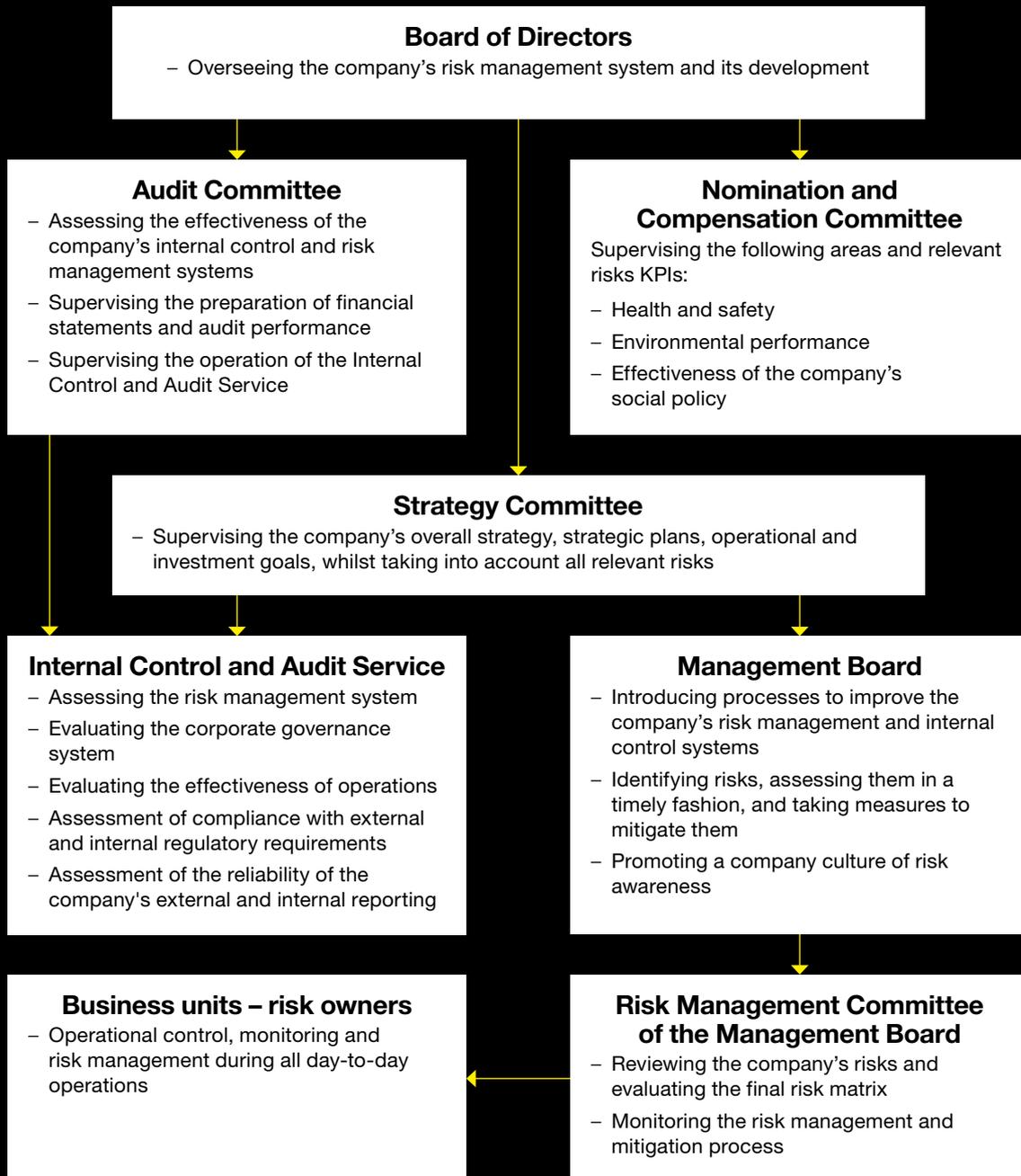


# Proactive risk management

Effective risk management is essential for us to achieve our strategic goals. We are committed to continually improving our risk management system in order to identify external and internal risks and develop effective mitigation processes.

