

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 the Chinese mainland and Hong Kong.

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 92 to 94.

Business Environment

The outbreak of COVID-19 in 2020 has created unprecedented challenges in the global business environment, including lockdowns, global supply chain disruptions, travel bans and restrictions, and at-home work and school arrangements.

Despite the relatively effective measures to contain the virus, including the rapid deployment of vaccines and accommodative fiscal support, the performance of many of the major economies remains uneven and unsteady. While some economies have been able to rein in new cases and, consequently, experience a faster recovery, some are still ramping up their containment measures amid local resurgences of the pandemic. Moreover, the spread of the Delta and Omicron variants coupled with the potential threat of new variants has increased uncertainty about just how quickly the pandemic can be overcome.

At the same time, sustainability will be an important focus for 2021 and is already being positioned as an opportunity for accelerating the business and policy transition to net zero carbon. The push for economic recovery and growth could drive green infrastructure investment, creating a turning point in the fight against climate change.

Hong Kong's estimated GDP grew notably by 6.4 per cent in 2021, reversing the declines in the previous two years. Yet it was still 3.6 per cent below the level in 2018. And the growth pace is subject to various uncertainties, especially those relating to the local epidemic development. The latest wave of

COVID-19 and tightened social distancing measures have created renewed pressure on economic activities and consumer sentiment.

In 2021, the freeze on inbound tourism continued to exert a drag on the Hong Kong economy. Visitor arrivals sank 97.4 per cent compared with 2020, dropping precipitously from 55.9 million in 2019 to 3.6 million in 2020 and down to 0.1 million in 2021. On the other hand, the average hotel occupancy rate rose from 46 per cent in 2020 to 63 per cent in 2021 (December 2021: 72 per cent) as a result of staycation packages and quarantine arrangements. The Government's Consumption Voucher Scheme also helped to support consumption-related activities. Total retail sales volume rose by 6.5 per cent in 2021 compared with the slump of 25.5 per cent in 2020. In addition, the unemployment rate continued to improve, from 4.5 per cent in Q3 2021 to 3.9 per cent in Q4 2021.

China's GDP grew by 8.1 per cent in 2021, beating the target of 'above 6 per cent'. But GDP growth in Q4 2021 slowed to 4 per cent, amid disruptions caused by the appearance of the COVID-19 Omicron variant and property market slowdown, as well as the turbulence triggered by US trade policy tightening. In 2021, total export value increased 29.9 per cent, a significant improvement from the 3.6 per cent increase in 2020. The PMI was 50.3 in December 2021, compared with 50.1 in November. The Brent crude oil price increased 69 per cent from an average of USD42/barrel in 2020 to USD71/barrel in 2021. The average RMB currency exchange rate was 6.45 in 2021 and 6.93 in 2020. In the energy sector, electricity consumption grew 10.3 per cent in 2021 compared with 3.1 per cent in 2020, while natural gas consumption grew 12.7 per cent (372.6B m³) in 2021 compared with 5.6 per cent in 2020.

Business challenges faced by the Group included a slowdown in gas demand as a result of global warming, 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 the Chinese mainland. Other threats to our business included the increased number of extreme weather events, rising commodity prices due to logistics interruptions 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 the Chinese mainland and Hong Kong, while maintaining close communication with our operational partners and governments whose support is essential for our business growth. We will also conduct a pilot study on the supply of hydrogen separated from our town gas for bus companies in Hong Kong, as part of our green initiative to combat climate change and achieve carbon neutrality.

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

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 the Chinese mainland, 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 from Russia to northern and north-eastern China, LNG imported directly from receiving terminal owners and 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, changes in regulatory requirements for gas reserves applicable to our gas operations in the Chinese mainland 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 the Chinese mainland 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 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.

With regard to COVID-19, counter measures (e.g. social distancing, video conferencing, enhanced hygiene controls, an employee quarantine policy) have been incorporated into the "new normal" way of operating in order to reduce the risk of the pandemic spreading to working premises and ensure business continuity. In addition, special Human Resources initiatives have been adopted to encourage our Hong Kong workforce to participate in the government's vaccination programme.