

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 order to contain the rapid spread of COVID-19 in 2020, widespread global lockdowns were imposed. In many countries, businesses ranging from factories to restaurants closed, which dealt a heavy blow to the economy. Nearly all types of businesses were seriously affected, but the retail, travel and catering sectors were particularly hard hit.

COVID-19 triggered the deepest global economic recession in decades. While the ultimate outcome of the recession is still uncertain, the pandemic will result in contractions across the vast majority of emerging markets and developing economies. It will also affect labour productivity and industrial output.

Hong Kong is still suffering after two years of unprecedented economic weakness triggered by social unrest and the global pandemic. Annual GDP showed a record 6.1 per cent contraction in 2020, following the decline of 1.2 per cent in 2019. This was the first time Hong Kong had posted back-to-back annual contractions since 1962.

In 2020, tourism was almost non-existent. The number of visitors dropped by 93.6 per cent from the decrease of 14.2 per cent in 2019 due to social unrest. Arrival figures dropped to 3.6 million from 55.9 million a year before. The average hotel occupancy rate fell to 46 per

cent in 2020, down from 79 per cent in 2019 (in December 2020, the rate was 58 per cent, mainly due to local staycations and visitors under quarantine). The consumer price index averaged just 0.3 per cent, the lowest in the past 15 years (2.9 per cent in 2019). The unemployment rate surged to a 16-year high of 6.6 per cent.

Mainland China experienced a very difficult beginning in 2020 but delivered satisfactory results by the end of 2020, after bringing COVID-19 under control. The country was the only major economy in the world to register growth for the year, with a GDP growth of 2.3 per cent. Despite continuing Sino-US trade tensions, mainland China's total export value increased 3.6 per cent, beating the 0.5 per cent increase in 2019. The Brent crude oil price dropped 35 per cent from an average of US\$64 per barrel in 2019 to US\$42 per barrel in 2020.

Business challenges faced by the Group included a slowdown in gas demand as a result of the global economic downturn, competition from 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 included drops in oil prices and changes in government policy (political, legal, regulatory, environmental or competition related), all of which 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.

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.

In response to the potential impact of COVID-19, a variety of counter measures has been put in place to alleviate the impact on our operations and relieve the operating pressure on our customers, including the granting of a credit period extension. In addition, special measures have been taken to minimise the impact of the pandemic on our workforce, as mentioned later in this section.

Despite the reduction in social unrest in 2020, we continued to put mitigating measures in place to enhance safety and security controls on our premises and gas facilities, while continuing to review and assess our contingency preparedness.

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. A variety of energy sources have also been obtained, including natural gas supplied to northern and northeastern China from Russia as well as through the reinforcement of pipeline network interconnections.

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. Moreover, the development of regulatory requirements for gas reserves applicable to our gas operations in mainland China are being closely monitored.

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.

In 2020, we put additional measures in place to protect our workforce during the outbreak of COVID-19. These included, but were not limited to, the adoption of a variety of special work arrangements to maintain social distancing and the provision of necessary personal protective equipment to our employees.