

Gaza Strip Evacuation Plan Underway

It is not clear yet whether all Israeli settlements in the Gaza Strip will be evacuated, as part of Prime Minister Sharon's plan to withdraw from the area.

The American administration's main worry is that chaos will prevail in areas Israel evacuates. Israel has already promised to continue providing water, electricity, gasoline, raw materials and import/export services to the Gaza Strip, following its withdrawal.

The scope and timetable of the pull-out is still unknown, but projections are for the plan's implementation to begin in June or July. In any case, the plan need first undergo a referendum and be approved by the government.

The director of Military Intelligence, Major General Aharon Ze'evi (Farkash), warned lawmakers that the Palestinians will interpret Prime Minister Sharon's plan to "relocate" 17 settlements in the Gaza Strip as a victory for terrorism, and encourage them to step up terrorist attacks.

Separation Fence Cost May Reach 3B NIS

The total budget for the construction of the separation fence between Israel and the West Bank could reach 3B NIS (about €527M) this year, if the Government agrees to finance measures intended to ease disruptions to Palestinian lives caused by the fence.

The fence is being erected in order to keep off terrorist infiltrations from the West Bank into Israel. In response to the international criticism of the fence's route interfering with Palestinians' daily lives, a task force was set up, to draft proposals for improving the situation. Its recommendations include alternative roads, tunnels and gates in the fence.

BACK TO THE MARKET

After three barren years, 2004 begins to appear as the capital-raising year of the Private Equity and Venture Capital sectors in Israel. Dozens of Israeli funds have returned to the market in recent months, and there are quite a few new indications for closing funds and new capital raising.

Some of the major venture capital funds in Israel have set out on raising hundreds of millions of dollars. Alongside the larger funds like Pitango, Star, Gemini, Giza and Genesis is a long list of mid-size and smaller funds, which have also started to raise capital.

As far as Private Equity is concerned, sophisticated investors world-wide have identified appealing opportunities in the Israeli market, and decided – so it seems - to create a whole new Private Equity industry.

While until recently only FIMI and Apax (which used to act mainly as a venture capital fund) were active in Israel, there are now many large scale and small scale funds growing here as well. It is already clear that 2004 is going to be a record year in capital raising for this asset class.

The first such fund is the Markstone, which recently announced the first closing of \$400M out of a planned \$500M fund. Israeli press confirms that the company has already shown interest in purchasing leading companies such as Bezeq and Cellcom.

But Markstone is not alone. Fortissimo has also closed \$60M of its planned \$100M, and Galil, another LBO fund, is in the process of raising a \$50M fund. Other new, focused and sophisticated investment tools are being formed as well, such as the turnover fund established by FIMI, a second venture lending fund by Plenus, the mezzanine fund directed by Eli Yunes, former director of Bank Ha'Poalim, and of the second-largest secondary fund in Israel, Vintage.

All this capital raising is clearly indicative of greater optimism among private equity players in Israel. Yet it also reflects the growth and development of a market, which was known until now mainly for its start-ups. It seems that in the future, doing business in Israel is going to be easier not only for entrepreneurs, but also for investors in private equity, who will be able to find here almost any private investment venue they like.



Moshe Price, *Managing Partner*

israel economy

VENTURE CAPITAL

Capital Raised by Israeli Firms in 2003 Exceeds \$1B

During 2003, Israeli high-tech companies (371 in total) raised \$1.011B from venture investors, local and foreign, according to the quarterly survey conducted by the IVC Research Center. The sum is only 11% below the \$1.138B raised in 2002, but approximates the \$1.013B raised in 1999.

