Opinion

FROM THE CAPITAL

Miners fight biotechs for investors

Similarities end when it comes to selling key investment messages

John Robertson

Miners face some insuperable hurdles trying to grab the attention of everyday investors when they are pitched into competition with biotech investments.

Biotech and mining investments have a lot in common. Investment performance often involves binary outcomes. A drug works or it does not. A drill finds an orebody or it does not.

The dispersion of biotech investment returns resembles the returns experienced by miners. Since the beginning of 2011, the median return for companies classified as pharmaceuticals and biotechnology by the ASX has been minus-31%. Thirty percent of the companies in the sector experienced share price falls in excess of 75%.

The probability of success in both cases is low. One estimate puts the chance of a drug being eventually approved for use at just 8%. Richard Schodde, of MinEx Consulting, has estimated that globally, despite thousands trying, an average of only 60-70 mineral discoveries of any significance are made in a year.

In both cases, there are well defined development paths for companies to follow in order to prove their commercial worth. Companies can stumble at each of several critical steps in the process. Far fewer finish than start.

Biotech companies face losing profits from expiring patents. The patent cliff is the biotech equivalent of an exhausted resource. Both circumstances require more investment to sustain profits without any guarantee of success.

Gestation periods are similarly long. In both mining and biotech, the time from an initial analytical inference to a profitable outcome will be measured in many years and sometimes decades. After preclinical testing, the average time required for the clinical trial phase of a new drug is seven years. Investors incur extraordinary opportunity costs while waiting for commercialisation in both instances.

There are some important differences. The mining industry is inherently cyclical. A persistent mismatch between available supplies of raw materials and how much is needed by industry requires prices to continually rebalance markets, making profitability uncertain and high returns on capital invested unsustainable.

For biotechs, the patent regime protects profitability for a period allowing companies to recover a sizeable part of their investments before new entrants and generic equivalents forever slash their profits.

The important point in this context is that the two sectors are similar enough in their risk characteristics to compete for the same pool of retail money. This is especially true at the very early stage of the corporate life cycle when relatively small amounts of capital are required and companies are insufficiently advanced in their business models to attract the attention of larger institutions.

In competing for this pool of funds, both groups are promoted through investment seminars and conferences pitched at retail investors. Miners and biotechs alike must rely in part on the impressions they make on their audiences. In this, the mining fraternity suffers distinct disadvantages.

Biotech executives addressing investors are more likely to have had direct sales and marketing experience, possibly involving brand management. Some have headed up formal sales functions with day to day operational targets and are used to making sales pitches. Hardly any mining industry executives have had to earn a full-time living selling a product in a competitive market where users are subjected to competing claims about product efficacy.

The difference shows in the way audiences are addressed. The miner tends to emphasise how busy he has been. The biotech executive is more likely to hone in directly on the product attributes and why they are going to make a difference. Having built the case for the product, he will typically go on to talk about what the company is doing to meet the need.

There is more diversity among the biotech presentations. That makes them more interesting. The miners seem to take pride in looking the same.

Having a product that makes a difference is a handy advantage. The biotech company is solving a problem with which people can often too readily identify. Whether it's a treatment for urinary incontinence or a new way to shrink a renal tumour, the problem is usually meaningful to the listener who ends up barracking for its success. By comparison, the miner citing long lists of drill results is fighting a losing battle against creeping indifference.

Biotech companies are better able to quantify the commercial potential of their products. They often start with clear evidence about the incidence of the problem they are trying to solve. They know how much is being spent currently on a treatment and, by inference, how much a demonstrably superior product might be able to earn. Since the steps to commercialisation are well defined, the company is usually able to articulate a relatively clear investment proposition.

Some will claim that heavier regulation of the mining sector prevents it from painting the investment picture as clearly. There is some truth to this. Regulators circumscribe the nature of claims a mining company can make about its intentions or future business outcomes. Some of this control arises, of course, from miners themselves not always being sufficiently careful in the construction of their forward looking statements.

In other ways, miners get it easy. The biotech must define an endpoint against which to test the validity of its product. Many miners, in contrast, go on indefinitely, never having to posit a hypothesis that distinguishes between success and failure and against which they can be judged. If they fail to meet their exploration or operational targets, as nearly all do at some time, their approval to continue is not automatically revoked.

Above all, individuals engaged in biological and medical research are more highly regarded in the broader community than those out exploring. My ongoing test of this proposition is Australia's Queens Birthday Honours List. Twenty-eight percent of the 53 awards in the top two echelons of the Order of Australia went to individuals engaged in or contributing to medical research this year. The extent of this community deference, verging on obsequiousness, is not unusual. The number of gongs for mining: zero. ▼

John Robertson is a director of EIM Capital Managers, an Australia-based funds-management group. He has worked as a policy economist, business strategist and investment-market professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia