Life Sciences

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Big pharma | Biotech market | Artificial intelligence

Venture capital insights and consequences for real estate

UBS

Top 3 trends and challenges affecting the life sciences industry

In June 2024, UBS Asset Management hosted its second life sciences conference to discuss the latest trends and challenges affecting the life sciences industry. One of the panels focused on the funding landscape and venture capital (VC) perspective.

Nicola Goll, Head Multi-Managers Private Equity Americas, moderated the session and was joined by four specialists across the sector.

Tim Haines, Managing Director at Abingworth
Alex Mayweg, Managing Director at Versant Ventures
Dina Chaya, Partner at Orbimed
Jasper Bos, General Partner at Forbion

Over the last 24 months, the biotech market has been varied with excitement due to the secular technological advancements in gene editing and AI incorporations contributing to the global biotech growth forecast.

With that said, the industry sees headwinds due to the underperformance of biotech stocks in listed markets; with contributors being geopolitical tensions, drug pricing issues and restrictive policies limiting collaboration with China. The panelists discussed these ups and downs in the industry and three key themes emerged from their discussion.

Importance of collaboration with big pharma

Complementary to last year's panel, the discussions this year spoke to the ever-growing collaboration between biotech companies of all maturities, including at their VC stage, and big pharma. The alignment of interest has grown further, and the panelists believe there is further potential for this symbiotic relationship to flourish.

Tim spoke about the changing dynamics between pharma and biotechs:

"Relationships with pharma have changed out of recognition in the last 20 years. Looking at what has changed; pharma is looking to acquire assets and is paying very attractive premiums."

This change in philosophy is a result of ca. USD 208 billion of product patents due to expire.
Big pharma needs biotech to continue to grow, it has effectively outsourced cutting-edge innovation to this part of the company landscape. Over 75% of assets in pharma company pipelines are licensed from the biotech industry.

Whilst it may seem there is a dominance of big pharma, Alex believes the relationship between big pharma and biotech is symbiotic. Market forces have also forced companies to cooperate:

"There was a time when public markets were strong and pharma was sometimes priced out of biotech, then the market changed, and pharma had the upper hand."

This change to the funding markets has led venture capitalists to bring pharma companies into the process far earlier than before.

Jasper explained that prior to investing, *"a number of senior BDR&D people"* from pharma companies are consulted, in order to gain an understanding of what type of data and therapeutic profile would drive an acquisition. From an investor's perspective, it ensures that there is direct demand to be met from the get-go.

Biotechs in the public market

When looking at the public market, the panelists acknowledged the poor performance of the XBI, the leading US biotech index. The index shows performance 50% off its peak, contrasting the outperformance of AI and technology stocks.

However, despite the seemingly negative sentiment, our panel sought to challenge this. Dina explained:

"That investment fundamentals have not changed, but the pace of investment has slowed, which is creating compelling investment opportunities."

Further to this, Jasper explained in his view that one can't compare the 2021 XBI market to today's environment where sentiment is more sober:

"People were playing the stock market during COVID-19, and it meant massive overvaluation."

Jasper had a positive view on the outlook:

The market is more rational, and valuations are realistic.

Across the pond, European public markets face greater challenges. *"European filings are even tougher"* explains Tim and that *"it's more of a structural issue, [Europeans companies] don't have the same kind of public markets [as in the US]."*

Outside of the public markets, Jasper argued that the European market continues to grow. European companies are seeing some *"mega rounds, that 5–6 years ago would not have been possible, demonstrating the maturity of the market. As an example, the number of rounds in excess of 100 million has gone up tremendously in Europe in the past few years, indicating strong demand for investment opportunities".*

Nevertheless, European companies face the reality that they will likely have to look to the US for a public listing. Tim argued that improved market transparency was needed to get European public markets to work: *"you are in a world where you need to have compelling data and access to deep pools of capital committed to higher risk (and potentially longer-term) investments."*

AI and its use in the biotech industry

The panel participants agreed that the potential applications of AI for the biotech industry are far reaching. Uses include improved operations, data interpretation and mining, and faster drug development to name just a few.

Tim saw large-scale potential for the application of AI in the industry:

"There will be a gold rush in certain spaces where AI is providing novel and actionable insights"

Referencing Google Deep-Mind's use of AI to predict the 3D structure of protein targets via AlphaFold, Tim noted the *"unbelievable value of the tool*", highlighting that "prior to AlphaFold, we only knew about 17% of structures, now we are at 98%." There was unanimous agreement amongst the panelists that companies that do successfully create proprietary tools to address extensive data sets will move ahead of their peers, with successful tools acting as a key differentiator.

Looking to the application of AI for drug discovery, Alex explained that even with the power of AI, the bespoke and complex nature of the industry means *"you can't press a button and a drug will come out*." AI will undoubtedly disrupt and accelerate the drug discovery process but not eliminate all of its steps.

The panel concluded that whilst the potential for AI in the biotech industry is vast, it is also filled with uncertainty, as Alex conducted on a lighter note:

"Everyone said, 20 years ago, that email and Google were going to create three-day work weeks, when the reality is that now it makes you work all the time! So, the question is, what will AI do to us?"

Potential consequences for real estate investors

In light of the panel's discussion, one can theorize on how real estate investors in the sector should react.

First, the closer collaboration between biotech companies and big pharma is likely to drive leasing demand close to existing big-pharma research centers as they seek to minimize physical distances between employees across different companies.

Second, keeping a firm eye on the underlying fundamentals rather than volatile market sentiment in public markets can help investors in better understanding where the need is growing the fastest. Real estate is a long-term investment, while sentiment in public markets can be fleeting.

Finally, facilitating the use of AI in lab-oriented real estate assets may increase tenants' demand for the space and lift rents. This may e.g., include closeness to data centers storing the computational power that is the driving force of AI and making sure that internet and power supply to the premises are first class at all times.

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