## SUEK'S RISK MANAGEMENT SYSTEM





**Q. What were the priorities of the risk management system in 2018?**

**A.** During 2018, the Risk Committee considered matters related to increased restrictions around the use of coal as a result of international and national regulatory decisions and PR campaigns.

The Committee also focused on issues relating to IT, insufficient railway infrastructure and the integration of the energy business.

**Q. What changes do you plan to make to the risk management system following the consolidation of SGC?**

**A.** We have already made a number of updates to the Group's risk management system. We have created a consolidated methodology and identified and assessed key risks related to the heat and power industry. The consolidation of the energy business has led SUEK's Risk Committee to increase its risk management activity and responsibilities.

The company's management team prepared and assessed a list of risks relating to the energy business and has started to develop measures required to minimise them. In 2019, these risks will be consolidated into a common risk map.

VALERY DMITRIEV,  
DIRECTOR FOR  
TAXES, RISK MANAGEMENT  
AND INSURANCE

SUEK has a corporate risk management system, which is continually enhanced through the development of new measures to minimise risks across the company. The company's management is fully informed on all significant risks and approves all key parameters for the risk management system. We give full consideration to risk management issues and processes in our strategic planning and they influence all of our operational decisions.

Our Management Board controls and monitors the company's risk management system, working closely with the Audit Committee of the Board of Directors. The process of risk management is carried out in accordance with the risk management procedure. It is developed and approved by SUEK's Risk Management Committee, which factors in both the specifics of the Group and recommendations of Russian and international risk management standards. This procedure includes the main objectives and principles of risk management, and methods for identifying, assessing and mitigating the risks we face.

SUEK also has an Internal Control and Audit Service, which provides independent assessment and prepares recommendations for improving a number of systems, including the risk management system. The Internal Control and Audit Service applies a risk-based approach to planning its work, whilst taking into account the external environment and the company's performance, focus areas of the management and Board of Directors and risk assessment results.

We monitor changes in risk levels through our established risk map, which is reviewed annually. To achieve independence and compliance with the company's approved strategy, we carry out a thorough risk assessment once a year by assigning a risk category based on the possible damage if the adverse situation occurs, and the risk probability category. This approach allows us to analyse identified risks and determine which are the most significant in each area of the company's operations. The responsibility for managing specific risks is delegated to the employees of relevant departments.

