

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 2004 to 31 May 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 ARC 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. 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 another update since the one submitted in March 2004 and is the thirteenth quarterly report since then². In February 2003, the Administration also briefed Members on the review of the role and future of the ARF.³ In April 2004, the Administration reported to the Panel the then latest situation of the ARF in the context of overall

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) and CB(1)1381/03-04(01).

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

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.

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, ARC has 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, ARC has written off a total of some \$30.75 million or 31.7% of the total approved amount.

6. Among the remaining six projects, ARC has 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, ARC is still holding shares in one company.

Loan Cases

8. Among the five loan cases, one loan case has been fully repaid during this reporting period. ARC also reached a settlement agreement with the guarantors of a loan case. During the reporting period, ARC wrote off an additional \$2.44 million or 2.5% of the total approved amount. Together with this case, companies/guarantors of three cases were repaying the loan.

9. The ARC has taken legal actions for the remaining one case. The legal proceedings were still on-going.

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.

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 May 2004, the ARF has supported a total of 23 projects through fund managers with approved funding of \$378 million. During this reporting period, ARC has sold the shares in one investee company to a NASDAQ-listed company. Details of the 16 active investments⁵ are at **Annex A**. The sectoral distribution of these funded projects is at **Annex B**.

11. The latest valuation as at 31 March 2004 of all the 23 investments made by our fund managers stood at 48% 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.

12. The Administration is reviewing the future role of the ARF in the overall framework of innovation and technology development and aims at briefing the Panel on the outcome of the review before the end of the year.

ADVICE SOUGHT

13. Members are invited to note this paper.

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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, 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. We have sold the shares in another company as covered in paragraph 10 of this paper. This means a loss of a total of \$98 million or 25.9% of the approved funding. Hence, a total of 16 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 May 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
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
i-Security Solutions Ltd.	Walden Technology Management (HK) Ltd.	To develop and market encryption and authentication tools to facilitate e-commerce functions	10.82

Investee Company	Fund Manager	Technology Area	Funding Approved (HK\$m)
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 143.00

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 May 2004)**

