

Proactive risk management

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

Q:

How does integrated risk management help SUEK to achieve cost-efficiency?

A:

As part of our risk management process, we review the cost-efficiency of our business decisions and investment opportunities, while taking into account the regulatory environment, the availability of necessary resources and the liquidity of assets. This approach ensures the sustainability of our growth, increases the efficiency of resource use and prevents or minimises the risks of financial losses.

Q:

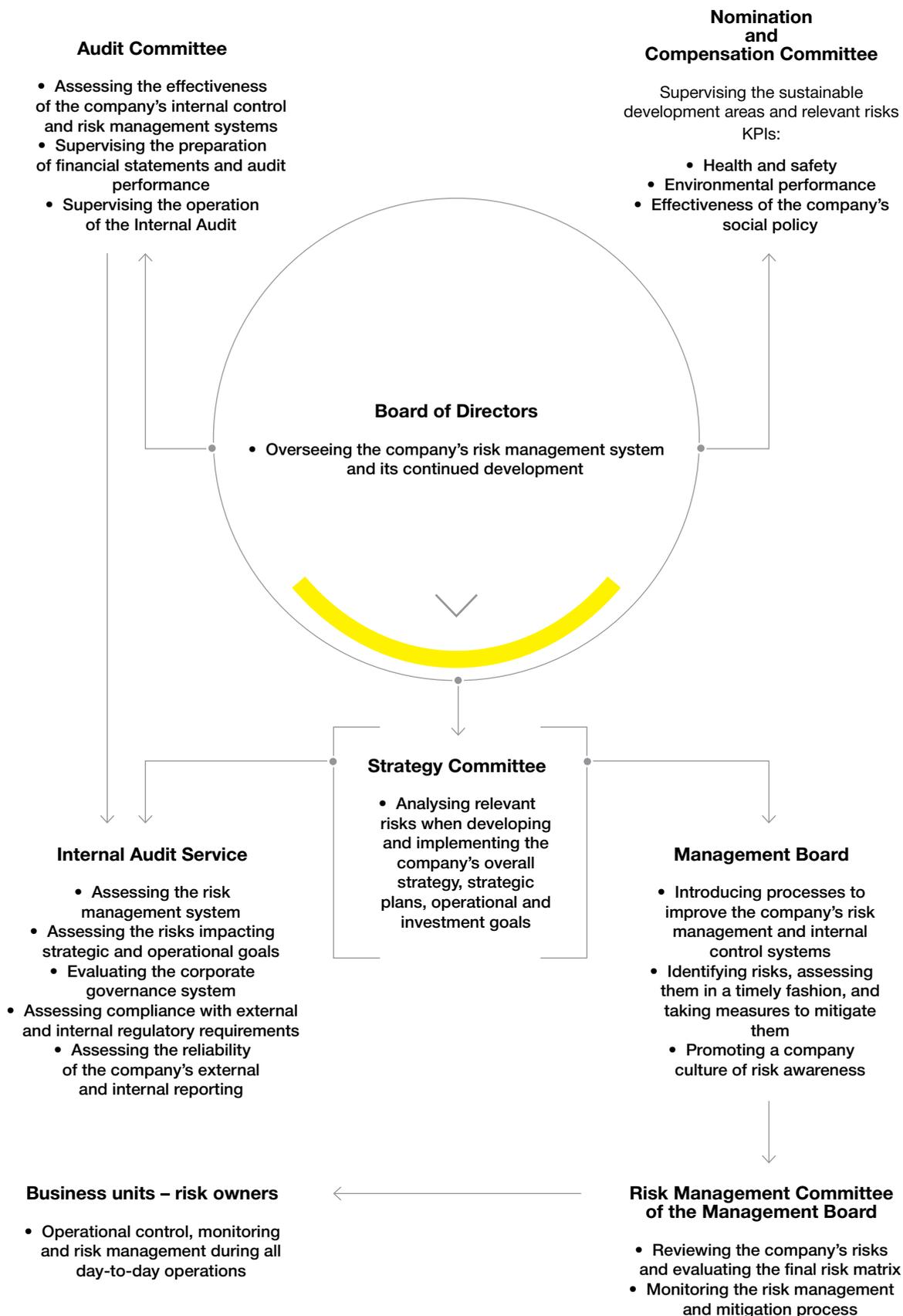
What changes to risks in 2019 will have the most impact on the company's strategy?

