





FINANCIAL RESULTS

90

Financial (accounting) statements of Kubanenergo PJSC

92

Results of financial and economic activities of the Company

FINANCIAL (ACCOUNTING) STATEMENTS OF KUBANENERGO PJSC

SKIBA

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CHIEF ACCOUNTANT – HEAD OF ACCOUNTING AND TAX
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ACCOUNTING (FINANCIAL) STATEMENTS FOR 2018 WHICH KUBANENERGO PJSC PREPARED IN ACCORDANCE WITH THE CURRENT LEGISLATION OF THE RUSSIAN FEDERATION. THE AUDIT OPINION WAS RECEIVED THAT THE ACCOUNTING (FINANCIAL) STATEMENTS REFLECT RELIABLY IN ALL PHYSICAL ASPECTS OF THE FINANCIAL POSITION OF THE COMPANY AS OF DECEMBER 31, 2018.

The accounting statements of Kubanenergo PJSC for 2018 are formed based on the standards and regulations on accounting and reporting in effect in the Russian Federation (further referred to as Russian Accounting Standards (RAS)):

- Federal Law of 06.12.2011, No. 402-ФЗ "On Accounting";
- Order of the Ministry of Finance of Russia dated 02.07.2010 No. 66n "On the Forms of Accounting Statements of an Organization";
- Order of the Ministry of Finance of Russia of 05.10.2011 No. 124n "On Amendments to the Forms of Accounting Statements of Organizations, Approved by Order of the Ministry of Finance of the Russian Federation of 02.07.2010, No. 66n";
- Order of the Ministry of Finance of Russia dated July 29, 1998 No. 34n "Concerning the Approval of the Regulation on Accounting and Accounting Reporting in the Russian Federation";
- Chart of Accounts of financial and economic activities of enterprises, approved by order of the Ministry of Finance of Russia dated 31.10.2000, No. 94n;
- Accounting Regulation "Accounting policy of the organization" PBU 1/2008, approved by order of the Ministry of Finance of Russia of 06.10.2008 No. 106n.

THE COMPOSITION OF THE ANNUAL REPORTING OF KUBANENERGO PJSC FOR 2018, COMPILED UNDER RAS, INCLUDES:

- BALANCE SHEET.
- STATEMENT OF FINANCIAL PERFORMANCE.
- STATEMENT OF CHANGES IN EQUITY.
- CASH FLOW STATEMENT.
- EXPLANATIONS.
- AUDIT REPORT.

KEY ACCOUNTING POLICIES OF KUBANENERGO PJSC

Accounting of fixed assets in the Company is carried out in accordance with the Regulation on Accounting "Accounting for Fixed Assets" PBU 6/01, approved by order of the Ministry of Finance of Russia dated 30.03.2001, No. 26n. Depreciation on fixed assets is calculated on a straight-line basis based on their useful life. For fully depreciated (worn) items of fixed assets, depreciation was not accrued.

Work in progress is estimated at actual cost.

Recognition of the expenses incurred as an expense of a future period and equating it to an asset with reflection in accounting and reporting is related to the principal approach established in the Company. This approach is based on an understanding of the temporary fact of the likelihood that an organization will receive economic benefits in the future from this asset and an assessment of its value with a sufficient degree of reliability.

Advances related to the acquisition of a non-current asset in the future, as well as raw materials and supplies intended for use in the creation of fixed assets, are recorded in line 1150 "Fixed Assets".

Real estate objects are actually exploited, for which capital investments are fully completed and primary documents are drawn up, are accepted for accounting as fixed assets with the release of a separate subaccount "Real estate objects for which no title is registered." For such objects, depreciation is calculated in a general manner from the first day of the month following the month in which the object was put into operation.

Accounting for revenue and other income is maintained by the Company in accordance with the Accounting Regulation "Income of the Organization" PBU 9/99, approved by order of the Ministry of Finance of Russia of 06.05.1999, No. 32n.

The Company has established estimated liabilities due to possible payments of compensation for unused vacations, unresolved requirements of electricity suppliers to compensate for losses and electricity transmission services, legal proceedings and other payments to employees in accordance with PBU 8/2010 "Estimated liabilities, contingent liabilities and contingent assets" approved by order of the Ministry of Finance of Russia dated December 13, 2010, No. 167n.

The Company reserved doubtful receivables that are not repaid or with a high degree of probability will not be refunded within the terms established by the contract and are not provided with appropriate guarantees.

The Company forms a reserve for the depreciation of financial investments in the event of a sustained significant reduction in their value.

