Develop Complementary Portfolio Through Coal Acquisition

BCG Strategy Cup 2013

The Economists

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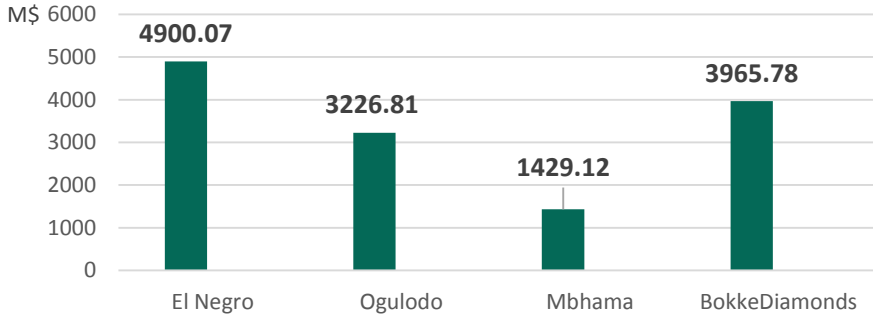
Executive Summary

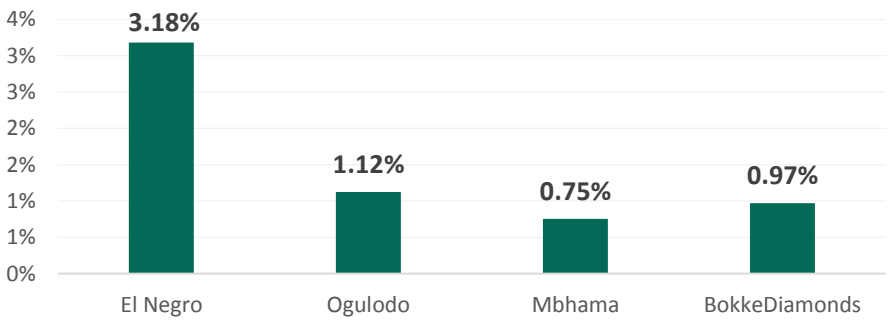
WakkaWakka's Goals	Recommendations	Supporting Evidence
Sustain impressive past growth	Metcoal industry offers the best growth opportunities	✚ High expected demand in Brazil & Mexico ✚ No currently available substitutes
Diversify risks and portfolio	Armada mines hold a strategic position minimizing risks	✚ Armada mines has the largest market share from the potential acquisition targets ✚ 10-year contract and low price volatility make revenues predictable
	Mitigating the threat of synthetic diamonds is costly	Vertical integration to guarantee demand for natural diamonds ▬ Sign agreements – weak negotiating position of WakkaWakka ▬ Form joint venture – risk of poor cooperation and integration Enter the synthetic diamonds market ▬ M&A – very high risks and costs
Leverage current expertise	Acquisition of Armada mines provides strong synergies	✚ WakkaWakka's technical expertise applicable to coal mining ✚ Utilizing Armada's excess transportation capacity ✚ Leveraging existing distribution channels ✚ Metcoal forms a complementary portfolio with existing products

Acquire Armada mines, owner of El Negro Coal

NPV of Acquisition Targets



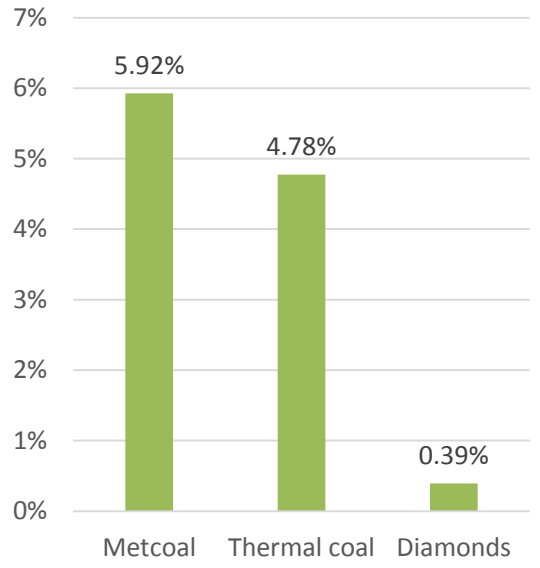
Market Share of Acquisition Targets



Metcoal industry has clear advantages over other industries

Metcoal industry globally achieved **greater 2010-12 CAGR** than thermal coal or diamonds.

