

STARTER HOMES

by Alex Lash

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In the comedy "The Jerk," Steve Martin's character, Navin Johnson, thinks a gas station bathroom is his new apartment and exclaims, "Like it? I love it! This is fabulous!"

Douglas Crawford chuckles as he recalls the scene. He's standing in what resembles a storage room with fluorescent lighting, no windows and gray, blue and green recycling bins. In fact — and this is what makes Crawford laugh — it's office space in the QB3 Garage, the biotech incubator on the new campus of the University of California, San Francisco.

Except for the bins, the tiny room — it's barely 100 square feet — is empty. For an entrepreneur with a bright idea and almost no cash, it will be as much a home as the bathroom was for Navin Johnson.

"These are hungry young scientists who need a place to start," says Crawford, who runs the Garage for QB3, a public-private research institute affiliated with UCSF. In a space the size of the recycling room, one early Garage tenant put desks against each wall. One held his laptop, the other three bench experiments, "and he swiveled around on a chair like a robotic arm in a factory," Crawford says.

Now two unlikely landlords hope to follow Crawford's lead and nurture that creative hunger at biotech incubators of their own. **Biogen Idec Inc.**, one of the biggest biotechs, and **Pfizer Inc.**, one of the world's biggest

drugmakers, are opening workspaces in Cambridge, Mass., and La Jolla, Calif., respectively. The idea is similar to traditional incubators found at venture firms, research institutions and regional economic development programs: nurture a half-dozen tiny startups in cramped, shared spaces. But for drug companies, there's a twist: After two years, they prefer to absorb their tenants, not kick them out.

Whether or not this "spin-in" model will work for Pfizer and Biogen Idec remains to be seen. But their impetus for trying is clear. Like most drugmakers these days, Pfizer and Biogen Idec are seeking new ways to bolster their pipelines. High R&D costs, low productivity and strict regulation have vexed the drug industry. As patents of blockbuster drugs expire — and with the ever-present threat of big sellers getting pulled from shelves — firms need replace revenues not just today but 10 years from today.

Both companies are shrinking their in-house research staffs. Pfizer is in the midst of a \$4 billion cost-cutting campaign. Biogen Idec, meanwhile, laid off 17% of staff and shifted resources toward business development in the wake of diminished revenues from multiple sclerosis drug Tysabri.

If their incubators succeed, the firms could add a couple promising candidates a year to their pipelines. They'll be picky: the more developed an idea when it joins the incubator, the better. "More than two or three years [of incubation] is

outside what we see as reasonable," says Rainer Fuchs, the Biogen Idec vice president in charge of the program. "We want to take things very rapidly into the clinic."

He and his Pfizer counterparts will require patience and cash, say those with incubator experience. "Incubators can never make money as real estate ventures," says Crawford. "The transaction costs and constant management costs are too high. They require subsidies from someone."

For Crawford, that "someone" is the state of California; the University of California is the Garage's landlord, but it takes no financial stakes in its tenants. There are other models, too (see table). In fact, in the past decade, biotech incubators have roughly quadrupled to 66, according to the National Business Incubation Association in Athens, Ohio.

Life sciences real estate giant **Alexandria Real Estate Equities Inc.** wants to develop biotech clusters in several cities worldwide, often taking equity stakes with venture partners.

Accelerator Corp. is the first test of that strategy. It houses three startups on the shore of Seattle's Lake Union a few blocks from a funky houseboat community. Alexandria and several VC firms, including **Amgen Ventures** and **MPM Capital LP**, committed \$26 million with a second, slightly smaller round in the works, says Accelerator CEO Carl Weissman. "We think between \$15 million and \$20 million to do five or six

companies over three years is about right," he says.

In exchange, the firms have rights to participate in future rounds when the tenants leave the nest. Since Accelerator launched three years ago, two of six tenants have graduated and one has disbanded. **VLST Corp.** and **Spaltudaq Corp.**, both drug developers, respectively raised \$55 million and \$29 million in their first rounds outside the incubator.

Accelerator was one model the corporate tyros investigated; Fuchs held conversations with CEO Weissman over a year ago. According to early projections, Pfizer and Biogen Idec plan to spend a bit more than Accelerator, though by corporate standards their budgets are modest.

Pfizer Incubator CEO Alex Polinsky says the drug giant has committed \$10 million a year for five years, spread between five to eight startups. It has no financial partners. Biogen Idec will give each tenant a maximum of \$10 million and three years to prove its work worthy, although Fuchs says the time and cash allowance for many will be less. He wants to add two tenants a year until he has six.

Unlike other incubators, however, these corporate versions don't want too many graduates. If tenants' work looks promising, both Biogen and Pfizer have first rights to buy it — or more likely, buy the startup outright. If they decline, they say they will help the startup leave the nest and look for venture funding.

It's a model that exists in high tech but not in life sciences, says NBIA CEO Dinah Adkins. **Monsanto Co.** sponsors a site in its hometown of St. Louis, but its aim is not to "spin in" new technology but to foster an ag-bio hotbed "for fear that it will develop elsewhere," says Adkins.

The model also raises this important question: If Pfizer or Biogen Idec doesn't want a drug

program that's been inside its walls for nearly two years, why would a VC want to fund it? "Let's say Pfizer has 50% of my company and someone on my board," says David Weinstein, CEO of **GliaMed Inc.**, a tiny startup in the Columbia University-affiliated Audubon Center in Manhattan. "If Pfizer passes on my drug, what's the matter with it? I have one foot and one leg tied down. It'll have a half-life of exactly two years."

A rejection might not be so dire, however. "It does raise some questions, but there could be good reasons [other than quality] that a program doesn't fit," says Corey Mulloy of **Highland Capital Partners LLC** in Menlo Park, Calif., a firm that specializes in seed funding.

Both Polinsky and Fuchs say they will decline their options for reasons unrelated to the quality of the work — such as unexpected internal competition — which should be "transparent" to outside investors, says Polinsky. And because Pfizer's support will usually give it a majority stake in its tenant companies by default, it "will continue to have an interest in the future success of the company."

Biogen Idec will only take a minority stake in its tenants, but the principle is the same, says Fuchs.

Both Pfizer's and Biogen Idec's tenants will be incorporated as separate firms. And both companies will place a representative on their tenants' board of directors. They also say they might participate in follow-on rounds even if they decline to option their tenants' work.

So what's in it for a startup? Other than the money — which is significant in a climate where VCs have shied away from funding early-stage work — Pfizer and Biogen Idec can offer expertise. "You can walk across the street and talk to our scientists, people who know how to make drugs," says Fuchs.

The close arrangement has made some entrepreneurs cautious, Polinsky admits. "We're perceived as being part of Pfizer. There is some baggage."

But he and Fuchs say they'll set up strict firewalls — in Pfizer's case right down to separate servers and e-mail systems for its tenants.

Polinsky is optimistic he'll sign his first tenant by mid-July and is negotiating with three others. Fuchs has some term sheets on the table but says only that he's on track to have two tenants by year's end. Once they're settled in, the daily realities of administering lots of small moving parts will become obvious. "There's a mountain of bureaucracy," says Accelerator CEO Weissman. "It's a lot harder than people appreciate."

Then again, if there's anything big drug companies know how to deal with, it's mountains of bureaucracy. **TD**