up to 25% compared to its value today,

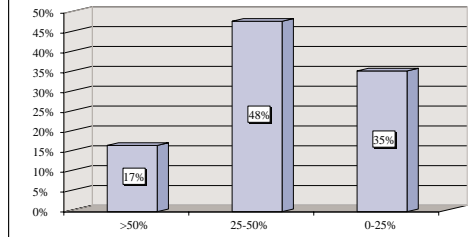
over the course of 2003. If this expectation is to become realistic, we should expect an increase in VC investment levels as well. *(Chart D)*

Chart D: Over the course of 2003, I expect the value of NASDAQ to:



65% of the respondents expect over 25% of their total funds to be deployed for new investments rather than follow-on investments during 2003, with 17% of them expecting to deploy over 50% of their total funds for new investments. When looking to invest this money, a slight increase can be seen in the number of respondents that expect the majority of their new investments to be made in the second round (46% compared to 38% in Q1, 2003) and a slight decline can be seen in the expectations towards seed investments (22% compared to 28% in Q1, 2003). *(Chart E)*

Chart E: In 2003 I expect the percentage of total funds that will be deployed for new investments rather than follow-on investments to be:



In reference to new investments the VC community in the Silicon Valley while asked about evaluating a potential new investment, 73% of the respondents indicate that the most important factor in determining pre-money valuation for the investment is an evaluation of milestones reached by the company and only 25% appear to still be mostly concerned with public company valuation as an important benchmark.

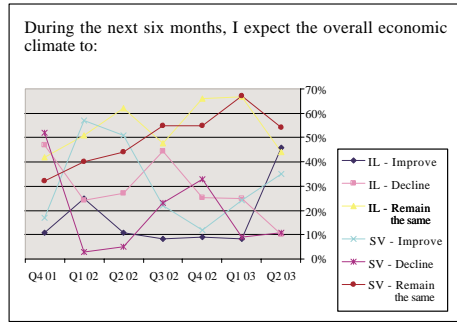
80% of the respondents indicate that up to 25% of their portfolio companies are actively seeking a strategic buyer. 72% of the respondents expect the likely results of this search to be an acquisition by a larger player, while 23% expect the companies to sell their assets.

INSIGHTS

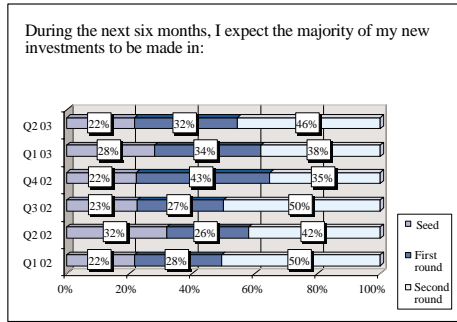
- The local situation in Israel - fragile as it may be - appears to be moving in a positive direction: the political road map, the new economic plan, together with the end of the war in Iraq and the stabilizing economic conditions in the US, are raising hopes towards the local economic environment and high expectation for the investment of foreign funds in Israel. Further improvement in any of the above shall further benefit the Israeli economy, high tech industry and VC community.
- Despite the rising hopes towards raising new funds for VCs, the future fund sizes are expected to decline. The VC industry shall be composed of VCs that will be managing smaller amounts of money and with a stronger "hands on" approach.
- Due to the lack of an IPO market, M&As will continue to be the most likely exit route in the near and mid-term future. Companies who wish to use this route must shift their business plans, their structure and strategies in order to position themselves as attractive candidates for an acquisition by larger players.
- As a preliminary approach to an M&A, VCs should explore the possibility of mergers among their own portfolio companies or with other Israeli companies, especially when it comes to niche companies. The new company created by the merger may be more successful in its new format or may turn out to be an even more attractive candidate for an acquisition than each company was alone...
- Valuation expectations have fallen to realistic ranges, and this will only help the expected pace of investing and VC exits.