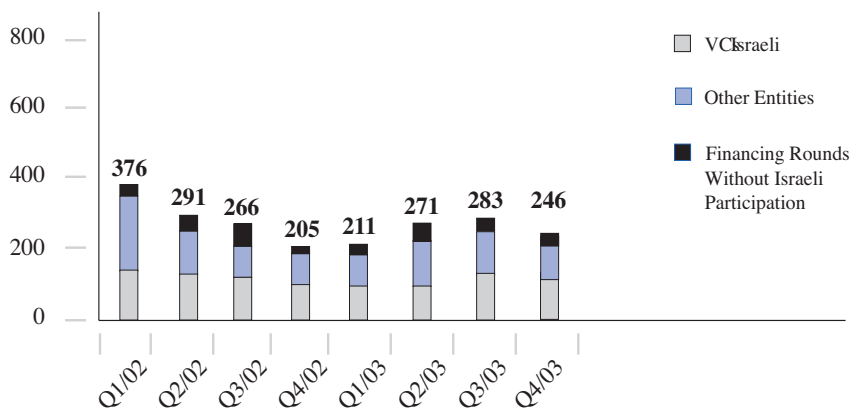
The Survey, conducted with the cooperation of the Israel Venture Association (IVA), is based on reports from 125 venture investors, of which 66 are Israeli management companies and the rest are mostly foreign investment entities.

Zeev Holtzman, Chairman of IVC Research, said "Today, some ten VCs are in a race to raise new funds, and we forecast that they will succeed in raising \$1B in 2004.

"Therefore, we foresee an increase in the pace of technology investments in Israel".

In Q4/03, 96 Israeli high-tech companies raised \$246M, 13% lower than the \$283M raised by 103 companies during Q3/03, yet 20% above the \$205M raised by 89 companies in Q4/02.

Capital Raised by Israeli High-Tech Companies by Quarter (\$M)



- Israeli start-up **Atrica** is raising \$20M, after having completed a \$17M round six months ago. This is the company's sixth financing round, which will bring its total funding to more than \$150M. Among the company's investors have been Intel Capital, Gemini, St. Paul Venture Capital, France Telecom's (NYSE:FTI) investment arm Innovacom, Ascend, Accel Partners and Benchmark Capital.

- Application support software company **Identify Software**

(formerly Mutek) raised \$15M in a round co-led by Star and Evergreen, with participation of existing investors Earlybird, Formula Ventures, Infinity Funds, Intel, Mofet Venture Capital Fund, NIF Ventures, UBS, and Vertex Venture Capital. It has so far raised about \$50M.

- Rich media technology provider **Eyeblander** closed an \$8M round of venture capital funding from Insight Venture Partners. Eyeblander, founded in 1999, is headquartered

in New York, with product development facilities in Israel.

FINANCE

- Three consortia have submitted letters of intent to buy the controlling interest in **Israel Discount Bank** (TASE: DSCT) from the State: Larry Meizel, an American real estate baron; Australian tycoon Frank Lowy; and the Nazarians, an American family of Iranian descent, whose fortune is estimated at \$1B, and who is involved in real estate, infrastructure and high-tech.

Others interested in the bank include the Hamburger family, which controls the Harel insurance company, and Matthew Bronfman, an owner of the Dor-Alon company, which bought the Blue Square Co-Op supermarket chain last year.

STOCK MARKET

- **M-Systems** (Nasdaq: FLSH) announced at the beginning of February it plans to offer 5.6M ordinary shares in a public offering. At its current share price, the sale would generate \$118M. The offering is being made through an underwriting syndicate led by Citigroup Global Markets. M-Systems currently trades on Nasdaq at a market cap of \$490M.

- **Lipman Electronics Engineering** (TASE: LPMA), which manufactures end-user systems for reading and clearing credit card transactions, issued 2.25M shares, and the company's current shareholders sold 750K shares in an offer for sale. Lipman raised a total of \$93.6M, at \$41.60 per share. Merrill Lynch led the issue.

- **Tower Semiconductor** (Nasdaq: TSEM) raised \$72M from a stock

issue on February 2nd. The chip manufacturer sold only 11M of the shares (instead of the 12M expected) at a price of \$7 per share, lower than expected. The leading underwriter was the CIBC investment bank. Proceeds from the issue are intended for the completion of Tower's new manufacturing plant in Migdal Ha'emek.

