

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 Israeli 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 the US, the UK, Canada, Israel, Germany, Austria, Switzerland, the Netherlands, Italy, Australia, Hong Kong and China.

The results were collected from August 5th through August 20th, 2003, from 50 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

## Are we beginning to climb the curve?

### Introduction

It is the second quarter that the VC community is expressing optimistic expectations and with an even stronger positive pole than before. These signs appear across the board starting with the expectations as per the overall economic climate, onwards through the statements about the return of a healthy IPO market in the mid-term future and followed by the anticipation regarding raising the next fund in a much more foreseeable future.

Hopefully these expectations, which might imply the beginning of climbing the curve, will evolve into a more substantial and viable activity.

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:

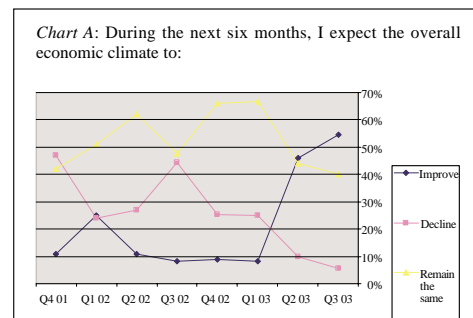
- Economic and market climate
- Deal activity
- Investment and Managerial focus

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.

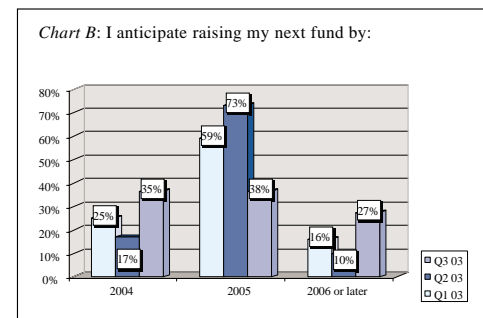
The 8th Deloitte & Touche - Brightman Almagor Israel VC Indicator Survey results for Q3 2003, include a comparison, where relevant, with responses from the previous quarters surveys in Israel.

### Results

This quarter's results indicate that the positive signs, brighter outlook and optimistic expectations, which began last quarter, continue. The VC community has an increasingly positive outlook on the economy with 54% of the respondents expecting the overall economic climate to improve over the next six months (compared to 46% in Q2, 2003) and only 7% expect a decline (compared to 10% in Q2, 2003). (Chart A)



In spite of the positive outlook on the economy, the majority of the respondents (76%) still expect the difficulties in raising new funds by VCs to remain the same as they are at the present time (76% in Q2, 2003). Yet taking a closer look at the results, reveals that, 35% of the VC community members expect to raise their next fund during the year 2004 (compared to 17% of the respondents in Q2, 2003) and 38% of them expect to do so during 2005 (compared to 73% of the respondents in Q2, 2003). (Chart B)



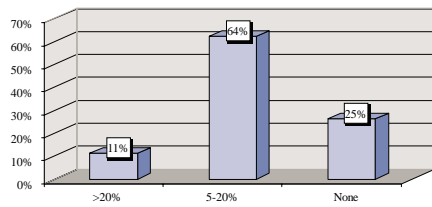
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Other indications of the continued upward trend can be seen in the following factors: 58% of the respondents expect the value of Nasdaq to increase between 10-25% over the next six months and 70% of the respondents expect a healthy IPO market for technology companies to return by the end of 2005. In addition, 55% of the respondents expect the recovery of public markets to be the most important factor leading to an increase in VC investment levels.