Adjustments relating to previous periods

ADJUSTMENTS AND OTHER ACCOUNTING CHANGES RELATING TO PREVIOUS PERIODS IN THE REPORTING FOR 2018 ARE ABSENT.

THE COMPANY HAS FORMED CONSOLIDATED FINANCIAL STATEMENTS FOLLOWING THE REQUIREMENTS OF THE FEDERAL LAW DATED JULY 27, 2010, NO. 208-F3 "ON CONSOLIDATED FINANCIAL STATEMENTS."

In accordance with the requirements of the legislation of the Russian Federation, the Company is obliged to conduct an annual audit of financial statements. To check and confirm the annual financial statements, the General Meeting of Shareholders annually approves the Company's auditor.

In order to ensure the independence and objectivity of the external auditor, the selection of the external auditor of the Company was carried out through an open competitive procedure using the Unified Procurement Information System of PJSC Rosseti (hereinafter referred to as the ETP). Information about the open tender for the right to conclude contracts for the audit of financial statements for 2018–2020 was published in the unified information system (www.zakupki.gov.ru, № 31806037793), on the ETP (<http://www.etp.rosseti.ru>). The duration of the competition is from February 1 to April 16, 2018. The evaluation of the contest participants was carried out according to the criteria set in advance and stated in the conditions of the contest.

According to the results of an open one-stage competition without a preliminary qualification selection for the right to conclude contracts for auditing financial statements for 2018–2020, Ernst & Young LLC was declared the winner (Minutes of the meeting of the Competition Commission of PJSC Rosseti dated 16.04.2018, No. 13/595p). Mandatory audit of financial statements for 2018 includes an audit of accounting (financial) statements prepared in accordance with RAS and IFRS for the year ending December 31, 2018.

Cost of services for Kubanenergo PJSC for 2018–2020 determined in the amount of 15 853 783.64 rubles, including VAT.

This auditor was also approved by the decision of the Annual General Meeting of Kubanenergo PJSC Shareholders (minutes No. 40 dated 28.05.2018).

Full name of the audit firm: Limited Liability Company Ernst & Young.

Abbreviated name of the audit firm: Ernst & Young LLC.

Location and mailing address: Russia, 115035, Moscow, Sadovnicheskaya nab. 77, bld. 1.

Phone/fax: (495) 755-97-00 / (495) 755-97-01.

E-mail address: rfp@ru.ey.com.

The audit organization Ernst & Young LLC is a member of the Russian Auditors Union (Association), a Self-Regulatory Organization of Auditors (Incorporated Society of Accountants) with the primary registration number of entry (PRNE) 11603050648.

The amount of remuneration of an auditor for audit check of the annual financial statements for 2018 was approved by the decision of the Board of Directors of Kubanenergo PJSC (minutes No. 319/2018 dated 24.09.2018) 5,284,594.54 rubles in total, including VAT. In connection with the entry of amendments to the Tax Code of the Russian Federation in accordance with Federal Law of 03.08.2018, No. 303-F3 "Concerning the Amendments to Certain Legislative Acts of the Russian Federation on Taxes and Duties", in force from January 1, the cost of audit services for 2018 amounted to 5,333,857.71 rubles (Supplementary Agreement No. 1/407/30-1511 dated December 13, 2014).

There are no deferred and overdue payments for services rendered by the auditor.

On December 29, 2018, the was the concluded a Contract with the Contractor Ernst & Young, LLC on "assessment and consulting services," for the services of a comprehensive analysis of the financial and economic activities of Kubanenergo PJSC. The Company has no facilities provided in the reporting year by this Contract.

RESULTS OF FINANCIAL AND ECONOMIC ACTIVITIES OF THE COMPANY

OCHEREDKO

OLGA VYACHESLAVOVNA

DEPUTY DIRECTOR GENERAL FOR ECONOMICS AND FINANCE



THE KUBANENERGO PROGRAM OF INCREASING OPERATIONAL EFFICIENCY AND REDUCING COSTS FOR 2018–2022 WAS DEVELOPED AND PUT IN PLACE IN 2018. THE PROGRAM HAS THE AIM TO OPTIMIZE COSTS, IMPROVE THE MANAGEMENT EFFICIENCY OF PROCUREMENT AND SUPPLY CHAIN, REDUCE THE UNIT COSTS FOR THE OPERATION OF POWER EQUIPMENT, REDUCE ENERGY LOSSES IN THE NETWORK AND INCREASE THE OVERALL ENERGY EFFICIENCY.

