

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 June 2002 to 31 August 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. This paper provides another update since the one submitted in June 2002 and is the sixth quarterly report since then².

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), and CB(1)2185/01-02.

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 have yet to be completed. We reported in the last update that of the two yet-to-be-completed projects, it was too early to assess the performance of one. Another one was indicating problems. We have initiated legal action in this case during the reporting period. Among the completed projects, 17 were reported to be problematic one way or the other in the last update. The situation has remained more or less the same as at end August 2002. For the remaining eight completed projects, loans disbursed to seven cases have been repaid whereas ARC still owns equity in one case. The former seven cases are closed cases.

6. In sum, there are a total of 18 problematic cases, (as mentioned in paragraph 5 above) out of the 27 projects. Among the 18 problematic cases, we have provided support in the form of equity injection for four cases and in the form of loans for the other 14 cases. We have completed actions in seven cases among these 18 problematic cases. Discounting these seven closed cases, the number of outstanding cases as at end August 2002 is 11 (please refer to paragraphs 9 to 11 below). All the 11 outstanding cases are loan cases.

Equity Cases

7. There is no outstanding equity case. We reported in the last update that we had sold the ARC's shares in three companies at nominal values, and wound up the fourth company. This means a loss of a total of some \$19 million or 20% of the total approved amount. These four cases are among the seven closed cases mentioned in paragraph 6 above.

Loan Cases

8. We reported in the last update 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. These three cases are among the seven cases mentioned in paragraph 6 above.

9. Among the 11 outstanding cases, the companies of two cases have been repaying the loan in accordance with their repayment schedules. We received another company's request for deferment of loan repayment by six months. The ARC is considering whether to accede to the request.

10. Among the four cases for which we have taken legal actions and obtained favourable court rulings, the guarantor concerned for one case has been effecting repayments according to the agreed repayment arrangement. 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 still taking legal actions or considering settlement offers as appropriate.

II. Projects funded through fund managers

12. Since the last update, the ARC has approved one follow-on investment of \$0.2 million in the telecommunications sector. However, one investment approved by the ARC back in March 2002 has been withdrawn. As of end August 2002, the ARF has supported a total of 19 projects through fund managers with approved funding of \$326 million. Due to financial difficulties, one investee company is in the process of liquidation. Details of the 14 active investments³ are at **Annex A**. The sectoral distribution of these funded projects is at **Annex B**.

³ 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, and in the last update (Ref: LC Paper No. CB(1)2185/01-02) that another investee company is in the process of liquidation. 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 \$60 million or 18.4% of the approved funding. Hence, a total of 14 investments are active.

13. The latest valuation as at 30 June 2002 of all the investments managed by our fund managers⁴ stood at 62% of the total investments at cost⁵. 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.

ASIATECH VENTURES LIMITED

14. On 19 August 2002, the ARC and one of its fund managers⁶, AsiaTech Ventures Limited (AsiaTech), announced that the latter had ceased to manage the ARF on behalf of the ARC. Following the cessation, the ARC has taken over the management of investments previously handled by AsiaTech.

ADVICE SOUGHT

15. Members are invited to note this paper.

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⁴ The investments previously managed by AsiaTech Ventures Limited have been managed by the ARC directly since 3 May 2002 (please refer to paragraph 14).

⁵ 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.

⁶ The other fund managers are HSBC Private Equity Technology (Asia) Ltd., Softech Investment Management Company Ltd. and Walden Technology Management (HK) Ltd..

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

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
Total			150.50

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
Total			15.58

* 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 August 2002)**

