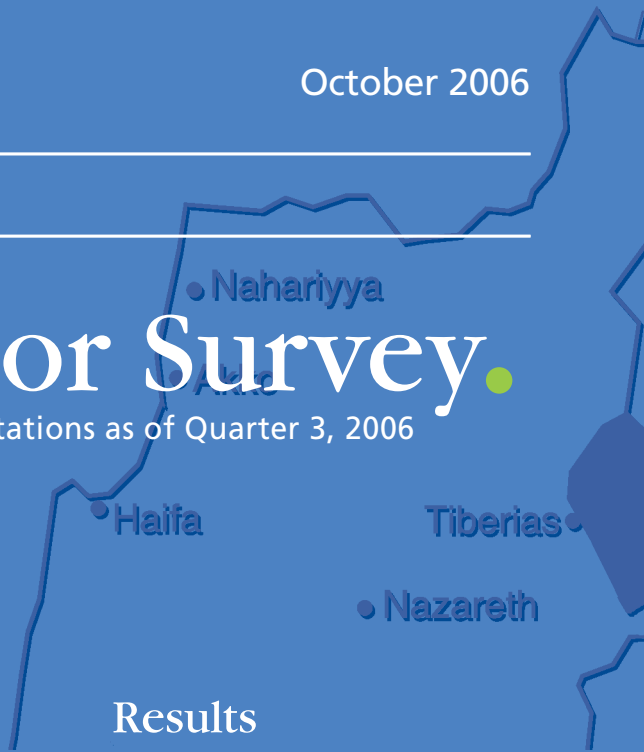


# Israel VC Indicator Survey.

Expectations as of Quarter 3, 2006

*Business as Usual*



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 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 September 14th through October 3rd, 2006 from venture capitalist in Israel, including replies from the major VCs in the country.

Previous survey for Q2 2006 was conducted but results were not published since the replies were collected before the war erupted, thus became irrelevant.

## Introduction

The Israeli economy has shown fortitude during and after the war with Hezbollah in Lebanon. One of the sectors of the economy which the war had clearly little effect on is the high tech sector. As far as the local venture capital and high tech industries it's business as usual these days.

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.

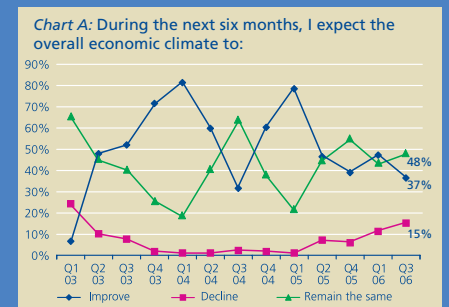
The 18th Deloitte Brightman Almagor Israel VC Indicator Survey results for Q3 2006, include a comparison, where relevant, to responses from previous surveys.

In this survey we also included findings from Deloitte Global trends in venture capital 2006 survey which had found that Israel continues to attract significant interest from the venture capital community. The global survey was undertaken in 2006 and is based on responses from partners at VC firms in the Americas, Europe, the Middle East and Asia Pacific ●

## Results

The results of the third quarter 2006 reflect moderate expectations by the VC community regarding the months to come. But when considering that Israel was engaged in war for over a month during this quarter, the results clearly indicate that venture capitalists are convinced the war will not derail Israel's steady growth.

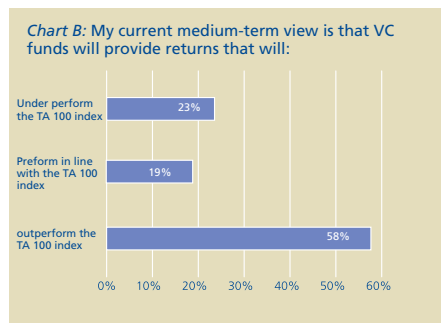
There is however a large portion of respondents (15%) that expect the overall economic climate to decline over the next six months, the highest percentage of respondents seeing an economic slowdown coming since Q1 2003. 37% expect the overall economic climate to improve over the next six months (compared to 47% in Q1, 2006). 48% believe the economic climate will remain the same (*Chart A*).



When focusing on the high tech sector, results are clearer. 82% think the war in Lebanon had only a minor effect on the local high tech industry. 11% think it didn't affect it at all.

It may be too soon to know how much the war had shaken foreign investors' confidence but Israeli venture capitalists are convinced that we will not see a dramatic change in foreign investments. 52% think foreign investments in venture capital funds are likely to show only a slight slowdown, 44% believe that the war will have no effect at all on investments level.

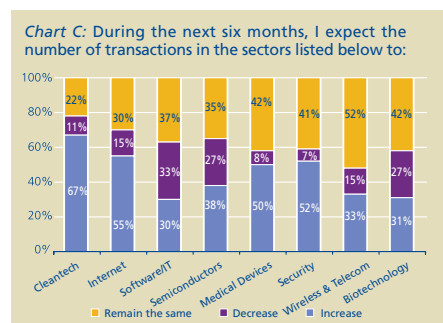
With the Tel Aviv Stock Market showing excellent performance not everybody in the VC community believes that VC funds will do better than TA100 Index. 42% of respondents do not believe that in the medium term view VC funds will provide returns that will outperform the TA100 Index. Of those, 23% believe that the funds will under perform the TA100 Index (Chart B).



High portion of respondents, 30%, expect that during the next six months raising new funds by companies from VCs will increase by 25% or more (significantly higher than the 11% who expected such an increase both in Q1 2006 and Q4 2005). On the other hand there are also more venture capitalists who believe that the market will see a decrease in the number of companies that will raise new funds, 22% believe so (compared to 17% in Q1 2006 and only 2% in Q4 2005).

The seed investments level continues to stay relatively high with 27% of respondents expect the majority of their new investments to be made in seed stage companies, a slight decrease compared to Q1 2006 peak of 32%. Another activity that seems to be gaining traction is venture lending, with 63% of respondents expecting to see an increase in that activity.

Cleantech is the current buzz word in the industry 67% of respondents expect to see an increase in transactions in that investment field, far higher than other sectors. The hype around Web 2.0 continues and a couple of local VCs have already made investments in Internet companies. 55% of the VC community believes the number of transactions in the Internet sector will increase. Expectations for an increase in the Internet sector are second only to the Cleantech sector but it certainly seems that overall enthusiasm about Web 2.0 have mellowed a bit compared to Q1 2006 (Chart C).



Recent reforms in the local capital market have made the Israeli VC industry somewhat more optimistic regarding raising money from local institutional investors. 38% feel that the understanding and attitude of institutional investors in Israel towards the VC industry are improving, 58% still feel there hasn't been much of a change. 16% of respondents, who intend to raise funds during the next 6 months, said that they intend to raise the capital from Israel. The US remains by far the main source for fund raising with 63% of respondents intending to raise money there.

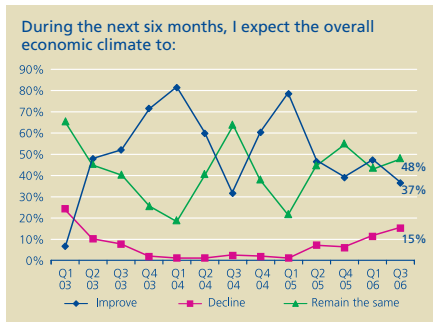
VC community members don't foresee a comeback for the IPO market as a leading exit strategy. Only 4% of them expect that more than 7 companies will go public during the next 6 months. Only 33% of respondents believe exit valuations are expected to improve (compared to 47% in Q1, 2006 and 55% in Q4, 2005). 11% actually think exit valuations are expected to decrease (compared to 4% in Q1, 2006 and 2% in Q4, 2005) ●

## Insights

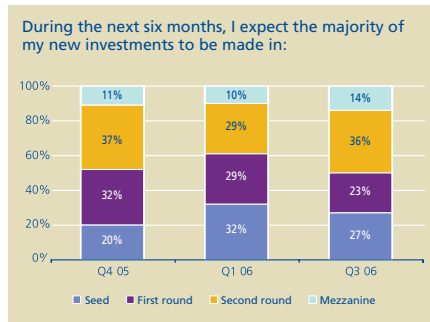
- There's probably never been a better time to be a Cleantech startup. It's true that the VC industry is not yet familiar enough with the sector but Cleantech companies will find it easier to raise money as the increased interest translates into growing capital for Cleantech investments. Deal flow in this sector should continue to rise substantially during the next few years. There is money to be made in Cleantech and early investors should expect sizable rewards.
- Web 2.0 start ups are attracting serious investments from VCs in the US. Israeli Web 2.0 companies on the other hand, have received little funding from local VCs. A few Israeli VCs are keen to join the hype and invest in these companies but for the time being it appears that most Israeli VCs plan to stay the course, focusing on traditional investments fields.
- IPO activity of Israeli companies has been slow in 2006. IPO continues to be a weak exit option for American companies and for Israeli companies it looks like an even less viable option. On the other hand, M&As are continuing on a healthy steady pace and would keep being the preferred way for an exit for venture-backed companies.
- VCs around the world are taking the idea of global investing more seriously than ever before. Recent Deloitte Global VC Survey indicated that over half of foreign VCs around the world aspire to expand their investment focus internationally within the next five years. It seems that Israeli VCs prefer to keep it locally and focus on the Israeli market. Yet, it is expected that the leaders will explore new regions to invest in.

# Detailed Results, Quarter 3, 2006

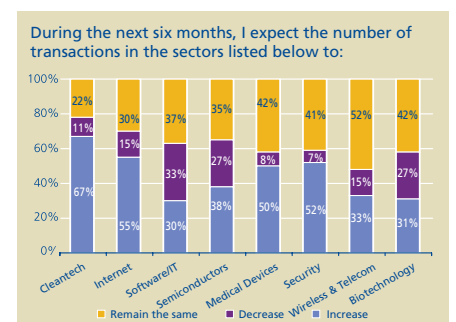
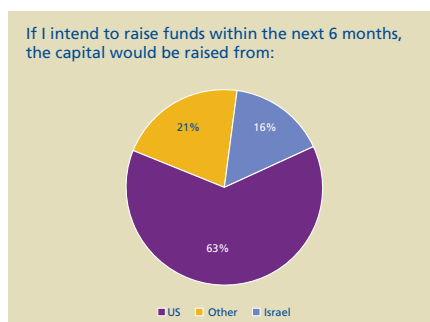
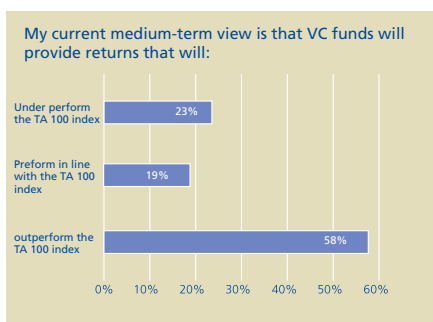
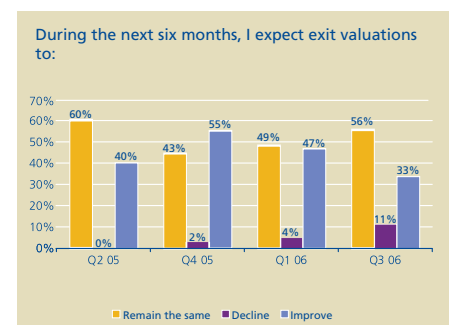
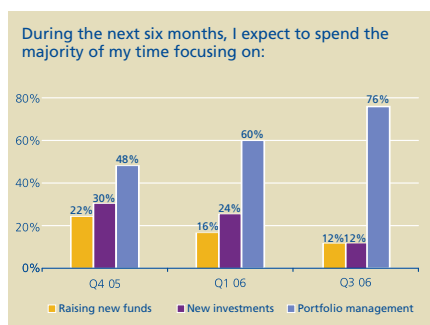
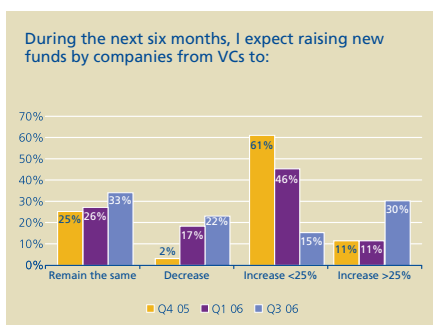
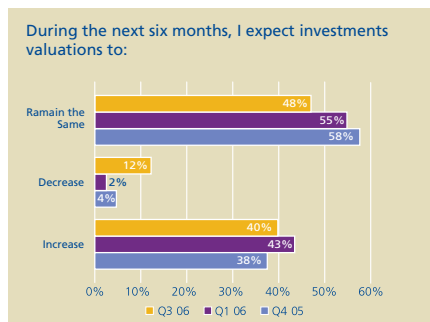
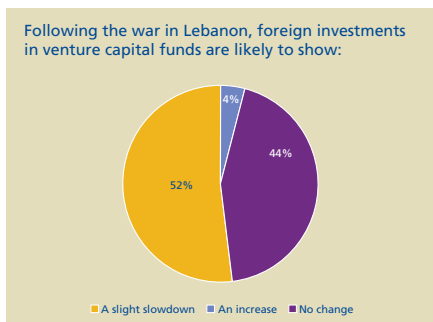
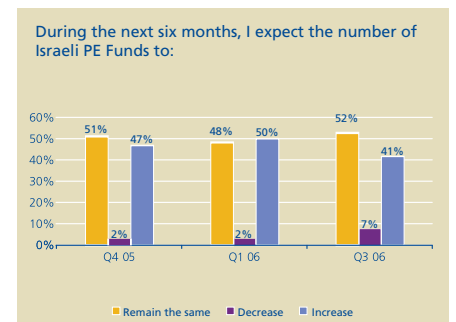
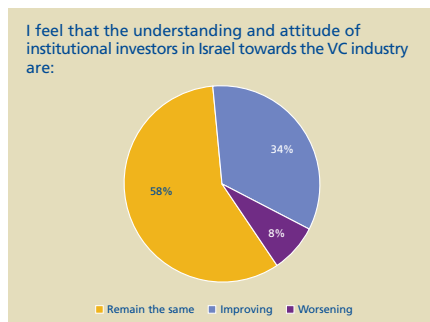
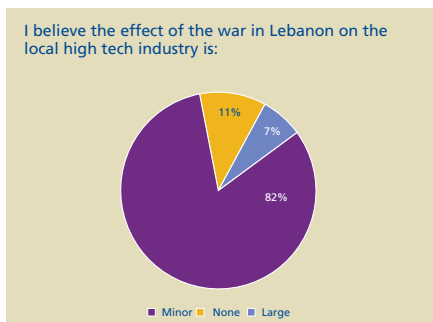
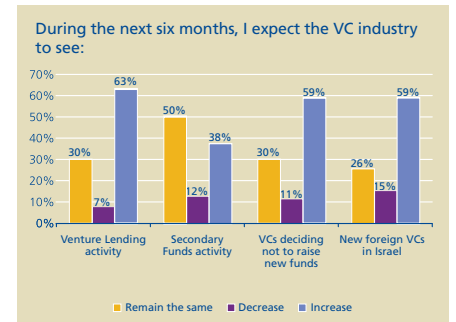
## Economic Climate



## Deal Activity



## Investment & Managerial Focus



## Contacts

We welcome suggestions for issues to be addressed in future Israel VC Indicator Surveys.

