

# Israel VC Indicator Survey.

Expectations as of Quarter 1, 2011

With Risk Comes Opportunity...



# First Quarter, 2011

## About

The purpose of the Israel VC Indicator Survey is to identify trends within the venture capital arena. Its objective is to give a comprehensive picture of the Israel VC community expectations 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 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 36th Deloitte Brightman Almagor Zohar Israel VC Indicator Survey results for Quarter 1, 2011 include a comparison, to responses from previous surveys.

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, whose 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 Israel's VC Indicator Survey Quarter 1, 2011 were collected from March 13th, 2011 to March 27th, 2011. The responses were collected from venture capitalists in Israel.

Deloitte TMT Business Development Team uses a variety of research and statistical tools to provide extensive and accurate analysis of the survey results. If respondents do not answer a question, the count for the question is adjusted accordingly. All charts presented in this report are sourced from the survey results.

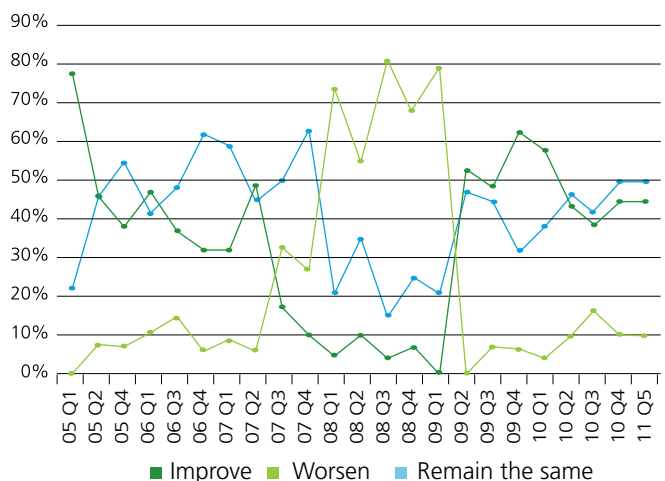
## Highlights

- Economic climate sentiment holds steady
- Internet poised to be the center of attention
- Shift to earlier stage investments becomes more clear
- Facebook evidently received much more than it's worth
- Recent tensions in the Middle East are expected to have little effect on VC fund raising

## Results

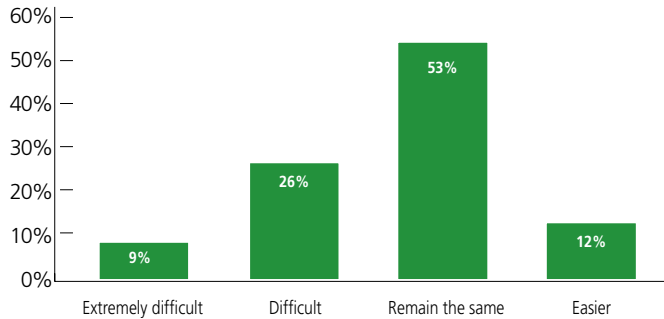
Q1 2011, experienced equivalent results to that of Q4 2010, in terms of venture capitalist expectations of the overall economic climate during the next six months. This thus reveals that the general perception among venture capitalists indicates that market sentiment is holding steady. Such that, 50% of venture capitalists expect that the overall economic climate will remain the same, 41% believe that the conditions will improve and only 9% claim that economic climate will deteriorate.

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



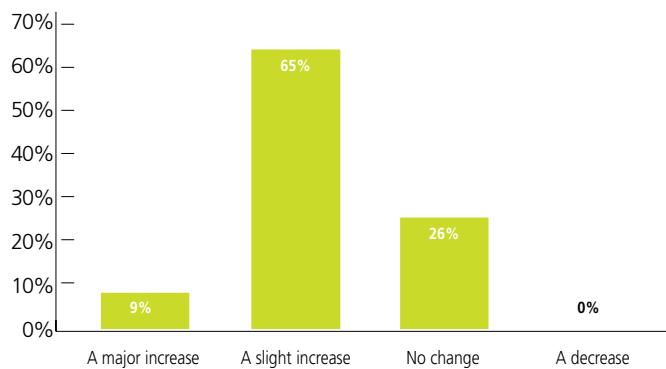
After Israel experienced one of its worst years in 2010 in terms of venture capital fund raising, surveyed participants conveyed cautious optimism regarding future fundraising activities. Despite one in every two surveyed participants expecting fundraising activities to remain the same, 12% claim that it will become easier, translating into a 9% climb QoQ.

