Strategic expansion, conservative approach

In 2018, SUEK's total assets increased to $14 billion and its revenue to $8.3 billion, reflecting the favourable coal market environment and the acquisition of the energy business.

The combined business model of the Coal and Energy Segments enabled SUEK to reduce the dependence of its EBITDA on volatile global coal prices.

In August 2018, SUEK Group acquired SGC[1]. Since this consolidation was treated as a transaction with respect to a company under common control, for the purposes of this MD&A report SUEK has provided like-for-like retrospective figures for FY 2017 which include a representative full year contribution from SGC to the Group's financials.

Macroeconomic conditions were favourable for the company overall. Average annual coal indices in Asia and Europe rose by 21% and 9% respectively, compared to 2017.

In Russia, 2018 inflation reached 4.3% and led to an increase in labour costs, rail costs and material purchase expenses in Rouble terms; it also impacted electricity and heat prices. With that, a 7% decrease in the average annual RUB/US$ exchange rate allowed us to maintain coal division expenses at the level of 2017 in US Dollar terms, compensating for the growth in Rouble expenses. The lower exchange rate also limited the growth of the average selling price of coal and energy to domestic consumers in US Dollar terms.

Group financial highlights

$m	2018	2017	%
Revenue	**8,296**	**6,939**	**20%**
Coal	6,711	5,693	18%
Energy	2,137	1,702	26%
Intragroup operations	(552)	(456)	21%
Cost of sales	**(5,488)**	**(4,630)**	**19%**
Coal			
Cost of sales	(2,760)	(2,235)	23%
Logistics	(1,809)	(1,786)	1%
Energy			
Cost of sales	(1,471)	(1,065)	38%
Intragroup operations	552	456	21%
Administrative and other expenses	**(267)**	**(240)**	**11%**
EBITDA	**2,541**	**2,069**	**23%**
EBITDA margin, %	31%	30%	1 p.p.
Net profit	**1,164**	**873**	**33%**
Net margin, %	14%	13%	1 p.p.
Capital expenditure[2]	**903**	**763**	**18%**
Net debt	**4,187**	**4,351**	**(4%)**
Net debt/bank EBITDA ratio[3]	1.6x	2.0x	(0.4x)
Bank EBITDA/interest expense ratio	9.1x	6.7x	2.4x

Revenue increased by 20% to $8,296m, driven by growth in coal sales and a positive global market situation, along with higher sales of electricity and heat due to the acquisition of new assets and lower than average annual temperatures.

EBITDA rose by 23% to $2,541m reflecting the revenue growth and efficient cost control.

Net Profit grew by 33% to $1,164m as the increase in EBITDA was partially offset by higher depreciation owing to the expanded fixed asset base and by higher foreign exchange losses due to the weakening Rouble.

$m	2018	2017	%
EBITDA	**2,541**	**2,069**	**23%**
Depreciation	(669)	(575)	16%
Income tax	(314)	(270)	16%
Finance costs	(311)	(338)	(8%)
Foreign exchange loss	(83)	(13)	538%
Net profit	**1,164**	**873**	**33%**

Administrative and other expenses increased by 11%, primarily through the increase in expenses relating to SUEK's charity work in the company's regions of operation.

Administrative and other expenses
($m)

11%

COMPARED TO 2017

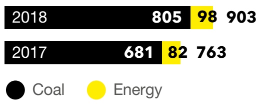
1. By purchasing 99.9% shares in LLC SGC.
2. Cash outflow.
3. Bank EBITDA is calculated in accordance with our existing credit agreements

Operating cash flow rose by 9% year-on-year to $1,901m. Warm weather in Europe led to higher leftover coal inventories at the year-end, increasing our working capital at the end of 2018. This restricted the growth rate of our operating cash flow compared to EBITDA.

Capital expenditure was $903m, which represents an 18% increase year-on-year. The investments largely targeted an increase in high-CV coal production, productivity upgrade, health and safety, and environmental measures.