To find out how Deloitte's TMT group can assist you, please contact us:

### Igal Brightman

TMT Global Managing Partner  
Chairman & CEO  
+972 (3) 608 5500  
ibrightman@deloitte.co.il

### Eyal Hendler

Leader of the Israel TMT Group  
+972 (3) 608 5522  
ehendler@deloitte.co.il

### Services:

#### Assurance & Advisory

Asher Mechlovitz  
+972 (3) 608 5524  
amechlovitz@deloitte.co.il

#### Due Diligence & VC Tools

Shlomi Anfang  
+972 (3) 608 5550  
sanfang@deloitte.co.il

#### Tax

Yitzchak Chikorel  
+972 (3) 608 5511  
ychikorel@deloitte.co.il

#### Incentives

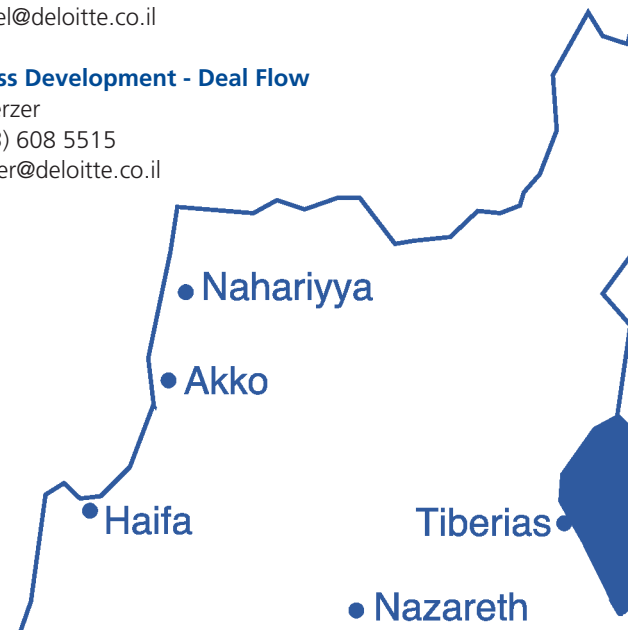
Danny Younisian  
+972 (3) 608 5501  
dyounisian@deloitte.co.il

#### Business Development

Omri Barnes  
+972 (3) 608 5408  
obarnes@deloitte.co.il

#### Business Development - Deal Flow

Gil Shterzer  
+972 (3) 608 5515  
gshterzer@deloitte.co.il



## About us

### [www.deloitte.co.il](http://www.deloitte.co.il)

Deloitte Brightman Almagor is one of Israel's leading professional services firms, providing a wide range of world-class audit, tax, consulting, financial advisory and trust services. Our 40 partners and over 650 employees serve domestic and international clients, public institutions and promising fast-growth companies whose shares are traded on the Israeli, US and European capital markets. The firm is a fully integrated member of Deloitte Touche Tohmatsu.

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, its member firms, and their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu is an organization of member firms around the world devoted to excellence in providing professional services and advice, focused on client service through a global strategy executed locally in nearly 150 countries. With access to the deep intellectual capital of 135,000 people worldwide, Deloitte delivers services in four professional areas—audit, tax, consulting, and financial advisory services—and serves more than one-half of the world's largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global growth companies. Services are not provided by the Deloitte Touche Tohmatsu Verein, and, for regulatory and other reasons, certain member firms do not provide services in all four professional areas.

As a Swiss Verein (association), neither Deloitte Touche Tohmatsu nor any of its member firms has any liability for each other's acts or omissions. Each of the member firms is a separate and independent legal entity operating under the names "Deloitte", "Deloitte & Touche", "Deloitte Touche Tohmatsu", or other related names.

This material has been prepared by professionals in the member firms of Deloitte Touche Tohmatsu. It is intended as a general guide only, and its application to specific situations will depend on the particular circumstances involved. Accordingly, we recommend that readers seek appropriate professional advice regarding any particular problems that they encounter. This information should not be relied upon as a substitute for such advice. While all reasonable attempts have been made to ensure that the information contained herein is accurate, Deloitte Touche Tohmatsu accepts no responsibility for any errors or omissions it may contain. Whether caused by negligence or otherwise, or for any losses, however caused, sustained by any person that relies upon it.