**In the next six months, I expect VC fundraising activity to become:**



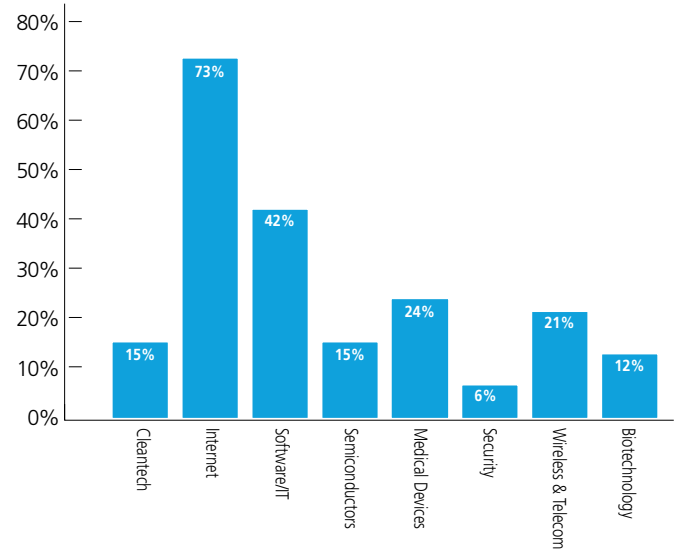
VC manager's expectations regarding deal flow activity are becoming more optimistic, given that currently 74% believe this to increase in the next six months in contrast to 56% of respondents claiming deal flow activity to increase in Q4 2010. The positive sentiment towards deal flow is even more apparent due to the fact that no surveyed participant forecasts a decrease in activity to come within the next six months. This is in parallel to 26% of respondents forecasting deal flow to remain at current levels.

**I expect deal flow activity in the next six months, compared to the last three quarters, to show:**



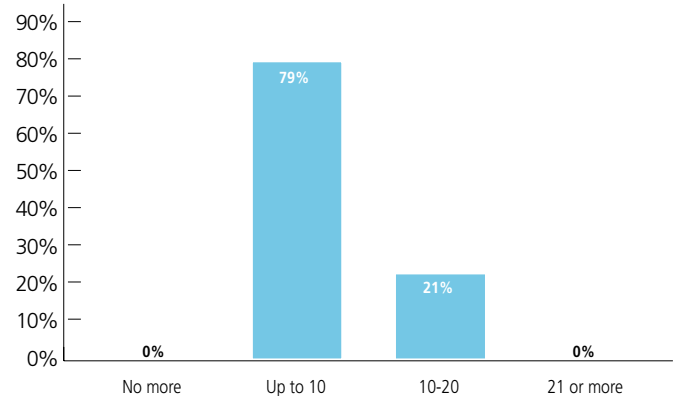
The hi-tech sector that venture capitalists believe will yield the most M&A activity within the next six months is the Internet sector (73%). This constitutes a 23% jump for M&A activity perceptions for the Internet sector since the previous quarter, while M&A activity expectations for the Medical Device sector faltered 25% QoQ. The Software/IT sector is also believed to experience much attention, such that 42% of venture capitalists expect this sector to have the highest M&A activity. Whereas the Biotech and Security sectors are forecast to experience the least M&A activity (12% and 6%, respectively) during the next six months.

**In which hi-tech sector do you think there will be the highest M&A activity during the next six months? (You can submit more than one answer):**



As "exits" will always be the name of the game in the VC world, it is of no surprise that VCs believe that we will continue to witness additional tech companies acquired, merge, IPOs, etc. Vast majority - 79% of surveyed venture capitalists expect to see 0 – 10 exits in the next six months and 21% expect to see 10 – 20 companies to exit during the next six months. Initial signs of confidence on this front could be understood by a 5% rise in venture capital "exit" sentiment shifted to believe that 10-20 technology companies will exit during the next six months.

