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January 2006

Technology, Media & Telecommunications

Israel VC Indicator Survey.

Expectations as of Quarter 4, 2005

Looking Forward to 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, China, India, Taiwan and Korea.

The results were collected from December 1st through December 14th, 2005 from 46 VCs in Israel, including all of the largest VCs in the country.

Introduction

2005 has been a better year for the high-tech industry than the three previous ones. A steady increase could be seen in investment levels by VCs, an increase in the number of seed companies that have raised funds, an increase in the number of Israeli IPOs (specifically on the AIM market), investment valuations were steady, a number of VCs have concluded raising new funds and an increase could be seen in the Private Equity activity in the country. During 2006 the positive atmosphere is expected to continue and further increase, hopefully resulting in an even better year for the high-tech industry.

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

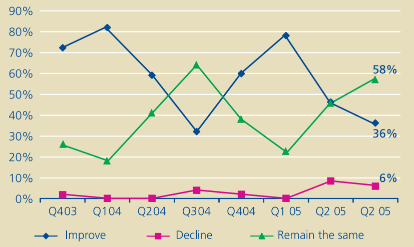
The results produce a forward-looking measure of the overall sentiment in the Israeli venture capital community, which is extremely relevant to immediate deal-flow.

The 16th Deloitte - Brightman Almagor Israel VC Indicator Survey results for Q4 2005, include a comparison, where relevant, to responses from previous surveys.

Results

The last quarter of 2005 and the expectations towards the first half of the new year (2006) reflect further moderate expectation. Only 36% of the respondents expect the overall economic climate to further improve over the next six months (compared to 47% in Q2, 2005 and 78% in Q1, 2005). 58% of the respondents expect the economic climate to remain the same (as opposed to 45% in Q2, 2005 and 22% in Q1, 2005) which indicates that the general atmosphere and expectations are optimistic. (*Chart A*)

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

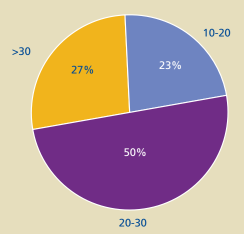


Despite the political changes viewed over the past few months and that are expected to continue during the first quarter of 2006, the majority of the respondents don't expect it to have a major effect on the economy with 70% of them expecting the election of Amir Peretz as head of the Labor Party to only have a minor effect on the local economy (only 15% of the respondents expect it to have a large impact).

2005 has continued the steady pace of investments by VCs and is expected by the industry to continue through 2006, with 87% of the VC members expecting the number of companies that will raise new funds during 2006 in comparison to 2005 to increase by less than 25% or remain the same, and 11% expecting an increase of more than 25%. Furthermore, 58% of the respondents expect the number of NEW companies that will raise funds from VCs to increase during the next six months. In regard to this expectation, only 20% of the respondents expect the majority of their new investments to be made in Seed companies as opposed to 48% which expect to invest mostly in more mature companies (37% in second round and 11% in mezzanine).

During 2005 many VCs around the world and along with them Israeli VCs have succeeded in raising new funds. Some have not been as fortunate and have declared during the year that they have decided not to continue the process. The local industry members expect the VC community to continue and change during the next six months. 51% of the respondents expect the number of Israeli VCs to decrease during this period, with 73% of the VC community members expecting the number of Israeli VCs by the end of 2006 to be less than 30 (23% of them expecting the number to be less than 20 VCs). Furthermore, although a decline can be seen in the respondents' expectations regarding the number of VCs that will decide not to raise new funds (51% in Q4, 2005 compared to 62% in Q2, 2005), it is still a high percentage that expects the trend to continue. An additional increase can be seen in the VC members' expectations regarding a rise in secondary funds activity (41% in Q4, 2005 compared to 34% in Q2, 2005). (*Chart B*)

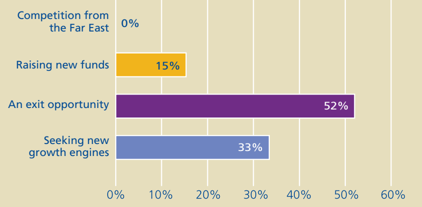
Chart B: I expect the number of Israeli VCs by the end of 2006 to be:



Along with the changes in the local VC industry during the past year, changes have been witnessed in the local Private Equity Funds as well. A large number of the VC community members (47%) expect the number of Israeli PE Funds to increase during the first half of 2006. In addition, 46% expect the number of foreign PE Funds active in Israel to increase during the same period.

