

Israel VC Indicator Survey

Expectations as of Quarter 1, 2005

Increasing Activity in the VCs

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 8th through March 22nd, 2005 from 47 VCs in Israel, including all of the largest VCs in the country.

Introduction

2005 has brought with it continued increase in investment levels and investment valuations. The increased foreign interest in the Israeli market during the past few months has continued and a number of Israeli companies have been involved in M&A transactions by foreign entities. Many of the VCs are beginning to look forward to some exits in the near future and are checking out various possibilities to do so. Many expectations will accompany the high-tech industry during the next few months.

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:

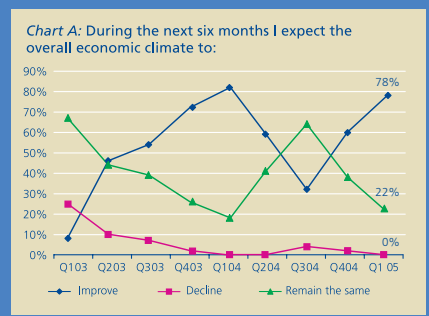
- Economic and market climate
- Deal activity
- Investment and Managerial focus

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 14th Deloitte Brightman Almagor Israel VC Indicator Survey results for Q1 2005, include a comparison, where relevant, to responses from previous surveys.

Results

The first quarter of 2005 brings continued and increased optimistic expectations regarding the next six months. As in the previous quarter, another large increase can be seen in the number of respondents that expect the overall economic climate to improve (78% compared to 60% in Q4, 2004 and 32% in Q3, 2004), and none of the respondents expect a decline in the economic climate (*Chart A*).

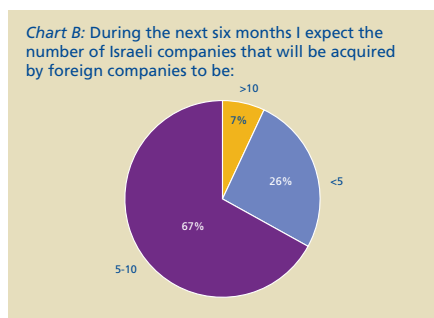


Insights

- Many of the VCs that haven't already raised a new fund or begun the process of raising one, are expected to do so during this year. New money in the VC industry will slowly and steadily bring an increase in investment levels in Seed and early stage companies. While investing in Seed companies, VCs must be ware of the valuations in order to remain in realistic rates that won't affect exit possibilities in the future.
- The increased involvement of foreign investors in the local industry will continue throughout the year. Along with them, many international companies have appeared on the scene, looking for local acquisitions. This trend is expected to continue and is viewed by many as a quicker and more realistic option.
- The increase in the number of exits that took place towards the end of 2004 will further grow during the current year, although through various options. Many more factors are taken into consideration while examining an exit possibility as opposed to previous years (the state of mind of investors in Nasdaq, Sarbanes Oxley Act, costs and expenses, etc.). Therefore, many VCs and high-tech companies are searching for alternative exit possibilities that can provide a respectable ROI for the investors and at the same time promote the companies interest, such as M&As or IPOs in different stock markets around the world (London, Singapore, Tokyo, etc.). Some of these options were not considered seriously in the past and are now viewed as a relevant opportunity.
- The challenge the far-east markets are presenting is continuing to increase and become urgent. The threat that they bring with it affects the local markets competitiveness, employment, the countries income taxes, etc. more every day. Many more Israeli companies will be forced to relate to this issue in one way or another. The VC industry and the government must continue to take this into considerations at all decision points in order to improve the edge of the local market.

