

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 2003 to 29 February 2004.

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 2003 and is the twelfth quarterly report since then². 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, CB(1)582/02-03, CB(1)1415/02-03, CB(1)2008/02-03, CB(1)2522/02-03(01) and CB(1)616/03-04(01).

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 21 projects in the form of loans fully repaid (8 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, we have written off a total of some \$30.75 million or 31.7% of the total approved amount.

6. Among the remaining six projects, we have provided support in the form of equity injection for one case and in the form of loans for the other five cases. Details on the progress of these six cases are reported in paragraphs 7 to 9 below.

Equity Cases

7. During this reporting period, we are still holding shares in one company.

Loan Cases

8. Among the five loan cases, the companies of three cases were repaying the loan.

9. We have taken legal actions for the remaining two cases and among which, we obtained favourable court ruling in one case. 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

10. Since the last update, the ARC did not make any new or follow-on investment. As of end February 2004, the ARF has supported a total of 23 projects through fund managers with approved funding of \$378 million. Details of the 17

active investments⁴ are at **Annex A**. The sectoral distribution of these funded projects is at **Annex B**.

11. The latest valuation as at 31 December 2003 of all the investments made by our fund managers stood at 44% of the corresponding total investments at cost. 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. Putting ARF's investments in a global and industry context, we notice that the financial return of the ARF is not immune to the rather soft technology investment market worldwide. For instance, industry statistics of the U.S. have also shown that the three-year result of venture capital funds in the U.S. formed in 1999 (roughly the time when ARF started to be operated by venture capitalists) also incurred some 38% "capital loss" in valuation terms.

ADVICE SOUGHT

12. 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 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, and in the update of June 2003 (Ref: LC Paper No. CB(1)2008/02-03) that the shares in another investee company were sold at nominal value. This means a loss of a total of \$75.39 million or 19.9% of the approved funding. Hence, a total of 17 investments are active.

**List of Active Investments Approved by the Applied Research Council
after the Engagement of Fund Managers in November 1998
(Position as at end February 2004)**

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	33.84
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			167.59

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
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
iMagic Infomedia Technology Limited	Softech Investment Management Co. Ltd.	Development of computerized public payphones and kiosks	5.00
Total			89.27

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 2004)**