A:

In 2019, we saw a significant change in the coal market environment and rising pressure from the gas market. In connection with Europe's planned transition to renewable energy sources and a decrease in coal demand in the Atlantic region, we focused on mitigating market risks. To minimise the impact of declining coal demand in Europe and relative higher price pressure, SUEK's management updated the consolidated strategic model taking into account new macro parameters by summarising the target parameters of the strategies for divisions, business segments and supporting functions. In particular, we reviewed and adjusted the strategic goals for the next five years in sales and logistics.

Valery Dmitriev,
Director for taxes, risk management and insurance

Risk management organisational structure



Our approach

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

Management and control

Our Management Board, including the Risk Management Committee, controls and monitors the company's risk management system, working closely with the Board of Directors' Audit Committee. SUEK also has an Internal Audit Service, which provides independent assessment and prepares recommendations for improving the risk management system.

Risk management relies on a common architecture that combines all aspects of SUEK's businesses. Risk monitoring is exercised as part of the daily work routine of the company's risk owning and monitoring units that are owners and/or co-owners of risks. The Directorate for Taxes, Risk Management and Insurance in charge of the corporate risk management system coordinates the activities of various divisions in terms of risk

management and shapes a risk management reporting system, which is reviewed by the Risk Management Committee of the Management Board.

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.

Methodology

The process of risk management is carried out in accordance with the procedure developed and approved by SUEK's Risk Management Committee. It factors in both the specifics of the Group and recommendations of Russian and international risk management standards and best practice. This procedure includes the main objectives and principles of risk management, and methods for identifying, assessing and mitigating the risks we face.

Risk management process

Identification

A comprehensive risk identification process is run once a year. Responsible division employees indicate the sources of risks and the potential measures to minimise them. Based on expert assessment, a risk register for the future period is compiled.

Assessment

In order to achieve independence and compliance with SUEK's approved strategy, a comprehensive risk assessment takes place once a year by assigning categories to risks. For each risk identified, the probability of its materialising and potential impact is rated. The adequacy of action plans to address any remaining control gaps is then assessed. The existing approach to maintaining a risk register allows us to analyse identified risks and determine the most significant risks in each area of the company's operations.

Response

Responsibility for managing specific risks, including for taking actions to mitigate them, is delegated to the employees of relevant departments. The Directorate for Taxes, Risk Management and Insurance supports and updates the plans of these actions with their current status.



Q: How does SUEK control reporting with the growing scale of operations?

A: We aim to implement unified procedures and principles of recording commercial and logistic operations in the target corporate system across all companies of the group, regardless of their location. Almost all Russian

units already work in SAP ERP, therefore, over the past two years, we have adopted the system extensively in our foreign divisions. As of 31 December 2019, 99% of the group's revenue was recorded in the ERP system (or 98% of foreign companies' revenue). This enables SUEK to improve the quality of control and management decisions



Monitoring and control

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.

Also, during the year, heads of business segments nominated as risk owners, when identifying new risks, report them to the Directorate

for Taxes, Risk Management and Insurance. After that, the Directorate considers the initiated risk for inclusion in the year’s risk register in compliance with the overall risk identification procedure.

Reporting

A summary report prepared by the Directorate for Taxes, Risk Management and Insurance is considered by the Risk Management Committee and then by the Audit Committee. It covers a final risk register, information on the actions taken to mitigate risks and the materialisation of risks during the year.

Results

At the beginning of 2019, the Risk Management Committee analysed the 2018 risk matrix and submitted a report on the risk management structure and process, for consideration by the Audit Committee of the Board of Directors. The Audit Committee took note of the report on the Risk Management Committee’s work in 2018 and approved crucial activities for 2019.

The key area of work during the reporting year was the introduction of risk management in a wider range of risk-based decisions to support SUEK’s activities. Special care was given to integrating the risk management process and culture into the energy business. One of the main outputs has been the updated risk map including risks of our acquired energy business.

by promptly receiving the most detailed information from the system, as well as to develop a complete distribution chain to the final customer and assess the end-to-end transaction economics.