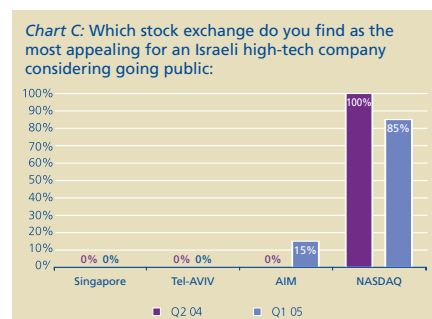
During last year (2004) we have witnessed a large increase in the number of companies that have raised funds from VCs and in the amounts raised. 62% of the respondents expect the number of companies that will raise funds during 2005 in comparison to the previous year to increase by less than 25%, and 26% expect the number to increase by more than 25%. Only 8% of the VC community members expect the number of companies that will raise new funds to remain the same in comparison to 2004. Along with the increase in investments, investment valuations have risen as well and are expected to further increase during the next six months by 57% of the respondents, compared to only 40% in Q4, 2004. In addition, as in the three previous quarters, a slight but steady increase can be seen in the number of respondents that expect the majority of their new investments to be in Seed companies (24% in this quarter compared to 21%, 19% and 15% in the past three quarters respectively).

The increase in the involvement of foreign investors in the local market that has been witnessed during the second half of 2004 and the beginning of 2005, is expected to continue according to ALL of the respondents, with the large majority (78%) of them expecting it to further increase (compared to 56% in Q4 2004). Furthermore, during the past few months there has been an increase in the number of exits of Israeli companies through acquisitions by foreign companies. This trend is expected to continue with many VCs considering it as a positive option and a realistic alternative to once expected IPOs. 74% of the VC community expects more than 5 Israeli companies to be acquired by a foreign one during the next two quarters of the year. Concurrently, a further decrease can be seen in regard to Israeli IPO expectations. Only 35% of the respondents expect more than 5 Israeli companies to perform an IPO by the middle of the year (as opposed to 42% in Q4, 2004 and 83% in Q3, 2004) (Chart B).



No matter what form of exit will be chosen, 92% of the respondents expect to exit over 5% of their portfolio companies during 2005 with 39% of them expecting to exit over 10% of their portfolio companies during this period (compared to 25% in the previous quarter). In addition, exit valuations are expected to continue and rise by 72% of the VC community members.

In regard to stock markets, an increase can be seen in the number of VCs that expect the value of NASDAQ to remain the same (19% in this quarter as opposed to 10% in Q4, 2004) and in the number of respondents that expect its value to increase by less than 10% (70% in the current quarter compared to 64% in Q4, 2004). This expectation, along with the slow IPO rate at present, the high costs, the investors' state of mind and the regulation changes, has forced many of the VCs to consider alternative IPO options for their portfolio companies. As opposed to Q2, 2004 when ALL of the VC community members stated that NASDAQ is the most appealing stock exchange for Israeli companies considering going public, in the current quarter, 85% of the respondents stated the above and 15% of the respondents claim that the AIM stock exchange in London is at present the most appealing for Israeli high-tech companies (Chart C).

