

# Israel VC Indicator Survey

Expectations as of Quarter 1, 2007

Internet hype continues,  
bubble concerns grow

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 Israeli VC community for the next six to twelve months. The survey is designed to explore relevant key aspects, such as economic and market conditions, deal activity and investment and managerial focus.

The VC Survey and Private Equity Surveys are a Deloitte initiative. The surveys have been conducted for some years, running concurrently in Israel, the United Kingdom, Germany, Spain, Portugal, Central Europe, Mexico, South Africa and India, to name but a few. Moreover, once a year, Deloitte also releases a Global VC Survey. The Global Survey purpose is to identify attitudes of venture capitalists and private equity investors regarding investing on a global basis and tracking long-term trends about the attitudes of international investing.

Responses for VC Indicator Q1 2007 were collected from March 22<sup>nd</sup> 2007 through to April 10<sup>th</sup> 2007 (before the Winograd Report's release). The responses were collected from venture capitalists in Israel, including replies from the major VCs in the country.

## Introduction

The Israel VC Indicator Survey provides 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 conditions
- Deal activity
- Investment and managerial focus

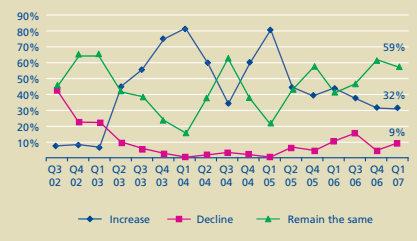
The results produce a forward-looking measure of the overall sentiment in the Israeli venture capital community, which is extremely relevant to immediate deal flow.

The 20th Deloitte Brightman Almagor Israel VC Indicator Survey results for Q1 2007 include a comparison, where relevant, to responses from previous surveys ●

## Results

Corruption allegations on one hand, stock exchange indices on the rise on the other hand lead most venture capitalists, 59%, to predict no change in the overall economic climate. 32% of respondents expect the overall economic climate to improve similar to expectations in the previous quarter (32% in Q4 2006). Responses were collected before the Winograd Report's release. (Chart A)

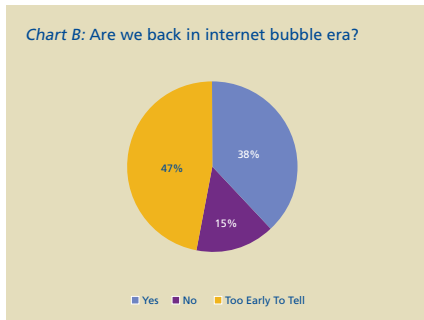
Chart A: During the next six months, I expect the overall economic climate to:



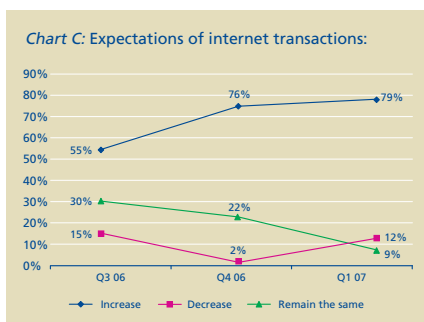
The first quarter of 2007 witnessed an increase in volatility in global stock markets. Most venture capitalists believe this will not deter foreign investors whom invest in Israeli VCs. 59% of respondents believe that foreign investors are indifferent to stock markets volatility when considering whether to invest or not to invest in Israeli VCs. But there are also 29% of respondents who think that global market volatility will prompt investors exercise more cautious regarding investment in Israeli VCs. 12% say they are now more confident in the performance of Israeli VCs.