By the end of the next year, we plan to complete the implementation of the ERP in all group companies.

Q: How do SUEK’s units benefit from the unified ERP system?

A: Automation and unification of processes in a corporate ERP system reduce the risk of potential errors, improve the overall working environment through broader involvement of employees in business processes, sharing their expertise

and optimisation of role distribution in the company. Moreover, the use of automated algorithms and a common set of group system requirements allows for faster data consolidation and preparation of financial statements.

Ekaterina Paramonova
ERP methodology integration project manager

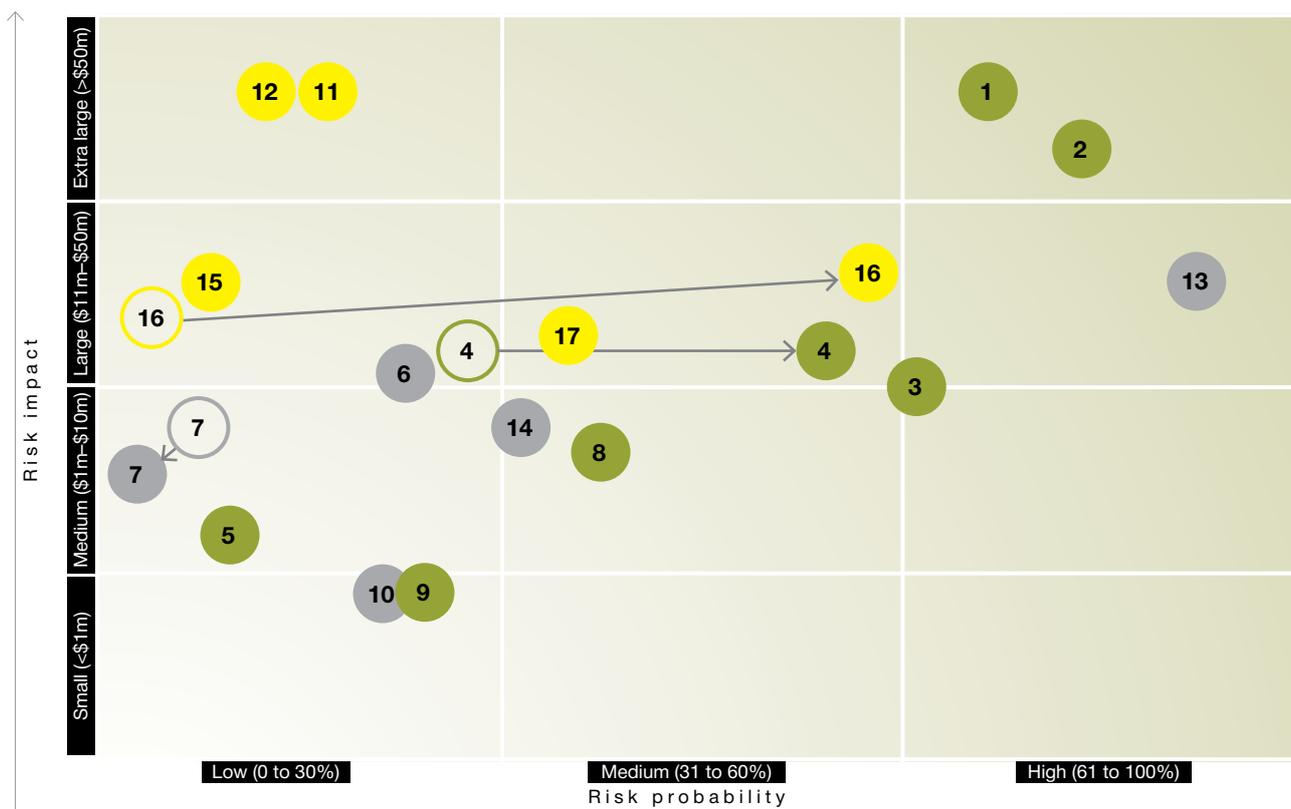
Review of key risks

Below we set out a list of the major potential risks to SUEK's operational and financial performance and activities. 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.