- Bank Hapoalim plans to float its subsidiary **Signature Bank of New York** in Q2/04 at a company valuation of \$400M after the money. About 30% of Signature will be floated for the public and its shares will be registered for trade on Nasdaq. By those figures, Signature should raise \$90M, lifting its shareholder equity by that amount. This implies a present value for the bank of \$320M before the money. Signature manages about \$2B in assets.

GENERAL

- Business activity showed signs of recovery, including increased exports and private consumption, in H2/03. Demand intensified in Q4, and most economic indicators improved, continuing the positive trend from Q3, according to a Bank of Israel survey of economic developments.

The Central Bank added that the decline in economic uncertainty in 2003 was influenced by the government's decisive policies to restore fiscal confidence and enable a less restrictive monetary policy. Nevertheless, the Bank states that the turnaround in business activity, especially in the high-tech and service industries, was due more to the increase in global demand than to the rise in domestic consumption.

Bank of Israel figures also show that purchases of NIS assets and Israeli shares by foreigners grew 2.26-fold

to a three-year high of \$5.634B in 2003, compared with \$2.489B in 2002. Foreign investments in Israeli real estate and shares, both in Israel and overseas, totaled a net of \$3.944B in 2003, compared with \$2.332B in 2002. Direct net share investments by foreigners reached \$3.47B in 2003, double the \$1.745B in 2002.

Bank of Israel figures show that foreigners are once again making large investments in Israeli real estate, indicating potential for a real estate and construction recovery in 2004, and for a rise in real estate prices, which have been falling continuously since July 2002.

Foreign investment in the Tel Aviv Stock Exchange (TASE) rose over 730% to \$354M in 2003 from \$48M in 2002.

DEALS

- **Ormat Industries** (TASE: ORMT) completed a \$190M offering of dollar-denominated bonds. The bonds, which were placed with institutional investors in the U.S., bear fixed interest of 8.25% and come due in 2020. The proceeds will be used to finance the \$55M acquisition and upgrading of two geothermal power stations in the Rio Nevada. Ormat will also be buying the operating rights to the plants for another \$30M.

- **Clal Industries and Investments** (TASE: CII) sold its holdings (24.6% of the shares) in NegevTech, which makes inspection equipment for the semiconductors industry, to Orbotech (Nasdaq: ORBK), for \$14.1M. Orbotech makes gear to inspect PCBs and flat display panels in production.

NegevTech's diagnostics equipment inspects silicon during semiconductor production, using a

unique imaging engine.

- **Israel Aircraft Industries** (IAI) is likely to sign a \$1.1B deal to sell three Phalcon early warning radar systems to India by the end of Q1/04. IAI, the maker of the Phalcon systems, is expected to ship the first system in 18 to 24 months.

The Phalcon can pick up aircraft, including at low altitude, hundreds of kilometers away in any weather, day or night.

- **BBC Broadcast** has selected **SintecMedia's** OnAir to manage the broadcast operations of all BBC's public TV channels as well as its regional radio stations.

No value was disclosed for the deal, but industry sources estimate that it is worth \$20-30M over three years. SintecMedia is a member of the Formula Group and is based in Jerusalem.

- Printing and photography equipment giant **Eastman Kodak** (NYSE:EK), which has a market cap of \$8M, plans to acquire Israeli start-up company **RealTime Image** in a deal estimated at \$25M. Kodak is already invested in the company.

RealTime Image develops systems for transmitting images via the Internet, which have applications in the commercial printing industry and in medicine.

- **Elbit Systems** (Nasdaq: ESLT), which announced in recent weeks contracts amounting to \$146M, has won over \$10M in contracts to supply its new aircraft and boat surveillance systems to European and Asian countries.