Another interesting angle - with respect to the future expectations as per the stock markets and the VC backed company's efforts to get ready to that day - is the fact that 64% of the respondents expect 5-20% of their portfolio will have to shift their business model or strategy during the next six months. Are those the companies planning to go to an IPO? (Chart C)

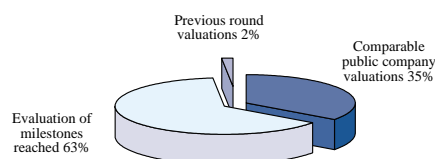
Chart C: I expect the percentage of my portfolio that will have to shift its business model/strategy during the next six months to be:



All of the above supports the notion that the worst is behind us and that VCs should search for good investments and increase their investment pace as well as the levels. And indeed, 37% of the respondents expect raising new funds by companies from VCs to be less difficult than it is today (compared to 16% in Q2, 2003).

In terms of the relationship between the VC and its potential investment, 63% of the respondents feel that the most important factor in determining pre-money valuation for a potential venture is the evaluation of milestones reached, whereas only 2% of the respondents define the previous round valuations as the most important factor. (Chart D)

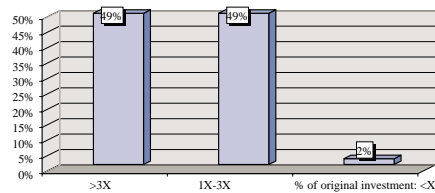
Chart D: Of the following the most important in determining pre-money valuation for potential investments is:



Once the investment has been made, 93% of the respondents indicate that the total dollar amount they expect to invest over the life of each portfolio company would be less than \$10 million, with 61% of them indicating that the amount would range between \$5 to \$10 million. In addition, 91% of the respondents indicate that the optimal fund size in the current environment and given the pool of investable private companies is up to \$250 million. Those inputs, shed a new light on the number of portfolio companies - perceived by the investment managers themselves - each VC intends to handle.

Adding to the equation another fact, by which 49% of the VC community members feel that in the current environment their funds acceptable return on a potential exit opportunity for a portfolio company exceeds 3 times of their original investment (compared to 38% of the respondents in the Silicon Valley's VC community in Q2, 2003) and 49% indicate that a one to 3 times is an acceptable return (compared to 54% of the respondents in the Silicon Valley's VC community in Q2, 2003), could help better understand the pressure many VCs have experienced, over the last year or so. (Chart E)

Chart E: In the current environment, my fund's "acceptable" return on a potential exit opportunity for a portfolio company (X=the amount invested) is:



It seems that the Homeland security arena is not just a temporary buzz. This has been the third quarter in a row that this field attracts a positive outlook by more than 60% of the respondents. In this quarter 61% of them expect that during the next six months the number of transactions in the sector will increase.

## INSIGHTS

- It is clear that there is a linkage between capital markets, their motion and the VC industry and it's flow, as it is known that expectations where always an important ingredient in the economical growth recipe. It's only a question of time for the stock markets to rise and for the stream of IPO's to return. If a VC backed company is headed that way, the sooner will it adjust it's course, the better and more successfully would it get there. It seems that the time to start with the adjustments and preparations for that long journey has arrived.

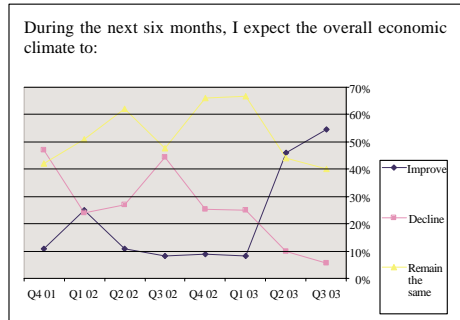
- On one hand the VC arena is becoming more and more a dominion of the professional players. Experienced entities, that this type of activity is their core and sole business will be the ones to remain on the map. On the other hand, this evolution must be viewed in the context of the consolidation in that industry. Consolidations among VC's has it's natural limits, especially in days that the vast majority of the community - given the current pool of investable private companies - has marked the line of \$250 million as the maximum fund size.

- There is a craving for "good" companies. Companies that have a genuine offering, sustainable business operations, a viable back-log of contracts, etc. When coming to discuss VC investments, only "real" parameters and milestones reached are relevant these days.

