

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

Global economic growth has been weaker than expected with sluggish demand conditions in major economies. Given the economic slowdown on Mainland China, slackening trade flows and weaker tourist spending, growth in the Hong Kong economy was modest.

The prevailing global uncertainty may materially and adversely affect the business of customers or potential customers, or cause a slowdown in economic activity 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 expenditure investment. The Group also strives for efficiency and cost effectiveness in all aspects of its operations to enhance financial performance.

INTEREST RATES AND CURRENCY MARKETS

The Group is exposed to interest rate risk on its interest-bearing assets and liabilities. The risk has increased as the Fed has raised interest rates in December 2015 and pledged a gradual pace of increases in the future. The Group is exposed to currency risk that mainly arises from the import of fuel and capital equipment, and from its debt issuances in capital markets.

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 52 to 54.

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 was renewed in 2008 for a term of ten years commencing 1 January 2009 with an option for the Government to extend it for a further term of five years. The implementation of the 2014-2018 Development Plan under the SCA, its extension beyond 2018, the structure and regulation of the power industry in Hong Kong, and the Government's policies on air quality, 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 proactively engages with various stakeholders, including the Government, on electricity market and regulatory issues.

HEALTH AND SAFETY

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

An accident or the outbreak of a communicable disease 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 and the public by conducting its business in a safe and socially responsible manner.

RELIABILITY OF SUPPLY

The Group can be exposed to supply interruptions. A severe earthquake, storm, flood, landslide, fire, sabotage, terrorist attack, failure of critical information and control systems that support the power system, extreme weather phenomena due to climate change 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 network damage 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 assessment including the emerging risk of climate change, adopts resilient designs, performs regular 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 standards are maintained.

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. Four subsequent Technical Memoranda issued in 2010, 2012, 2014 and 2015 have further tightened the emission allowances starting from 2015, 2017, 2019 and 2020 respectively. The Government will also review later this year the emission allowances for 2021 and beyond based on the policy decision from an earlier public consultation on the future fuel mix for electricity generation for Hong Kong and other updated information.

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

The Group has an Environmental Management System and a dedicated team to ensure compliance with relevant environmental regulations and closely monitor and control the emission of pollutants from the power plant.

LAWS AND REGULATIONS

Our 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, we must comply with the conditions contained in our operational and construction licenses and permits. Failure to do so could expose us to prosecution and litigation and result in fines, sanctions, criminal penalties and/or the suspension, revocation or non-renewal of licenses or permits. Moreover, changes in laws and regulations may cause us to incur additional capital expenses or other obligations or liabilities incurred in order to comply with such changes, or possibly materially and adversely impact our business, financial condition and operating results.

The Group has taken a proactive approach to monitoring changes in laws and regulations to ensure compliance and assess their impacts. Adequate mitigation measures are in place for our compliance risks, and are constantly reviewed for enhancement.

FUEL SUPPLY

Our generating units in Lamma Power Station mainly rely on coal and natural gas as a fuel source. Any interruptions or shortages 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 is also a risk to the Group.

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