- **Check Point** (Nasdaq: CHKP), the leader in Internet information security, is using its \$1.5B in cash to acquire US-based **Zone Labs** Inc., a developer of firewalls for home users and internal enterprise defense systems, for \$205M (\$113M in cash and \$92M in Check Point shares).

● **ColorChip** started selling its splitter products in Q3/03. These products are based on ColorChip's glass ion exchange PLC (Planar Light Circuits) technology, which yields high performance, low cost products.

Splitter modules have been delivered to customers in Israel, Italy, Germany, USA and Japan and optical splitter chips have been delivered to Far East countries as OEM products.

ColorChip also initiated a feasibility study on utilizing its PLC for low-cost bi-directional optical transceivers. The market for such products is larger as it is being used for Fiber To The Home (FTTH) and data-com applications.

www.color-chip.com

● **Schema**, a global provider of solutions and services that improve the way wireless communications companies plan, implement and manage their network resources, continues to show rapid growth and a strong market presence.

Schema is currently expanding its sales efforts to Asia-Pacific, Europe and Latin America, having recently completed several successful trials in these regions.

In Q4/03, Schema was ranked the 8th fastest-growing technology company in the 2003 Deloitte European Technology Fast 500 – after having achieved the #1 ranking in the 2003 Deloitte-Brightman Almagor Israel Technology Fast 50.

www.schema.com

● **Hotbar** enables its users to personalize their Web browsers and emails, thus adding fun, color, excitement and functionality to these key applications. The company continues to benefit from positive trends in the Internet advertising space, from its diverse

revenue base, and from its ability to communicate directly with its users (thus being independent of distribution partners).

Revenues in 2003 increased more than threefold over 2002 and the company is now highly profitable. New fee-based services are being introduced. These include an anti-spam solution developed jointly with Commtouch and services such as dating, comparative shopping, and greeting cards. Hotbar continues to invest in leading edge technologies that enhance its capabilities.

www.hotbar.com

● **Passave**, a fabless system-on-chip vendor, developing core technology for broadband fiber access systems, has achieved a major positioning in the FTTH (Fiber To The Home) rapidly growing market. Today, more than 80,000 FTTH new subscribers are being installed monthly in Japan.

NTT, Japan's incumbent carrier, completed an RFP process for EPON OLT (Central Office) equipment for the FTTH market, selecting two leading Japanese suppliers. The OLTs of both companies utilize Passave PAS5001 OLT chip as their EPON core.

In Q4/03, NTT issued a second RFP, for EPON ONU (Subscriber Premises) equipment. Passave is working with bidders to ensure the success of ONUs based on its PAS6001 ONU chip. Winners will be selected in March 2004.

www.passave.com

● **CyOptics**, a developer and manufacturer of Indium Phosphide (InP) optical engines for broadband solutions, announced its new product for use in XFP small form factor transceivers.

This new product enables optical transmission up to 40km, offers x4

reduction in power consumption versus comparable products on the market today. Cyoptics was recently awarded a U.S. Utility Patent.

www.cyoptics.com

● **MobileAccess Networks**, a leading developer of converged wireless enterprise networks, closed a \$10M round of funding in Q4/03. The financing will enable MobileAccess to continue the rapid growth experienced in the past 12 months by leveraging current profitability and expanding its international presence.

In addition to direct sales successes across the globe, MobileAccess has solidified several strategic distribution and marketing agreements which will enable the company to maximize its market presence through reseller relationships.

www.mobileaccess.com

● **ART** Advanced Recognition Technologies, maker of recognition software for voice and handwriting, has recently closed a \$6M financing round led by Bessemer Venture Partners and including current investors.

ART announced that BenQ has chosen an upgraded version of its advanced natural handwriting recognition software, smARTwriter, for its new P30 smartphone, which includes camera and PDA functionalities. The upgraded smARTwriter provides greater ease in using handwriting UI with major European languages and Chinese.

ART develops and markets solutions for the control and command of mobile devices by human voice and natural handwriting.

www.artcomp.com

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