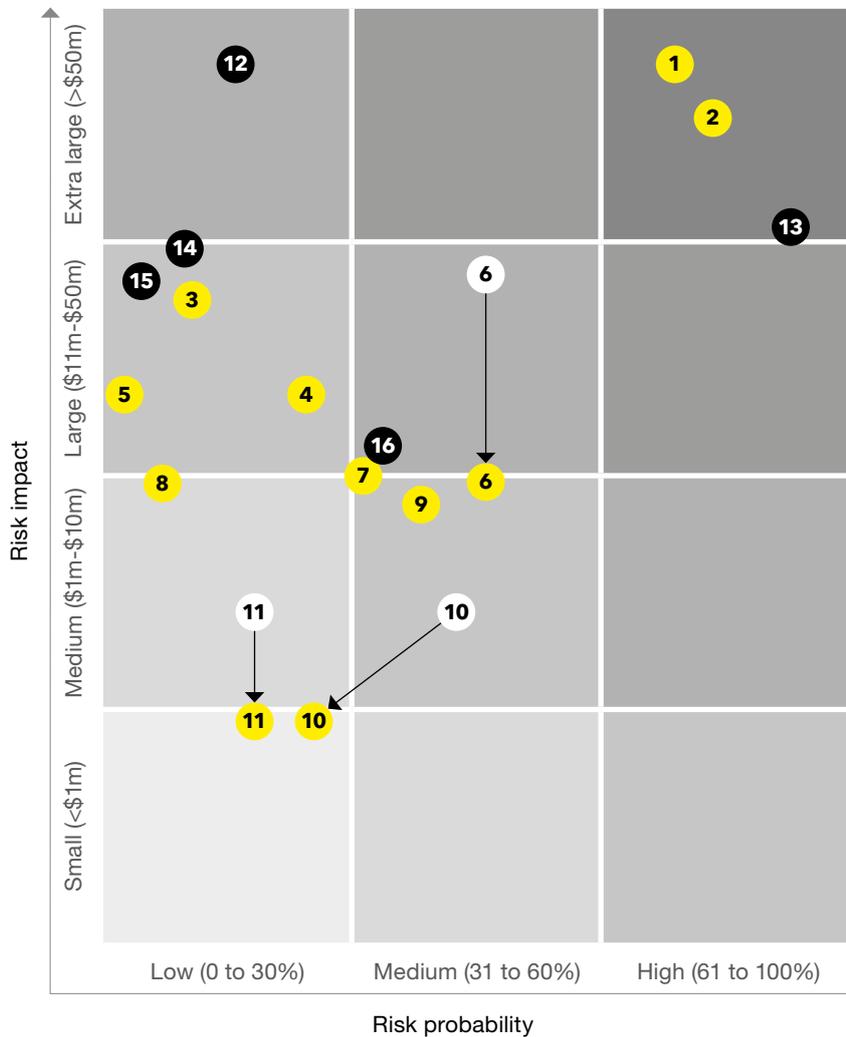
The Risk Management Committee holds meetings at least once a quarter, in which it considers any changes within the area of controlled risks. Where appropriate, adjustments are made to the risk management action plan and the risk management system. The Risk Management Committee also ensures cross-functional interaction between senior managers and internal operational experts. Employees responsible for managing certain types of risks devise appropriate responses to emerging issues, and inform the Risk Management Committee of all measures taken to mitigate the risks in question.

In order to ensure we are prepared to respond quickly to any adverse developments, we continuously monitor and analyse trends in key markets and related industries. We also monitor the macroeconomic environment, both in Russia and in countries that import SUEK's products. Based upon this analysis, we can further adjust the company's production, sales and financial policies.

In early 2018, the Risk Management Committee analysed the risk map for 2017. Following this, it submitted a report on the risk management structure and process to the Audit Committee of the Board of Directors, which commended the Risk Management Committee for its efficient work. The Committee also reviewed and approved a new risk map for 2018.

### Review of key risks<sup>1</sup>

Below we set out a list of the major potential risks to SUEK's operational and financial performance. Whilst this report highlights the key risks, there are other less major inherent risks, not listed below, that may have an adverse impact on SUEK's performance.



- External risks**
- R1 Risk of changes in current legislation
- R2 Regulatory risk
- R3 Risk of emergency situations
- R4 Risk of reduction in coal prices
- R5 Anti-monopoly risk
- R6 Risk of reduction in coal demand
- R7 Cyber risk
- R8 Foreign exchange and interest rate risks
- R9 Inflation risk
- R10 Credit risk
- R11 Liquidity risk
  
- Operational risks**
- R12 Production risk
- R13 Risk of restricted infrastructure availability
- R14 Health and safety risk
- R15 Environmental risk
- R16 Human resource risk

→ Change in 2018 vs 2017

1. This report was compiled using SUEK's risk map for 2018, which was approved at the end of 2017 and did not contain risks related to the energy business; energy risks are included in the risk map for 2019.

