

Legislative Council Panel on Commerce and Industry
The Applied Research Fund

INTRODUCTION

This information paper provides an update on the financial position of the Applied Research Fund (ARF) for the period of 1 March 2002 to 31 May 2002.

BACKGROUND

2. The ARF is a government owned venture capital fund of \$750 million set up in 1993 to provide funding support to technology ventures and research and development projects that have commercial potential. The longer term aim is to increase the technology capability and to enhance the competitiveness of local industry, thereby promoting high value added economic development in Hong Kong. The ARF is controlled and administered by the Applied Research Council (ARC), a company wholly owned by the Government and formed specifically for this role.

3. As we started to engage private sector venture capital firms to be the ARF's fund managers in November 1998, the investments of the ARC fall into two categories: those which were processed by the then Industry Department (ID) and funded before the appointment of private sector fund managers, and those which were identified by fund managers and funded after the appointment of fund managers.

4. We briefed Members on the application and management of the ARF at the Panel meeting on 11 December 2000¹, and undertook to provide quarterly written reports on the progress of the ARF. The first and second quarterly reports were sent to Members in April and July 2001 respectively². Another report on the updated progress since July 2001 and on the latest investment strategy of the ARF was sent to Members for the meeting on 4 February 2002³. A further report on the position as at end February 2002 was sent for Members' discussion at the meeting on 11 March 2002⁴. This paper provides another update since March 2002.

¹ Ref : LC Paper No. CB(1)276/00-01(02)

² Ref : LC Paper Nos. CB(1)989/00-01 and CB(1)1834/00-01 respectively

³ Ref : LC Paper No. CB(1)939/01-02

⁴ Ref : LC Paper No. CB(1)1232/01-02(04)

LATEST DEVELOPMENT

I. Projects processed by the then ID

5. The ARC has approved 27 projects in this category with a total amount of \$97 million, 25 of which have been completed and two are in progress. We reported in the update of March 2002 that of the two projects in progress, it was too early to assess the performance of one while another one was indicating problems. Among the completed projects, 17 were considered problematic one way or the other. The situation has remained the same as at end May 2002.

6. Of the total 18 problematic cases as mentioned in paragraph 5, we have provided support in the form of equity injection for four cases and in the form of loans for the other 14 cases.

Equity Cases

7. For the four equity cases, we reported in the update of March 2002 that we had reached agreement with buyers to sell the ARC's shares in three companies at nominal values, and agreed with the other shareholders to wind up the fourth company which had ceased operation. This means a loss of a total of some \$19 million or 20% of the total approved amount.

Loan Cases

8. Regarding the 14 loan cases, we reported in the update of March 2002 that our outstanding loans in two cases had been written off as the companies/guarantors concerned were not expected to be financially capable of repaying the loans, while a smaller sum had been settled for our loan in another case so as to facilitate the sale of the company in question to prospective buyers. As a result, we have written off a total of some \$5.84 million (excluding interest) or 6% of the total approved amount.

9. Since March 2002, we have further decided not to convert our loan into equity for another case and the company in question will be required to repay the loan in accordance with the agreed repayment schedule. We have also accepted another company's proposed revised repayment arrangement, on condition that the company pays interest at the commercial rate. Meanwhile, the company in a third case has

been repaying the loan in accordance with the original repayment schedule after our rejection of its proposed settlement offer.

10. Among the four cases for which we have taken legal actions and obtained favourable court rulings as reported in the update of March 2002, we have settled with the guarantor concerned on the repayment arrangement for one case and the guarantor has been effecting repayments accordingly. For the other three cases, we are continuing with the appropriate course of enforcement actions and negotiation on settlement offers.

11. As regards the remaining four cases, we are taking legal actions or considering settlement offers as appropriate.

II. Projects funded through fund managers

12. Since the update of March 2002, the ARC has approved one new investment of \$15.6 million in the information technology sector. As of end May 2002, the ARF has supported a total of 20 projects with approved funding of \$337 million. Of the two investee companies which were reported to be in severe financial difficulties in the update of March 2002, one is in the process of liquidation while the other is still confronted with financing problems. Details of the 16 active investments⁵ are at **Annex A**. The sectoral distribution of these funded projects is at **Annex B**.

