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 on 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 76 to 78.

Business Environment

In 2023, global economic recovery remains slow. Countries have adopted stricter interest rate hike to combat inflation. According to the International Monetary Fund's "World Economic Outlook" in January 2024, global growth is expected to decelerate from 3.5 per cent in 2022 to 3.1 per cent in 2023 and to remain at 3.1 per cent in 2024. Global inflation rate is forecast to decline steadily, from 8.7 per cent in 2022 to 6.8 per cent in 2023, and 5.8 per cent in 2024. Factors such as the pandemic, the Russia-Ukraine war, increasing geoeconomic fragmentation, tightening monetary policy to reduce inflation, the withdrawal of fiscal support amid a high-debt environment, and extreme weather events are all hindering economic recovery.

The Federal Open Market Committee of the Federal Reserve (the Fed) kept interest rates unchanged in January 2024. The Hong Kong Monetary Authority expected that the Fed's future interest rate decisions will be dependent on incoming data, the evolving outlook and the balance of risks. When will the Fed begin to cut rates and the interest rate path thereafter remain uncertain, and the high interest rate environment may last for some time.

Affected by geopolitics and an ongoing sluggish property market, the post-pandemic economic rebound in the Chinese mainland fell short of expectations. China's gross domestic product (GDP) recorded a year-on-year growth of 5.2 per cent in 2023. The Purchasing Managers' Index (PMI) for the manufacturing sector was 49.0 per cent in December 2023, a decrease of 0.4 percentage point from the previous month. The issuance of RMB1 trillion treasury bonds in the fourth quarter of 2023, as well as the arrangement outlined in the Central Economic Work Conference in December, will help drive domestic demand and further consolidate the momentum of China's economic recovery.

Hong Kong's post-pandemic economy continues to recover. Real GDP resumed growth of 3.2 per cent in 2023. The overall consumer price index increased by 2.4 per cent from last year while basic consumer price inflation remains moderate in 2023. For 2023 as a whole, the underlying consumer price inflation rate averaged 1.7 per cent, the same as 2022. In 2023, there were 34 million visitor arrivals to Hong Kong, an increase of 55 times compared to 2022 and 52 per cent compared to 2018 (pre-pandemic period). Government spokesman said that visitor arrivals should increase further as handling capacity continues to recover, with additional boost from the Government's efforts to promote mega events. Together with the Government's various measures, rising household income should continue to support private consumption. Fixed asset investment should also grow further alongside continued economic growth.

Business challenges faced by the Group include a slowdown in natural gas demand owing to global warming, competition from electricity providers in Hong Kong, and direct sales by upstream gas companies, as well as suppliers of liquefied natural gas (LNG) and alternative energy sources on the Chinese mainland.

Other threats to our business include the increased number of extreme weather events, rising commodity prices due to logistics interruptions, information security risk and changes in government policy, 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. 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 customer default.

In 2023, frequent occurrences of extreme weather events were observed globally, with June to August being the hottest three months ever recorded on Earth.

Therefore, sustainability remained an important focus for 2023. It is already being positioned as an opportunity for accelerating business growth in the transition to net-zero carbon emissions, and an opportunity to develop renewable energy. Policies supporting this transition could drive investment in green infrastructure, creating a turning point in the fight against climate change.

We are constantly exploring new gas applications and new business opportunities to achieve business diversification on 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. As part of our green initiative to combat climate change and achieve carbon neutrality, we continue to advance our ongoing pilot project on the supply of hydrogen separated from our town gas mix for bus companies in Hong Kong. Additionally, we are also transmitting waste heat to replace the use of electricity at the Maxim's Food Factory in Hong Kong. EcoCeres, Inc., invested by the Group, focuses on producing sustainable aviation fuel (SAF) from waste vegetable oil and animal grease, with efforts underway to expand production capacity. With the completion of a new production facility in Malaysia within the next two years, along with the existing facility on the Chinese mainland, the annual production of SAF is expected to reach 650,000 metric tons, providing airlines with a greater supply of SAF.

Reliability of Gas Supply

We secure multiple sources of feedstock for the production of town gas in our Hong Kong operations.

These include delivering natural gas from Australia to our LNG receiving terminal in Shenzhen via LNG tankers, and then transmitted to our gas production plant in 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 adverse weather delaying LNG tankers. We have addressed this risk under our diversified production strategy, in which we have given our Tai Po production plant the capability of switching between natural gas and naphtha for feedstock.

On the Chinese mainland, to facilitate more efficient gas inventory management and reduce supply bottlenecks during high-demand periods, we have built LNG storage facilities. Additionally, we constructed a natural gas storage facility at our underground salt caverns in Jiangsu province. We have established a gas supply chain department to strategically coordinate natural gas supply and transmit gas flexibly through the national pipeline network for the Group's gas business. A variety of energy sources have also been obtained, including natural gas from Russia, LNG purchased directly from overseas, unconventional piped natural gas in China and gas obtained through the reinforcement of our 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 on 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, floods 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.

Therefore, to mitigate these risks, Towngas conducts regular reviews of all operating procedures, implements targeted strategies for addressing them, and proactively enhances on-site safety inspections. For example, our Total Quality Management system covers all critical production, storage, transmission and distribution facilities, as well as renewable energy systems. We have established a centralised platform for our gas operations on the Chinese mainland to optimise operational management on safety. We also manage our assets according to international standards and external certifications, and maintain insurance coverage against any property damage or financial loss.

Financial Liquidity

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of credit facilities and the ability to close out market positions. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in funding by keeping adequate free cash and credit lines available.

Information Security

Our business operations are dependent on information technology systems that are vulnerable to critical system failure, leakage or loss of sensitive information, which would adversely affect the Group's business. To safeguard our operations against information security threats, we have protective measures to manage data loss and monitor suspicious cyber activities. We also commission third parties to perform security assessments. There are information security awareness programmes and system contingency plans with regular drills. Furthermore, China regulatory requirements relating to information security is 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.