$m	2018	2017	%
EBITDA	**2,541**	**2,069**	**23%**
Changes in working capital	(373)	(118)	216%
Income tax paid	(288)	(248)	16%
Other	21	35	(40%)
Operating cash flow	**1,901**	**1,738**	**9%**

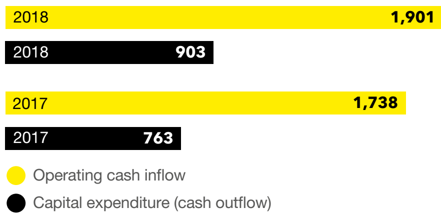
Capital expenditure[2] ($m)



18%

COMPARED TO 2017

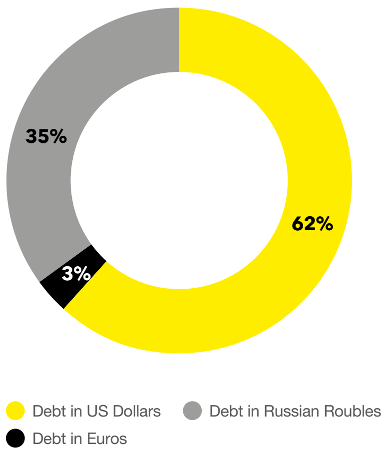
Operating cash flow vs capital expenditure ($m)



Net debt decreased by 4% to $4,187m as at 31 December 2018. As at 31 December 2018, most of our bank loans were denominated in US Dollars (62%); 35% were denominated in Roubles and the remaining part in Euros.

The effective cost of borrowing, normalised to the rate in US Dollars, was 4.5%. The company's main debt instrument is still pre-export financing secured by international sales revenue.

Debt structure as at 31 December 2018 (%)



Credit ratings

In 2018, Moody's international ratings agency raised SUEK Group's credit rating to Ba2 with a stable outlook. In May 2018, Fitch Ratings assessed the company for the first time and assigned it a BB rating with a stable outlook. Both agencies confirmed the Group's credit rating following the integration of SGC.

According to Fitch Ratings, the acquisition of the energy business expands SUEK's operations, improves the predictability of revenues and will help maintain or increase free cash flow. On the other hand, it may lead to a higher debt burden in the next two years compared to previous forecasts. Moody's analysts noted the leading position of SUEK in the global coal industry, a high level of operational diversification, a good quality of coal products, competitive costs, significant control over the infrastructure and a balanced financial policy.

In addition, in 2018 SUEK received a credit rating from the Russian Expert RA agency at ruAA-.

COAL

Reporting by product group

COAL

Export revenue from coal sales grew by 21% year-on-year to $5,051m, which was primarily due to the higher average selling price (+17%) and an increase in sales volumes by 2% to 55.4 Mt. The average coal selling price differed from the average index price because of the contracting time lag and differences in the quality characteristics of the coal sold and the index quality benchmark.

Revenue

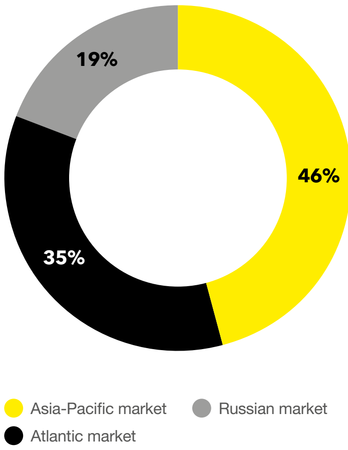
$m	2018	2017	%
Revenue from international sales	**5,051**	**4,190**	**21%**
Asia-Pacific market	2,894	2,494	16%
Atlantic market	2,157	1,696	27%
Revenue from sales in Russia	**1,200**	**1,103**	**9%**
Sales to third parties	655	654	0%
Intragroup coal sales	545	449	21%
Petroleum coke sales	**250**	**235**	**6%**
Other	**210**	**165**	**27%**
Total	**6,711**	**5,693**	**18%**

Average price of coal sold on international markets, FOB basis[1]
($ per tonne)

17%

COMPARED TO 2017

Coal sales revenue by market
(%)



1. The price is reduced to the FOB basis for Vanino, Maly Port and the eastern borders of China for shipments to Asia, and FOB Murmansk for sales to Europe. For shipments on other terms, we exclude the costs of freight, railway transit and cross-charged warehousing costs in foreign ports.