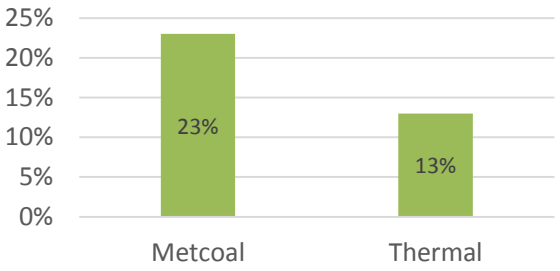
2010-12 CAGR*



*CAGR calculated from (1) the global metcoal supply for export, (2) the global thermal coal for supply for export and (3) the total global supply of diamonds during the 2010-12 period.

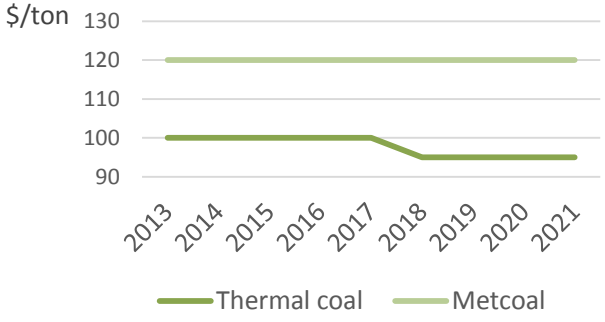
Average return on investment of metallurgical coal is almost double that of thermal.

Average return on investment



FOB prices for **metcoal will remain constant** over the 2013-2020 period, while they are expected to **decrease for thermal coal**.

Expected prices for metcoal



Market Trends

Metcoal:
- **Stagnating** demand in the US and Western Europe; **booming** in India, China, Brazil, Mexico
- No threat of substitutes

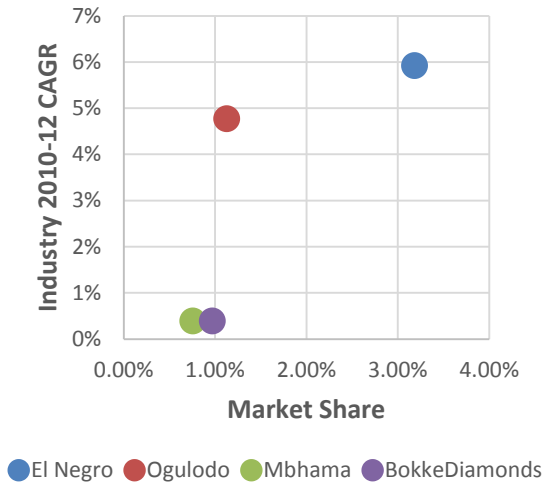
Thermal coal:
- **Decreasing** demand in the US and Western Europe; **growing** in China, India, Russia
- Substitutable by other energy sources

Diamonds:
- **High expected growth** in China and India, stagnating or declining everywhere else
- Oligopolized market; small firms largely unprofitable

Armada mines holds a strategic position minimizing risks

Armada holds the **highest market share** in its respective industry, which is also the **fastest growing**.

