



ISRAEL:

Key to Success

After a summer of armed conflict, Israel's economy is back on track. >>>

ISRAEL

Tel Aviv,
Israel

Back to Business

After armed conflict derailed Israel's growth this summer, its economy has quickly bounced back.

By Howard J. Stock

While Israel has been involved over much of 2014 in a military campaign against Hamas in Gaza, the 12 months of relative peace before the conflict saw an extremely active business environment in Israel. Now that hostilities seem to be waning, Israeli lawyers expected that things will pick up again, primarily on account of the end of the military campaign but also because of other factors in the Israeli economy.

Israel's high-tech economy is booming and \$930 million was raised by Israeli technology companies in second quarter of 2014, the largest single quarterly raise since 2000. In the first half of 2014, 335 Israeli start up companies raised \$1.6 billion which is an 81% increase from the same period in 2013.

"What is interesting about this increase in investment is that a large percentage of such investment is attributed to foreign investment while investment in Israeli technology by Israeli venture capital funds is on the decline,"

says Simon Weintraub, a partner in the international department and banking group at Yigal Arnon & Co.

In more traditional areas of the economy, the highest profile transaction was the proposed sale of the Tnuva, Israel's largest dairy concern, to Bright Food of China, says Alan Sacks, head of Herzog Fox & Neeman's banking and finance department and international practice. Chinese investment in Israel also spans technology and commodities.

Indeed, despite regional unrest, Israel's economy has remained healthy and viable, says David Tadmor, Managing Partner of Tadmor & Co. "Israel's growth rate in recent years has been steady while maintaining a low rate of unemployment," he says. "In 2010 Israel became a member of the Organisation for Economic Co-operation and Development (OECD) and the business, regulatory and legal environments have been, or are in the process of being, conformed to OECD standards."

There has been a significant revival of initial public offering (IPO) activity, especially on Nasdaq, and Israel's major offshore gas discoveries have also been good for the economy. Natural gas is expected to be a major driver of the Israeli economy in the coming years, following the discovery of large offshore natural gas deposits. "The Tamar and Leviathan reservoirs have been noted as game changers, enabling Israel not only to become independent of external supply, but also to become a substantial natural gas exporter, and to compete with major international exporters," Tadmor says. Weintraub notes that Leviathan Partners recently signed a deal with the Jordanian Electric Power Company which is rumored to be worth at least \$15 billion.

Israel's famous entrepreneurship greenhouse also continues apace, attracting professionals and investors from all across the globe. Multinationals such as Google, Apple, Facebook, Intel and GM have all recently invested in Israel and established research and development (R&D) operations in its many technology and research hubs.

Another area of business that is seeing significant growth in recent years is renewable energy. This field builds on Israel's abundant sustainable energy resources, such as sun and wind, with its cutting edge R&D ecosystem.

An important driver of Israel's R&D is the Office of the Chief Scientist, which supports early stage ventures in a range of programs. One such support channel is the technological incubator program, which offers government financial support at a very early stage. Some of these programs involve financial grants constituting up to 85% of R&D expenses.

STRONG FOUNDATIONS

Despite a number of macro issues facing the Israeli economy—at present the increased burden on the

defense budget is a concern for the government—the mood in the business community is cautiously optimistic, Sacks says. "Israel is politically stable. Business and commercial activity is governed by a highly developed set of up-to-date rules and regulation," In a turbulent region, "Israel is an island of calm in the middle of this storm."

A good example for this can be found in the field of infrastructure projects. The economic viability of such long-term projects "can only be attractive to foreign investors in an atmosphere of trust and confidence in the local economy and political stability," Tadmor says.

The government has made significant efforts to strengthen the Israeli economy in general, without specific emphasis on foreign investor confidence, intro-

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ducing legislation and regulations aimed at increasing competition in the marketplace. New measures ensure that companies cannot borrow recklessly, and companies that are in genuine financial difficulty have been given new legislative measures to enable a process of corporate rehabilitation rather than outright collapse, similar to a Chapter 11 bankruptcy rules in the of U.S.

Meanwhile, the new Competition Law prevents a sole entity from controlling a significant financial institution industrial entity, Sacks says. As a result, a number of corporate groups will have to divest themselves of significant holdings in financial or non-financial assets, potentially creating a buying opportunity for foreign investors.

Additionally, the Law for Encouragement of Capital Investments offers incentives to eligible companies in two forms: first, by enabling grants for production equipment, facilities, and fixed assets; and secondly by providing substantial tax benefits to eligible companies, such as a low corporate tax rate as low as 9%, instead of 26%.

The Israeli Companies Law also went through significant changes in recent years, aimed at strengthening corporate governance. Among other changes, a new procedure for the approval of transactions with controlling shareholders has been established; it requires audit committees to hold competitive processes before a company enters into certain transactions with controlling shareholders.

Perhaps most importantly, Israel is a party to some 40 bilateral and multilateral treaties, such as free

ISRAEL

trade agreements with the European Union, the United States, Canada and EFTA and five multinational European programs, all of which support R&D collaborations with international firms from all across the globe.