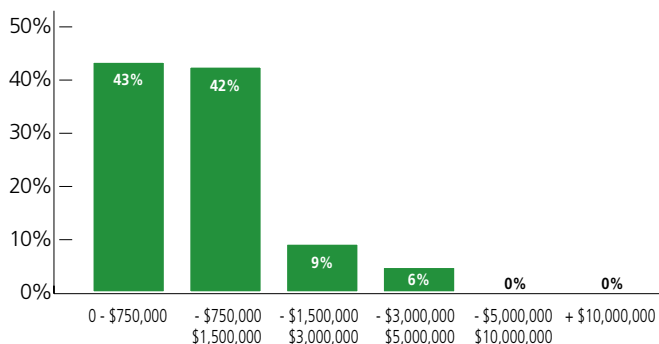
**I expect to see \_\_\_\_\_ technology companies to exit during the next six months:**



Signs of venture capital's hunger for risk are becoming more apparent as they shift their focus to earlier stage and smaller investments. This should be understood through a hefty 85% of respondents expecting the average investment per new company their VC will invest

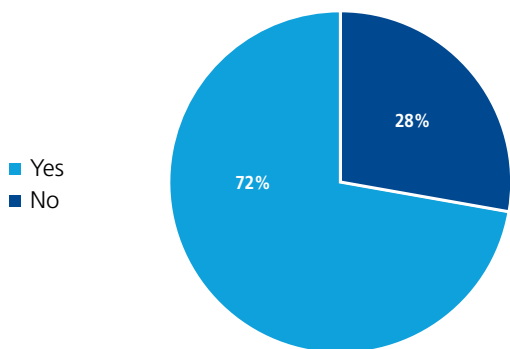
in to equal up to \$1.5M, compared to 58% in Q4 2010. It is also essential to point out that only 15% of surveyed respondents claim that they will invest \$1.5M - \$5M, whereas no venture capitalist expects their VC to invest above \$5M per new company.

**Do you expect the average investment per new company your VC invests in to equal (in USD):**



As debate heats up regarding Internet company valuations, one of the most asked questions that still have not received its deserved attention revolves around Facebook's recent \$1.5bn financing round led by Goldman Sach's and DST, giving Facebook a \$50bn price tag. 72% of interviewed venture capitalists believe that this financing round was over-valued and thus left Goldman Sach's and DST with too little of a stake for the price they paid.

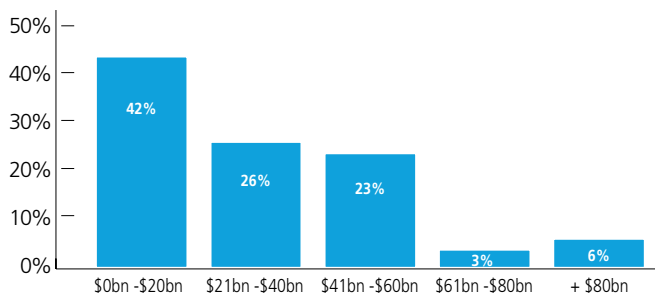
**Do you believe that Facebook's recent \$1.5bn financing round led by Goldman Sachs and DST (at a \$50bn valuation) was over-valued?**



The heated debate regarding internet company valuations, includes the #1 social network on the planet which has roughly 600M strong and was recently valued at \$50bn through its last financing round led by Goldman Sach's and DST. Despite this round being led by investment bank giant Goldman Sach's and one of the more globally prominent venture capital funds, 68% of Israel's venture capitalists believe the more correct valuation is under

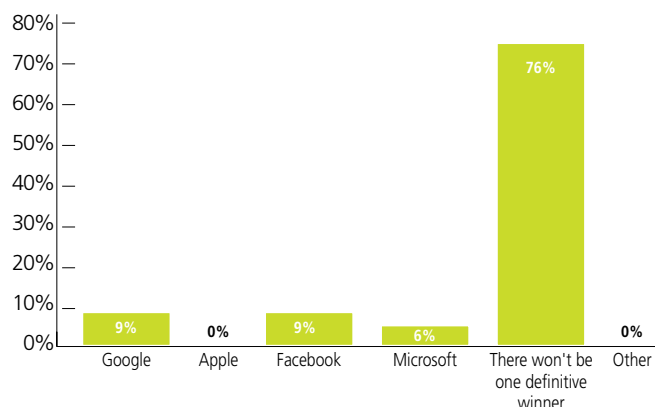
\$41bn, 23% claim it to be between \$41bn - \$60bn and only one in every ten respondents believes that Facebook should be valued at above \$61bn.

