

Israel VC Indicator Survey.

Expectations as of Quarter 4, 2004

High Expectations for the New Year



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 December 5th through December 21st, 2004 from 47 VCs in Israel, including all of the largest VCs in the country.

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

Introduction

After three slow years, 2004 has proven to be a turning point for the high-tech industry. VCs have begun raising new funds, investment levels are up, valuations are on the rise, foreign investments are back, an increase in the number of IPOs and M&As and the value of the stock markets have risen. The VC community has even higher expectations for the New Year that has begun.

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 13th Deloitte Brightman Almagor Israel VC Indicator Survey results for Q4 2004, include a comparison, where relevant, to responses from previous surveys. ●

Results

The last quarter of 2004 brings new optimistic expectations regarding the year to come. A large increase can be seen in the number of respondents that expect the overall economic climate to further improve over the next six months (60% compared to 32% in Q3 2004), and 38% of the VC community members expect the positive atmosphere that has been witnessed during the past few months to continue.

Furthermore, 86% of the VC community members expect the local instability to have a very slight impact or none at all on the local high-tech and VC industries, which indicates

that the industry is expected to be influenced more by changes in the global market than by those in the local one (*Charts A,B*). ●

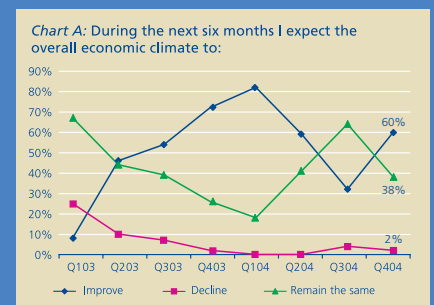
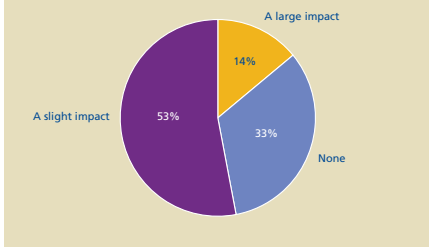


Chart B: I expect the impact of the local political instability on the local high-tech and VC industries to be:



Optimistic expectations can also be seen in regard to raising new funds both by VCs and by companies. 32% of the respondents expect raising new funds by VCs to be less difficult (compared to 21% in Q3 2004) and 62% expect it to remain as is at present. Due to the number of VCs that are already in the process of raising new funds, this can be seen as a positive sign regarding expected closings. 59% of the respondents expect to raise their next fund during 2005. In addition, 84% of the VC community expects the number of high-tech companies that will raise money during the next six months to increase compared to the 2004, with 28% of them expecting an increase of more than 25%. None of the respondents expect a decrease in the number of companies that will raise new funds during the first half of 2005.

Only a slight change can be seen in the expected investment stages. An increase can be seen in the number of respondents that expect the majority of their new investments to be made in Seed companies (21% in the current quarter, compared to 19% in Q3 2004 and 15% Q2 2004). 42% expect the majority of their investments to be made in the second round (as opposed to 38% in Q3 2004).

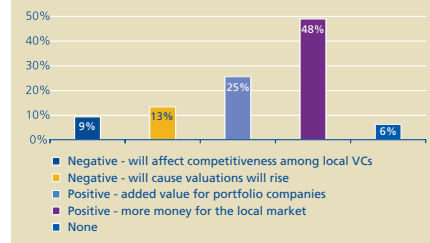
In regard to the investment process, over the past few months investment valuations have risen. 98% of the VC community members expect valuations to remain at present levels or further increase.

During the second half of 2004, the local market has seen an increase in the involvement of foreign investors. As in the previous quarter, all of the respondents expect this involvement to continue with 56% of them expecting an increase.

The large majority of the VC community members expect this increase of foreign involvement to have some kind of effect on the local market. 73% of the respondents expect this effect to be a positive one, either due to the fact that it will result in additional funds for the local market (48%) or due to an expectation that it will provide added value in business development, management input, etc. to the portfolio companies that will raise money from these foreign investors

and funds (25%). 21% of the respondents estimate that the increase in foreign investments will have a negative effect on the local VCs due to expectations that this will cause valuations to rise (13%) or due to expectations that this will affect the competitiveness among the local VCs (8%) (Chart C).

