

INTERVIEW : SANDEEP LAKHWARA

India's gold potential undermined

You need to generate a number of small ideas and work them right - to make the Big Idea work

SUPRIYA KURANE

BUSINESS WORLD

LAST week, gold prices touched a 16-year record high, and analysts believe this is just the beginning. BW caught up with Sandeep Lakhwara, MD, Deccan Gold mines, the only listed private gold exploration and mining company in India, to get his views on gold prices, the demand-supply of gold and the future of gold mining in India.

Your view on gold prices...

Gold prices have been on the rise for the past 18 months or so, and they are only going to move upwards from here. There are some fundamental reasons why this is happening. The major driver is the weakening US dollar. If it continues to deteriorate, then the price of gold will continue to strengthen. And the value of the dollar depends on basic fundamentals – budget deficit, continuous spending on war, terrorism, high borrowing, all of which point to a further weakening of the currency.

Economists believe the dollar could see some more weakness, going ahead. Of course, there are going to be adjustments in the price of gold generally heading up. So far, the US dollar has been the reserve currency of the world, but as its value decreases why would anyone want to hold their assets in dollars? The value that you get at the time of realisation could be much lower. Wouldn't you rather hold it in gold?

Geo-political tensions worldwide is another contributor to this northward movement. There are a lot of countries which are looking to add some gold into their system, and thereby gain substance within their currencies. The Malaysian government is looking to introduce a currency made of gold – the gold dinar. The new President of Argentina has proposed a gold-backed peso. Another important thing is that the price of gold is now being subdued deliberately by some bullion banks. According to the Gold Anti Trust Action Committee (GATA), about 15,000 tonnes of gold has been loaned by the Central banks to the bullion banks for which they paid about 1 per cent per annum. The bullion banks then sold the "loaned" gold on the open market and invested the proceeds at 6-7 per cent per annum. When gold prices started heating up, the bullion banks (that are in debt to the Central banks) have to buy it back to repay the gold borrowed from the banks. Each time gold rallies, the Central banks are reportedly selling more government gold to cap its price.

There is also a demand-supply deficiency internationally, according to the World Gold Council. The current demand for gold is about 3,200 tonnes per annum while the supply is only 2,200 tonnes. As supply shrinks, demand will bloat further. That is a natural phenomenon – we always tend to want more of something that is not easily available.

China is going to soon emerge as a big consumer with demands almost similar to India. The Chinese government has not allowed a ten-tola bar like we have here to be traded in the open market. However, from December 2002, they have opened the market and the consumption of gold has gone up considerably since. How long can the shortfall be met from existing reserves held by the banks? What would happen to the price, if the shortfall continues when the existing reserves are depleted? The buying back of hedged positions by the gold producers will also exert pressure on the price.

So does it make sense to invest in gold right now?

Definitely, it does. For all the reasons mentioned earlier, I remain confident that the price of gold will only move upwards from here, so it makes sense for even retail investors to buy gold right now.

You can either invest in the metal physically or invest in the stocks of a gold exploration company like ours. The stock is another form of investment for people who believe that gold, as an investment vehicle,

isn't going to lose its value. Internationally, there is a tremendous link between a gold mining and exploration company's stock and the price of gold. Exploration companies sitting on good land with a potential for discoveries and with good management -- the higher the price of gold, the greater the valuations. If the cost of mining an ounce of gold is say \$180 and if the price of gold is \$360, then your margins are 100 per cent. If the price of gold is \$450, your margins will increase making marginal deposits also feasible. This link is very well-established in the international markets. In India, that link isn't well established. There are a lot of indexes worldwide (like the HUI or the AMEX-Buggs index) that track the valuation placed on mining and exploration companies' stocks and the price of gold.

From a retail investors point, it makes more sense to invest in the stock than in gold as a commodity itself, because it gives you a much better leverage opportunity. If the price of gold goes up marginally, the stock price may increase proportionately. But if you hold gold as a commodity, then to really make money out of it, you have to make a fairly large investment. Alternatively, you can buy a futures contract that is now being offered, but those too require fairly large investments compared to what can be invested in the stock of a mining and exploration company.

What is your outlook for mining activities in the country?

The only gold producer currently in existence in India is in the government-owned Hutti Gold Mines in Karnataka. It produces around 3 tonnes of gold a year and an additional 6 tonnes is produced by Hindalco as a by-product of copper mining. That's a total production of 9 tonnes per annum. Contrast that to India's consumption of around 700-800 tonnes of gold per year. There is, therefore, a tremendous shortfall in production versus consumption. The shortfall is catered through imports. It costs the country about US\$ 8 billion a year to import gold. The only way you can push up the supply is if you mine more gold. The more you spend on exploration, the greater the chances of finding more gold. That is the way India should go ahead now.

The World Gold Council did a study a few years ago, and it believes that there is an approximate 20 million tonnes of ore containing gold in the country. The 20 million tonnes of ore may produce hundreds of tonnes of gold, but that really is dependent on the grade of the ore. Typically, we get 6 grams per tonne or 2 grams per tonne depending on the grade.

If it is so simple, why hasn't India done this in all these years?

In India all these years, exploration and mining of gold has purely been in the realms of the government. The government first opened up the sector in 1994, but the first private permits were delivered only in 2000. So, the exploration in the private sector has only started happening in the last four years.

If you look at Australia as comparison, the terrain is identical for both. The difference is that Australia has spent big on exploration and has invited FDI in the sector. They have created a regime of regulations that are amenable to the companies which are exploring. Australia has made some very large gold discoveries, and is now producing about 280 tonnes mainly due to intensive exploration activities carried out there.

