

Risk Factors

In the risks discussed below, we highlight the factors that could have an adverse material effect on the Group's revenues, cash flows, market competitiveness and operations in Hong Kong and mainland China.

For further details on how the Group manages its risks, please refer to the "Risk Management and Internal Control" section of our Corporate Governance Report on pages 80 to 82.

Business Environment

In 2019, the global economy went through a synchronised slowdown. The International Monetary Fund further downgraded its expectations for world economic growth by 0.3 per cent to 2.9 per cent for the year, the slowest pace since the global financial crisis of 2008. China-US trade disputes continued to hammer economic growth and heightened risk in the business environment. Key risks to economic growth include the build-up of trade and geopolitical tensions among major economies, greater uncertainty about the direction in which monetary policy adjustments in the developed economies are headed, and high and rising levels of debt in both developed and developing countries. Any of these factors could continue to affect recent improvements in the global economy.

In Hong Kong, the persistence of social unrest during the fourth quarter of the year took a heavy toll on economic sentiment as well as consumption and tourism related activities. Hong Kong's GDP contracted by 2.9 per cent in Q4 2019 from a year earlier, following the decrease of 2.8 per cent in Q3 2019, marking two consecutive quarters of year-on-year contraction. As a result, annual GDP decreased by 1.2 per cent, the first decline in a decade.

In 2019, the number of visitors dropped by 14.2 per cent compared with the increase of 11.4 per cent in 2018, with arrival figures dropping to 56 million from 65 million the year before. The number of overnight visitors tumbled by 18.8 per cent to 24 million. The average hotel occupancy rate fell to 79 per cent in 2019, down from 91 per cent in 2018. Total retail sales value decreased by 11.1 per cent compared with an increase of 8.7 per cent in 2018. For Q4 2019, the volume of retail sales fell by 24.1 per cent compared with the same quarter last year, representing the largest quarterly decline on record.

The unemployment rate increased to 3.1 per cent in Q4 2019, against 2.7 per cent in Q4 2018. Despite the negative impact of the US tariff increase on the Chinese economy as a result of the trade disputes, China's GDP grew in line with market expectations at 6.1 per cent in 2019, which marked the lowest annual growth rate in 29 years.

Business challenges faced by the Group include competition from the providers of electricity in Hong Kong and direct sales by upstream gas companies, as well as suppliers of liquefied natural gas (LNG) and alternative energy sources in mainland China. Other threats to our business include drops in oil prices and changes in government policy (political, legal, regulatory, environmental or competition-related) that could also affect our operations.

Our strategy for dealing with business risks continues to be critical for the sustainable growth and success of the Group. In line with this strategy, we remain

prudent in our capital investments and seek ways to improve the productivity and cost effectiveness of all our operations. Credit monitoring is also reinforced to minimise the risk of a customer default.

In response to incidents associated with the social disturbances in Hong Kong, a management taskforce was set up to monitor events and followed up with immediate action.

We also put in place mitigating measures to enhance the safety and security controls on our premises and gas facilities while continuing to review the potential impact of incidents on our workforce. Furthermore, we are constantly exploring new gas applications and new business opportunities to achieve business diversification in both Hong Kong and mainland China, while maintaining close communication with our operational partners and governments whose support is essential for our business growth.

Reliability of Gas Supply

We secure multiple sources of feedstock for the production of town gas in our Hong Kong operations. These include natural gas transmitted from our LNG receiving terminal at Shenzhen to our gas production plant at Tai Po, naphtha imported from places such as Southeast Asia and Australia, and treated landfill gas obtained from our landfill project sites in Hong Kong.

A major risk of interruption to our feedstock supply for natural gas includes the possibility of inclement weather delaying LNG tankers. We have addressed this risk under our

diversified production strategy, in which we have given our Tai Po plant the capability of switching between natural gas and naphtha for feedstock.

In mainland China, to facilitate more efficient gas inventory management and reduce supply bottlenecks during high demand periods, we have built LNG storage facilities as well as a natural gas storage facility at our underground salt caverns in Jiangsu province. New energy sources have also become available, including natural gas from Russia which started to supply northern and northeastern China in late 2019.

To ensure reliable gas transmission, we have a sophisticated Supervisory Control and Data Acquisition (SCADA) system to monitor and control our pressure-regulating stations and network. We also have a comprehensive staff training programme, asset management systems, and contingency plans with regular practice drills, in preparation for unforeseen events that might affect our customers and the public.

Production and Network Safety

Preventing gas leakages or explosions in our production and storage facilities, pipelines and networks is a top priority for Towngas. Risks include the possibility of damage to critical facilities or related infrastructure from a third party, a security threat or extreme weather events such as typhoons, flooding or landslides. These and other factors affecting the safety of our infrastructure or causing an interruption to service would have a significant legal, financial and/or reputational impact on the Group.

Towngas conducts regular reviews of all operating procedures to mitigate these risks and implements targeted strategies for addressing them. Our Total Quality Management system, for example, covers all critical production, storage, transmission and distribution facilities. We also manage our assets according to international standards and external certifications, and maintain insurance coverage against any property damage or financial loss.

Information Security

Our business operations are dependent on information technology systems that are vulnerable to a critical system failure, leakage or loss of sensitive information, all of which would adversely affect the Group's business. Accordingly, we have put in place protective measures to manage data loss and monitor suspicious cyber activities. We also commission third parties to assess our security standards and identify areas for enhancement. Other security measures include contingency plans with regular drills to counter system failures as well as staff awareness programmes on cybersecurity and sensitive information handling to fully safeguard our operations against growing information security threats. Furthermore, the development of new regulatory requirements in mainland China relating to information security is also under close scrutiny for proper compliance.

Ethics and Integrity

Maintaining strong corporate governance standards and operating ethically are among management's top concerns. Poor ethical behaviour by employees

could damage our corporate reputation as well as adversely affect our long-established business relationships with stakeholders, including our customers and suppliers, which may have potential financial implications. In order to provide an ethical workplace with integrity, we have policies on the standards of behaviour we expect of our employees and provide them with regular training in these policies. We have also established formal channels for reporting suspected cases of fraud and encourage our business partners to follow the same ethical principles that we promote in our Anti-Fraud Policy.

Health and Safety

We recognise the importance of maintaining high levels of occupational health and safety in all our operations. Serious accidents or the outbreak of a communicable disease, among other risks, could cause injury, loss of life and operational disruption that would result in huge recovery costs, litigation or reputational damage.

To mitigate and contain the risks directly or indirectly under our control, we encourage staff at all levels to monitor and report any hazards or potential threats. We also have comprehensive safety guidelines and measures that ensure our safety performance conforms to the highest industry standards. Our safety management system, certified for compliance with international standards, is reviewed and updated regularly. We also emphasise the importance of maintaining a comprehensive and effective safety culture by providing staff and contractors with systematic professional, technical and safety-related training.