Appendix: 2nd Quarter, 2003 Detailed Results

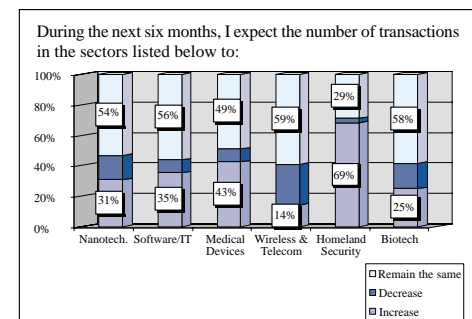
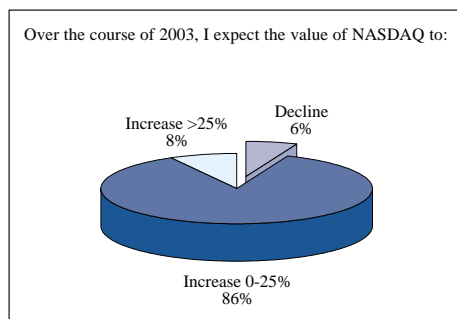
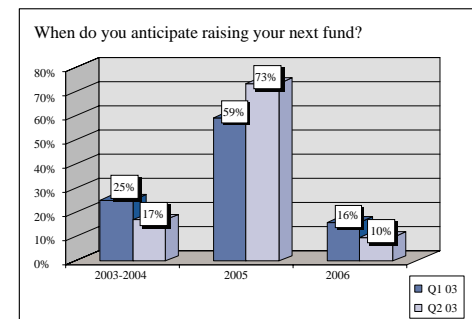
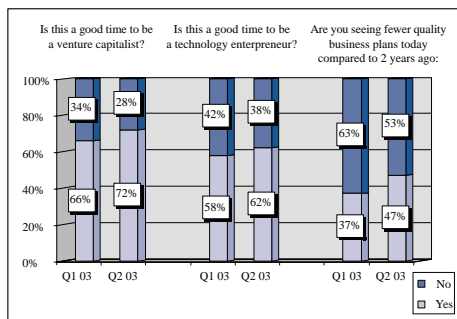
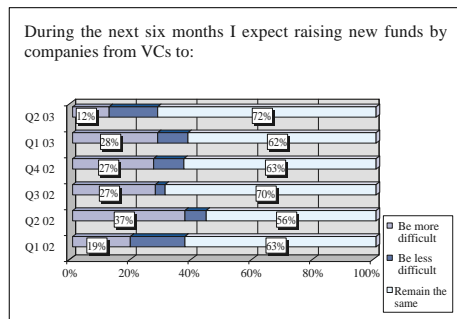
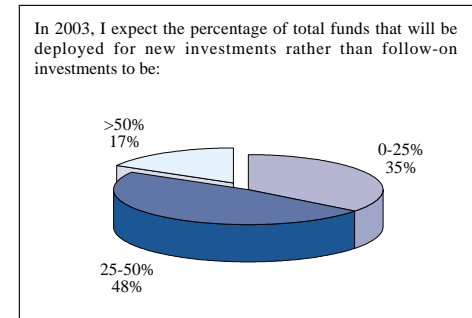
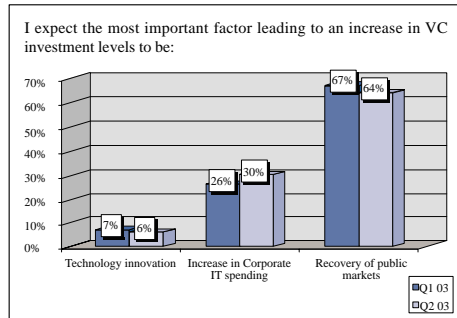
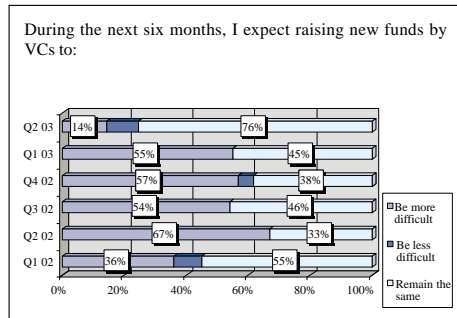
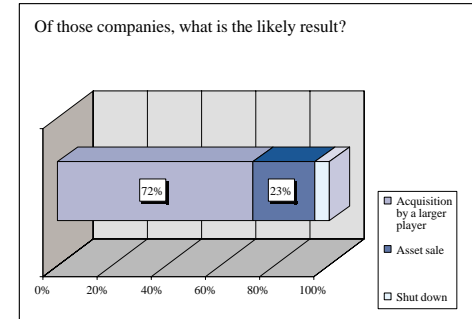
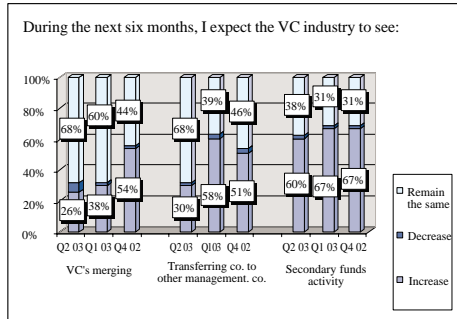
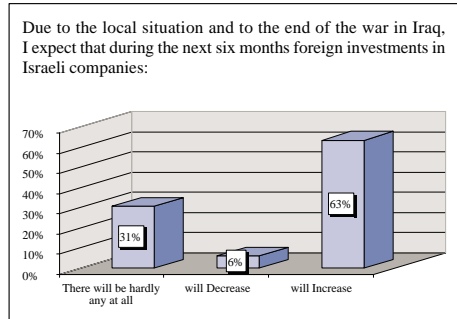
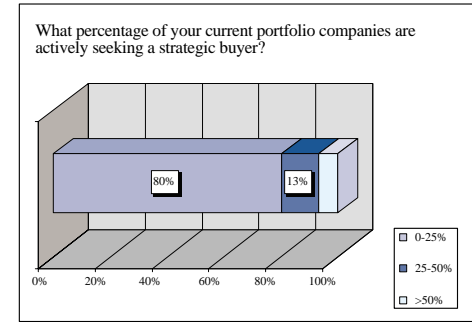
Economic Activity



Deal Activity



Investment & Management Focus





○ Contacts

Deloitte & Touche – Brightman Almagor initiated this survey and collected the results from May 19th through May 30th, 2003. The Israel VC Indicator Survey is conducted on a quarterly basis.

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 & Touche Brightman Almagor or its affiliates, to VCs, and how we can assist the deal initiation and execution process, please contact us as follows:

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