**What do you believe is the correct valuation for Facebook?**



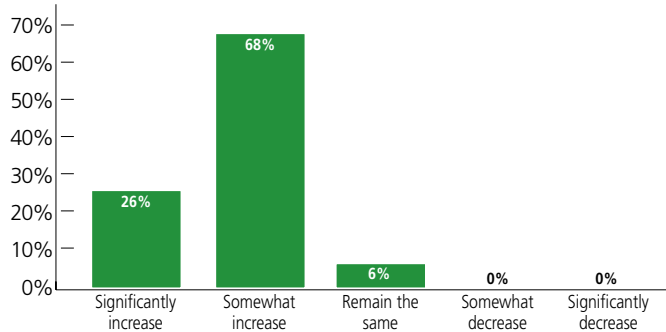
As Bertrand Russell stated, "wars do not determine who is right but only who is left". One could infer from the chart below that venture capitalists believe that all four tech giants will be left. Such that, 76% of venture capitalists believe that there won't be one definitive winner, in parallel to an equal 9% expecting Google or Facebook to win the war. Along the same lines, the belief in Microsoft as the tech conglomerate who will stand victor equates to 6%, and no venture capitalist believes that Apple will win.

**Who will win the war between Google, Apple, Facebook, or Microsoft by the end of the decade?**



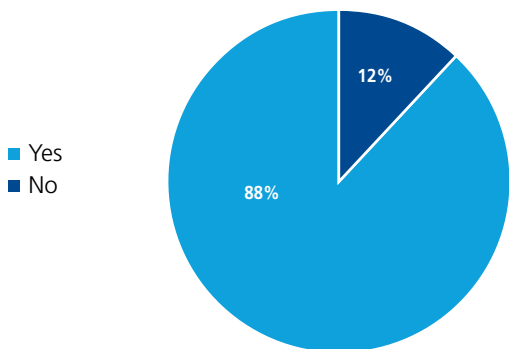
The crown jewel of many social platforms is the sale of virtual goods, but will this continue? According to 94% of venture capitalists, revenues will grow from sale of virtual goods. Such that 26% of respondents believe revenues to significantly increase and 68% forecast revenues to somewhat increase. This compares to 6% claiming revenues to stay the same while no venture capitalist expects revenues to decline.

**Will revenues from the sale of virtual goods during the next 12 months:**



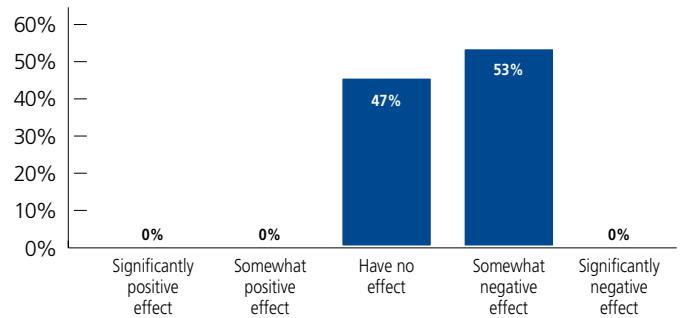
As the undisputed kings and queens of social networking expand ways for their users to interact, it's raising more questions about how much of their information is made available to people they do not know. This so-called "concern" has been deflated ultimately by the continuous exponential growth in social networks/platforms which has presumably led 88% of venture capitalists to believe that sharing is more important to the end-user than privacy.