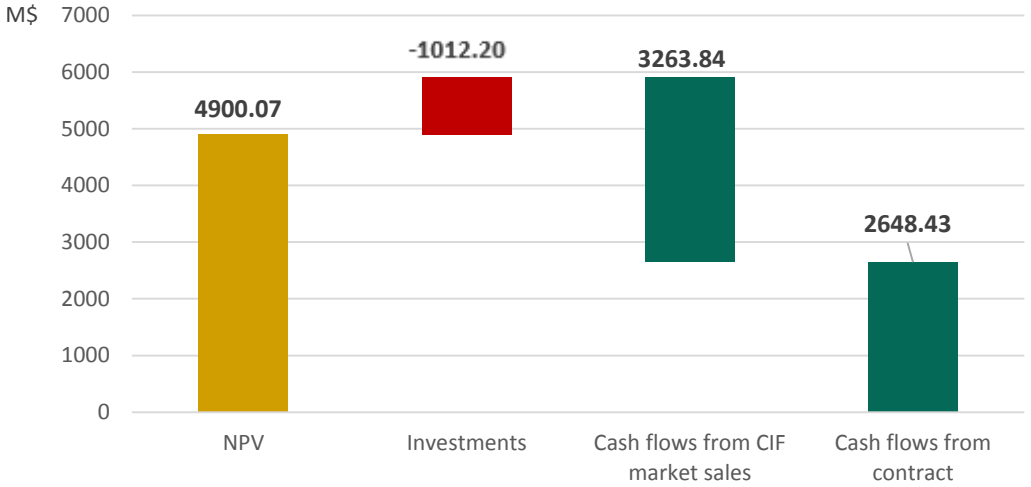
Industry growth-market share matrix



Mine	Market share
El Negro	3.18%
Ogulodo	1.12%
Mbhama	0.75%
BokkeDiamonds	0.97%

Key value drivers

Armada mines key value drivers



CIF market sales

- Strong cash flows are driven by expected **stable prices**, **growing demand** in Latin America and **favorable** long-haul transportation **costs**

Contract

- The 10-year contract for 50Mt (39% of remaining coal reserves) guarantees predictability of cash flows until the mine is exhausted by the end of 2021

Innovation

- Investments in semi-automated loaders, a new blast hole drilling system and renovation of the railway will help Armada to maintain its strategic position by being a **frontrunner in technology**.

Mitigating the threat of synthetic diamonds is costly

To mitigate the threat of synthetic diamonds, WakkaWakka would have to either:

Secure long-term purchase contracts for its diamond production

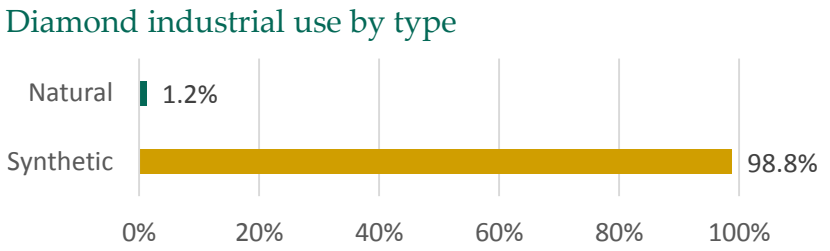
- **A majority of smaller companies unprofitable**
  - Concentrated supply chain
  - Substantial operational risk – quality/amount vs. expectations
  - Sensitivity of luxury market towards economic downturns

Vertical integration through:

- Agreements
  - ✚ Predictability of CF
  - ✚ Lower initial costs
  - ▬ Weak negotiation position
- Joint venture
  - ▬ Lower decision-making power
  - ▬ Costly & time-consuming

Enter the synthetic diamonds industry

- In industrial applications, synthetic diamonds dominate



Market entry through:

- M&A
  - ▬ High initial costs
  - ▬ Very costly & time-consuming
  - ▬ High level of risk

Acquisition of Armada mines provides strong synergies

	Synergies	Opportunities	Risks
Armada mines	1. Supply chain 2. Expertise 3. Customer relations	1. Strong demand for steel in Mexico and Brazil	1. Decrease in demand for steel
Ogulodo mine	1. Transportation from existing mines in Africa 2. Expertise	1. Serving increasing demand for thermal coal in India and China	1. Substitutes 2. Political uncertainty 3. Environmental laws
Mbhama mine	1. Low cost synergies 2. No revenue synergies	1. Strongly increasing demand for jewelry diamonds in India and China	1. Political uncertainty 2. High future volatility 3. Substitutes 4. High investments of large companies to gain market share in China/India
BokkeDiamonds mine	1. Low cost synergies 2. No revenue synergies	1. Strongly increasing demand for jewelry diamonds in India and China	1. Increase in taxes 2. High future volatility 3. Substitutes

