

RISK FACTORS

Risks and uncertainties can affect the Group's business, financial condition, operating results or growth prospects leading to a divergence from expected or historical results. Key risk factors affecting the Group are outlined below. In dealing with these, the Group remains in touch with its stakeholders with the aim of understanding and addressing their concerns.

These factors are not exhaustive or comprehensive, and there may be other risks in addition to those shown below which are not known to the Group or which may not be material now but could become material in the future.

GLOBAL AND HONG KONG ECONOMIC ENVIRONMENT

The global economy continues to strengthen with moderate expansion. The pace of US monetary policy normalisation, policy differences among major central banks and Brexit-related negotiations have, however, added uncertainties to the world economy and global financial market. Growth in the Hong Kong economy is moderate with improvement in exports and retail sales.

The prevailing global uncertainty may adversely affect the business of customers or potential customers, or cause a slowdown in economic activities in Hong Kong, which, in turn, may lead to a lower demand for electricity and related services in Hong Kong. This may adversely affect the Group's financial position, potential income, asset value and liabilities.

To address uncertainty in the global and Hong Kong economies, the Group pursues prudent and pragmatic strategies in financial management and capital investment. The Group also strives for efficiency and cost effectiveness in all aspects of its operations to enhance its financial performance.

HEALTH AND SAFETY

The nature of the Group's operations exposes it to a range of health and safety risks.

Major health and safety incidents resulting in fatalities or injuries to members of the public or employees could have significant consequences. These may include widespread distress and harm or significant disruption to the Group's operations, and could result in regulatory action, legal liability, material costs and damage to the Group's reputation.

The Group has in place a Health and Safety Management System to manage its exposure and protect its employees, customers, contractors, visitors and the public by conducting its business in a safe and socially responsible manner. Sustainable improvements are made to strengthen the organisation's culture and commitment to health and safety.

ENVIRONMENTAL COMPLIANCE

In 2008, the Government stipulated emission allowances for the power sector up to 2010 and beyond through the Technical Memorandum for Allocation of Emission Allowances in respect of Specified Licences under the Air Pollution Control Ordinance. Six subsequent Technical Memoranda issued in 2010, 2012, 2014, 2015, 2016 and 2017 have further tightened the emission allowances starting from 2015, 2017, 2019, 2020, 2021 and 2022 respectively.

In addition, the Government currently links the rate of return to compliance with emission allowance requirements. Failure to comply with these requirements could result in financial penalties and other legal action against the Group.

The Group has in place an Environmental Management System with a monitoring and reporting mechanism run by a dedicated team to ensure compliance with relevant environmental regulations, address public concerns and closely monitor and control the emission of pollutants from the power plant.

RELIABILITY OF SUPPLY

The Group can be exposed to risks in relation to supply interruptions. Extensive damage in generation or network facilities caused by severe earthquake, storm, flood, landslide, extreme weather phenomenon due to climate change, fire, sabotage, terrorist attack, failure of critical information and control systems that support the power system or any other unplanned event could lead to a prolonged and extensive power outage.

The loss of cash flow resulting from supply interruption, and the cost of recovery from damage to network and generation assets could be considerable. Such an incident could damage customer goodwill and lead to claims and litigation. Substantial increases in the number or duration of supply interruptions could result in increases in the costs associated with the operation of the Group's supply networks, which could have an adverse effect on the business, financial condition and efficiency of operations as well as the reputation of the Group.

RISK FACTORS

The Group conducts thorough risk assessment including the emerging risk of climate change, physical security and cybersecurity, adopts resilient designs, performs reliability centered maintenance and upgrades of its power supply equipment, undertakes reliability reviews, provides comprehensive training to operational staff and deploys sophisticated information technology control and asset management systems. It also conducts drills on contingency plans on a regular basis to ensure supply reliability is maintained at appropriate standards.

CYBER SECURITY

The Group's critical utility and information assets are exposed to attack, damage or unauthorised access in the cyber world. The fact that cyber-attacks occur with greater frequency and intensity around the world has increased the risk posed by cybercrime to the Group. Failure to protect the Group's critical utility and information assets from targeted or non-targeted cyber-attacks can result in reputational damage, financial loss and disruptions in operations.

The Group has taken a risk-based and integrated approach to combat cyber security risks. A robust Cyber Security Management Framework has been established with the implementation of an Information Security Management System that enables the Group to proactively identify, prevent, detect, respond to and recover from cybersecurity attacks. Resources and development efforts are focused on the three pillars of cybersecurity management, namely people, process and technology, to ensure the confidentiality, integrity and availability of corporate information assets and critical infrastructure.

ELECTRICITY MARKET

The operations of the Group's electricity business in Hong Kong are subject to a Scheme of Control Agreement ("SCA") with the Government, which provides for a permitted level of earnings based principally on average net fixed assets for electricity-related operations.

The current SCA, expiring on 31 December 2018, has been renewed in 2017. The new SCA has a longer term of 15 years from 2019 to 2033 commencing on 1 January 2019. The implementation of the 2014-2018 Development Plan under the current SCA, the implementation details of the new SCA, the details of the 2019-2023 Development Plan to be approved by the Government, and the Government's policies on air quality, climate change mitigation, fuel mix and electricity market competition for the medium to long term are all factors affecting the Group's results and growth.

The Group has established a mechanism to review these factors on a regular basis and continuously engages in discussions with the Environment Bureau as well as various stakeholders on electricity market and regulatory issues.

FUEL SUPPLY

Our generating units in Lamma Power Station mainly rely on coal and natural gas as fuel sources. Any interruptions or shortage in the supply of coal or natural gas or substandard fuel quality may result in significant disruption to the operations of our generating units. This could have an adverse effect on the reliability of supply, business, financial condition as well as the reputation of the Group. Possible fuel price volatility also poses a risk to the Group.

The Group has a fuel supply strategy and fuel quality control system in place to maintain reliable supply and sufficient stock of appropriate quality to meet its generation requirements.

INTEREST RATES AND CURRENCY MARKETS

The Group is exposed to interest rate risk primarily on its interest-bearing liabilities. The US Federal Reserve is expected to raise interest rates steadily in 2018 and interest rates in Hong Kong would likely follow suit. The Group is exposed to currency risk that mainly arises from the import of fuel and capital equipment. Volatility in interest rates and currency markets may adversely affect the Group's financial conditions and results of operations.

The Group's treasury policy guides the measures it undertakes to manage these exposures. Details of the Group's current practices to manage interest rate and currency risks are in the Financial Review on pages 55 to 57.

LAWS AND REGULATIONS

The Group's main operating company, HK Electric, engages in the generation, transmission, distribution and supply of electricity in Hong Kong, and is subject to strict compliance with Hong Kong laws and regulations relating to, amongst other things, development, construction, licensing and operation of our power facilities. Furthermore, it must comply with the conditions contained in its operational and construction licences and permits. Failure to do so could expose the Group to prosecution and litigation and result in fines, sanctions, criminal penalties and/or the suspension, revocation or non-renewal of licences or permits. Moreover, changes in laws and regulations may cause it to incur additional capital expenses or other obligations or liabilities in order to comply with such changes, or may possibly have material and adverse impact on its business, financial condition and operating results.

The Compliance Committee, chaired by the Chief Executive Officer, is responsible for overseeing the Group's compliance functions. A Compliance Framework is in place to manage its compliance obligations under a consistent and structured approach across the Group. As part of the Framework, a Regulatory Compliance and Monitoring Programme with designated responsible parties has been implemented to proactively monitor the Group's compliance obligations and status as well as any changes in laws and regulations and their implications.