This potential has not been realised in India because of lack of adequate exploration. The Geological Survey of India has done a commendable job of researching and coming out with reports but most large discoveries worldwide have been made by the private sector exploration companies listed on the respective stock exchanges. Companies like ours were not in existence until around 8-9 years ago. In my opinion, the opportunity for development of gold mining in India is very substantial.

How similar are Australia and India in terms of exploration?

There are similarities and differences. The gold mining industry in India dates back 8,000 years ago with about 900 gold panning and mining locations. Whilst the nationalistic policies of the Indian government in the 1970s had closed the gold exploration and mining industry to private sector and foreign investment, countries like Australia went the opposite way and opened its doors, and have come up with amazing results.

Australia now ranks as the leading producer of gold supplying about 12 per cent of world gold production. There are some 540 listed exploration and mining companies on the Australian Stock Exchange. In India, there is only a handful with Deccan Gold being the only listed gold exploration company.

Geologically, though, the Indian and Australian terrains are very similar. There should therefore be every possibility of making some big discoveries in India over the next few years and following the Australian example. What India needs is large doses of exploration capital to augment the development of its gold mining industry.

Are you looking at mining any other metals besides gold?

Our permit allows us to explore for anything else in the ground – zinc, copper, diamonds, nickel. But the development of nickel, zinc and diamonds prospects requires a special type of expertise, and rightfully should be developed by independent metal specific companies. This is exactly why we have been able to sign a JV with DeBeers. It requires a certain amount of expertise to be able to mine for diamonds or gold.

So, they will bring in their expertise to mine for diamonds in our areas and we will bring in our expertise to mine for gold in their area. DeBeers has prospects across the country, but the areas don't overlap. The JV gives each company the right to come into each other's area and give them the opportunity to explore in each other's area. If we find gold in their area, we keep 95 per cent and they keep the balance.

What is the quantum of investment you intend to make in terms of exploration and mining? How expensive is it to mine for gold?

When you start off exploration, the costs aren't too high in India. The basic sampling of rocks, soil and stream sediments are relatively inexpensive activities compared to the actual mining. The biggest costs are the analysis of samples and drilling. It could vary based on exploration activities pursued and the size of the gold deposit when found.

Our first objective is to deliver to India a deposit capable of being mined. We shall spare no effort in doing so. Exploration activities will continue beyond the first such delivery. India, as a country, has spent close to US\$35 million per annum on exploration every year, and Australia has spent US\$ 300 million a year on exploration, Canada, in a similar time zone, has spent between \$3 billion-4 billion on exploration worldwide. In India, 75 per cent of the money spent is from the public sector.

But as time goes on, the private sector will take the lead. Even with us, most of the 20-odd crores we have spent in India has been spent in the last two years. We have around 28 prospects granted to our subsidiary companies throughout the country comprising an area of some 34,000 square km. We are very optimistic in terms of discovery in the short term. Over the next 12 months, we intend to spend the whole of Rs 5 crore that we now raised in Deccan Gold on exploration programmes. When we find a gold deposit, we would consider setting up a processing plant which may cost around Rs 40 crore-50 crore.

How difficult is it to be a private operator in an erstwhile nationalised industry?

One of the problems we face is that the mining regulations are still not very friendly in terms of procedures and formalities. The whole process of applying for reconnaissance permits (RP), then applying for prospecting licence (PL), followed by mining leases (ML) is very time consuming and sometimes quite frustrating.

We have to approach several authorities at the district, state and Central government level, particularly for PL and ML applications quite apart from approaching land owners, areas where we propose to work in are not government owned. We have made submissions to the government to considerably simplify the procedures. The government is listening, but we are not expecting quick results. We remain optimistic though. There are also restrictions in terms of the areas being granted under a PL which need to be addressed. A 25-sq. km limit under a PL is too small for us, particularly when we have prospected large areas of between 500 to 1000 sq. kms under an RP. We had some industry representations to the government and the government is now considering giving greater areas under the PL. We have about 10 PL applications within the areas we are exploring which are waiting grant. We have made applications for 2 MLs, but they are a little premature here because the MLs are based on the studies we have done and GSI's studies.

Roughly how long does the legal process take?

The reconnaissance permit (RP) is much faster as this is the initial application. Prospecting licence (PL) application is a very tedious process because it requires some inputs at the grass-root level. It takes 6-9 months for the PL to be granted. We have to go to all the land owners and the tehsildar's office. A PL allows for more detailed drilling, not generally allowed under an RP. A mining lease grant could take a similar time. What the government should have is a single window, where once you get an initial permit, you can take it all the way to the mining lease. That would make progressing a prospect to mining stage so much easier.

How difficult is it with the ministries and all?

It has been very difficult. The first stage of the RP isn't too bad, but the second one is a long, tedious and frustrating process. People that are controlling the various departments in the ministry have their own ideas. We start at the village level, where we get the appropriate go-aheads from the villagers, the tehsildars, the district commissioners office. We have to get the necessary approvals from the land-owners, and incase the land is being tilled, we have to compensate the farmer. The application is initially made in the Ministry of Mines and Geology at the state level, then it will move to the state department of industries, and then to the central government offices. The mines and geology department then actually issues the deeds.

We will soon approach the Planning Commission and seek their help in fast-tracking the granting of permits. We sincerely hope they act. The sooner we get our PLs granted, the sooner we move into feasibility studies and sooner we announce discoveries.