

# 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 outbreak of COVID-19 has brought global economic activity to a near-standstill as countries impose measures such as lockdown, social distancing and quarantine to halt the spread of the virus. Escalating trade protectionism, heightened uncertainty over economic policy, rising geopolitical tensions and volatility in financial market movements have also brought uncertainties to the world economy and global financial market. Growth in the Hong Kong economy has been hindered by the virtual halt in tourist arrivals, contraction in business activities, and the US-China trade relationships which has had a dampening effect on Hong Kong's exports.

The prevailing global uncertainty and the economic downturn in Hong Kong have adversely affected the business of customers or potential customers which 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, injuries or ill health to members of the public or employees, or damage to the Group's properties, 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.

During the outbreak of COVID-19, the Group elevates the response level of its Influenza Pandemic Contingency Plan to emergency level and steps up the preventive and control measures in its operations with an aim to reduce the risk of infection to employees, contractors, visitors, customers and members of the public.

## 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 (APCO). Seven subsequent Technical Memoranda issued in 2010, 2012, 2014, 2015, 2016, 2017 and 2019 have further tightened the emission allowances starting from 2015, 2017, 2019, 2020, 2021, 2022 and 2024 respectively.

Failure to comply with these requirements could result in legal action against the Group under the APCO.

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.

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### 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, damages, 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.

The Group conducts thorough risk assessments including the emerging risk of climate change, physical security and cybersecurity; adopts resilient designs; performs reliability centred maintenance and condition monitoring; upgrades 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 to a high standard.

The Group has a series of health and safety measures in place across its entire operation and implements contingency plans to ensure the potential impact of the COVID-19 pandemic on its services can be minimised.

### 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 combating cyber security risks. A robust Cyber Security Management Framework has been established with the implementation of an Information Security Management System which is based upon a defense-in-depth cyber security management strategy with deployment of multiple layers of security controls throughout the IT landscape and integration with different cyber security processes. This 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 the 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 commenced on 1 January 2019, with a term of 15 years from 2019 to 2033. While the SCA is providing the necessary stability in the areas of financial and service regulation, the Government's strategies and policies on air quality, electricity sector decarbonisation for climate change mitigation, energy efficiency and conservation, and electricity market competition are among the factors affecting the Group's results and growth in the medium to long term.

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 interruption 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, achievement of the fuel mix target set by the Government, business, financial condition as well as the reputation of the Group. Fuel price volatility also poses a financial risk to the Group.

The Group has a fuel supply strategy and fuel quality control system in place to maintain reliable fuel supply and sufficient stock of appropriate quality to meet its generation requirements. To secure gas supplies at competitive prices, the joint-venture development of an offshore Liquefied Natural Gas (LNG) terminal is underway, which is scheduled for commercial operation in 2022.

### **Interest rates and currency markets**

The Group is exposed to interest rate risk primarily on its interest-bearing liabilities. The US Federal Reserve has cut interest rates twice in March 2020, aiming to protect the economy from the impact of COVID-19, and Hong Kong has followed suit to lower its interest rates. 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 44 to 46.

### **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.

### **Climate change**

The impacts of climate change are global in scope, affecting many countries and regions. Climate change may increase the frequency and intensity of extreme weather events, such as super typhoons, floods and natural catastrophes. It could disrupt supply chains, interrupt business operations and cause financial and physical damages. To combat climate change and address the growing expectation from the public for a low-carbon economy, Hong Kong has aimed to achieve carbon neutrality by 2050 in the Chief Executive's 2020 Policy Address.

As a major utility in Hong Kong, the Group has pledged full support for the Government's carbon neutrality target and is committed to addressing climate change risks by pursuing various decarbonisation initiatives. These include, but are not limited to, decarbonising our generation portfolio through coal-to-gas power generation transition, exploring ways of recycling to reduce wastes and discharges from our operations, promoting energy efficiency and renewable energy through funding schemes and educational activities, promoting the adoption of electric vehicles and supporting environmental projects by green groups and community organisations.