

# Israel VC Indicator Survey.

Expectations as of Quarter 2, 2005

## Moderate but Steady Expectations

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 June 26th through July 20th, 2005 from 44 VCs in Israel, including all of the largest VCs in the country.

### Introduction

**The first half of 2005 reflects an increase in the number of VCs that have concluded raising new funds, a steady pace in investment levels, exits of Israeli companies both by M&As and by IPOs, stability in investment valuations and a continued positive atmosphere. Many VCs are spending their time in search for new investments and accompanying their existing portfolio companies in order to reach a desired exit.**

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

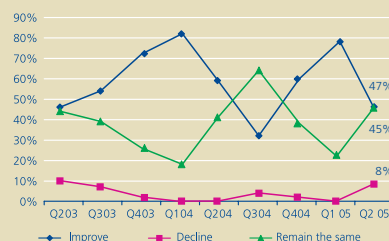
The results produce a forward-looking measure of the overall sentiment in the Israeli venture capital community, which is extremely relevant to immediate deal-flow.

The 15th Deloitte Brightman Almagor Israel VC Indicator Survey results for Q2 2005, include a comparison, where relevant, to responses from previous surveys. ●

### Results

The second quarter of 2005 reflects moderate expectations in comparison to the beginning of the year. Only 47% of the respondents in the current quarter expect the overall economic climate to continue and improve over the next six months, compared to 78% in the previous quarter, and 8% of the VC members in Q2 2005 even expect a decline (compared to none in Q1 2005). On the other hand, 45% of the respondents expect the economic climate to remain the same, as opposed to 22% in Q1 2005, which due to the steady improvement that has been witnessed during the last year around the world and along with it a local improvement as well, these expectation indicate that the VC community expects a continuing positive atmosphere. Due to the disengagement plan expected to take place over the next few weeks, these expectations prove once again that the Israeli VC industry views the local industry as influenced mostly by events in the global market rather than the local one, but the do expect an influence of some sort. (Chart A) ●

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



## Insights

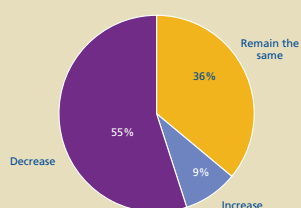
- Many VCs have already concluded the process of raising new funds or are in the middle of doing so, but some of those who have set out to raise a new fund have encountered difficulties and have decided not to continue the procedure. Over the next year more announcements of this sort are expected to be heard from the industry and the number of Israeli VCs is expected to decline. The Israeli VC industry will adjust itself to the local reality and be composed of fewer VCs.
- The foreign involvement in the local market is expected to continue and even increase during the next year, both through direct investments by foreign investors in Israeli companies and through additional foreign VCs that will open local branches that will allocate significant funds for the Israeli market and by this enlarge the amounts of money that will be available for local companies seeking financing.
- The new funds raised during the past few months and the increased amount of money in the market due to the presence of foreign investors, will continue to result in an increase in investment levels in Seed and early stage companies. Despite this increase, it seems that valuation levels have stabilized and the VCs will continue to perform their investments at a reasonable pace and preceding comprehensive due-diligence and examining.
- Many factors are taken into consideration while deciding upon a stock market for an IPO, such as the company's valuation, costs, the stock markets' regulations, access to a specific market and the ability to conduct an IPO on it, etc. Due to this, many Israeli companies have performed an IPO on the AIM market during the past few months. It will be interesting to see whether this trend will continue and if the market will be able to continue to attract Israeli companies that will provide the investors with respectable ROIs, or give them an option to sell their holdings.
- Acquisitions of local companies by foreign ones will continue and more exits of VC backed companies are expected to be seen during the next few months. It is yet to be seen which and how many VCs will reach desired exits from their portfolio companies during the near future.

As opposed to last year (2004) where we have witnessed a large increase in the number of companies that have raised funds from VCs and in the amounts raised compared to the three previous years, the first half of 2005 has reflected a steady pace in investment levels. Following this, moderation in the VC community members' expectations can also be seen in their anticipation regarding this issue with only 17% of them expecting an increase of more than 25% in the number of companies that will raise new funds from VCs during 2005 (compared to 26% in Q1 2005) and 8% expect a decrease compared to 4% in the previous quarter. The rest (75%) expect the number of companies to remain the same or increase by less than 25% in comparison to the previous year. Investment valuations are expected to stabilize as well, with only 38% of the VC community expecting a further increase compared to 57% in Q1 2005, and 62% expect it to remain the same (compared to 43% in the previous quarter).

