

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 2007 to 29 February 2008.

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 the 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. With ARC engaging private sector venture capital firms as the ARF's fund managers since 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. The Administration 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 the twenty-eighth quarterly report². In February 2003, the

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, CB(1)582/02-03, CB(1)1415/02-03, CB(1)2008/02-03, CB(1)2522/02-03(01), CB(1)616/03-04(01), CB(1)1381/03-04(01), CB(1)2431/03-04(01), CB(1)2521/03-04(01), CB(1)598/04-05(01), CB(1)1128/04-05(01), CB(1)1991/04-05(01), CB(1)2303/04-05(01), CB(1)537/05-06(01), CB(1)1086/05-06(01), CB(1)1864/05-06(01), CB(1)2281/05-06(01), CB(1)607/06-07(01), CB(1)1278/06-07(01), CB(1)2024/06-07(01), CB(1)2419/06-07(01) and CB(1)478/07-08(01)

Administration also briefed Members on the review of the role and future of the ARF.³

5. In April 2004, the Administration reported to the Panel the then latest situation of the ARF in the context of overall development framework for innovation and technology in future⁴. The Administration further briefed the Legislative Council in the context of a public hearing held by the Legislative Council Public Accounts Committee on 10 May 2004 regarding the funding of projects under the ARF as contained in chapter 2 of Report No. 42 of the Director of Audit tabled at the Legislative Council on 21 April 2004. On 23 June 2004, the Legislative Council Public Accounts Committee released its own report on the funding of projects under the ARF. In response, the Chief Secretary for Administration tabled the Government Minute on 20 October 2004.

6. On 18 January 2005, the Administration briefed Members on the review result of the ARF⁵. The Panel generally agreed to the winding down of the ARF as proposed.

LATEST DEVELOPMENT

I. Projects processed by the then ID

7. The ARC has approved 27 projects in this category with a total amount of \$97 million. As reported in the last update, among these 27 projects, ARC has exited from 22 projects in the form of loans fully repaid (9 cases), loans written off (8 cases), equities sold at net asset value (1 case), equities sold at nominal value (3 cases) and company dissolved (1 case). As a result, ARC has written off a total of some \$33.2 million or 34.2% of the total approved amount.

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

⁴ Paper ref. : CB(1)1470/03-04(05) titled "Strategic Framework for Innovation and Technology Development" discussed by the Panel on 13 April 2004 refers.

⁵ Paper ref. : CB(1)690/04-05(04) titled "New Strategic Framework for Innovation and Technology Development and Review of the Applied Research Fund" discussed by the Panel on 18 January 2005 refers.

8. Among the remaining five projects, ARC has provided support in the form of equity injection for one case and in the form of loans for the other four cases. During this reporting period, for the former case ARC is still holding shares in the concerned company. As regards the four loan cases, the companies/guarantors of three cases were repaying the loan, and legal proceedings were being taken for the remaining one case.

II. Projects funded through fund managers

9. Since the last update, the ARC has not made any new or follow-on investment (with the expiry of investment period for new investment and follow-on investment in end March 2005 and end March 2006 respectively). During the reporting period, the ARC has sold the Convertible Bonds of one company. As at end February 2008, there were a total of 24 projects supported by the ARF through fund managers with approved funding of \$392 million. ----- Details of the 8 active investments⁶ and their sectoral distribution are at **Annex**.

10. The latest valuation as at 31 December 2007 of all the 24 investments made by the fund managers was 45% of the corresponding total investment costs. The main reasons for the below-cost valuation remain to be that our fund managers are still prudent in the valuation in view of the financial difficulties confronting some investee companies and that the investment climate for technology businesses in Hong Kong remains generally sluggish

⁶ 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 was in the process of liquidation, in the update of October 2002 (Ref: LC Paper No. CB(1)24/02-03) that one investee company was in the process of liquidation, in the update of June 2003 (Ref: LC Paper No. CB(1)2008/02-03) that the shares in an investee company had been sold at nominal value, in the update of July 2004 (Ref: LC Paper No. CB(1)2431/03-04(01)) that the shares in an investee company had been sold to a NASDAQ-listed company, in the update of March 2005 (Ref: LC Paper No. CB(1)1128/04-05(01)) that the shares in another company had been sold, in the update of December 2005 (Ref: LC Paper No. CB(1)537/05-06(01)) that we had redeemed and sold the shares in another two companies, in the update of June 2006 (Ref: LC Paper No. CB(1)1864/05-06(01)) that another investee company had been wound up, in the update of March 2007 (Ref: LC Paper No. CB(1)1278/06-07(01)) that the shares in another investee company had been sold, and in the update of June 2007 (Ref: LC Paper No. CB(1)2024/06-07(01)) that the shares in another investee company had been sold, in the update of September 2007, (Ref: LC Paper No. CB(1) 2419/06-07(01)) that the shares in another investee company had been sold, in the update of November 2007, the shares of another investee company had been sold. The Convertible Bonds of one investee company had been sold as covered in paragraph 9 of this paper. In the ARC meeting held on 1 February 2008, the Council agreed not to further pursue the investment of one investee company since no progress had been made before 7 December 2007. This means a loss of a total of \$164.4 million or 41.9% of the approved funding. Hence, a total of 8 investments are still active.

even though there has been a revival of investments in the technology sector in the US and Mainland China in these two years.

CONCLUSION

11. Members are invited to note this paper.

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**List of Active Investments Approved by the Applied Research Council
after the Engagement of Fund Managers in November 1998
(Position as at end February 2008)**

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
Wisers Information Ltd.	Walden Technology Management (HK) Ltd.	Electronic aggregation and distribution of Chinese language-based content	33.84
iASPEC Technologies Inc. (formerly Uni-tech Systems Engineering Ltd.)	Softech Investment Management Co. Ltd.	System integration, application hosting services	15.55
Emsoft Limited	Softech Investment Management Co. Ltd.	To develop software applications and operating systems for embedded devices based on the Linux platform	7.80
Menfond Electronic Art & Computer Design Co. Ltd.	Softech Investment Management Co. Ltd.	Provision of digital effects and 3D computer animation	8.00

Total **92.43**

Electronics

Investee Company	Fund Manager	Technology Area	Funding Approved (HK\$m)
Dragonchip Limited	Softech Investment Management Co. Ltd.	To design IC chips with embedded Flash memory for consumer electronics applications	17.94
Total			17.94

Telecommunications

Investee Company	Fund Manager	Technology Area	Funding Approved (HK\$m)
Continuous Technologies International Ltd.	Softech Investment Management Co. Ltd.	Computer telephony applications	18.14
CommVerge Solutions Ltd.	Walden Technology Management (HK) Ltd.	Telecom system integration	7.80
Total			25.94

Sectoral Distribution