## EXTERNAL RISKS

Description of risk and its potential impact	Change over the year	Actions to mitigate the risk
<b>1. Risk of changes in current legislation</b>		
<p>The company follows Russian statutory regulations and other regulatory acts in the jurisdictions where it produces and sells its products. We also abide by the regulations of the countries and regions from which the Group imports goods and services.</p> <p>In Russia, changes in legislation can relate to tax, customs and foreign exchange regulations, securities market law, anti-monopoly and corporate law, licensing and mineral resources law, power industry law and judicial practices. Changes can also arise through the tightening of environmental protection requirements. SUEK's business can be significantly affected by decisions made by Russian governmental agencies to impose tariffs, quotas, trade restrictions, restrictions on the ownership rights of non-residents, subsidies, licensing and anti-monopoly policies, and refinancing rates.</p> <p>SUEK's companies can also be affected by unfavourable regulatory acts implemented by foreign authorities. Such changes can involve additional controls on exporting coal and its subsequent sale in certain countries and regions. Changes can also result in special conditions for importing goods and services to Russia.</p> <p>International sanctions against Russian individuals and legal entities, as well as industry (sectoral) sanctions, can also restrict certain sectors of the Russian economy. Currently, the sanctions in place do not directly target Russia's coal and energy industry, the Group's companies or their operation. However, a number of economic limitations do currently affect our business and necessitate special control in the selection of counterparties (while closing financial deals, for example). They also affect the availability of financial resources across the Russian market in general, and make it difficult for companies operating in Russia to import certain types of equipment.</p> <div data-bbox="84 1299 726 1366"> <p>.....</p> <p>STRATEGIC PRIORITIES <b>S1 S2 S3</b> MATERIAL MATTERS <b>M1 M5</b></p> </div>		<p>We constantly monitor proposed projects to amend legislation, as well as Russian legislation and other regulatory requirements. We also review and summarise law enforcement practices, taking into consideration the company's operation. This enables us to quickly adapt our business processes and organisational structure to any changes in the legislative environment, and to operate in full compliance with the current regulatory and legal framework.</p> <p>SUEK's senior managers and experts are actively involved in governmental policy panels for the coal and power industry, coal markets, transportation, technical supervision, social and labour relations, and financial markets.</p> <p>SUEK constantly monitors (either independently or through external consultants) relevant changes in legislation and law enforcement in other countries where our transactions may fall under local jurisdiction.</p> <p>SUEK's compliance system allows us to quickly detect and mitigate any compliance risks in the field of corporate ethics, environmental management, anti-monopoly regulation and licensing.</p> <p>We monitor the situation related to international sanctions in force.</p>
<b>2. Regulatory risk</b>		
<p>Our production operations are governed by numerous laws and regulations, covering natural resource management, mineral exploration and mining, healthcare, industrial safety and the power industry. Coal-mining licences obtained by production companies can be suspended, terminated ahead of schedule or left unrenewed upon expiry. These risks are mostly dependent on the decisions made by regulating and supervisory agencies (Rosnedra, Rosprirodnadzor) holding scheduled and ad hoc inspections at the Group's companies. Changes in national environmental and labour regulations may also influence the thermal coal market.</p> <div data-bbox="84 1702 726 1769"> <p>.....</p> <p>STRATEGIC PRIORITIES <b>S1 S3 S5</b> MATERIAL MATTERS <b>M1 M4</b></p> </div>		<p>We make every effort to comply with current legislation and minimise the risk of operations at our production units being suspended. We rigorously monitor any changes in the legislative environment. SUEK's companies have implemented procedures to ensure compliance with licence requirements for timely renewal or new applications. If any discrepancies with licence requirements are detected, we strive to complete the instructions from the regulator as quickly as possible.</p> <p>We also seek to adjust our product quality in line with the regulations of the countries where our customers operate.</p>

**Company ability to influence the risk:**

● No influence ● Partial influence ● Significant influence

**Description of risk and its potential impact**

**Change over the year**

**Actions to mitigate the risk**

**3. Risk of emergency situations**

Coal mining is inherently dangerous because of geological, seismic and other natural factors. The risk of accidents and emergency situations at our production facilities is therefore constant and requires due diligence, robust management and mitigation. Preventing fatal accidents and decreasing the number of injuries we experience, both due to emergencies and on an ongoing basis, is one of the company's most important tasks. Damage to, or destruction of, property because of explosions, fire or failures in equipment operation can result in direct losses. The costs of emergency response and recovery, as well as forced downtime at individual production units, can also negatively impact the Group's financial results.



