

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 December 2002 to 28 February 2003.

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. This paper provides another update since the one submitted in December 2002 and is the eighth quarterly report since then². Earlier on in February 2003, the Administration also briefed Members on the review of the role and future of the ARF.³

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

² Previous papers of the same series are LC Paper Nos. CB(1)989/00-01, CB(1)1834/00-01, CB(1)939/01-02, CB(1)1232/01-02(04), CB(1)2185/01-02, CB(1)24/02-03 and CB(1)582/02-03.

³ Panel paper CB(1)844/02-03(04) discussed by the Panel on 10 February 2003 refers.

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. We have reported in the last update that among these 27 projects, we have exited from 14 projects in the forms of loans fully repaid (7 cases), loans written off (3 cases), equities selling at nominal value (3 cases) and company dissolved (1 case). As a result, we have written off a total of some \$24.4 million or 25% of the total approved amount.

6. Among the remaining 13 projects, we have provided support in the form of equity injection for two cases and in the form of loans for the other 11 cases. Details on the progress of these 13 cases are reported in paragraphs 7 to 10 below.

Equity Cases

7. During this reporting period, we are still holding shares in two companies.

Loan Cases

8. During this reporting period, the loans in the case of four projects had to be written off due to the inability of the companies / guarantors to repay the loans despite we had obtained favourable court judgement and initiated bankruptcy proceedings against the guarantors. As a result, we have written off a total of some \$5.3 million or 5% of the total approved amount.

9. Among the remaining seven loan cases, approval was given to one company for deferment of loan repayment by six months. The companies of another two cases have indicated difficulties in repaying the loan in accordance with their repayment schedules. We have been discussing with them on how to resolve the matters.

10. We have taken legal actions for the remaining four cases and among which, we obtained favourable court rulings in three cases. Among these three cases, the guarantor concerned for one case has been making repayments according to the agreed repayment arrangement. For the other two cases, we were continuing with the appropriate course of enforcement actions and negotiation on settlement offers. The legal proceedings of the remaining case were still on-going.

II. Projects funded through fund managers

11. Since the last update, the ARC has approved one new investment totalling \$17.94 million in the electronics sector. As of end February 2003, the ARF has supported a total of 22 projects through fund managers with approved funding of \$363 million. Details of the 17 active investments⁴ are at **Annex A**. The sectoral distribution of these funded projects is at **Annex B**.

12. The latest valuation as at 31 December 2002 of all the investments managed by our fund managers⁵ stood at 61% 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.

ADVICE SOUGHT

13. Members are invited to note this paper.

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⁴ 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, in the update of January 2002 (Ref: LC Paper No. CB(1)939/01-02) that one investee company had been wound up, in the update of June 2002 (Ref: LC Paper No. CB(1)2185/01-02) that one investee company is in the process of liquidation, and in the update of October 2002 (Ref: LC Paper No. CB(1)24/02-03) that another investee company is in the process of liquidation. This means a loss of a total of \$60 million or 16.5% of the approved funding. Hence, a total of 17 investments are active.

⁵ We reported in the update of October 2002 (Ref: LC Paper No. CB(1)24/02-03) that the investments previously managed by AsiaTech Ventures Limited have been managed by the ARC directly since 3 May 2002.

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.

**List of Active Investments Approved by the Applied Research Council
after the Engagement of Fund Managers in November 1998
(Position as at end February 2003)**

Information Technology

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|--|--|--|---------------------------------|
| 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 | 24.55 |
| InfoTalk Corporation Ltd. | Walden Technology Management (HK) Ltd. | Automatic speech recognition | 24.15 |
| WebPro Ltd. | Walden Technology Management (HK) Ltd. | Internet and e-commerce technologies for the Asian electronics components industry (internet & e-commerce) | 15.60 |
| iASPEC Technologies Inc. (formerly Uni-tech Systems Engineering Ltd.)* | – | System integration, application hosting services | 15.55 |

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|------------------------------|--|---|---------------------------------|
| i-Security Solutions Ltd. | Walden Technology Management (HK) Ltd. | To develop and market encryption and authentication tools to facilitate e-commerce functions | 10.82 |
| QuotePower Information Ltd.* | – | Provision of online financial information and real-time electronic trading | 8.00 |
| Emsoft Limited | Softech Investment Management Co. Ltd. | To develop software applications and operating systems for embedded devices based on the Linux platform | 7.80 |
| Total | | | 158.30 |

Biotechnology

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|--------------------------------|--|---|---------------------------------|
| Plasmagene Biosciences Limited | Softech Investment Management Co. Ltd. | To research and develop non-invasive techniques for detection of prenatal and cancerous diseases based on proprietary and licensed technologies | 11.70 |
| Total | | | 11.70 |

Telecommunications

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|---|--|-------------------------------------|---------------------------------|
| Wafer Systems Limited | HSBC Private Equity Technology (Asia) Ltd. | Network integration | 46.70 |
| Continuous Technologies International Ltd.* | – | Computer telephony applications | 18.14 |
| Entone Technologies Inc. | Softech Investment Management Co. Ltd. | Broadband video streaming | 15.60 |
| Unitech Networks Ltd. | Walden Technology Management (HK) Ltd. | Internet/Intranet system integrator | 11.63 |
| CommVerge Solutions Ltd. | Walden Technology Management (HK) Ltd. | Telecom system integration | 7.80 |
| Total | | | 99.87 |

Electronics

| Investee Company | Fund Manager | Technology Area | Funding Approved (HK\$m) |
|-------------------------|--|---|---------------------------------|
| NSM Holdings Ltd.* | – | Original design manufacturer of telecom equipment | 15.58 |
| Dragonchip Limited | Softech Investment Management Co. Ltd. | To design IC chips with embedded Flash memory for consumer electronics applications | 17.94 |
| Total | | | 33.52 |

* Investments under the custody of the ARC

**Sectoral Distribution of Active Projects
Approved by the Applied Research Council
after the Engagement of Fund Managers
(Position as at end February 2003)**