Due to an increase in the amount of money in the Israeli VC market, and an increase in the number of new entrepreneurships, as in the four previous quarters, Q2 2005 reflects further increase in the number of VC members that expect the majority of their new investments to be made in Seed companies (32% in this quarter compared to 24% in Q1 2005, 21% in Q4 2004, 19% in Q3 2004, 15% in Q2 2004). 32% of the respondents expect the majority of their new investments to be made in first rounds and 36% in Second round companies.

During the past three quarters, many Israeli VCs have set out to raise new funds. Some of them have succeeded in doing so and others have come upon difficulties. As a result, 55% of the VC community members expect the number of Israeli VCs to decrease during the next six months. Furthermore, 62% of the respondents expect an increase in the number of VCs that will decide not to raise a new fund and 49% of the VC community members expect a decrease in the number of new VCs that will open in Israel during the same period. As a result, 34% of the respondents expect an increase in secondary funds' activity during the next six months (*Chart B*).

Chart B: During the next six months, I expect the number of Israeli VCs to:



Following the above, an increase can be seen in the number of VC members (52%) that expect to spend the majority of their time focusing on portfolio management (compared to 43% in the previous quarter), rather than on raising new funds (17% compared to 23% in Q1 05).

62% of the respondents expect an increase in the number of exits from VC backed companies during the next six months. When referring to their own portfolio companies, the VCs expectations are moderate, with 16% of them expecting not to exit from any of their portfolio companies during 2005 (compared to 8% in the two previous quarters) and only 14% expecting to exit from more than 10% of their portfolio, compared to 39% in the previous quarter and 25% in Q4 2004.

In addition, exit valuations are expected to stabilize at the current rate during the next six months or continue to increase slightly, with only 40% of the respondents expecting a further increase, compared to 72% in the previous quarter.

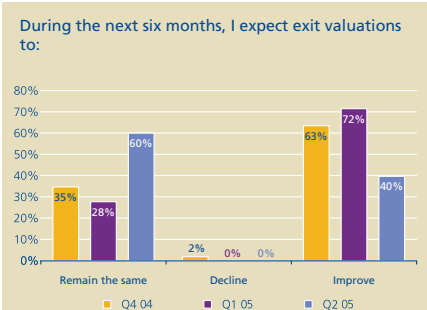
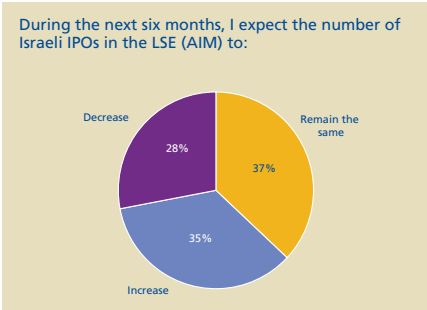
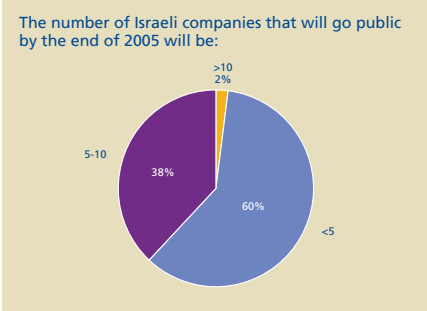
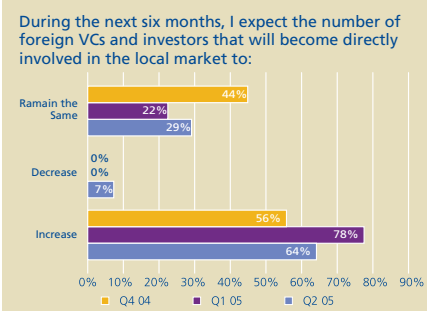
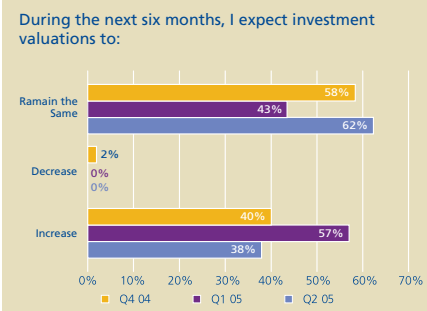
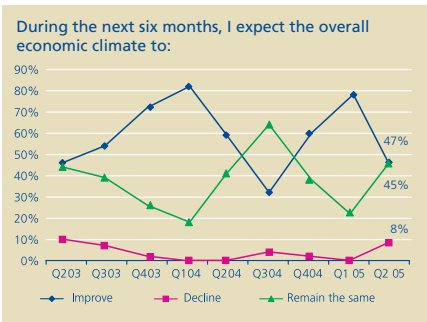
During the past few months, exits of Israeli companies through acquisitions by foreign companies have continued. The majority of the VC community (68%) expects more than 5 Israeli companies to be acquired by foreign companies during the next six months, and 40% of the respondents expect more than 5 Israeli companies to go public by the end of 2005.

