



# Federated Hermes Impact Opportunities

**Quarterly Impact Report**  
Q2 2023

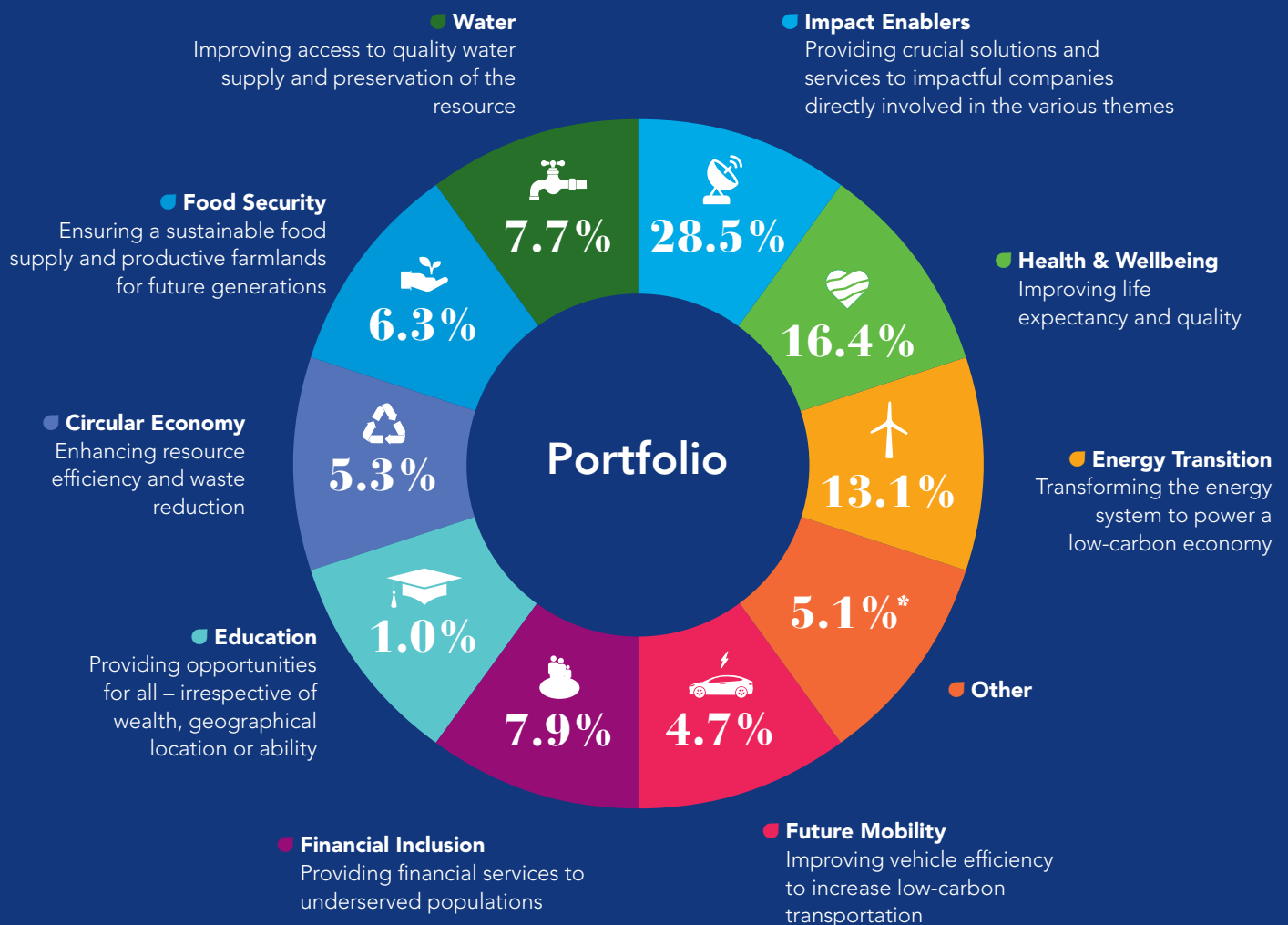
**Federated  
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The Federated Hermes Impact Opportunities Strategy is a high-conviction global equity strategy with a bold objective. It aims to generate long-term outperformance by investing in companies succeeding in their core purpose: to generate value by creating positive and sustainable change that addresses the underserved needs of society and the environment. In this way, it focuses on tomorrow's leading companies – today.

## Exposure by impact theme

We take a thematic approach: our holdings fit into one or more of nine impact themes that are aligned with the Sustainable Development Goals (SDGs) of the United Nations (UN).



Federated Hermes Limited, as at 31 March 2023.

\*Note: as at 31 March 2023, 5.1% of our exposure was not directly related to any of our nine impact themes, while 3.7% was held as cash.