**Will sharing on social platforms/apps supersede issues concerning privacy?**



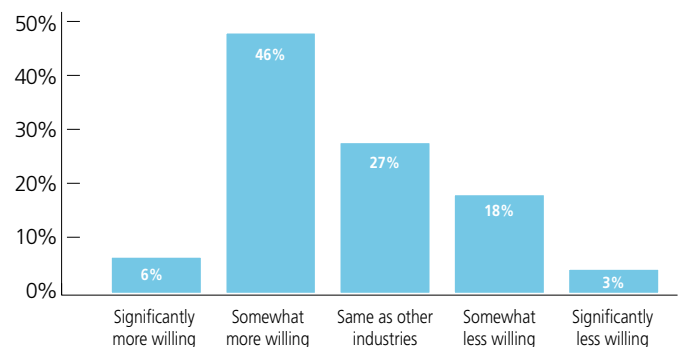
With tensions spreading contagiously for the past month throughout the Middle East, fears rose that civil unrest in such a volatile region could lead to severe market distress. However, it is evident that these fears are not as strong in the VC world as 53% of respondents claim that these events will only have a somewhat negative effect while the remaining venture capitalists forecast these tensions to have no effect on fund raising.

**What effect do you believe the recent civil unrest in the Middle East will have on VC fund raising?**



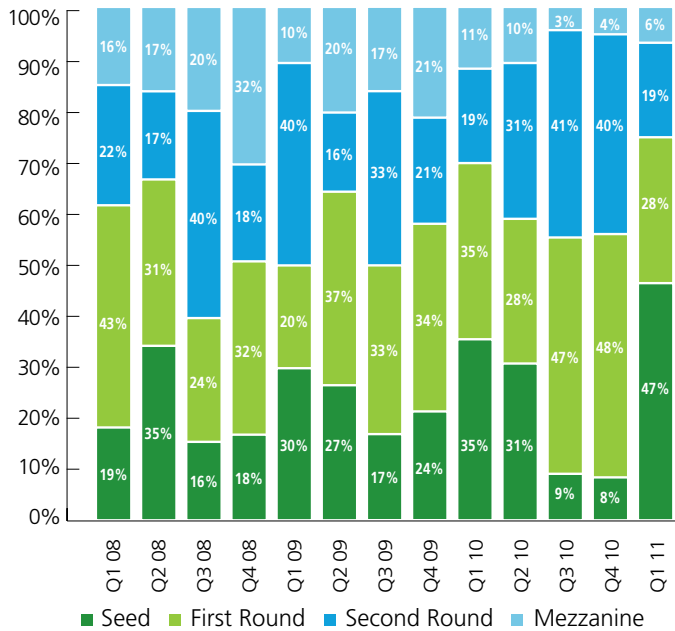
52% of venture capitalists claim that the hi-tech industry is more willing to integrate minority classes to their workforce compared to other industries. In contrast, only 21% believe that the hi-tech, as an industry, is less willing to integrate minorities. This seems to coincide with the logic that for Israel's hi-tech industry to continue in its efforts to be the global standard of excellence; they have to employ the highest caliber employees regardless of his/her race.

**Do you believe the hi-tech industry is more willing compared to other industries to integrate minority classes to their workforce?**



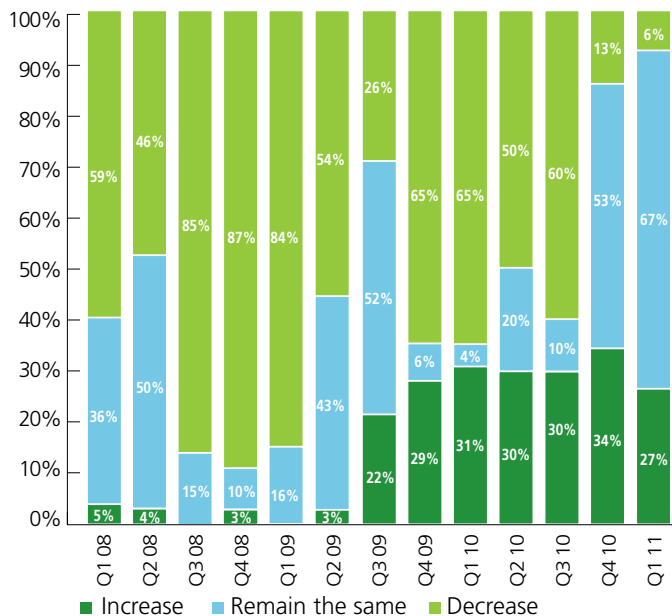
The segmentation of forecasted new investments reflects a jump in optimism. Our survey shows that 47% of venture capitalists currently expect the majority of new investments to be made in Seed while 28% forecast new investments to be made in First Round. Early investments (Seed and First Round) experienced a 19% increase QoQ, the highest in aggregate since Deloitte Brightman Almagor Zoar recorded investment stage investment expectations (Q1 2003). Since Q4 2010, forecasts for new investments in Mezzanine Round dropped 5% in parallel to Second Round investments which tumbled 21%.