In continuation to the previous quarter, the large majority of the respondents (87%, compared to 85% in Q1 2005 and all of the respondents in Q2 2004) still view NASDAQ as the most appealing stock exchange for an Israeli high-tech company IPO. The rest of the respondents view the AIM stock exchange in London as the most appealing to local high-tech companies considering going public. Since the beginning of the year, we have witnessed quite a few Israeli IPOs on the AIM market. 72% of the respondents expect Israeli IPOs in the AIM market to continue at the current pace or further increase, as opposed to 28% of the VC community members that expect a decrease in the number of Israeli IPOs in that market during the next six months.

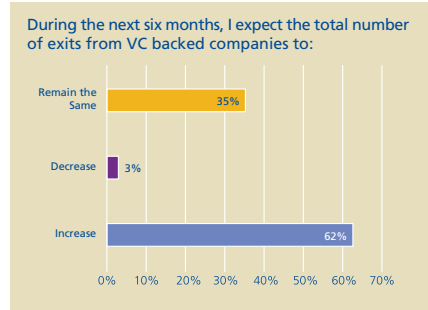
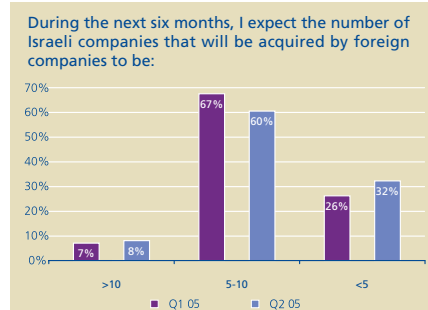
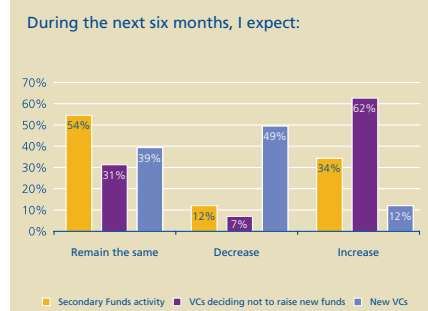
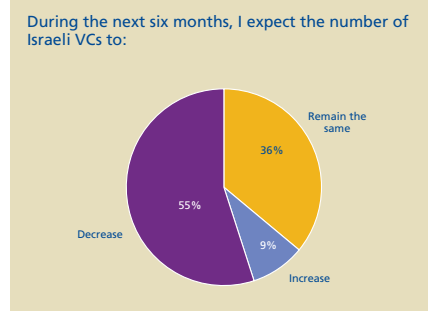
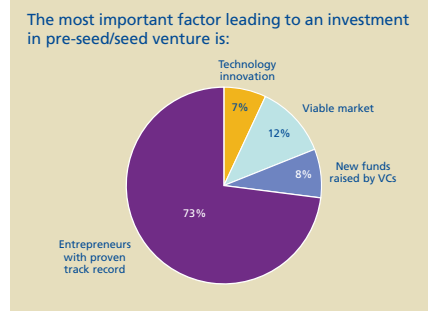
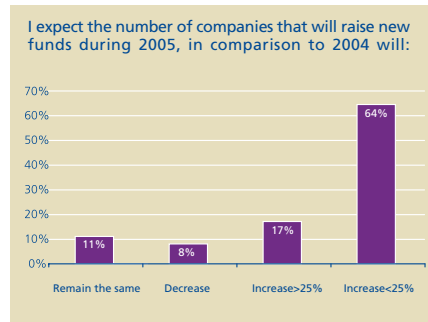
While considering an IPO, 53% of the VC community members state that the main factor that influences their and their portfolio companies' decision in choosing the relevant stock market, is the valuation. Only 7% of the respondents consider the main factor to be stock market regulations and 5% claim that costs is the most important factor in deciding where to execute an IPO. The rest (35%) indicate that other reasons influence their decision, such as the company's business strategy, the most valid possibility for the company and more.