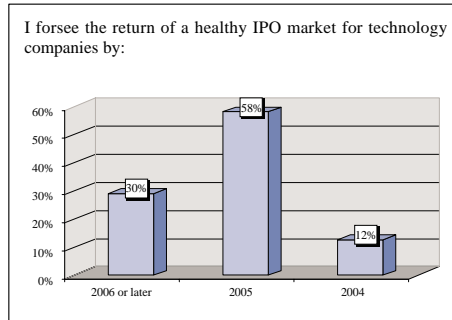
- The pressure LPs are putting-regarding the investment rate, the management fees and the demand to return a portion of the uninvested capital - has not yet reached its end, and it would also contribute to the separation of the boys from men...

# Appendix: 3rd Quarter, 2003 Detailed Results

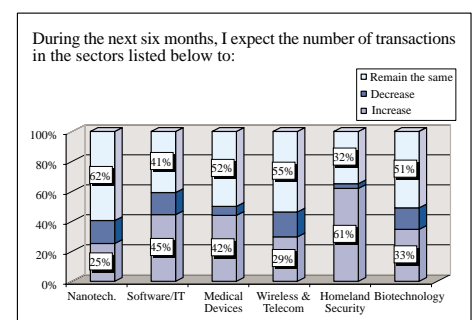
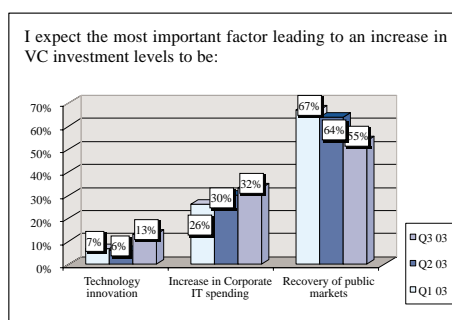
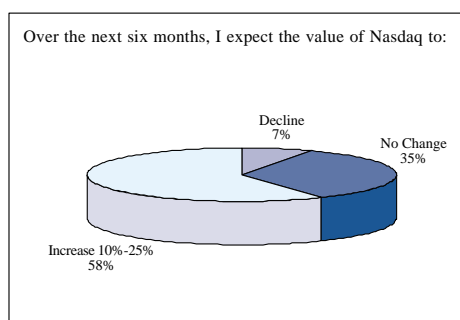
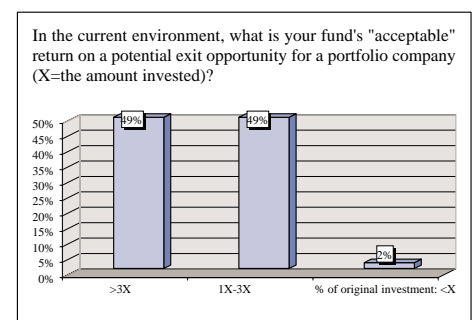
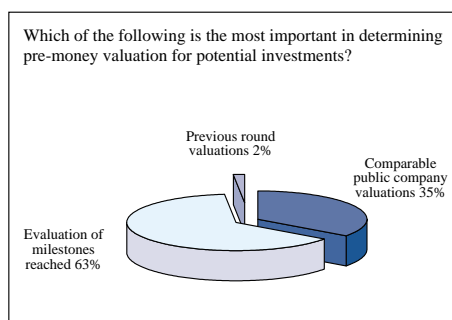
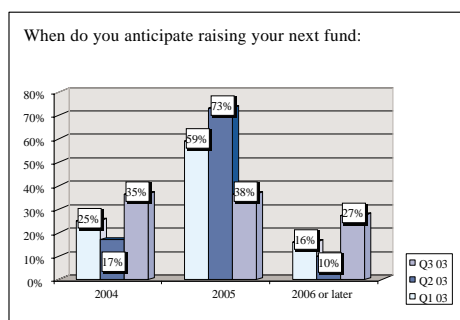
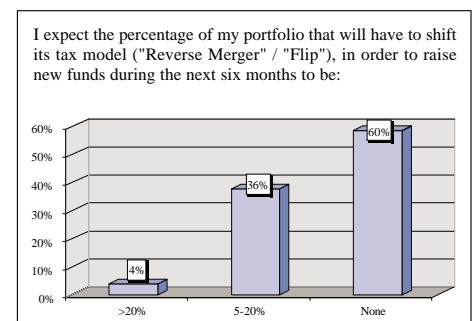
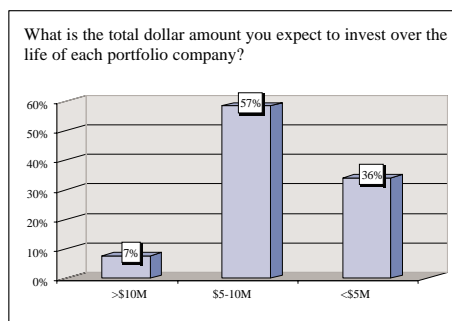