13. The latest valuation as at 31 March 2002 of all the investments managed by our fund managers stood at 63% of the total investments at cost⁶. The main reason for the below cost valuation remains to be that our fund managers have continued to be prudent in the valuation in view of the financial difficulties confronting some investee companies and the general unfavourable investment climate for technology businesses.

⁵ We reported in the paper of December 2000 (Ref: LC Paper No. CB(1)276/00-01(02)) that two investments had been written off, and in the update of January 2002 (Ref: LC Paper No. CB(1)939/01-02) that another investee company had been wound up. A further company is in the process of liquidation as covered in paragraph 12 of this paper. This means a loss of a total of \$59.4 million or 18% of the approved funding. Meanwhile, a new investment has been made as mentioned in paragraph 12. Hence, a total of 16 investments are active.

⁶ The valuations of investee companies are provided by fund managers on the basis of the evaluation of individual investee company in its latest round of financing or as evaluated by the fund managers. If there is no additional round of financing after ARF's investment, our equity will be valued at our investment cost.

ADVICE SOUGHT

14. Members are invited to note this paper.

**Commerce and Industry Bureau
June 2002**

Annex A

**List of Active Investments Approved by the Applied Research Council
after the Engagement of Fund Managers in November 1998
(Position as in May 2002)**

Information Technology

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|---|---------------------------------------|--|---------------------------------|
| QuotePower Information Ltd | AsiaTech Ventures Ltd | Provision of online financial information and real-time electronic trading | 8.00 |
| InfoTalk Corporation Ltd | Walden Technology Management (HK) Ltd | Automatic speech recognition | 24.07 |
| ecVision Ltd | Walden Technology Management (HK) Ltd | Business-to-business e-commerce software and services | 27.24 |
| LECCO Technology Ltd | Walden Technology Management (HK) Ltd | Software tools | 24.59 |
| Wisers Information Ltd | Walden Technology Management (HK) Ltd | Electronic aggregation and distribution of Chinese language-based content | 20.26 |
| iASPEC Technologies Inc (formerly Uni-tech Systems Engineering Ltd) | AsiaTech Ventures Ltd | System integration, application hosting services | 15.55 |

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|--------------------------|---------------------------------------|---|---------------------------------|
| WebPro Ltd | Walden Technology Management (HK) Ltd | Internet and e-commerce technologies for the Asian electronics components industry (internet & e-commerce) | 15.60 |
| i-Security Solutions Ltd | Walden Technology Management (HK) Ltd | To develop and market encryption and authentication tools to facilitate e-commerce functions | 10.82 |
| Spike Ltd | Softech Investment Management Co Ltd | To provide web-related services and solutions | 0.68 |
| Weniwen Technologies Inc | Softech Investment Management Co Ltd | To develop speech recognition and natural language processing technologies and provide solutions for interaction-intensive applications | 15.60 |
| Total | | | 162.41 |

Telecommunications

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|---|---|-------------------------------------|---------------------------------|
| Wafer Systems Holdings Ltd | HSBC Private Equity Technology (Asia) Ltd | Data networking | 46.50 |
| Unitech Networks Ltd | Walden Technology Management (HK) Ltd | Internet/Intranet system integrator | 11.63 |
| Continuous Technologies International Ltd | AsiaTech Ventures Ltd | Computer telephony applications | 18.14 |
| Entone Technologies Inc | Softech Investment Management Co. Ltd | Broadband Video Streaming | 15.60 |
| CommVerge Solutions Ltd | Walden Technology Management (HK) Ltd | Total solution services | 7.80 |
| Total | | | 99.67 |

Electronics

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|-------------------------|-----------------------|---|---------------------------------|
| NSM Holdings Ltd | AsiaTech Ventures Ltd | Original design manufacturer of telecom equipment | 15.58 |
| Total | | | 15.58 |

**Sectoral Distribution of Active Projects
Approved by the Applied Research Council
after the Engagement of Fund Managers
(Position as in May 2002)**