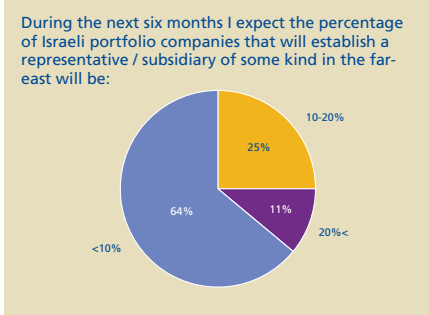
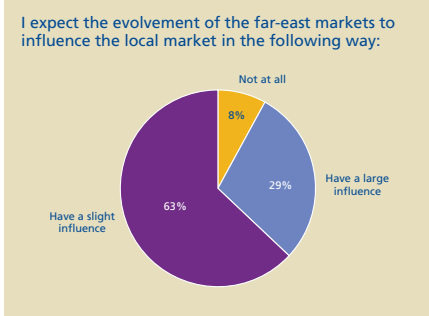
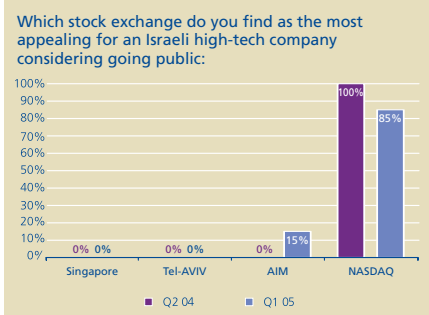
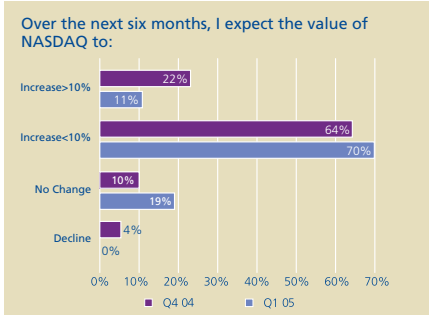
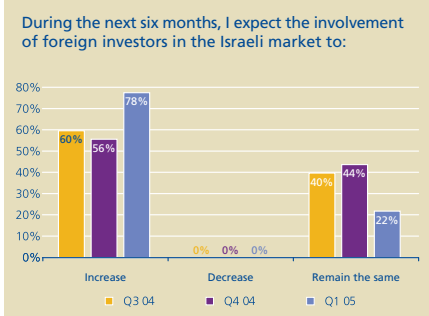
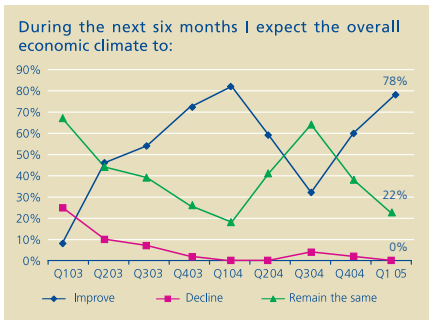


In regard to IPOs in the US markets, there's still an uncertainty as to the influence that the Sarbanes-Oxley act will have on portfolio companies' decision in regard to an exit by an IPO versus M&A (60% of the respondents expect the SOX Act to have an influence on the issue or claim that it is still too early to tell).

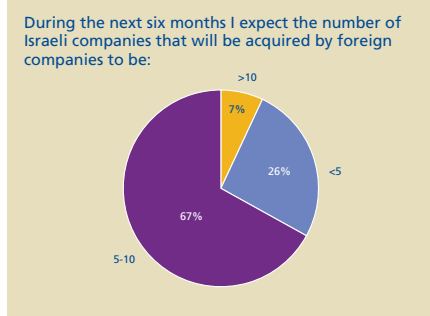
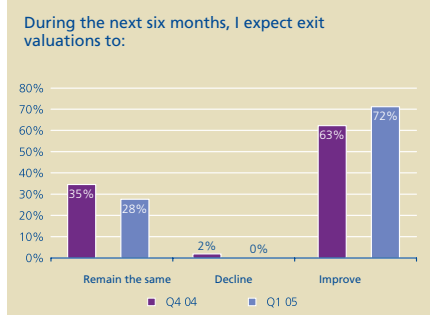
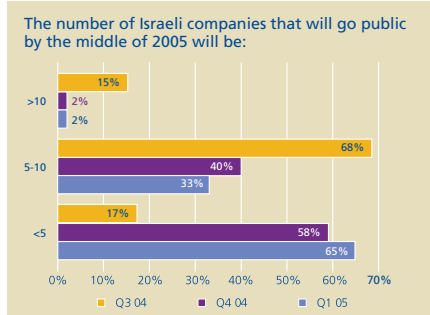
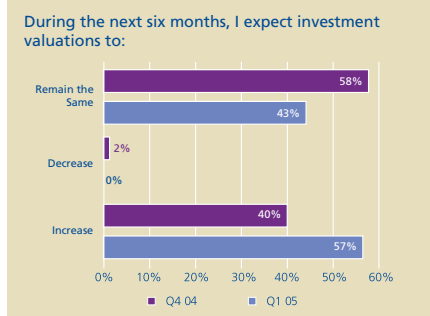
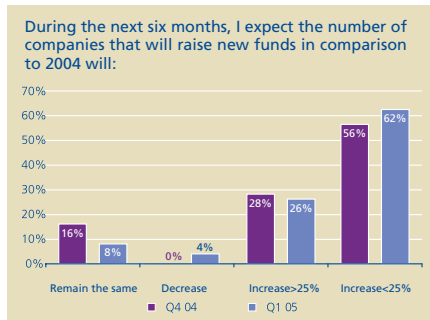
Other markets that have been slowly but steadily attracting and influencing the Israeli high-tech industry are the far-eastern markets. The majority of the respondents (92%) expect these markets to have an increasing influence on the local market, with 29% of them expecting this to be a large influence. In addition, 36% of the respondents expect more than 10% of the Israeli portfolio companies to establish a representative or subsidiary of some kind in the far-east during the next few months. ●