Chart C: I expect the effect of the increase of foreign investors involvement in the Israeli high-tech industry on local VCs to be:



Further optimism can be seen in expectations regarding the stock market and exits. 86% of the respondents expect the value of NASDAQ to increase over the next six months, with 22% of them expecting an increase of more than 10%. Furthermore, 92% of the VC community members expect to exit from over 5% of their portfolio companies during the year 2005 with 25% of them expecting to exit over 10% of their portfolio. 63% of the VC community members expect exit valuations to improve during the first half of 2005.

On the other hand, a decrease can be seen in the VCs expectations regarding Israeli high-tech IPOs during the same period. 58% expect less than 5 Israeli companies to go public by the middle of 2005 compared to 17% in Q3 2004. It seems that the IPO market in general and for Israeli companies specifically, is expected to continue and increase during the first half of the New Year but at steady pace.

In regard to expected IPOs, it seems that some of the VC community members already expect the Sarbanes-Oxley Act to have some influence, in one way or another, on their portfolio companies. Although 62% of the respondents have not yet reached a conclusion regarding the influence that the Act may have, 17% of the respondents state at present that it will influence their portfolio's decision regarding the preference of an IPO or a M&A. Furthermore, 20% expect the Act, which also requires personal liability of directors and management in public companies, to cause a decrease in the number of VC members that will serve as directors in portfolio companies.

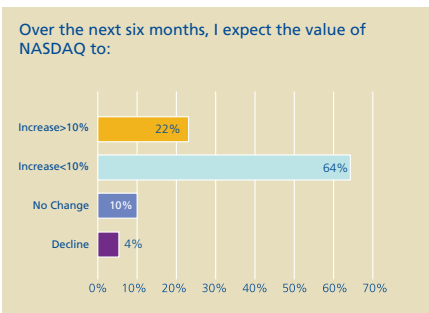
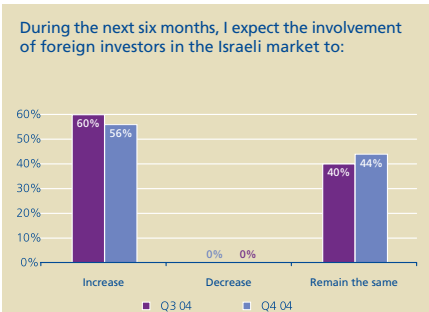
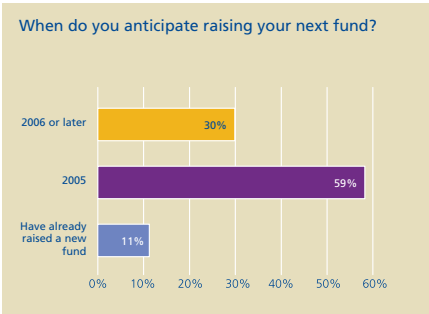
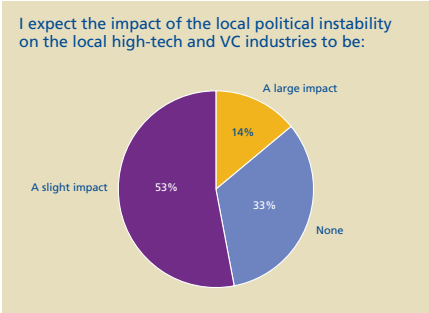
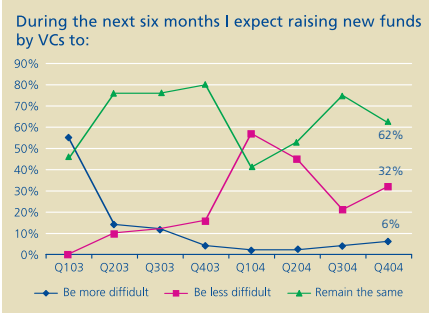
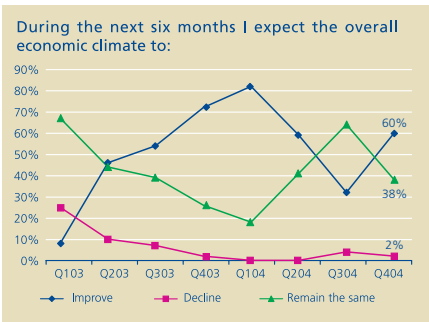
Well into 2005 the preferred industries are expected to be communications, software\IT as well as internet and e-commerce. In addition, investments in homeland security technologies and other niche technologies are also expected to take place. ●