We continuously monitor hazards at all operational stages, paying close attention to safe production processes, procedures and geological conditions at all mining sites. All accidents and incidents are thoroughly investigated by experts from special panels. Based on the results of their work, we prepare packages of measures to prevent similar accidents from happening in the future.

STRATEGIC PRIORITIES



MATERIAL MATTERS



**4. Risk of reduction in coal prices**

The company's business may be affected by a decline in demand for coal and a reduction in coal prices due to oversupply or a rise in demand for other types of fuel. A reduction in global prices for coal and natural gas (the main types of fuel in the power industry) is a key factor which could change the situation for the worse.



We continuously monitor and forecast the price behaviour of commodities in general and coal in particular. We also monitor trade policies relating to long-term contracts. We constantly analyse the correlation between demand trends, coal mine closure, opening and expansion and the postponement of development projects.

STRATEGIC PRIORITIES



FOR MORE DETAILS, SEE MARKET REVIEW ON PAGES 64-69.



MATERIAL MATTERS



**5. Anti-monopoly risk**

SUEK's companies occupy leading positions in the production and sale of thermal coal in a number of Russian regions. Consequently, our operations are subject to the anti-monopoly requirements set out in Russian legislation, including obligations and limitations introduced to protect competition within the thermal coal market.



SUEK has implemented procedures ensuring full compliance with the applicable anti-monopoly regulations.

STRATEGIC PRIORITIES



MATERIAL MATTERS



**Description of risk and its potential impact**

**Change over the year**

**Actions to mitigate the risk**

**6. Risk of reduction in coal demand**

Reduced use of coal by power generating companies and the emergence of alternative fuels may result in lower demand for coal. This trend could adversely impact the Group's performance.

Tighter international environmental standards on coal quality and production conditions coupled with lower consumption by generating companies could also result in reduced demand for the coal we produce.

STRATEGIC PRIORITIES



FOR MORE DETAILS, SEE MARKET FUNDAMENTALS ON PAGES 16-22.



MATERIAL MATTERS



SUEK's focus on increasing the shipments of high-CV products and the redistribution of sales to stable (South Korea, Japan) and emerging markets (Vietnam, the Mediterranean) allowed us to push up sales.

We wash our coal to improve its quality, enabling us to meet demand for higher-value products from international markets. We constantly monitor the production, sales and market environment within the industry, and prepare coal-demand forecasts based on studies and reports by investment analysts.

We diversify our sales to stable and growing markets to make up for declining sales in slowing markets. We also expand our presence in emerging markets and participate in projects to develop new technologies for coal-fired power generation.

**7. Cyber risk**

Today, protection against cyber risks, including cyber-attacks, employee errors and data leakage, is very important. Effective management of these risks helps us minimise and avoid the leakage of confidential information, network security breaches, problem notification costs, system recovery costs, cyber extortions, and protection costs associated with regulatory requirements.

STRATEGIC PRIORITIES



MATERIAL MATTERS



We took comprehensive actions to improve the security level of the office and process infrastructure (installation of additional mail traffic protection, higher security of the corporate Wi-Fi network, introducing the concept of 'Hybrid and Cloud Infrastructure').

We carefully monitor our compliance with IT security standards. SUEK is developing a system designed to limit access to IT systems, whilst upgrading its IT infrastructure, bringing it into compliance with corporate standards and best practice.

**8. Foreign exchange and interest rate risks**

Changes in market indicators, such as currency exchange and interest rates, can have an adverse effect on the Group's financial performance. They can also impact our debt burden and the value of the financial instruments on the company's balance sheet. Currency and interest rate risks need to be managed to mitigate unfavourable fluctuations in these areas.

STRATEGIC PRIORITIES



FOR MORE DETAILS, SEE FINANCIAL REVIEW ON PAGES 78-83 AND NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS ON PAGE 147.