ACCORDING TO THE RESULTS OF THE REPORTING PERIOD, THE TARGET PARAMETERS FOR REDUCING OPERATING EXPENSES UNDER THE DIRECTIVE OF THE GOVERNMENT OF THE RUSSIAN FEDERATION NO. 2303P-P13 OF APRIL 16, 2015, FOR 2018 RELATIVE TO THE LEVEL OF 2017 WERE FULFILLED."

ANALYSIS OF THE RESULTS OF FINANCIAL AND ECONOMIC ACTIVITY

In 2018, the proceeds from the sale of the Company's services amounted to 46,401.1 million rubles, which is 4,148.1 million rubles. (9.8%) more than in 2017, including:

- Revenue from electricity transmission was equal to 45,583.5 million rubles (by 4,097.8 million rubles more than in 2017); growth was triggered by:
 - / an increase in the volume of services rendered by 562 million kWh,
 - / with a change in the procedure for reimbursement to the Wholesale Market for Electricity and Power (WMEP) participants of the cost of load losses accounted for in the prices on the WMEP, as a result of which, which set up to calculate the revenue for electricity transmission services without deducting the specified value from August 1, 2017 (Clause 1b of the Resolution of the Russian Federation 07.07.2017 No. 810 "On Amendments to Certain Acts of the Government of the Russian Federation Regarding Payment for Electricity Losses on the Wholesale Electricity and Capacity Market and Retail Electricity Markets, and

Obtaining the Status of a Subject of the Wholesale Electricity and Capacity Market");

- Proceeds from technological connection services amounted to 602.5 million rubles, which is 45.5 million rubles less than in 2017.

The cost price (including management expenses) in 2018 amounted to 41,616.9 million rubles, which is 3,247.9 million rubles. (8.5%) more than in 2017. The increased costs are due to the rise in the price of purchased electricity to compensate for losses, expenses for services of PJSC FGC UES, services of distribution grid companies, depreciation of fixed assets and intangible assets.

Profit before tax amounted to 1,279.8 million rubles, which is 112.1 million rubles (9.6%) more than in 2017.

The Company's net profit in 2018 amounted to 151.2 million rubles (by 374.1 million rubles (71.2%) below the level of 2017).

The main factors that influenced the financial result:

- + increase in revenue from sales of services by 4,148.1 million rubles (9.8%), including due to the rise in revenue from electricity transmission services for 2018 by 4,097.8 million rubles (9.9%) relative to the parameters of the previous year, while revenue from technological connection services decreased by 45.5 million rubles (7.0%);
- increase in cost, with account for 3,247.9 million rubles of management expenses (8.5%), relative to the parameters for the same period of 2017;
- deterioration of the balance of other income and expenses from profits by 787.99 million rubles (29%) relative to the parameters of 2017;
- increase in income tax by 486.2 million rubles in comparison with the parameters of the same period in 2017;

Key financial and economic indicators of the Company for 2016–2018, million rubles.

SEQ NO.	INDICATOR	2018	2017	2016
1	Proceeds from sales of products (services), including:	46,401	42,253	41,726
1.1	from power transmission	45,583	41,486	39,262
1.2	from technological connection	602	648	2,381
1.3	from the sale of electricity	0	0	0
1.4	from other activities	215	119	83
2	Cost of products (services)	-41,461	-38,259	-35,830
3	Gross profit	4,940	3,994	5,896
4	Administrative expenses	-155	-110	-98
5	Selling costs	0	0	0
6	Profit (loss) from sales	4,784	3,884	5,798
7	Interest receivable	82	47	90
8	Interest payable	-1,911	-1,907	-1,889
9	Income from participation in other organizations	9	0,3	0
10	Other income (total)	2,575	2,393	2,616
11	Other expenses (total)	-4,259	-3,249	-3,109
12	Profit (loss) before tax	1,280	1,168	3,506
13	Profit tax and other payments	-1,129	-642	-1,366
14	Net profit	151	525	2,141
15	EBITDA¹	7,158	6,847	9,015

IMPLEMENTING AN EFFICIENCY AND COST REDUCTION PROGRAM

The program for enhancement of operating efficiency and reduction of Kubanenergo PJSC costs for 2018–2022, approved by the Board of Directors of the Company on December 27, 2017 (minutes of the meeting of the Board of Directors dated 28.12.2017, No. 294/2017). Implementation of the program's activities is taken into account in the business plan, investment program, energy-saving, and energy efficiency improvement program, innovative development program and other targeted programs developed by the Company.

The performance indicators of the program take into account the targets set by the Strategy for the Development of the Electric Grid Complex of the Russian Federation, approved by the decree of the Government of the Russian Federation of 03.04.2013 No. 511-p, and also by the directive of the Government of the Russian Federation of 16.04.2015 No. 2303p-P13.

