

Israel VC Indicator Survey.

Expectations as of Quarter 1, 2008

Hold on tight



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 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 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 24th Deloitte Brightman Almagor Israel VC Indicator Survey results for Quarter 1, 2008 include a comparison, where relevant, 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. 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 Israel VC Indicator Survey Quarter1, 2008 were collected from March 11th, 2008 through to March 23rd, 2008. The responses were collected from venture capitalists in Israel, including replies from the major VCs in the country.



1st Quarter, 2008 - Detailed Results

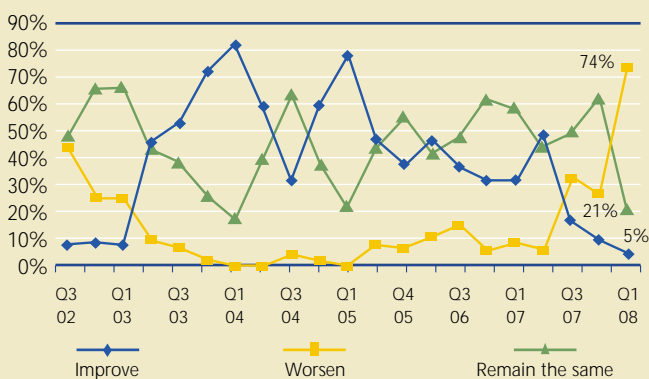
Highlights

- Expectation for the overall economic climate to worsen hit highest levels since 2001
- 49% of venture capitalists anticipate that the stock markets' fall will end within the next six months
- Most venture capitalists foresee a decrease in both investment and exit valuations
- 75% of venture capitalists predict that the number of VCs in Israel will decrease
- The most interesting deal flow opportunities are in mobile application sector
- Cleantech transaction expectations remain strong

Results

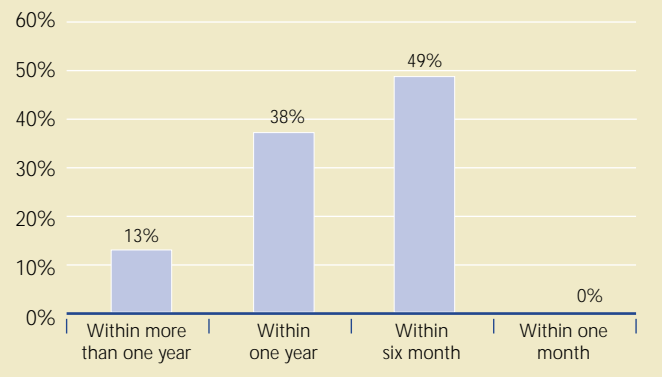
Israeli venture capitalists' worries about the economic climate grow as stock markets continue to fall and the depth of the U.S economic slowdown is becoming more evident. The downwards shift in economic expectations amongst respondents that begun in Quarter 3, 2007 continues into Quarter 1, 2008 and has become significantly predominant with 74% believing that the overall economic climate will worsen over the next six months (compared to 27% in Q4, 2007). This is the highest expectation level for the economic climate to worsen since Quarter 4, 2001 when Deloitte's first Israel VC Indicator Survey was launched. At the same time, a mere 5% of respondents believe that the economic climate will improve over the next six months (down from 17% in Q4, 2007) - again, the lowest expectation level for economic improvement since Quarter 4, 2001. 21% of respondents predict no change in the overall economic climate.