# Detailed Results, 2nd Quarter, 2005

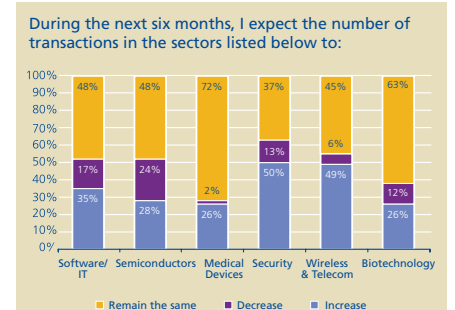
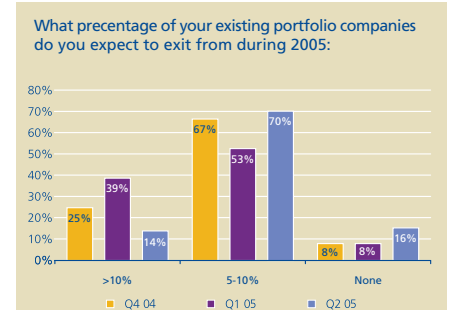
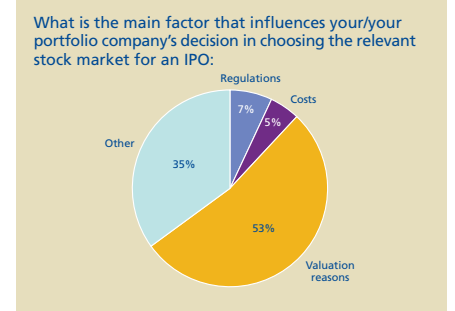
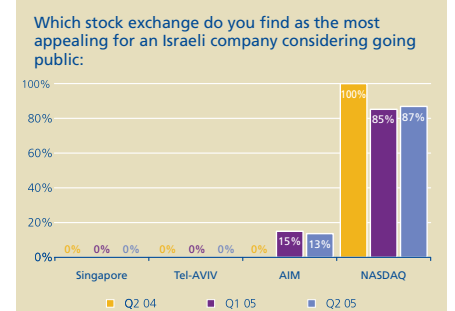
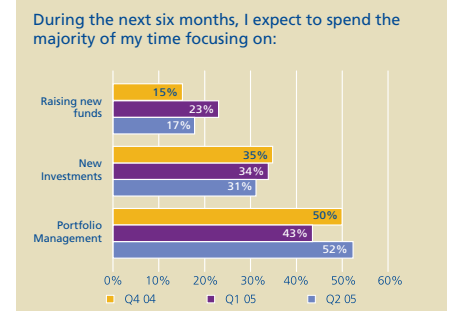
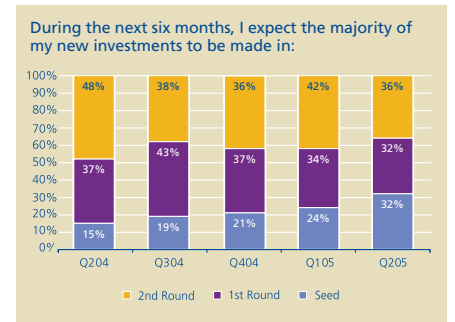
## Economic Climate



## Deal Activity



## Investment & Managerial Focus



# Contacts

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

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