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



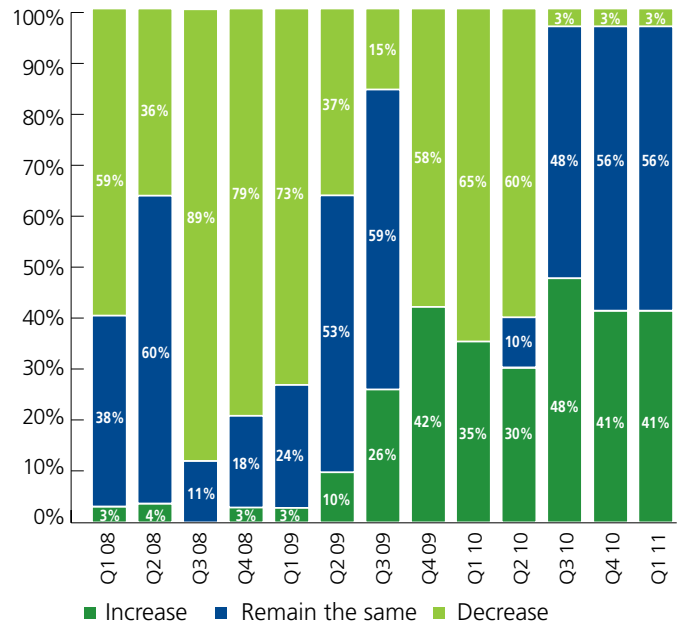
This quarter's investment valuation expectations for the next six months clearly show a drop in venture capitalist expectations pertaining to investment valuations to decrease. This is understood through only 6% of respondents expecting investment valuations to decrease, the lowest level recorded since Q2 2007. Despite this presumed optimism, increases in investment valuations decreased for the first time since Q2 2010. Venture capitalists seem to be on the 'fence' regarding investment valuations as two thirds of them believe it will remain at current levels.

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



Unchanged to last quarter's surveyed responses, venture capitalists are split apart on the path that exit valuations are going to take during the next six months. This is evident from the fact that 97% of venture capitalists are still virtually torn between whether they believe exit valuations to improve or remain the same. Despite of what may be seen as general confusion about future exit valuation expectations; forecasts indicating improvement are the third highest since Q1, 2006.

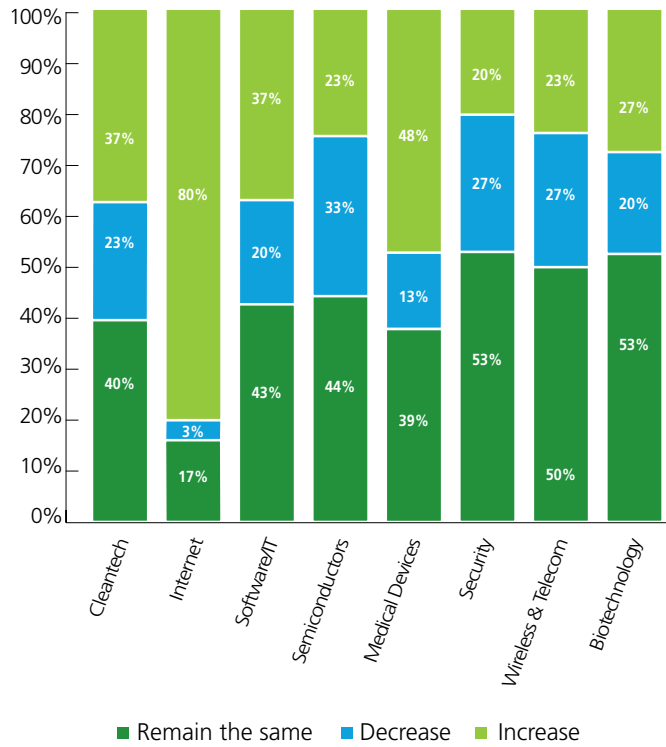
**During the next six months, I expect exit valuations to:**