Chart 1:
During the next six months, I expect the overall economic climate to:



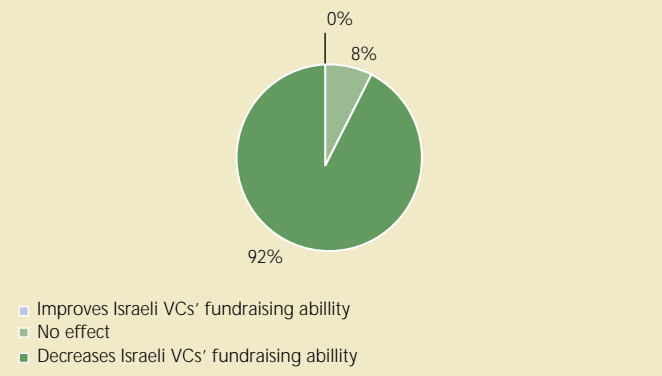
As the stock exchanges around the globe continue to tumble, 49% of venture capitalists estimate that the stock markets fall will end within six months. 38% estimate that the stock markets fall will end within one year and 13% estimate it would take the markets more than one year to stabilize.

Chart 2:
When do you anticipate that the stock markets fall will end?

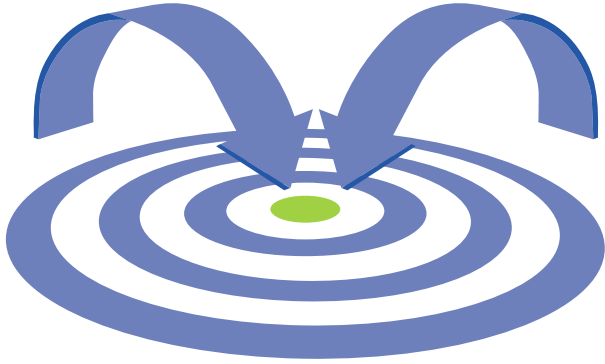


With one of Israel's oldest Venture Capital firms recently failing to raise sufficient capital for its follow-on fund, it is clear that the U.S. economic slowdown could have a severe impact on raising new funds. 92% of respondents say that the U.S. economic slowdown decreases Israeli VCs' fundraising ability. Another 8% say it has no effect on their fundraising ability.

Chart 3:
What impact does the U.S. economic slowdown has on raising new funds?

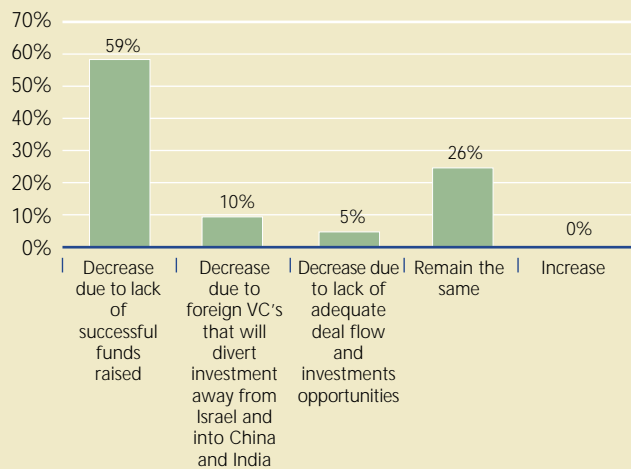


75% of venture capitalists believe that by 2010 the number of active VCs in Israel will decrease. Of those, 59% believe the number of active VCs will decrease due to lack of successful funds raised, 10% believe it will be due to foreign VCs that will divert investment away from Israel and into China and India. Another 5% believe it will be due to lack of adequate deal flow and investments opportunities. 26%



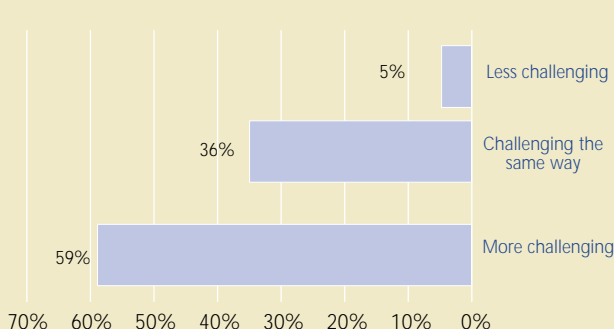
of all respondents believe the number of active VCs will be the same in 2010. Not one respondent believes that the number of active VCs will increase by 2010.

