

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

The global economy showed a return to growth in 2017 as a result of a pick-up in manufacturing and trade, improved market confidence and a recovery in commodity prices. Global market trends were driven by a decline in some global policy uncertainties since early 2017 and expectations for a smooth and gradual transition to the monetary policy stance in the United States of America. Stock markets rose noticeably during this period, and the ongoing recovery in global trade supported growth in the business environment.

In Hong Kong, GDP growth of 3.8 per cent was recorded for the whole year. With an increase in visitor arrivals of 3.2 per cent, compared with a 4.5 per cent decline in 2016, the hotel occupancy rate rose from 87 per cent in 2016 to 89 per cent in 2017. Gas sales in the hotel and restaurant trades increased accordingly. In mainland China, the economy grew 6.9 per cent in 2017, beating the official annual expansion target of 6.5 per cent and outpacing the growth rate of 6.7 per cent in 2016. Driven by the solid economic recovery and enforcement of the government's coal-to-gas policy, natural gas consumption grew significantly in the year.

Despite the above factors, the Group faces competition from the use of electricity in the Hong Kong market; in the mainland market, it must contend with competition in the form of direct sales by upstream gas companies, as well as from suppliers of liquefied natural gas (LNG) and alternative energy sources. Other threats to our business include volatile energy 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 addition, we are constantly exploring new gas applications 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 liquefied natural gas (LNG) receiving terminal at Shenzhen to our gas production plant at Tai Po, naphtha imported from Southeast Asia, Australia and the Middle East, 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 is 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, LNG storage facilities are in place and we have built new underground salt caverns for gas storage in Jiangsu province, which commenced trial operations in 2017.

To ensure reliable gas transmission, we have a sophisticated Supervisory Control and Data Acquisition (SCADA) system in place 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 (TQM) 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.

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.