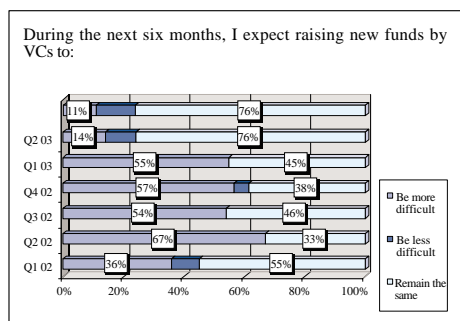
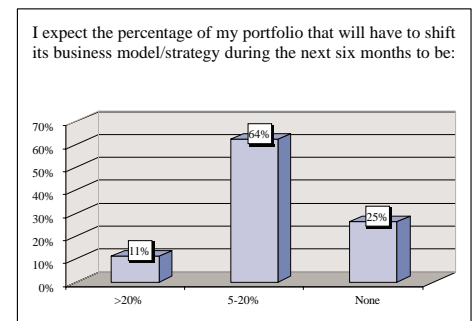
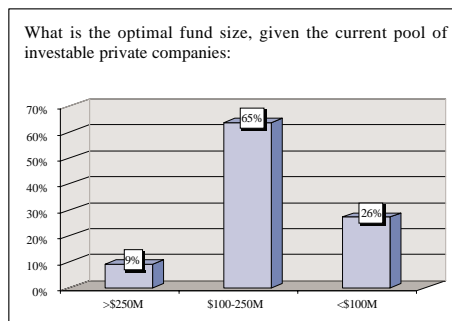
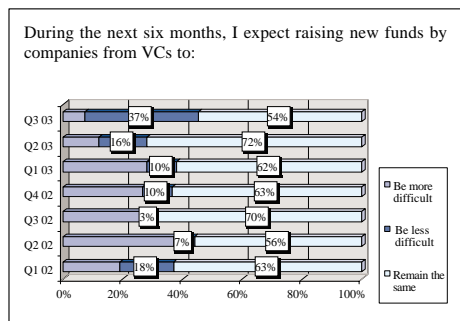
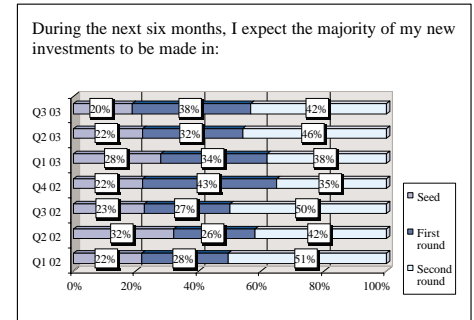
## Economic Activity



## Deal Activity



## Investment & Management Focus





## ○ Contacts

Brightman Almagor initiated this survey and collected the results from August 5th through August 20th, 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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**Our mission is to help our clients and our people excel**

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