Chart 4:
By 2010 the number of active VCs in Israel will:



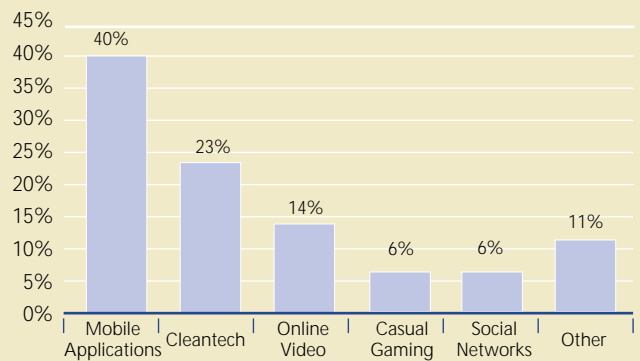
Uncertain economic times mean more difficulties, not only for venture capital firms, but also for entrepreneurs. 59% of venture capitalists think that compared to last year it will be more challenging for entrepreneurs to raise seed money. 36% say that the challenge will remain unchanged. 5% say it will be less challenging.

Chart 5:
Compared to last year, will it be more challenging for entrepreneurs to raise seed money?



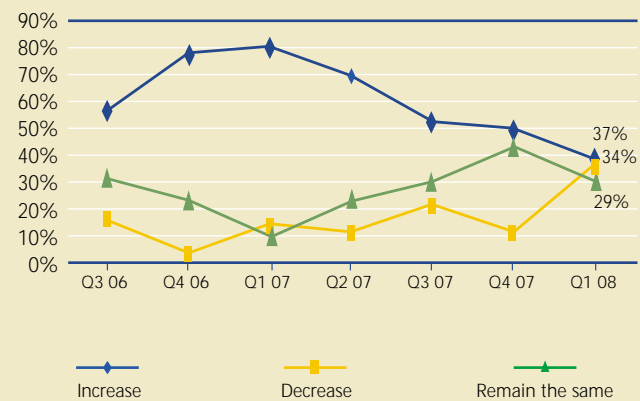
During 2008 the most interesting deal flow opportunities will be in mobile applications sector, say 40% of respondents. Other hot investment sectors include cleantech (23%), online video (14%), casual gaming and social networks (each with 6%).

Chart 6:
During 2008 the most interesting deal flow opportunities will be in:



For the fourth consecutive quarter, expectations for an increase in internet transactions decrease and they are the weakest they have been since Quarter 3, 2006. 37% of respondents are expecting an increase in number of internet transactions over the next six months (compared to 48% and 51% in Q4, 2007 and Q3, 2007 respectively). The number of respondents who foresee a decline in internet transactions has jumped to 34% (compared to 10% in Q4, 2007).

Chart 7:
Expectations of internet transactions:



2008 brings the Israeli high tech industry two true attempts to create giant Israeli companies - Dov Moran's cellular venture Modu and Shai Agassi's electric car venture Project Better Place. Trying to predict the success or failure of these

ventures left about half of the respondents undecided. 34% think that Moran's Modu will succeed, 16% think it will fail, 50% don't know whether it will succeed or fail. As for Agassi's Project Better Place - 24% think it will succeed, 21% think it will fail, 55% are undecided.

Chart 8:
Modu, Dov Moran's cellular venture is likely to:

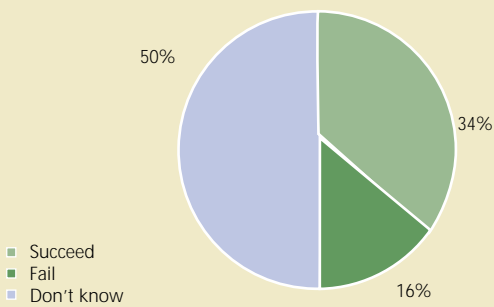
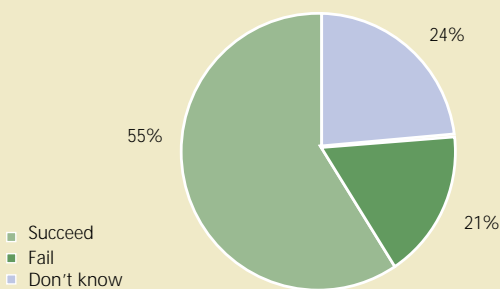
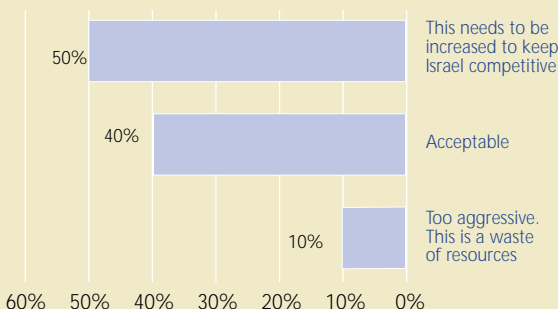


Chart 9:
Project Better Place, Shai Agassi's electric car venture is likely to:



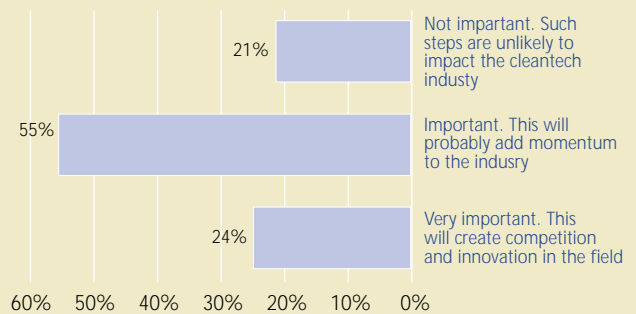
The Minister of National Infrastructure, Binyamin Ben Eliezer, has recently announced a target of 10% electricity production from cleantech energies by 2020. Most venture capitalists support the minister's pledge. 50% say this target needs to be increased to keep Israel competitive in the cleantech sector. 40% say the 10% goal is acceptable, 10% say this goal is too aggressive and will lead to a waste of resources.

Chart 10:
The minister of National Infrastructure announced a target of 10% renewable energy by 2020. Do you think this is:



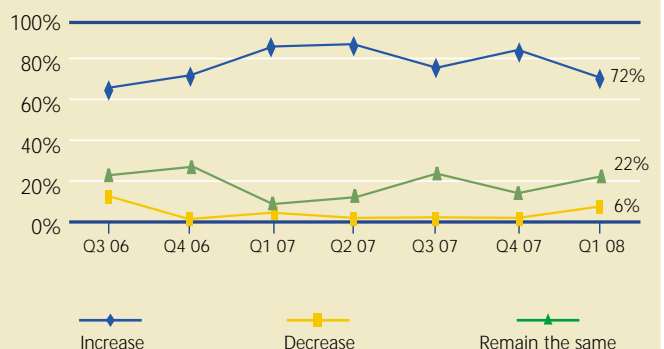
To check another aspect of the potential influence the state's actions have over the cleantech sector we asked how important is the privatization of public utilities in Israel for the progress of the Israeli cleantech industry. 24% of respondents say it is very important, this will create competition and innovation in the field. 55% say it is important, and that it will probably add momentum to the industry. 21% say it is not important, and that such steps are unlikely to impact the cleantech industry.

Chart 11:
How important do you think the privatization of public utilities in Israel is for the progress of the Israeli Cleantech Industry?



For the fifth quarter in a row, cleantech remains the favored sector for increased investment. Expectations of cleantech transaction increase continue to be high but are lower than previous quarters, 72% (compared with 86% in Q4, 2007 and 77% in Q3, 2007). 6% expects cleantech transactions to decrease in the next six months compared with 0% in Q4, 2007).