Most favorable or least threatening to the company

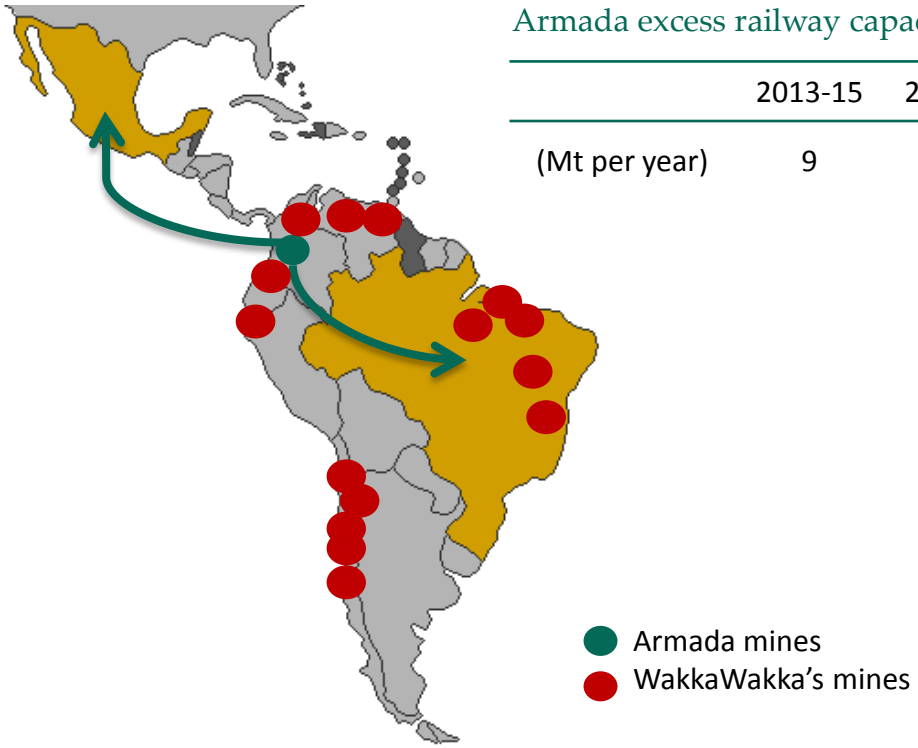
Moderately favorable to the company

Least favorable and most threatening to the company

Acquisition of Armada mines provides strong synergies

Utilizing Armada's extensive logistics operations

Armada's proximity to key markets and existing WakkaWakka's mines with complementary commodities enables the development of **economies of scale in transportation**



Armada excess railway capacity

	2013-15	2016-20
(Mt per year)	9	5.7

Leveraging WakkaWakka's technical expertise and distribution channels

- Coal mining similar to existing operations
- Metcoal is a complementary commodity that will share the same distribution channels

Strong cost synergies

Acquire Armada Mines

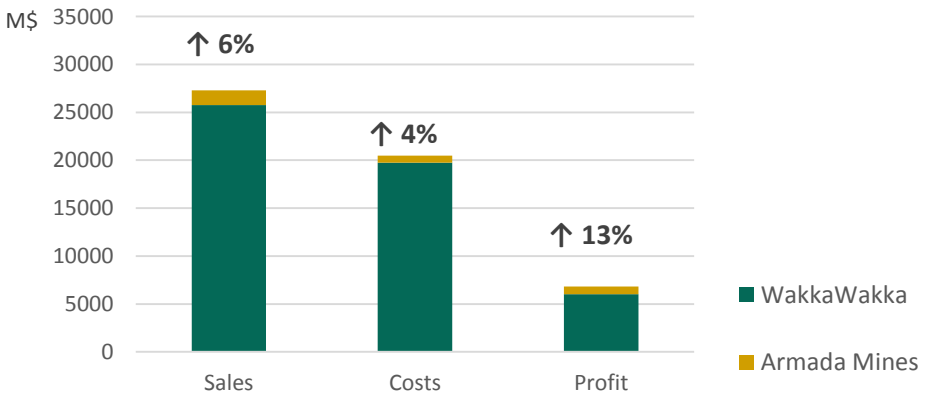
WakkaWakka provides 3 out of 5 materials needed for steel production

Copper	✓
Sulfur	
Nickel	✓
Metcoal	✓
Iron	✓

By adding metcoal, it will provide its customers a highly complementary portfolio

- Capitalize on growing demand for steel in Latin America
- Leverage existing customer relations to drive sales
- Utilize current supply chain to reduce costs and risks
- Create opportunities for vertical diversification

Pro-Forma Analysis for Combined Group (2012)



Pro-Forma Geographical Distribution (2012)