The following changes have been made to the risk map posted in the current Annual Report:

- Excluding anti-monopoly risk, since SUEK has built a strong system of compliance procedures, which reduces the probability of this risk to the minimum
- Combining coal demand and price risks because they have interrelated reasons and similar dynamics
- Combining production and emergency risks because they have interrelated reasons

Risk map in 2019



Regulatory and legal risks

- 1 Risk of changes in current legislation
- 2 Regulatory risk
- 3 Risk of changes in electricity tariffs for residential customers and heat tariffs

Market risks

- 4 Risk of reduction in coal demand and prices
- 5 Risk of reduction in power plant load and electricity prices in the wholesale market
- 6 Risk of reduction in demand and prices in the capacity market

Financial risks

- 7 Foreign exchange and interest rate risks
- 8 Inflation risk
- 9 Credit risk
- 10 Liquidity risk

Operational risks

- 11 Production risk (mining)
- 12 Production risk (energy generation)
- 13 Risk of restricted infrastructure availability
- 14 Cyber risk

Sustainability risks

- 15 Health and safety risk
- 16 Environmental risk
- 17 Human resource risk

Company ability to influence the risk:



No influence



Partial influence



Significant influence



Change in 2019 vs 2018

REGULATORY AND LEGAL RISKS

1. Risk of changes in current legislation

The company follows statutory regulations 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.

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, heat and 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.

In foreign jurisdictions, changes can involve additional controls on selling and using coal. Changes can also result in special conditions for importing goods and services to Russia.

International sanctions against Russian individuals and legal entities, as well as industry sanctions, can also restrict certain sectors of the Russian economy.

The sanctions currently in place do not directly target Russia's coal and energy industry or SUEK. However, a number of economic limitations do currently affect our business and necessitate special control in the selection of counterparties. 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.

STRATEGIC PRIORITIES



MATERIAL MATTERS¹



Changes over the year



Actions to mitigate the risk

We constantly monitor proposed projects to amend legislation in Russia and other countries of operation, and review law enforcement practices, taking into consideration the company's activities. 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.

SUEK's senior managers and experts are actively involved in governmental policy panels for the coal, power and other related industries.

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.

We monitor the situation related to international sanctions in force and make sure our counterparties are not under sanctions.

2. Regulatory risk

Our 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 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 sites.

Changes in national environmental and labour regulations may also influence coal-fired power generation.

STRATEGIC PRIORITIES



MATERIAL MATTERS



Changes over the year



Actions to mitigate the risk

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 procedures in place 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.

3. Risk of changes in electricity tariffs for residential customers and heat tariffs

The company's operations may be affected by heat and power tariffs set below our production costs and by non-fulfilment of obligations to raise heat tariffs as part of the 'alternative boiler' model.

STRATEGIC PRIORITIES



MATERIAL MATTER



Changes over the year



Actions to mitigate the risk

We monitor the situation and cooperate with regulators regarding changes in tariff setting methods, with switching to long-term tariffs as top priority.

¹ Please see definitions of material matters in Materiality section on p. 45.

MARKET RISKS

4. Risk of reduction in coal demand and prices

The company's business may be affected by a decline in demand for coal and a reduction in coal prices in the export market due to oversupply or a rise in demand for other types of fuel. Tighter international environmental standards on coal quality and production conditions could also result in reduced demand for the coal we produce.

STRATEGIC PRIORITIES



MATERIAL MATTERS



For more details, see Market review on pages 50–55.

Changes over the year



Risk increased due to lower coal prices in major markets because of weather conditions, and coal substitution with other fuels such as gas and renewables.

Risk materialised in 2019.

Actions to mitigate the risk

We continuously monitor and forecast the price behaviour of commodities in general and coal in particular. When necessary, we also adjust 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.

Coal washing and our own logistics make it possible to consistently supply high-quality, demanded products to the international market. We regularly analyse the state of production in the industry and the situation in export markets and, accordingly, update production and marketing strategies.

We also expand our presence in coal emerging markets and participate in projects to develop new technologies for coal-fired power generation.

5. Risk of reduction in power plant load and electricity prices in the wholesale electricity market

SUEK's operations may be affected by a decrease in the load of thermal power plants and a drop in electricity prices in the wholesale market due to market (lower demand, excess supply), natural (high water level, average annual temperature) and regulatory factors.