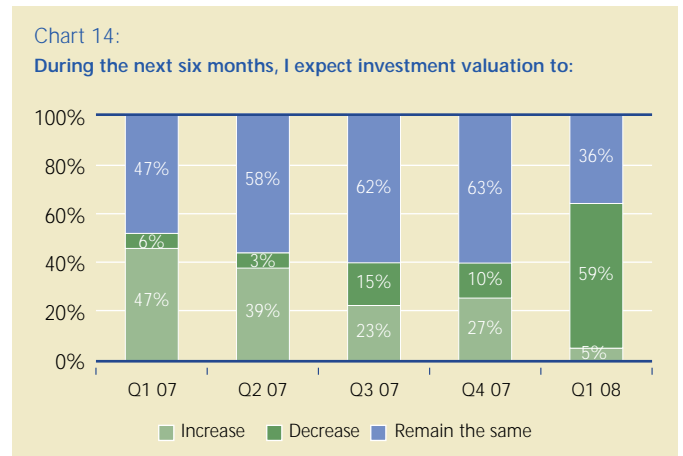
Chart 12:
Expectations of cleantech transactions:



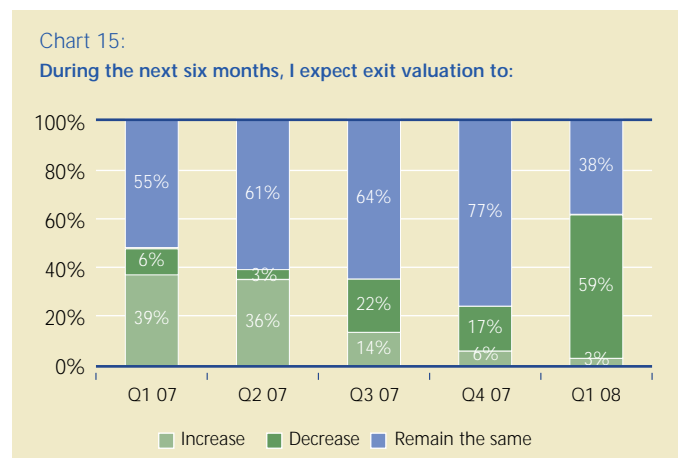
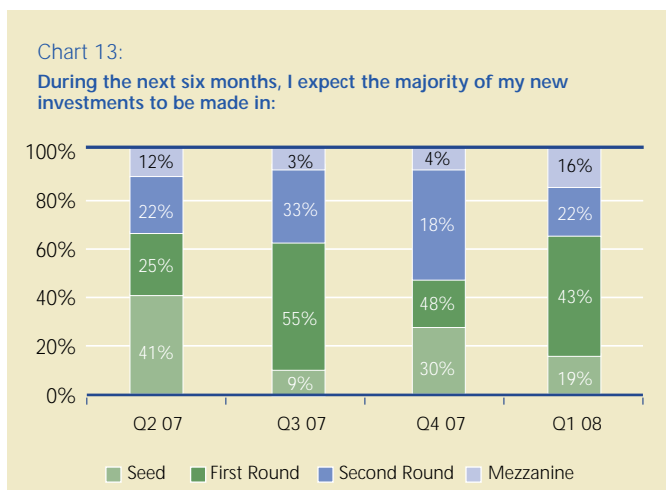


expectations for decrease since first posting this question on Deloitte's Israel VC Indicator Survey in Q4, 2004. Only 5% foresee that investment valuations will increase during the next six months, the lowest expectations for increase since first posting this question on Deloitte's Israel VC Indicator Survey in Q4, 2004.

43% of venture capitalists expect that during the next six months, the majority of their new investments will be made in first round funding. 22% expect to invest mainly in second round, 19% in seed round and 16% in mezzanine.