However, while there are many positive signs showing increased foreign investment activity in Israel, there is still much that can be done at a policy level to increase and sweeten the business environment. One example that has affected the high tech industry is that the Israeli Registrar of Companies a few years ago stopped accepting documentation in the English language. This is an issue for foreign compa-

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nies since Israeli law mandates that many documents be filed with the Israeli Registrar of Companies, including any changes to the incorporation documents and including pledge agreements.

“Notwithstanding this change in government policy, the high tech industry in Israel still operates by in large in the English language and it is problematic to expect that foreign investors should negotiate their rights in Hebrew,” Weintraub says. “This is not in line with many other non English speaking countries and creates a level



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of uncertainty in the investment community. There has been much push back by the business and legal community on this point and there is hope that the government will ultimately reverse this position.”

With Israel’s energy boom in play, its government also has to get back to work on regulations first drafted in 2011. The regulations regard procedures for submitting applications to transfer petroleum rights. These draft regulations have still not been converted to law even though in practice the Petroleum Commissioner has been acting in accordance with these draft regulations for some time.

“It is imperative that Israel has clear and precise guidelines to govern the transfer of petroleum rights as this is a cornerstone today of the Israeli economy and it is essential that foreign investors have certainly on these issues particular foreign banks who invest in these projects and need to clearly understand the procedures regarding enforcement,” Weintraub says.

FDI IN ISRAEL

Growth of the Israeli economy has been largely fueled by a steady increase in international investment. FDI in Israel has skyrocketed in recent years. In 2009, FDI



Tel Aviv skyline

reached \$4.4 billion; by 2011, it had reached a high of \$10.8 billion; and in 2013 it hit a high of \$11.8 billion, according to the World Bank. In fact, Israel ranked fourth place in FDI behind the U.S., the Cayman Islands and Canada, according to OECD, with approximately 4% of its GDP from FDI. “Figures for the first half of 2014 are substantially lower, which may be attributed to the recent conflict with Gaza,” Tadmor notes. “However, the Israeli economy is known for its ability to recuperate very quickly.”

One-fourth of FDI flows into commerce and services sector; computers, electronics and optics industries account for 17% of total FDI; R&D accounts for 16%; and 15% is invested in the media and information sectors, according to the Central Bureau of Statistics.

Israeli entrepreneurs are actively investing outside Israel, too, Sacks says. The traditional area of investment has been real estate, in regions such as Eastern Europe, Canada and the U.S. But major Israeli companies such as Teva Pharmaceuticals have been active in acquiring operations around the world with a view to globalizing their business operations.

Tadmor adds that the Netherlands, with their significant tax advantages, have attracted Israeli in-

vesting, and Singapore has also been popular, among other destinations. Industrial investments including oil, chemicals and pharmaceuticals lead the way, but Israelis also invest in commerce and services as well as in the financial industry.

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Israeli investors were among the first to invest in emerging markets, Sacks says. “We saw this with the opening of markets in Eastern Europe, and perhaps less so in Latin America, and we have seen this more recently in China and Southeast Asia. At an official level, the government is clearly making efforts to encourage two-way investment between Israel and China and Israel and India,” he says. Just as China is

already a major investor in Israel, there are likewise a number of significant investment operations on the part of Israelis in China.

“Israelis are active players in emerging markets, in various areas including commerce, industry, finance, construction and infrastructure,” Tadmor says. “Israelis are experienced and nimble promoters, quick to identify opportunities in foreign markets.”

Given the tense geopolitical environment, it is more difficult for Israel to participate in the broader MENA community. However, Sacks notes that there is a level of discrete economic cooperation with a number of countries in the region, including areas such as homeland security, that usually occur far from the public eye.

“Israel’s political ties with countries in the Middle East are challenging, and its commercial and business relations are necessarily low key,” Tadmor agrees.

In a geopolitical environment like Israel’s, it is impossible to say where Israel will be in 10 years time, but Israeli lawyers remain optimistic. Weintraub’s hope is that rather than being bought outright by bigger fish in the U.S., promising Israeli technology companies will instead turn to the U.S. market for capital with which to grow, and “that Israeli technology companies

will become larger, will acquire foreign competitors and will turn into global companies.”

One potential challenge could be Israel’s falling education standards, which “have been on the decline in Israel and for many years now Israeli schools have been suffering with decline based on international standards,” Weintraub says.

That said, it is expected in the coming years that Israel will receive large sums of capital from royalty payments on account of its offshore natural gas reserves. Weintraub hopes that much of these funds will be invested in education. “At the level of higher education, the statistics have been better and recently it was reported that Tel Aviv University was listed as one of the top ten universities in the world in terms of successful entrepreneurship,” he says.

For now, Israel seems set on a solid growth trajectory that has now spanned decades. “We see a constant stream of investment from overseas and Israelis continue to invest outside Israel. The Israeli economy will be boosted by the massive offshore discoveries of gas in the Mediterranean,” Sacks says. “All of the indicators suggest that Israel will be much stronger economically in 10 years time.” ■