MATERIAL MATTERS



SUEK analyses the risks relating to changes in currency exchange and interest rates on a regular basis. We strive to keep these risks within acceptable limits, and to achieve optimal profitability where possible. We also make use of 'natural hedging' as a significant part of the company's revenue, and the majority of our loans are denominated in US Dollars.

**Company ability to influence the risk:**

● No influence ● Partial influence ● Significant influence

**Description of risk and its potential impact**

**Change over the year**

**Actions to mitigate the risk**

**9. Inflation risk**

Rising inflation rates in the countries where SUEK conducts its operations and individual business transactions can result in higher production costs.



In order to ensure the appropriate level of protection, we hedge inflation risks by using derivatives and investing available cash assets in a stable foreign currency. Most export contracts for coal are concluded in US Dollars, which largely compensates for the effect of inflation in Russia on the Group's EBITDA.

STRATEGIC PRIORITIES



MATERIAL MATTERS



**10. Credit risk**

Increase in overdue receivables under domestic coal supply contracts, and the transition of overdue receivables to problematic or collectible accounts, can result in direct losses for the company and restricted access to debt capital markets.



We focus on liaising with the financial departments of regional governments where we supply coal. The aim here is to improve or establish a mechanism which ensures timely payments by housing and public utility companies, as well as upfront payment clauses in supply contracts. The company may suspend coal deliveries to customers who carry debt, and if necessary re-direct supplies to more financially reliable customers – for example, retail and small-scale wholesale buyers using our own storage network.

STRATEGIC PRIORITIES



FOR MORE DETAILS, SEE FINANCIAL REVIEW ON PAGE 79.



MATERIAL MATTERS



**11. Liquidity risk**

Liquidity risk is directly related to cash turnover. It arises if the company cannot fulfil its payment obligations. It is often linked to the effects of inflation, foreign exchange and interest rate risk. The effective management of liquidity risk requires maintaining an adequate level of cash and cash equivalents while ensuring the prompt raising of funds using available lines of credit. Liquidity risk also arises from decreases in coal sales volumes or price, which can result in insufficient revenue being generated to serve the Group's external debt.



In 2018, Moody's credit rating was upgraded to Ba2, while Fitch assigned us an initial BB rating. Expert RA's rating was ruAA-.

We continuously monitor loan covenants and use a comprehensive forecasting system to ensure we comply with them. At present, the amount of credit lines provided to SUEK fully cover its financing needs.

In 2018, we expanded the number of international banks participating in syndicated loans.

STRATEGIC PRIORITIES



MATERIAL MATTERS



## OPERATIONAL RISKS

Description of risk and its potential impact

Change over the year

Actions to mitigate the risk

### 12. Production risk

In our operations, we face various production risks linked to different factors. These can be either internal (downtime, adverse geology, low coal quality) or external (higher fuel, electricity and equipment requirements, service prices, and the failure of suppliers and contractors to fulfil their obligations). Such factors can affect production targets, which sometimes requires additional expenses, resulting in an increase in our overall production costs.



At all of our production units, we use Life of Mine (LoM) deposit development models. Based on geological data and created using XPAC-XERAS software, the LoM models enable each production unit to check its annual budgeted and actual expenses on a regular basis. As part of this process, we pay special attention to operational efficiency projects that reduce the duration of longwall face moves. We also monitor projects designed, among other aims, to improve work rates and increase the availability and deployment of open-pit mining equipment. In addition, we employ a monthly reporting procedure based on KPIs, and Enterprise Resource Planning (ERP) systems, allowing management to promptly assess the performance of SUEK and its subsidiaries.

STRATEGIC PRIORITIES



MATERIAL MATTERS



### 13. Risk of restricted infrastructure availability

The risks consist of reduced access to railway and port infrastructure, electricity networks and water facilities. Limited access to infrastructure can result in reduced profit due to higher operational costs, and losses due to downtime at our production units. A number of SUEK's facilities operate in regions where harsh environments can influence power supply and transportation, increasing this potential risk.