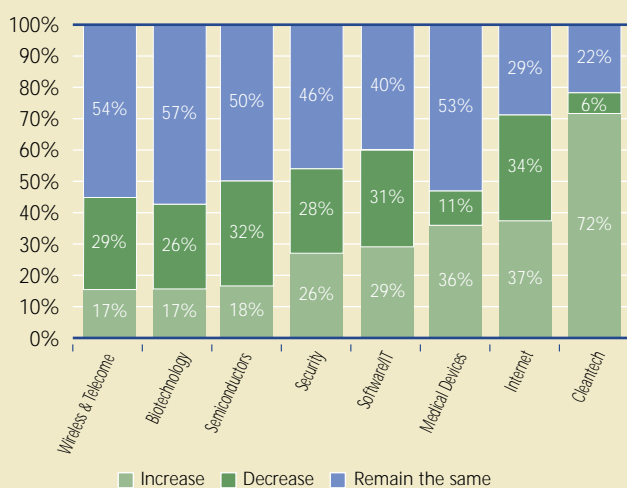
Low expectations are also noted for exit valuations during the next six months. 59% of venture capitalists expect exit valuations to decrease compared to 17% in Q4, 2007 and the highest expectations for decrease since first posting this question on Deloitte's Israel VC Indicator Survey in Q4, 2004. Only 3% foresee that exit valuations will increase during the next six months, the lowest expectations for increase since first posting this question on Deloitte's Israel VC Indicator Survey in Q4, 2004.



The immediate effect of the U.S. economic slowdown is that both investment and exit valuations are going to decrease during the next six months, according to the VC community. The trend of pessimistic sentiment which has begun in Q3, 2007 in both investment and exit valuations has reached a new height. 59% of respondents expect investment valuations to decrease compared to 10% in Q4, 2007 and the highest

The highest expectations of transaction increase are, once again, in cleantech. 72% of respondents expect an increase of transactions in this sector. Internet sector is second in expectations of transaction increase with 37% but also with a notable 34% who foresee a decrease of internet transactions. The medical devices sector continues to be among the most positive sectors with 36% expecting an increase of transactions in this sector. For the second consecutive quarter the weakest expectations are for the wireless and telecom sector. Only 10% of respondents expect an increase in transactions in that sector, while 29% expect a decrease.

Chart 16:
During the next six months, I expect the number of transactions in the sectors listed below to:



Insights

It is unknown how long the U.S slowdown and the falls in global stock markets will last and what their full impact on the technology market and on venture capital firms will be. Some of the negative impact is already being felt. VCs who are in the process of raising money for a follow on fund may find it extremely difficult to convince current and prospective limited partners to make investments and to reach the target that the VC has set for its fund. This will result in a decrease in the number of active VCs in Israel.

Late stage startups will soon start to feel the negative impact of the stock markets' fall and the tightening of the IPO market. Startups might postpone their planned IPO this year to avoid the risk of poor valuations. This situation puts pressure both on the startups and on their VC backers. M&A activity might also be affected. As large technology, media and telecommunications companies brace for the possibility of a long recession, these potential startups acquirers might change their M&A strategy and acquire fewer startups. Less viable IPO option and dwindling M&A opportunities mean lower exit valuations.

Difficult times for VCs mean even more difficult times for entrepreneurs. The economic slowdown bring VCs to be more cautious and choose their investments more carefully. Some VCs might prefer to manage their current portfolio than to seek new investment. For the entrepreneurs it means that it is more challenging to raise seed investment these days and that investment valuations are likely to decrease in the near future.

As VCs will get more cautious with choosing their new investments, internet startups might be the first to feel it. The immediate impact of an economic slowdown - a drop in consumer spending and advertising budgets, could strongly affect internet companies. Now more than ever it might be the right time for internet startups to bootstrap.

Mobile applications are turning into big business and are one of the few investment areas that may not be affected by the economic slowdown and receive substantial VC funding. With cellular phones growing more and more capable, changing into cross functional multimedia devices, new exciting mobile applications can be developed. Apple recent release of the iPhone software development kit (SDK) and Google's mobile phone platform Android have boosted the industry's interest in mobile applications. Phone manufacturers and cellular operators are all seeking to combine new mobile applications to their products and services. As there is high demand for mobile applications there will also be VC money available for investment in this field.

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.

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 with deal initiation and the execution process.

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