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Analysis: Is Israel's romance with Nasdaq over?

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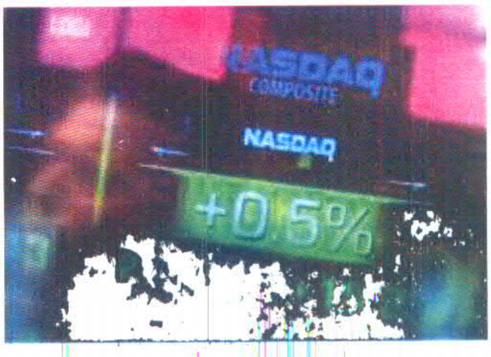
By Tova Cohen



TEL AVIV (Reuters) - Israeli technology companies, once the darlings of New York's Nasdaq, have turned their backs on the exchange and are looking for suitors to acquire them.

As recently as 2009 Israel was the country with the most listings on Nasdaq outside of North America.

Today it has been outstripped by China as Nasdaq's biggest foreign presence, and a huge cultural change is underway as Israeli firms reconsider. Many now prefer to sell to strategic buyers, or the new players in the country: private equity firms.

The shift goes beyond the global financial crisis, which has staunched the flow of initial public offerings (IPOs) on markets around the world.

Strict new U.S. regulations and reduced small-cap expertise among U.S. banks, along with an unwillingness of Israel's free-wheeling entrepreneurial culture to take on longer-term managerial strategies has combined to create a major rethink.

A change in the kind of companies that are being forged in Israel's renowned technological research labs is also having an impact, with more being designed as bolt-on applications for mobile and social networking businesses rather than standalone companies that would benefit from listing.

In 2000, at the peak of Nasdaq's popularity with Israeli firms, 33 Israeli firms listed and raised $4.65 billion. Since 2008, only four have held offerings in the United States, raising $192 million.

Over the same period acquisitions of Israeli firms reached $5.6 billion in value, according to data from Cukierman & Co Investment House and Israel Venture Capital (IVC) Research Center.

"There's definitely been a dramatic change," Richard Gilden, a partner at New York law firm Kramer Levin Naftalis & Frankel, said. "It's a shadow of what existed in the boom times and I don't see that coming back anytime soon."

R&D HOTBED

Israel has long been famed for its cutting-edge technological sector, fostered by the presence of long-established and well-funded military intelligence research that has been the wellspring for much innovation.

Multinationals have flocked to the country to dip in the pool: according to Dafna Schwartz, director of the Bengis[illegible] Center for Entrepreneurship and Hi-Tech Management at Ben-Gurion Universit[illegible]ompanies have set up some 250 R&D centres in Israel with the aim of being close to and purchasing the in[illegible]stage.

"This is an Israeli phenomenon," Schwartz said, adding it had led to a mentali[illegible]ell."

The focus on early innovation and creation of prototypes, combined with constraints ranging from security issues to a scarcity of resources to international boycotts, means that Israeli entrepreneurs have had little opportunity to learn how to develop and lead big companies.

Alon Sahar, head of the technology department at Herzog Fox & Neeman, one of Israel's leading law firms, believes the lack of ability to scale up has helped fuel the growing preference for acquisitions over IPOs in Israel.

SARBANES-OXLEY STRIKES

In the United States financial regulations have been sharply tightened under the Sarbanes-Oxley Act of 2002 in the wake of major corporate and accounting scandals, such as Enron.

As a result, preparing for an IPO in the United States has become more time-consuming and costly, putting many companies off.

While many American technology firms still aim to go public, the U.S. regulations seem even more off-putting and rigorous from thousands of miles away, said Gilden, who worked with many Israeli companies on their IPOs in the boom years.

They are also particularly frustrating to the Israeli entrepreneurial mindset, he said.

"It's a management process that is not really attractive to an Israeli entrepreneur," said Gilden.

"I think they would much rather work a couple of years for a multinational and then form another company. It's easier to have an IBM or Intel or HP buy a company and pay a valuation that's reasonably close to what the firm could get in the market."

The disappearance of Lehman Brothers, which foundered during the financial crisis, meant many technology start-ups lost important support and expertise when the bank's small-cap analyst coverage stopped, according to market watchers.

"When Lehman Brothers disappeared Israeli companies traded on Nasdaq became orphans. Lehman was very good for Israeli small caps on Nasdaq," said Edouard Cukierman, founder and chairman of Israel-based Cukierman & Co Investment House.

Lehman, which opened its office in Israel in 1994 with a ceremony attended by then-prime minister Yitzhak Rabin, was instrumental in promoting Israeli firms on Wall Street.

"There are small players doing small IPOs but they don't have offices in Israel," Cukierman said. "The other firms that operate are looking for large transactions."

Although Barclays Capital, a unit of Barclays PLC, bought Lehman's operations in Israel, Cukierman noted: "It's not an American firm and they do a different type of work."

VENTURE CAPITAL

The trend to sales and acquisitions can also be accounted for by the dominance of the venture capital (VC) industry in Israel, which grew exponentially alongside the steady production line of technology start-ups created by Israel's entrepreneurs.

These funds were hard hit by the global financial crisis and are now struggling to raise money. According to IVC Research Center, Israeli VC funds raised no new capital in 2010 and only $234 million in 2009, down from $1.5 billion in 2005 and $2.8 billion in 2000.

"Israeli VC funds are very dominant and there aren't enough alternative sources of financing in Israel so when the VC funds are hurting it affects the whole start-up industry," said Dafna Schwartz.

Many VCs now want a safer route to get their money back rather than lengthy and often unpredictable IPOs.

"Israeli VCs are more eager to see their return," said Oren Nissim, CEO of Israeli mobile navigation software maker Telmap, which is being acquired by Intel Corp.

The arrival of foreign private equity firms has widened the pool of interested buyers.

Apax Partners struck the first significant deal when it bought a controlling stake in Bezeq Israel Telecom with two partners in 2005 and sold it for a more than 300 percent return, prompting other firms to sit up and take notice.

Recent examples include Vector Capital's purchase of software security company Aladdin Knowledge Systems in 2009 and Summit Partners' purchase of Q&A website Answers.com this year. Financial technology provider Fundtech is in the process of being acquired by Chicago-based GTCR.

As venture capital firms invest less and the tech climate changes, the type of businesses being created have also changed.

More Israeli entrepreneurs are creating internet, social networking and mobile applications with an eye to selling them rather than seeking to become a major player, said Sahar at Herzog Fox & Neeman, whose firm represented Facebook in its acquisition this year of Snaptu, which developed and launched applications for Facebook and LinkedIn on mobile devices.

"Snaptu was almost built from day one to be purchased by someone like Facebook," Sahar said.

(Editing by Sophie Walker)