Russian market revenue increased by 9% to $1,200m, mainly driven by growth in sales to the Group's own power facilities (+5.5 Mt). The price increase in Russian Roubles was offset by the Rouble weakening against the US Dollar.

Average price of coal sold in Russia

($ per tonne)

0%

COMPARED TO 2017

(RUB per tonne)

7%

COMPARED TO 2017

Cash cost of coal sold

The unit cost of own coal sold in US Dollar terms did not change year-on-year due to the lower Rouble exchange rate. The cost in Roubles rose by 9% compared to 2017 following a sharp increase in the cost of fuel and lubricants and rising prices for imported spare parts.

Cash cost of coal sold

($ per tonne)

0%

COMPARED TO 2017

(RUB per tonne)

9%

COMPARED TO 2017

Logistics

Transportation costs in US Dollar terms increased by $21m (+2%) compared to 2018, which resulted from higher transportation volumes.

The company continued transport export shipments using mainly railcars under management in order to maximise the margins of export sales. Operators, despite an increase in rates by 43%, began to provide higher capacity cars for loading. This improved the efficiency of using the operators' fleet.

Specific coal transportation costs in Roubles rose amidst the continued growth in operator rates caused by a shortage of railcars due to the intense freight traffic during the period of high export prices, as well as a rise in railway tariffs in the domestic and international markets by 5.4% and 4%, respectively. The specific increase in expenses was partially offset by the weakening of the Russian currency.

SUEK is one of the few global coal companies that tranships coal via its own ports, such as Vanino Bulk Terminal and Murmansk Commercial Seaport. In addition, SUEK also uses the Maly Port for coal transshipment. The share of coal transhipped through the Group's ports increased to 85% of the total transshipment volumes in 2018. Total transshipment costs at the above ports in 2018 increased by 15% mainly reflecting the growth in volumes and increase in transshipment rates according to market level.

Freight costs grew by 5% from the previous year, principally due to higher transportation volumes.

Transportation costs

$m	2018	2017	%
Rail costs	**1,383**	**1,362**	**2%**
Freight costs	**223**	**212**	**5%**
Port costs:	**184**	**174**	**6%**
Group's port facilities	92	80	15%
Third-party ports	92	94	(2%)
Other	19	38	(50%)
Total	**1,809**	**1,786**	**1%**

Rail costs (international market)

($ per tonne)

4%

COMPARED TO 2017

(RUB per tonne)

6%

COMPARED TO 2017

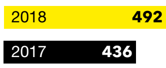
Rail costs (Russian market)

($ per tonne)

14%

COMPARED TO 2017

(RUB per tonne)

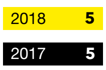


13%

COMPARED TO 2017

Ports costs (international market)

($ per tonne)



0%

COMPARED TO 2017

Freight costs (international market)

($ per tonne)

0%

COMPARED TO 2017

ENERGY

Heat sales revenue amounted to $734m. The acquisition of new facilities and a longer heating season due to lower air temperatures, together with higher tariffs, made it possible to achieve a 50% increase in revenue year-on-year.

Capacity sales revenue totalled $720m, representing a 9% growth year-on-year. The main share of revenue comes from capacity supply contracts. The connection price for these is on average five times higher than the price of a standard connection. The generating facilities acquired in 2018 operate under standard supply contracts, and therefore do not have such a significant impact on revenues.

Electricity sales revenue rose by 28% to $588m. The growth in production due to the expansion of generating capacity and higher tariffs caused by a more intense electricity flow from the European part to Siberia compensated for the negative impact of the Rouble depreciation.

Cash cost of energy sold

The cash cost of energy sold in 2018 was $1,471m. The impact of cost growth in Rouble terms, due to the indexation of labour costs and an increase in fuel costs, was partially offset by the lower Rouble exchange rate.

Revenue

$m	2018	2017	%
Heat sales revenue	734	490	50%
Capacity sales revenue	720	659	9%
Electricity sales revenue	588	461	28%
Total	**2,042**	**1,610**	**27%**

Energy sales revenue
(%)