Innovation and Technology Venture Fund

Frequently Asked Questions

Background

1. What is the Innovation and Technology Venture Fund?

The Government has set up a HK$2 billion Innovation and Technology Venture Fund ("ITVF"). The main purpose of the ITVF is to encourage more private venture capital ("VC") funds to invest in local innovation and technology ("I&T") start-ups so as to create a more vibrant I&T ecosystem in Hong Kong. The ITVF, through a special-purpose vehicle "The Innovation and Technology Venture Fund Corporation" ("ITVFC"), will co-invest with VC funds selected as Co-investment Partners ("CP") in Eligible Local I&T Start-ups at a matching investment ratio of approximately 1:2.

Co-investment Arrangement

2. How would CPs co-invest with the ITVFC?

Upon selection, each CP will enter into a contractual relationship with the ITVFC by signing a MA, which stipulates the rights and obligations of both parties for co-investment. Under the MA, the CP has the obligation to invite the ITVFC to co-invest in local I&T start-ups within a five-year window ("Active Investment Period"). Throughout the Active Investment Period, the CP is responsible for identifying and recommending potential investee companies ("IC") which qualify as Eligible Local I&T Start-ups to the ITVFC for co-investment.

3. What are the eligibility criteria for a local I&T start-up to qualify as an Eligible Local I&T Start-up?

An "Eligible Local I&T Start-up" should meet the following criteria -

(a) it or its wholly-owned HK company was incorporated under the Companies Ordinance within the last seven years and with one of its offices (headquarter or regional office) or its main business operation or its key management or leadership team being located in Hong Kong;

(b) it or any of its subsidiar(ies) (if any) engages in I&T business, covering any part of the research and development or production chain in Hong Kong; and

(c) it and all of its subsidiar(ies) (if any) have a total number of employees (including Hong Kong and overseas offices) being less than 250.

4. Is there any restriction on the company structure of an Eligible Local I&T Start-up?

An Eligible Local I&T Start-up should either be a company incorporated in Hong Kong or an offshore company with only one direct wholly-owned subsidiary incorporated in Hong Kong (wholly-owned HK company). If there is any other company structure, the ITVFC will approve on a case by case basis.

5. What is the investment preference of the ITVFC?

The ITVFC investments are mainly targeted at local I&T start-ups which are raising capital from series A or B round.

6. Will there be any limit on the ITVFC investments with each selected CP?

The aggregate amount of ITVFC co-investments with each CP is capped at HK$400 million.

7. Will there be any limit on the ITVFC investments in each IC?

The ITVFC has set its investment limits for each IC -

(a) the aggregate ITVFC investments in the same IC shall be capped at HK$50 million; and

(b) for each investment in an IC, the ITVFC investment amount shall constitute

(i) not more than 40% of the original total target investment amount sought by the IC, or (ii) HK$30 million, whichever is the lower.

8. Could individual start-ups submit applications or investment proposals to ITVF directly for seeking funding and investment?

ITVF will NOT accept applications or investment proposals submitted by individual start-ups directly. Instead, CPs are responsible for identifying and recommending eligible start-ups to ITVF for co-investment. Start-ups may contact the CPs direct to explore investment opportunities. The list of the CPs is available on our website (https://www.itf.gov.hk/l-eng/ITVF_Partners.asp).

9. What are the investment and exit terms for the ITVFC?

The ITVFC will co-invest and exit on the same price and terms alongside the CPs.

10. What will happen if upon the expiry of the MA, there are co-investments that have not been sold to a third party?

During the contract period of the MA, a CP should try its best to identify third party buyers to acquire the co-invested shares of the ICs. However, if there are any unsold shares upon the expiry of the MA, the ITVFC may exercise a redemption right to request the ICs to redeem the ITVFC's shares.

Incentives and Expenses

11. What incentives will be provided to CPs?

The ITVFC will provide CPs with two incentives. The first one is a carried interest which is equal to 35% of the realised capital gain upon the sale of ITVFC's shares in the IC to a third party buyer. The second one is an option for the CP to purchase all of ITVFC's shares in all of the co-invested ICs within the "Active Investment Period" ***(Note 3)***.

Note 3:
The "Active Investment Period" refers to the period within five years since the commencement of the MA.

12. How could a CP exercise its option to purchase ITVFC's shares of the co-invested ICs?

During the "Active Investment Period", a CP can exercise its option for a maximum of two times to purchase all of the co-invested shares in all of the ICs in which ITVFC has been invited by the CP to invest. When this option is exercised, the CP has to purchase **<u>all but not some</u>** of the shares of all of the ICs under the co-investment portfolio. The purchase price is the ITVFC investment cost plus interest accrued ***(Note 4)***.

Note 4:
The interest rates to be applied for determining the accrued interest are the rates of fee payable by the Exchange Fund to Government funds and statutory bodies for placements which are published by the Hong Kong Monetary Authority for the relevant respective years.

13. How to calculate the 35% of the realised capital gain to be provided to a CP when the co-investment is sold to a third party?

Upon the sale of all of the ITVFC's shares in an IC to a third party buyer, the ITVFC would pay to the CP 35% of the realised capital gain arising from the sale. The realised capital gain would be the net amount of the cash proceeds from disposal minus the ITVFC investment cost and the interest accrued (***Note 4***).

14. Will the ITVFC pay CPs any management fees?

The ITVFC will not pay any management fees to CPs.

15. What types of costs and expenses arising from co-investment will be shared by the ITVFC?

The ITVFC will bear all taxes, stamp duties, capital duties and registration fees chargeable by the Inland Revenue Department on the ITVFC arising from the acquisition or sale of the ITVFC investments. All other costs and expenses incurred by CPs in performing the MA such as but without limiting to due diligence expenses and all legal costs incurred for the investments would have to be borne fully by CPs.

Termination of the Master Agreement by the ITVFC

16. Under what circumstances will ITVFC terminate the MA before expiry?

The ITVFC has the right to terminate the MA under the following circumstances:

(a) a CP has committed a gross default, including but are not limited to fraud, wilful misconduct, gross negligence, violation of criminal law or breach of the MA.

(b) a CP has failed to make any co-investment within the first 2 years since the commencement of the MA, whereas the ITVFC reserves the right to terminate the MA with the CP or at its discretion provide a further grace period for the first co-investment to be completed.

(c) Any other termination events as specified in the MA (e.g. early termination of a Partner Fund co-investing with the ITVFC).