Insights

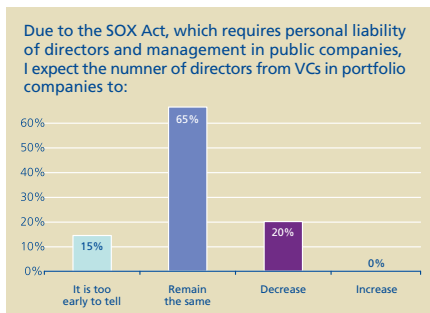
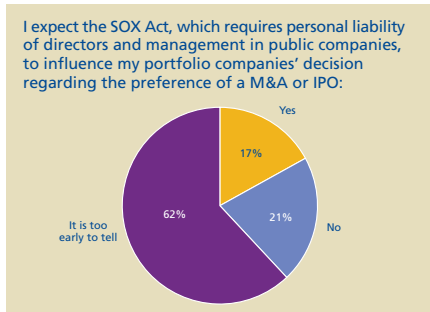
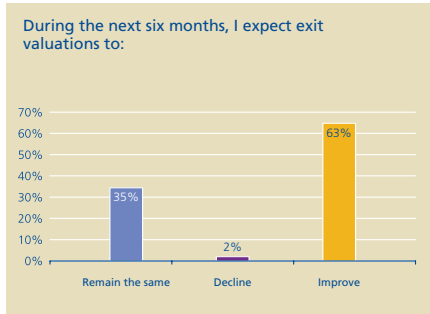
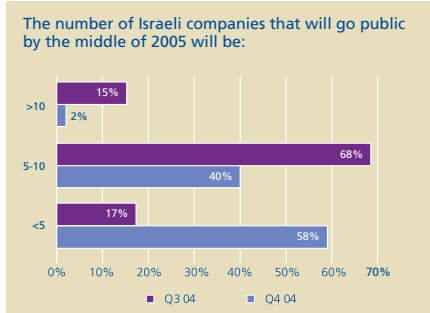
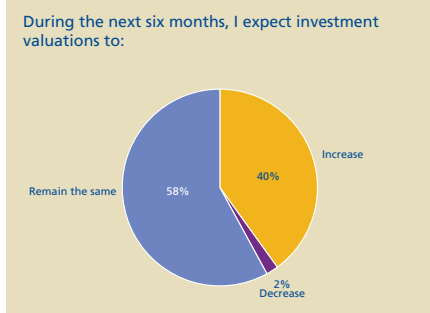
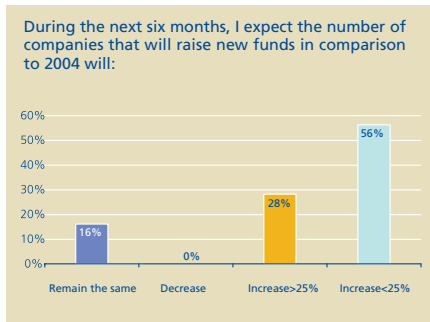
- Over the past year, the local high-tech market has proven its almost complete and total immunity to local instabilities and that it is influenced by, and part of the global high-tech industry. Further improvement of the stock markets, an increase in corporate IT spending and demand for products from developing markets will influence the global high-tech industry for the better and along with it the local market, and both are expected to continue improving at a steady pace during 2005.
- Many VCs are expected to raise a new fund this year. If successful, this will stream a large amount of money to the local industry and will lead to an increase in the number of companies that will raise money in general, and "seed" companies specifically. Along with this valuations are also expected to rise and "bargains" will be much harder to come by.
- The past year has brought with it a large increase in the number of foreign investors that have become involved directly in Israeli companies at earlier stages as opposed to doing so through\with local VCs. This is expected to continue, and although most VCs view this situation as a positive one, it will enhance the competition between the local VCs and the foreign ones. Time will tell if this will turn out to be a turning point for the local VC industry for better or for worse.
- An increase in the number of exits will be seen during 2005 both IPOs and M&As. Exit valuation will rise in comparison to the past three years but are not expected to return to the levels known during 1999-2000. Due to this, Time to Market will become an even more important factor while deciding regarding new investments.
- Many of the VC members still haven't internalized and come to a conclusion as to the effect that the Sarbanes-Oxley Act will have on their portfolio companies, both for the purpose of an IPO and for the purpose of a M&A with\by a SEC company. This Act is yet to influence the industry and will require close attention from the VCs in portfolio management.
- The challenge presented by the Far East markets will continue to increase and present a real threat to the local market and its competitiveness during 2005. While conducting new investments VCs must look for the Israeli technologies that can improve the local edge and growth.