Our internet bubble index shows an interesting change. The number of respondents who say we are back in an internet bubble has significantly grown. 38% say we are back in a bubble, compared to only 23% who thought so in Q4 2006. At the same time the number of venture capitalists that claim that we are not in a new bubble is dropping. Only

15% are now confident enough to say this is not another bubble compared to 43% who said so in Q4 2006. The number of those who are undecided has grown to 47% (compared to 34% in Q4 2006). (Chart B)



It is interesting to note that at the same time, expectations for an increase in internet transactions are on the rise with 79% expecting such a trend (compared to 76% in Q4 2006 and only 55% in Q3 2006). There is also an increase in the amount of those who foresee a decline in internet transactions but the numbers are much lower, 12% compared to 2% in Q4 2006. (Chart C)



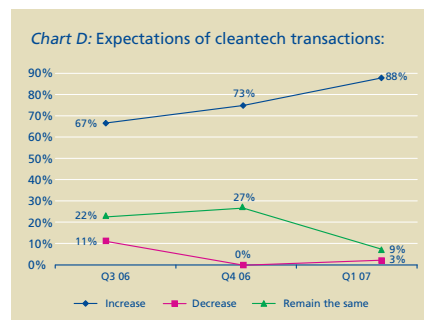
67% of respondents believe that in the medium-term VC funds will provide returns that will outperform the TA100 Index (compared to 71% in Q4 2006). 18% think VC funds will under perform the TA100 Index (compared to only 9% in Q4 2006). These results should be viewed in light of the fact that the Tel Aviv Stock Exchange continues to rise and the leading indices continue to set new records.

Quite a few in the VC community fear that foreign VCs will divert investment away from Israel and into China and India. 30% of respondents fear that the investments in Asian high tech would be at the expense of Israeli high tech and a great deal of investment could be lost. The majority of venture capitalists are still not too worried. 40% predict that only an insubstantial amount of investment money may be lost to Asia. 30% think that the growing investments in Indian and Chinese high tech are unlikely to effect foreign investment in Israel.

Only a minority of the VC community are pessimistic regarding the future of Israeli high tech industry. We asked whether the Israeli high tech industry will continue to thrive in 10 years from now. 18% said it will not continue to thrive and will lose its competitive advantage to new emerging markets. 35% of respondents think Israeli high tech will be positioned globally pretty much as it is today. The majority, 47%, believe Israeli high tech shall continue to prosper, it will be bigger, better and will continue to be a global leader.

So what should be done to sustain and enhance the Israeli high tech industry? There are many suggestions, we offered five options in the questionnaire. The most popular answer, 29%, was that the government should invest more money in education. 24% said that the government should increase the budget of the Office of the Chief Scientist (OCS) to support R&D. 22% said that startups should strive for an IPO and becoming long-term sustainable companies. 18% said that the government should lower tax rates. Only 7% said that the government should allow American, Indian, Chinese and other foreign nationals to work in the Israeli high tech industry.

The highest expectations of transaction increase are in Cleantech. 88% of respondents expect an increase of transactions in this sector (compared to 73% in Q4 2006 and 67% in Q3 2006). Only 3% expect cleantech transactions to decrease. (Chart D)