STRATEGIC PRIORITIES



MATERIAL MATTER



For more details, see Market review on pages 50–55.

Changes over the year



Actions to mitigate the risk

SUEK takes measures to raise the efficiency of participation in the electricity market by improving methods and technologies of operational planning and forecasting, and by increasing the loading efficiency of power plants.

We also cooperate with infrastructure organisations of the wholesale electricity and capacity market regarding changes in the regulatory documents affecting pricing and plant loading procedures.

6. Risk of reduction in demand and prices in the capacity market

SUEK's activities may be affected by lower than expected growth rates in capacity demand due to the failed commissioning of large industrial facilities in Siberia, alongside regulatory changes.

STRATEGIC PRIORITIES



MATERIAL MATTERS



Changes over the year



Actions to mitigate the risk

The company monitors market demand, interacts with infrastructure organisations in the wholesale electricity market in terms of improving regulatory documents that affect the volume and cost parameters of the capacity market. SUEK fulfils all obligations to supply available and new capacity to the market, minimising the risk of being penalised for a failure to comply.

FINANCIAL RISKS

7. Foreign exchange and interest rate risks

Changes in market indicators, such as currency exchange and interest rates, can have an adverse effect on the SUEK’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 effects in these areas caused by currency fluctuations and rising interest rates.

STRATEGIC PRIORITIES



MATERIAL MATTER



For more details, see Financial review on pages 56–59, and notes to the Consolidated financial statements on pages 129–161.

Changes over the year



During the year, the LIBOR rate decreased by 0.7 p. p., which had a positive effect on the floating rate on PXF lines with a share of approximately 40% in our loan portfolio. Interest rates on RUB-denominated financing also went down, following a decrease in the key rate (from 7.75% to 6.25%).

Actions to mitigate the risk

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 or hedged. We hedge risks using forward exchange transaction instruments as well.

8. Inflation risk

In Russia, growing inflation leads to higher costs related to procurement and payment to personnel, which can impact negatively EBITDA, as the company’s revenue is nominated in US dollars.

STRATEGIC PRIORITIES



MATERIAL MATTER



Changes over the year



Actions to mitigate the risk

We mitigate inflation risks by developing a balanced procurement strategy, using derivatives and investing available cash 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.

9. Credit risk

Increase in overdue receivables under domestic coal, heat and power 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.

STRATEGIC PRIORITIES



MATERIAL MATTER



For more details, see Financial review on pages 56–59.

Changes over the year



Actions to mitigate the risk

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. In each company’s branch, there is a department that monitors heat payment arrears and provides information support to heat buyers. SUEK’s priority is pre-judicial recovery, the company always negotiates with its customers, enquires about the reasons for debt, offers options for milestone or instalment payments if some consumers are going through hard times.

10. Liquidity risk

Liquidity risk is directly related to cash turnover. It arises if the company cannot fulfil its payment obligations on time. 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.

STRATEGIC PRIORITIES



MATERIAL MATTER



Changes over the year



Actions to mitigate the risk

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 covers its financing needs. The adoption by European banks of coal policies reduces the amount of available borrowing in the pre-export lending market. At the same time, SUEK diversifies its funding sources. In particular, the company increased the share of financing from Asia-Pacific region banks and in 2019 implemented a large-scale borrowing program in the Russian bond market, thereby offsetting the indicated trend.

OPERATIONAL RISKS

11. Production risk (mining)

Various internal (downtime, adverse geology, low coal quality) or external factors (higher prices of materials and services, the failure of suppliers and contractors to fulfil their obligations, natural and other factors) can affect our activities. They can hinder the achievement of our production targets, which may require additional expenses, resulting in an increase in production costs, and cause accidents and emergencies at our production facilities.

STRATEGIC PRIORITIES



MATERIAL MATTERS



Changes over the year



Actions to mitigate the risk

At our coal production units, we use Life of Mine (LoM) deposit development models. They enable each production unit to check its annual budgeted and actual expenses with LoM on a regular basis. As part of this process, we pay special attention to operational efficiency projects. Moreover, we use monthly KPIs allowing management to assess the performance regularly and, if necessary, adjust the plans in time and ERP system as well.