Detailed Results, 4th Quarter, 2004

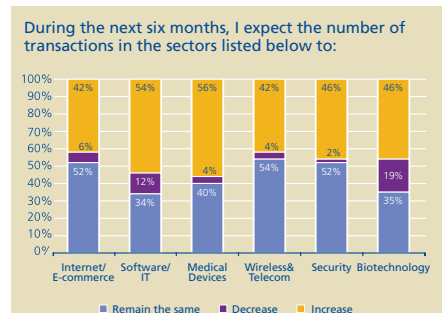
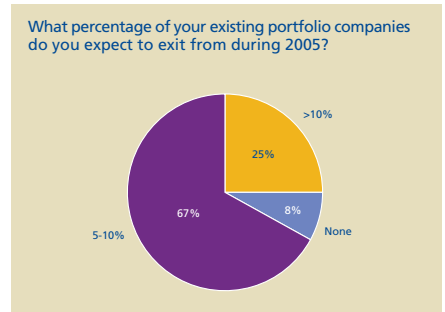
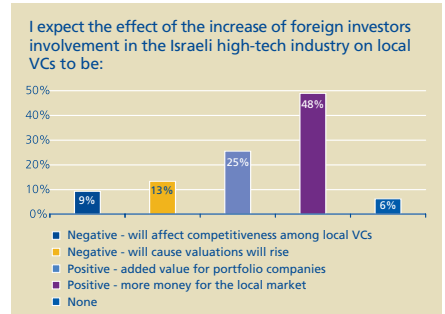
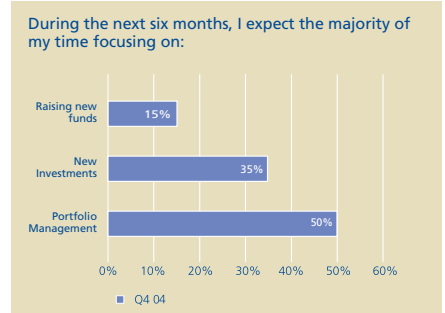
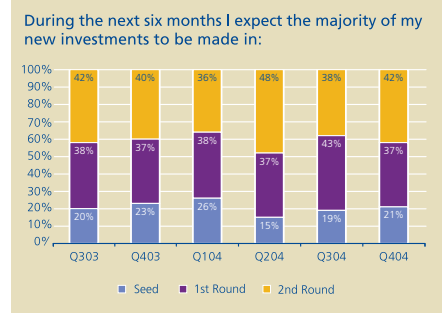
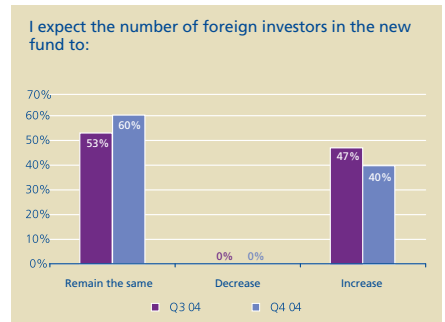
Economic Climate



Deal Activity



Investment & Managerial Focus



For more information...

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