While a slight decrease can be seen, many of the respondents (48% in Q4, 2005 compared to 52% in Q2, 2005) still expect to spend the majority of their time focusing on portfolio management. 30% expect to spend the majority of their time focusing on new investments (mostly the VCs that have raised new funds) and the rest on raising new funds. While referring to their portfolio, 33% of the VC community members expect the most pressing business issue their companies will be confronting during the first half of 2006 to be seeking new growth engines and 52% of the respondents expect it to be an exit opportunity. (*Chart C*)

Chart C: During the next six months, I expect the most pressing business issue confronting my portfolio companies to be:



An increase in the number of exits has been viewed and has taken place during 2005. This is expected to continue and further increase during 2006, with 74% of the respondents (compared to 68% in Q2, 2005) expecting more than 5 Israeli companies to be acquired by foreign companies during the next six months (20% of them expecting the number to be more than 10 companies). Furthermore, 57% of the respondents expect more than 5 companies to go public during the first half of 2006. Although this year has reflected a large increase in the number of Israeli companies that have preformed an IPO on the AIM stock exchange in London and a small amount of Israeli IPOs on NASDAQ, no change can be seen in regard to the preferred stock exchange for Israeli high-tech companies considering going public, with 89% viewing the NASDAQ as the most appealing stock exchange (compared to 87% in Q2, 2005, 85% in Q1, 2005 and ALL of the respondents in Q2, 2004) and 11% referring to the AIM as such. Due to the changes in the TASE lately, 49% of the VC members expect this stock exchange to become more attractive for Israeli companies considering going public than previously.

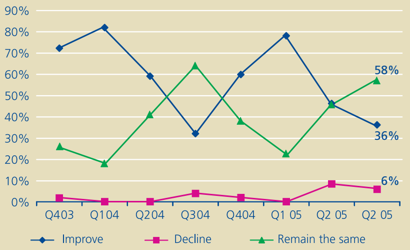
Insights

- Although the local environment has experienced some dramatic domestic changes (disengagement, new party, etc.), they are not expected to influence the local high-tech industry in a significant way as in previous quarters; the influence of local events on this industry has been minor in comparison to global events and has proven that the Israeli high-tech industry is part of the global industry and the global economic climate and therefore is influenced by it.
- 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 foreign involvement in the local market is expected to continue to increase during the next year, through different channels: direct investments in Israeli companies, Israeli VCs and through additional foreign VCs. These foreign VCs 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.
- Following 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, the investment levels in Seed and early stage companies will continue to increase. Despite this increase, it seems that valuation levels have stabilized and the VCs will continue to perform their investments at a reasonable pace and precede comprehensive due-diligence and examining.
- Acquisitions of local companies by foreign ones will continue and more exits of VC backed companies are expected to be seen during the next months. It is yet to be seen which and how many VCs will reach desired exits from their portfolio companies during the near future.
- On one hand, we can expect that the last year, which was better for the Israel economy in general and for the high-tech industry specifically, will contribute to the increase of the VCs investments in mature companies. On the other hand, the increase of the PE funds investments and activities might have a direct influence on the VCs and shift their investments back to early stage and seed companies.

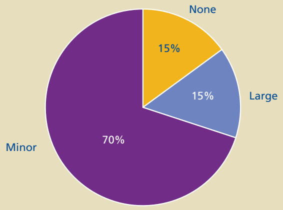
Detailed Results, Quarter 4, 2005

Economic Climate

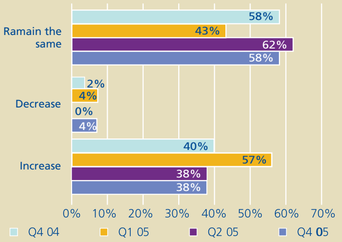
During the next six months, I expect the overall economic climate to:



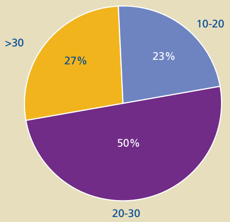
I expect Amir Peretz's election as head of the Labor party and the calling of elections to have the following effect on the local economy:



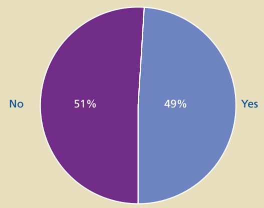
During the next six months, I expect investment valuations to:



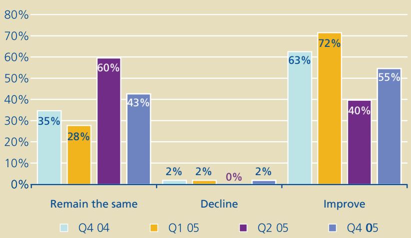
I expect the number of Israeli VCs by the end of 2006 to be:



I expect the changes in the TASE to increase the attraction for Israeli companies considering going public:

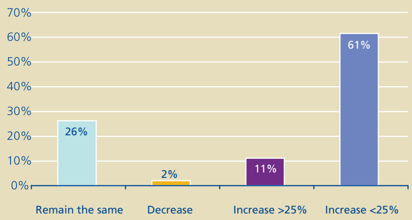


During the next six months, I expect exit valuations to:

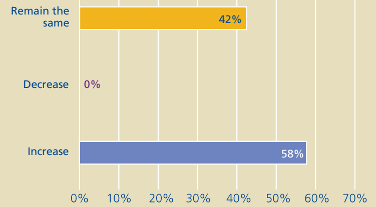


Deal Activity

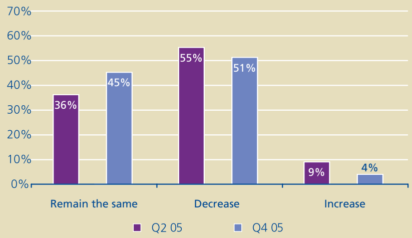
I expect the number of companies that will raise new funds during 2006, in comparison to 2005 will:



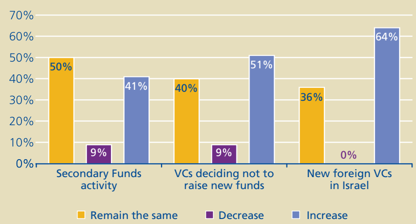
During the next six months, I expect the number of NEW companies that will raise funds from VCs to:



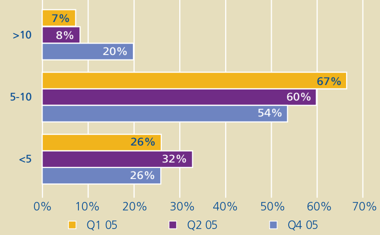
During the next six months, I expect the number of Israeli VCs to:



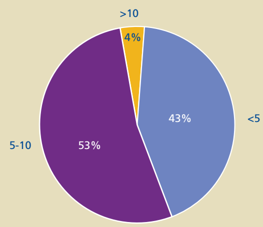
During the next six months, I expect the VC industry to see:



During the next six months, I expect the number of Israeli companies that will be acquired by foreign companies to be:

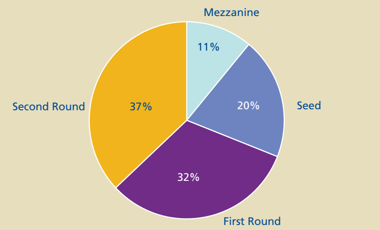


The number of companies that will go public during the first half of 2006 will be:

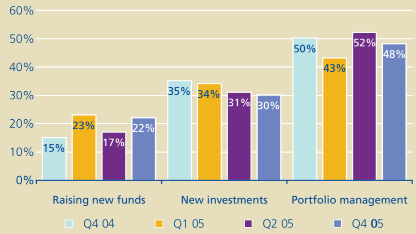


Investment & Managerial Focus

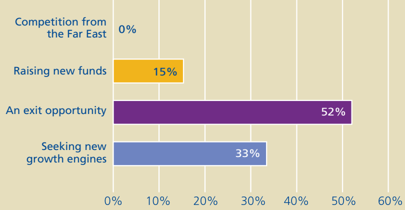
During the next six months, I expect the majority of my new investments to be made in:



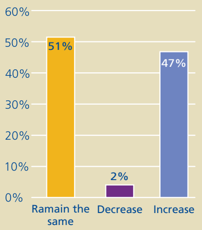
During the next six months, I expect to spend the majority of my time focusing on:



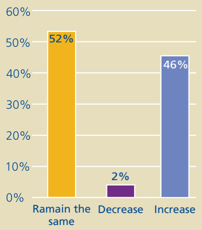
During the next six months, I expect the most pressing business issue confronting my portfolio companies to be:



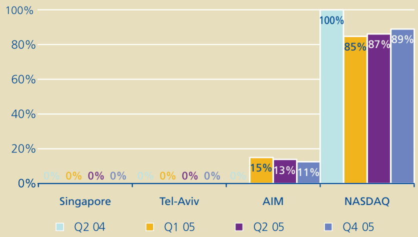
During the next six months, I expect the number of Israeli PE Funds to:



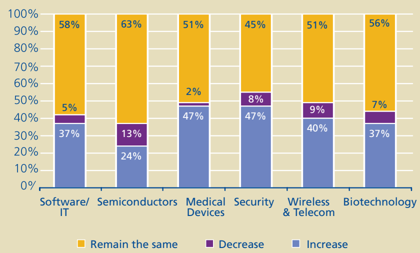
During the next six months, I expect the number of new foreign PE Funds in Israel to:



Which stock exchange do you find as the most appealing for an Israeli high-tech company considering going public:



During the next six months, I expect the number of transactions in the sectors listed below to:



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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