Detailed Results, 1st Quarter, 2005

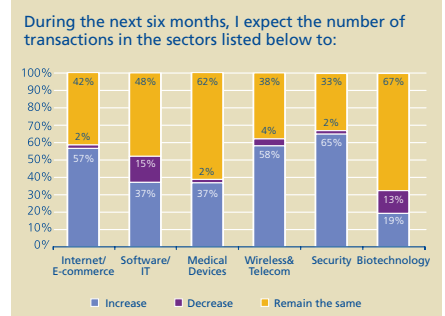
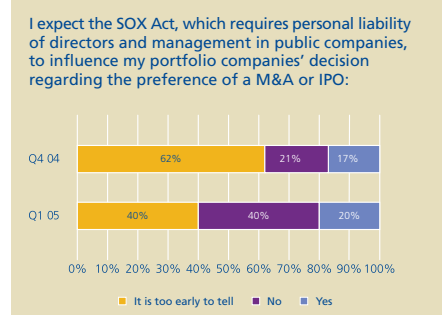
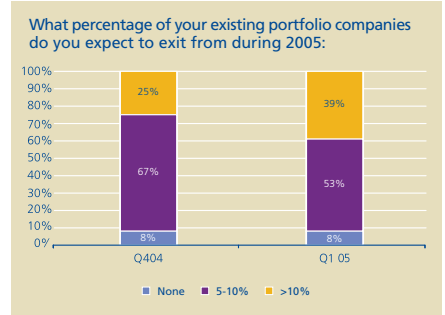
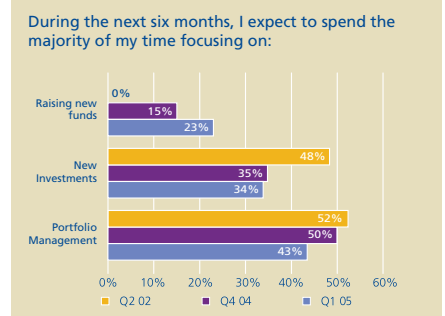
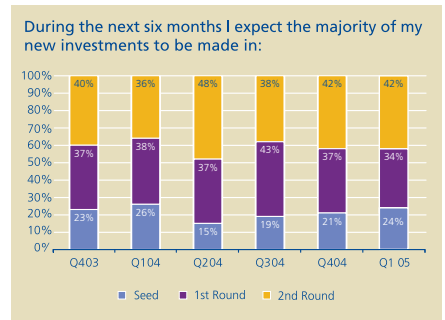
Economic Climate



Deal Activity



Investment & Managerial Focus



“The increase in the involvement of foreign investors in the local market that has been witnessed during the second half of 2004 and the beginning of 2005, is expected to continue according to ALL of the respondents.”

For more information...

If you would like to find out more about this survey or how Deloitte's TMT group can assist you, please contact us:

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