The reduction in operating expenses following the directive of the Government of the Russian Federation No. 2303p-P13 dated April 16, 2015, for 2018 relative to the level of 2017 was 2%, which corresponds to the target value.

1. Regulation for payment of remuneration and compensation to members of the Auditing Commission of Kubanenergo PJSC is published on the website www.kubanenergo.ru – section 'About Us/ Constituent and internal documents'.

As a part of improving operational efficiency and generating additional revenues, the Company in 2018 implemented the following measures:

- improving the efficiency of the process of managing the maintenance and repair of equipment, buildings and structures (the implementation of a set of measures aimed at the redistribution of the method of performing work in the technological areas: OTL 35–220 kV, SS 35–110 kV; distribution networks 0.4–10 kV (OTL, transformer substation); optimization of the distribution of works between contracting and business methods);
- improving working capital management (optimization of receivables (reduction of overdue debts for electricity transmission services), destocking of the emergency reserve, including through adjustments in the direction of reducing the volume of reserve stocks, and transferring a part of the inventories for repair and operation of equipment in 2018);
- improving the management of fixed assets, including:
 - / consolidation of power grid assets
 - / implementation of the event "Development of Price Expertise",
 - / reducing the cost of purchasing raw materials and materials, procuring contractor services for new construction, technical re-equipment and reconstruction as a result of regulated procedures in the framework of investment activities;
- improving energy efficiency (implementation of measures to reduce the level of electricity losses under the Kubanenergo PJSC Electricity Loss Reduction Program for 2018–2022 and the Energy Saving and Energy Efficiency Improvement

Program of Kubanenergo PJSC; organizational and technical measures to ensure the rational use of fuel and energy resources and water for the production and economic needs of the Company);

- increase in operating efficiency (reduction in unit operating expenses), including:
 - / reuse of previously used (post-consumer) materials
 - / reduction of maintenance materials, consumables for office equipment maintenance, reduction of costs for communication services, IT services, write-off of software products,
 - / optimization of costs associated with the decommissioning of vehicles, the further management of which is impractical, including reducing the cost of fuel, optimizing the fleet of cars to be insured by Compulsory Civil Liability Insurance for Vehicle Owners (CCLIVO),
 - / reducing the cost of purchasing raw materials and materials, production and non-production services in terms of operating activities as a result of regulated procedures;
- other activities (implementation of measures aimed at reducing non-contractual electricity consumption).

The program to improve operational efficiency and reduce costs creates a useful tool to improve in-process efficiency and ensure profitability through the productive use of the Company's private reserves to implement the main strategic directions of the Company's activities.

ACCOUNTS RECEIVABLE

Analysis of changes in receivables, mln rub.

	ON 31.12.2018	ON 31.12.2017	ON 31.12.2016
Accounts receivable, including:	7,057.41	6,847.39	7,119.42
Customers and Buyers of electricity transmission	6,206.67	6,155.95	6,410.58
Notes receivable	6,091.36	6,104.65	6,381.93
Advances issued	34.49	32.12	13.37
Other receivables	816.26	659.32	695.47

The total amount of receivables of Kubanenergo PJSC at the beginning of the reporting year amounted to 6,847.39 million rubles, and as of December 31, 2018 – 7,057.41 million rubles.

Accounts receivable from buyers and customers amounted to 6,206.67 million rubles, which is 50.72 million rubles (0.82%) above the level as of December 31, 2017, the increase was due to a rise in the debt on other buyers and customers by 59.45 million rubles.

Accounts receivable on advances issued amounted to 34.49 million rubles, which is 2.37 million rubles (7.38%) above the level as of December 31, 2017.

Accounts receivable for other debts amounted to 816.26 million rubles, which is 156.93 million rubles. (23.80%) below the level as of December 31, 2017.

The main share (86.31%) of accounts receivable of the Company was formed in settlements for the services rendered for the transmission of electricity.

Cost accounts receivable reduction efforts for electricity transmission services

Accounts receivable for services rendered for the transmission of electricity to counterparties of Kubanenergo PJSC as of December 31, 2018 (net of allowance for doubtful debts) 6,091.36 million rubles in total. Disputable receivables at the end of the reporting year amounted to 829.79 million rubles.

Compared to 2017, accounts receivable (based on debt before deducting allowance for doubtful debts) were reduced by 226.71 million rubles. (3.07%).

PJSC "TNS Energo Kuban" is one of the largest debtors for electricity transmission services rendered, whose debt as of December 31, 2018, was 3,456.47 million rubles, including the disputed part - 506.45 million rubles, with the average monthly volume of services provided by the Company in the amount of 2,079.57 million rubles is 1.7 of a settlement period.