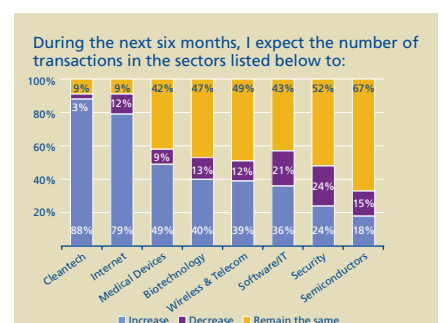
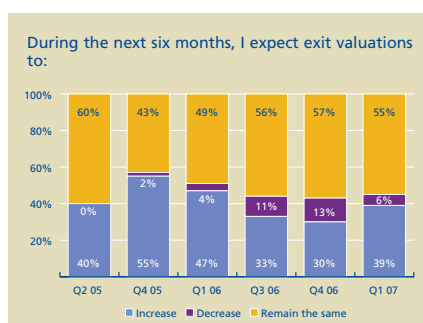
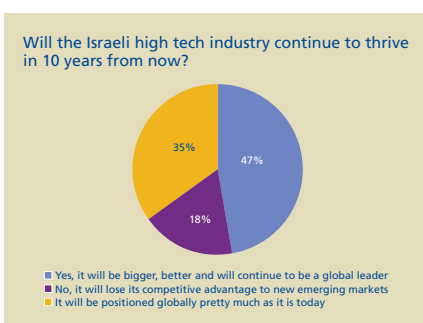
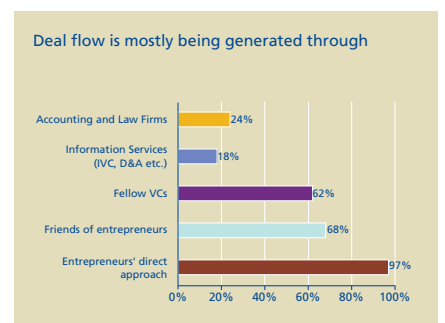
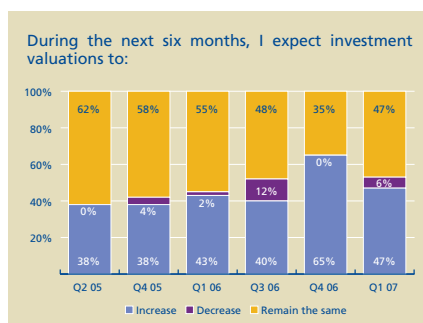
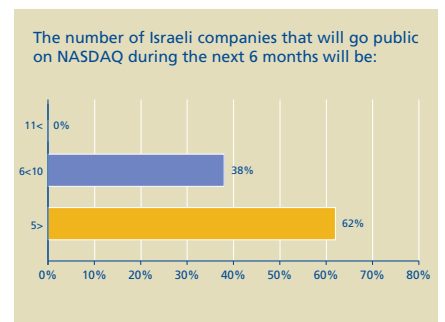
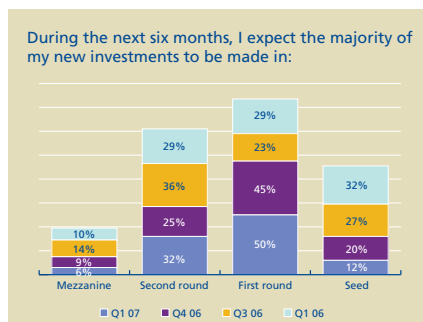
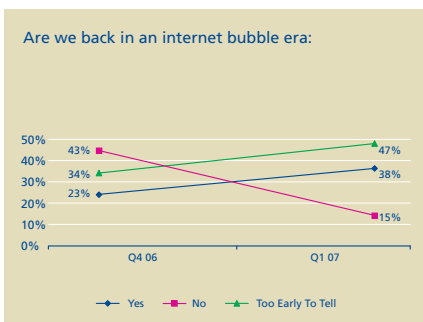
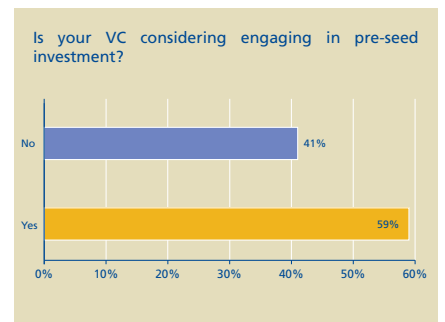
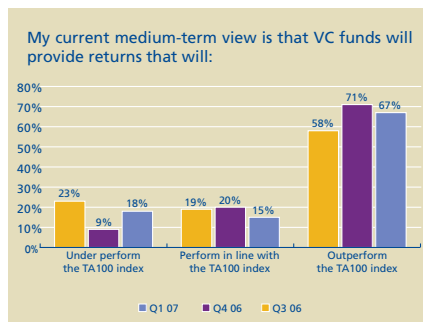
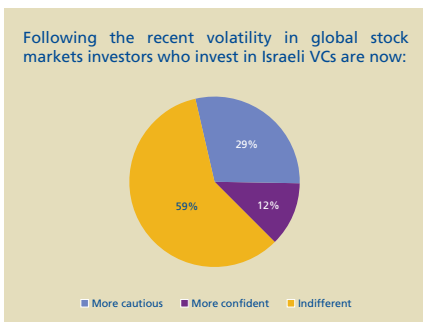
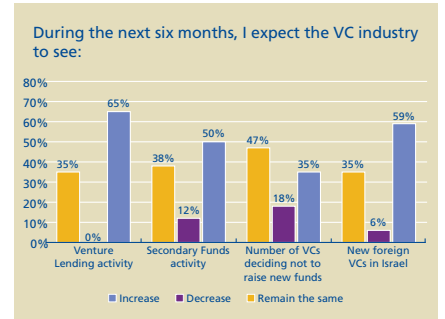
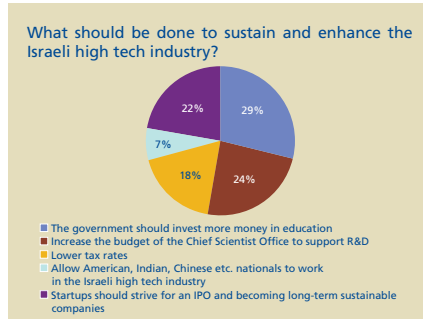
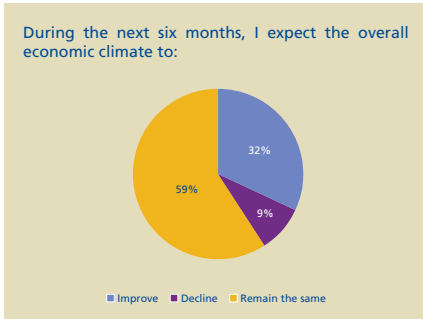