As for emergencies, we continuously monitor hazardous situations at all stages of our operations, caring about compliance with safety requirements at our production sites and geological characteristics at all mining facilities. All emergencies and off-normal situations are thoroughly investigated with the involvement of sectoral experts making part of dedicated commissions.

12. Production risk (energy generation)

The main factors affecting the generation and sales of electricity and heat are the physical wear and obsolescence of equipment, including heat networks, its downtime, underestimation of the impact of possible failures, the absence of the required amount of primary materials, non-fulfilment by suppliers and contractors of their obligations, etc.

STRATEGIC PRIORITIES



MATERIAL MATTERS



Changes over the year



Actions to mitigate the risk

We use a maintenance strategy and develop a programme for prioritising repairs and managing production risks. In addition, we employ a monthly reporting procedure based on KPIs, and ERP system, allowing management to promptly assess the performance of SUEK and its subsidiaries.

13. Risk of restricted infrastructure availability

Reduced access to railway and port infrastructure, electricity networks and water facilities can result in higher operational costs, and losses because of downtime at our production units. Certain infrastructure is operated by state-owned monopolies and is subject to tariff regulation, which can affect the availability and quality of their services. A number of SUEK's facilities operate in regions where extreme weather can influence power supply and transportation. 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 and negatively impact our financial performance.

STRATEGIC PRIORITIES



MATERIAL MATTERS



Changes over the year



Actions to mitigate the risk

We 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, power and heat networks.

We also invest heavily in developing our own infrastructure that is critical to our business, such as Vanino Bulk Terminal, Murmansk Commercial Seaport, railcar fleet.

For more details, see logistics review on pages 71–75.

14. Cyber risk

Effective management of risks related to cyber-attacks and employee errors 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 PRIORITY



MATERIAL MATTERS



Changes over the year



Actions to mitigate the risk

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 in line with best practice.

SUSTAINABILITY RISKS

15. Health and safety risk

SUEK's operations are 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 accidents can lead to investigations from state watchdogs resulting in suspension of production, as well as a possible increase in reputational risk, the discontinuation of business partnerships or claims from the company's lenders for early loan repayments.

STRATEGIC PRIORITIES



MATERIAL MATTERS



For more details, see *Health & safety section* on pages 80–85.

Changes over the year



The risk materialised in 2019.

Actions to mitigate the risk

Every meeting of the Board of Directors and the Nomination and Compensation Committee starts with a review of health and safety issues. Our Industrial Safety Committee of the Management Board analyses every injury sustained at our sites by our employees or contractors 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 coal segment employees against permanent or temporary disability.

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

16. Environmental risk

The environmental risks related to coal mining, washing, processing and coal-fired power generation supposes environmental damage including, contamination of soil and water, land disturbance by mining activities.

In the event of its occurrence, possible claims from supervisory bodies, may affect the operational and financial performance of the company.

STRATEGIC PRIORITIES



MATERIAL MATTERS



For more details, see *Environmental section* on pages 86–94.

Changes over the year



The probability of risk has increased due to planned legislative changes, introducing additional and changing current environmental requirements regarding greenhouse gas emissions, obtaining permissions, and others.

Actions to mitigate the risk

SUEK carefully monitors compliance with all environmental norms and standards set by law in the countries where we operate and sell our products. We take every effort to reduce environmental and ecosystem impacts and pollutant emissions, and to ensure the efficient disposal and recycling of waste.

We install electrostatic precipitators with 99.6% efficiency and tall stacks at our power plants, ensure safe ash and slag disposal, utilise mine methane and rehabilitate disturbed lands, employ state-of-the-art anti-dust measures at ports, and build closed water circulation systems at production facilities.

We also increase coal washing to reduce the environmental impact of our products during their transportation and use.

17. Human resource risk

Failure to recruit and retain qualified personnel can result in missed production targets and increased costs. 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, complicate recruitment.

STRATEGIC PRIORITIES



MATERIAL MATTERS



For more details, see *Our people and corporate culture section* on pages 95–99.

Changes over the year



Actions to mitigate the risk

SUEK has 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.

We also implement projects aimed at social development, including improving housing conditions in the regions where we operate.