To reduce accounts receivable, the Company conducts claim-related work, including settlement of disputes in the pre-trial and court proceedings.

The results of the Company's work on reducing accounts receivable for services rendered for the transmission of electricity to counterparties of Kubanenergo PJSC in 2017–2018

2017				
TOTAL RECEIVED POSITIVE COURT DECISIONS, CASES/SUMS OF CLAIMS	TOTAL RECEIVED WRITS OF EXECUTION FOR THE AMOUNT OF	EXTINGUISHED DEBT ACCORDING TO THE WRITS OF EXECUTION	DENIED IN RECOVERY, CASES/ AMOUNT OF CLAIMS	SHARE OF CLAIMS SATISFIED IN FAVOR OF THE COMPANY
62 cases/ 911.15 million rubles	913.63 million rubles	544.38 million rubles/ 59.58%	2 cases / 50.320 million rubles	99.7%

2018				
TOTAL RECEIVED POSITIVE COURT DECISIONS, CASES/SUMS OF CLAIMS	TOTAL RECEIVED WRITS OF EXECUTION FOR THE AMOUNT OF	EXTINGUISHED DEBT ACCORDING TO THE WRITS OF EXECUTION	DENIED IN RECOVERY, CASES/ AMOUNT OF CLAIMS	SHARE OF CLAIMS SATISFIED IN FAVOR OF THE COMPANY
127 cases/ 1,070.5 million rubles	995.06 million rubles	780.47 million rubles/ 78.43%	3 cases/ 22.95 million rubles	97.9%

The coverage of overdue receivables for electricity transmission services measures aimed at its reduction is at a consistently high level and December 31, 2018, is 99.16%.

ACCOUNTS PAYABLE

Analysis of changes in short-term payables, mln rub.

	ON 31.12.2018	ON 31.12.2017	ON 31.12.2016
Short-term payables, including	12,833.09	11,044.75	8,280.20
Suppliers and contractors	5,238.56	6,198.14	4,837.35
Promissory notes payable			
Taxes and fees	606.53	258.01	654.43
Advances received	5,164.80	2,889.10	1,922.41
Other accounts payable	1,823.20	1,699.51	866.01

Short-term payables for 2018 are higher by 1,788.34 million rubles, compared with 2017 and as of December 31, 2018, amounted to 12,833.09 million rubles.

The following changes occurred during the reporting year:

- the indebtedness to suppliers and contractors became lower by 959.58 million rubles due to a decrease in the debt on settlements for electricity transit services by 809.44 million rubles, and a reduction in debt for electricity purchased in order to compensate for losses by 253.46 million rubles;
- the debt on advances received was higher by 2,257.71 million rubles, advances for technological connection make up the bulk of the debt on advances received – 5,144.42 million rubles;
- wage arrears to staff is higher by 103.65 million rubles;
- arrears of taxes and duties are higher by 348.52 million rubles.

Overdue payables in Kubanenergo PJSC based on the results of activities in 2018 is 3,058.04 million rubles.

According to the results of 2018, long-term payables amounted to 1,248.68 million rubles.

BONDED LOANS AND CREDIT RATINGS OF THE COMPANY

September 20, 2016 the Board of Directors of Kubanenergo PJSC approved the Program for the exchange of Kubanenergo PJSC bonds of the 002P series (minutes No. 251/2016). On October 24, 2016, the program of bonds exchange had received the identification number 4-00063-A-002P-02E. The program provided for the possibility of placing documentary interest non-convertible exchange bearer obligations with mandatory centralized storage and total nominal value of all issues of exchange bonds, placed under the program of exchange of obligations of the 002P series is up to 25 billion rubles, with a maturity date that comes no later than 10 920th day from the date of commencement of placement of issuance of exchange-traded bonds under the program of exchange-traded obligations placed by open subscription. In 2017, the placement of bonds under this program was not carried out.

Also, documentary interest-bearing non-convertible exchange-traded bearer bonds with mandatory centralized storage of the 001P-01 and 001P-02 series, which were placed in 2015 under the Program of exchange bonds with the identification number 4-00063-A-001P-02E from 26.08, are in circulation. 2015, in the amounts of 3.6 and 3.4 billion rubles respectively. Payments of coupon income were made in full within the prescribed period.

In 2018, based on the results of the open request for proposals of Kubanenergo PJSC, an agreement dated August 15, 2018, No. 293D/18-28 was concluded with the rating agency Expert RA JSC for three years. In the framework of this contract, in 2018 the rating was not assigned to the Company.