Following in expectations for increase in transactions is the internet sector, with 79% of respondents expecting an increase. Expectations in the semiconductors sector are the weakest (for the second consecutive quarter), with only 18% who foresee an increase in transactions, 67% say the number of semiconductor sector transactions will remain the same, 15% say it will decrease ●

## Insights

- Internet investments are on the rise in the US, Israeli internet startup deal flow is strong and getting stronger each day, more angel investor money goes into early stage internet startups. All this convinces more and more Israeli VCs to invest in pre-seed companies, a custom made investment model for internet startups. The result is that internet startups are raising more and more capital from VCs. Surprisingly as more money is invested in internet, more VC professionals think we're in a new bubble. It seems that we haven't reached the peak in internet investment, yet, and in the coming months internet transactions will increase.
- Some VCs advise their portfolio companies to refrain from getting funds from the Office of the Chief Scientist (OCS). Nonetheless, as it appears in this survey, there are many in the VC community who think that increasing the budget of the OCS is an important step to enhance Israeli high tech. And indeed, the OCS provides crucial funding to early stage startups that cannot get capital from VCs. No doubt that the government plays an important role in the early stage of high tech companies through the OCS and should play a bigger role in R&D expenditure through an increase in the OCS budget.
- China VC investment reached \$1.05B in 2006 at 13% growth rate compared with 2005. Early stage investment is booming due to the impact of M&A rules. Non-tradable share reform improves exit on Chinese markets, inspiring both Chinese and foreign VCs. In India VCs have moved beyond investments in IT services. The overall business climate in India and the climate for fund raising specifically are constantly improving and therefore attracting more foreign investment. The above mentioned implies that some of the money invested in China and India could come at the expense of investments in Israel.
- Israel is lagging behind the US and has not (yet) joined the cleantech investment hype. But cleantech is getting more and more attention from Israeli VCs as the number of transaction persistently increases. It is better to examine cleantech deals carefully since the investment and exit models are not exactly the same as in high tech. There are significant opportunities in cleantech, but VCs should not rush and invest without doing some study.

# Detailed Results, 1st Quarter, 2007



# Contacts

We welcome suggestions for issues to be addressed in future Israel VC Indicator Surveys. You are welcomed to send them to Gil Shterzer at [gshterzer@deloitte.co.il](mailto:gshterzer@deloitte.co.il)

Please contact us for further information about: this survey's results, the special services offered by Deloitte Brightman Almagor and its affiliates to VCs, how we can assist deal initiation and the execution process.

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