The Internet sector once again shined brightest with 80% forecasting this sector to project the highest number of transactions during the next six months. This compares to 55% in Q4 2010 where the Internet sector was also considered to be the sector which will undergo the highest number of transactions. In addition, Medical Device and Biotechnology sectors are also perceived with much interest, such that 48% and 37% (respectively) of respondents expect these sectors to have the highest amount of transactions. The sectors perceived to result in the least amount of transactions are Wireless & Telecomm (23%) and Security (20%).

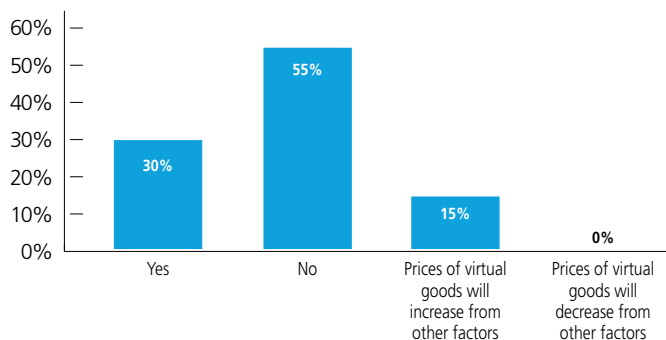
# Insights

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



Recent tensions in the Middle East have attributed to much of the increase in energy prices which have led to a recent rise in inflationary pressures. Despite many economists arguing that deflation is a much greater danger than inflation, oil breaching \$100 has led to global concerns about price increases. Almost a third of respondents believe these concerns will spill over to prices of virtual goods, making it more expensive to purchase everything from virtual yam's to virtual cow's... whereas 55% of venture capitalists believe this recent surge in prices will not have a spillover effect on virtual goods...

Do you think that recent global inflationary pressures will increase prices of virtual goods?



Venture capitalists perception regarding market sentiment indicates that there is a steady and continuous improvement. But for sentiment to climb higher, markets will need additional pushing and less global conflict. A vast majority of surveyed participants presume the Internet sector to be the hi-tech sector that will yield the most M&A activity, a 23% jump since the previous quarter. This is in contrast to sectors such as the Medical Device sector which faltered in terms of M&A expectations by a significant 25% QoQ. With such strong conviction allocated to just one sector provides a clear indication that the internet sector will be the driving force paving the way forward.

Venture capitalists claim that the Internet sector will be at the forefront of this M&A expansion. As "concerns" with users' privacy continue to deflate, the kings and queens of social networking and the Internet sector as a whole will benefit from higher traffic and valuations that may be more in tune with current valuation projections. 94% of venture capitalists expect revenue generation from sale of virtual goods to grow, which will ultimately enable such platforms to increase their IPO valuations, rumored to being right around the corner.

However, companies such as Facebook are presumed to currently hold valuations at levels that most feel are farfetched. In contrast, many visionaries seem to believe that such networks inherently possess the ability and the potential to become a world within a world. Such visionaries believe no price can justify their true intrinsic value and this thus provides many with the concern that we are heading towards the premier of "The Internet Bubble Returns".

With overall positive sentiment and fund raising expectations steadily on the rise in parallel to VCs obligation to prove that the VC model has never been broken, it is no wonder that deal flow activity is forecast to rise at rates Deloitte Brightman Almagor Zoar has never previously recorded. Capital is rumored to be making its way back into the hands of venture capitalists, which need to find the way to channel it into the pockets of talented and promising entrepreneurs. Together they will aim to prove once and for all that the VC model is alive and kicking.

# Contacts

We welcome suggestions for issues to be addressed in future Israel VC Indicator Surveys. You are welcome to send your suggestions to Rony More at [romore@deloitte.co.il](mailto:romore@deloitte.co.il)

Please contact us for further information about the results of this survey, the special services offered by Deloitte Brightman Almagor Zohar and its affiliates to VCs, and assistance with deal initiation and the execution process.

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