SUEK's production and logistics units actively create long-term relations with infrastructure providers. When executing contracts, we pay special attention to the technical conditions and servicing of railway tracks at connecting stations, railway and port-loading facilities, electrical substations, and networks.

Availability of infrastructure is also dependent, to a significant degree, on whether our service providers meet their obligations. Refusal to provide services can result in forced suspension of production, which in turn can negatively impact our operational and financial performance. Certain infrastructure is operated by state-owned monopolies. Operation of such facilities is subject to tariff regulation, which can affect the availability and quality of the services in question.

We also invest heavily in developing the infrastructure that is critical to our business, such as Vanino Bulk Terminal, Murmansk Commercial Seaport and others.

STRATEGIC PRIORITIES



MATERIAL MATTERS



### 14. Health and safety risk

Coal mining is associated with an elevated risk of accidents and emergencies, which can occur due to geological factors, technical conditions and the action or inaction of individuals. Major emergencies can negatively impact SUEK, leading to a possible increase in reputational risk, the discontinuation of business partnerships or claims from the company's lenders for early loan repayments.



Every meeting of the Board of Directors and the Nomination and Compensation Committee of the Board starts with a review of health and safety issues. Our Industrial Safety Committee of the Management Board analyses every injury sustained at our sites and proposes actions to prevent similar accidents in the future. As owners of dangerous industrial equipment, all the Group's facilities maintain general liability insurance against possible damage to life, health and the property of third parties. In addition, we insure our employees against permanent or temporary disability.

STRATEGIC PRIORITIES



FOR MORE DETAILS, SEE HEALTH AND SAFETY SECTION ON PAGES 88-93.



MATERIAL MATTERS



We also provide constant training for the company's personnel and regularly monitor the knowledge of our employees in industrial safety and protection.

**Company ability to influence the risk:**

● No influence   ● Partial influence   ● Significant influence

**Description of risk and its potential impact**

**Change over the year**

**Actions to mitigate the risk**

**15. Environmental risk**

The environmental risks related to coal mining, washing and processing include air emissions of pollutants, ash and coal dust, contamination of soil and water, and land disturbance by mining activities. These negative impacts can result in claims from regulatory authorities and the suspension of operations, which in turn affect the company's operational and financial performance.



We seek to minimise environmental risks by developing and implementing projects for land rehabilitation, mine methane disposal, and health protection where our production operations are located in the immediate vicinity of inhabited areas.

STRATEGIC PRIORITIES



FOR MORE DETAILS, SEE ENVIRONMENTAL SECTION ON PAGES 94-99.



MATERIAL MATTERS



The company takes measures to reduce environmental and ecosystem impacts and pollutant emissions, and to ensure the efficient disposal and recycling of waste. The frequency of these measures is determined by current legislation, as well as by the company's Environmental Policy and environmental protection programme.

We have also increased the scope of our coal washing activities, which allow us to reduce the environmental impact of our products during their transportation and use.

**16. Human resource risk**

Experienced and highly qualified personnel, in particular mining engineers and mine workers, are the company's most important assets. Failure to recruit and retain qualified personnel can result in missed production targets and increased costs. The socio-demographic situation in Russia increases the risk of a qualitative and quantitative human-resource deficit. Factors complicating recruitment include a decline in birth rates and underdeveloped housing infrastructure in the regions where we operate, plus a shortage of vocational training institutions and low levels of professional skills among graduates.



SUEK develops a system of employee training and professional development. We also work to improve motivation initiatives and enhance remuneration.

In terms of recruitment, we actively seek out and support talented vocational college and university students, providing them with employment opportunities at SUEK's facilities.

In addition, we implement projects aimed at delivering social development, including improving housing conditions in the regions where we operate.

STRATEGIC PRIORITIES



FOR MORE DETAILS, SEE OUR PEOPLE SECTION ON PAGES 100-105.



MATERIAL MATTERS