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## THEMATIC FOCUS:

## AI: Using big data to create a healthy future for humanity

Both excitement and fear around the accelerating evolution of AI have dominated the headlines in recent months. Like any new technology, we believe AI will be a disruptor in the truest sense, bringing both positive and negative impacts for society and the global economy. Health is one area where we believe AI will overwhelmingly be a force for good.

**Fast reading:**

- Fears concerning the risks created by uncontrolled development of AI are understandable, however, they should not obscure the huge societal benefits the technology can offer. The healthcare sector is one area where we see clear potential for AI to deliver positive impact.
- Digitally driven drug discovery will benefit society by unlocking solutions to the most intractable problems in pharmaceutical research. Using the power of AI and big data in this way also holds the promise of reducing the cost of drugs, thereby increasing access for all.

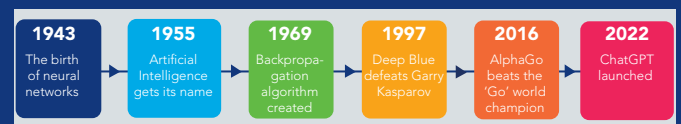
**Why now for AI?**

The concept of artificial intelligence (AI) has been around since at least the mid-1950s, when, building on the work of British polymath Alan Turing, American computer scientist John McCarthy coined the phrase and founded AI as an academic discipline.<sup>1</sup>

In the intervening decades, AI has seen a series of breakthroughs – or false dawns, depending on your viewpoint. High profile milestones have included the 1997 defeat of world chess champion Gary Kasparov by IBM's Deep Blue, and Google DeepMind's AlphaGo program beating Go world champion Lee Sedol in 2016.

98%

of global executives see AI foundation models playing an important role in their organisation's strategies within the next three-to-five years.

**Figure 1:** How did we get here?

However, it is arguably only in the last year that AI has really exploded into the public consciousness. The release of generative AI chatbot ChatGPT in November 2022 generated a huge buzz of excitement around AI's potential, closely followed by rising concern regarding the risks if the technology is not effectively regulated.

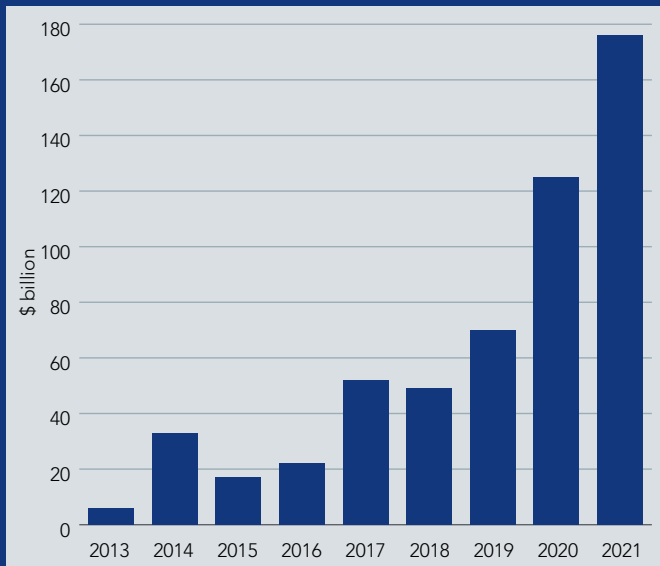
Plenty of debate still exists around whether what currently constitutes AI is 'intelligent' in the strictest sense. However, the practical potential of neural networks like GPT-3, the AI system that powers ChatGPT is undeniable; by training neural networks and machine learning on the vast amounts of data increasingly available in a wide range of disciplines, AI can perform tasks that would otherwise be prohibitively expensive and/or time-consuming, if not impossible. It is little surprise therefore that, according to research by Accenture, 98% of global executives see AI foundation models playing an important role in their organisation's strategies within the next three-to-five years.<sup>2</sup>

With AI seeing an acceleration in computing beyond Moore's Law, we believe AI could be disruptive in the truest sense.

<sup>1</sup> 'The History of Artificial Intelligence', Rockwell Anyoha, Harvard University Graduate School of Arts and Science blog, August 28, 2017. <https://sitn.hms.harvard.edu/flash/2017/history-artificial-intelligence/>.

<sup>2</sup> 'A new era of generative AI for everyone', published by Accenture, March 22, 2023. <https://www.accenture.com/gb-en/insights/technology/generative-ai>.

**Figure 2:** Annual global corporate investment in AI



Sum of private investment, mergers and acquisitions, public offerings, and minority stakes. This data is expressed in US\$, adjusted for inflation.

Source: [Our World in Data](#), as at 2021.

In fact, the increased availability and affordability of sufficient computing power mean AI and big data tools are already becoming commoditised. As such, we believe the real differentiator will be who has access to the best datasets.

One area where we see clear potential for AI as a force for good is in the healthcare sector, specifically in the field of pharmacological research.

The returns on R&D investment at big pharma have been steadily declining over the past

**30-40 years.**

**Drug discovery and the law of diminishing returns**

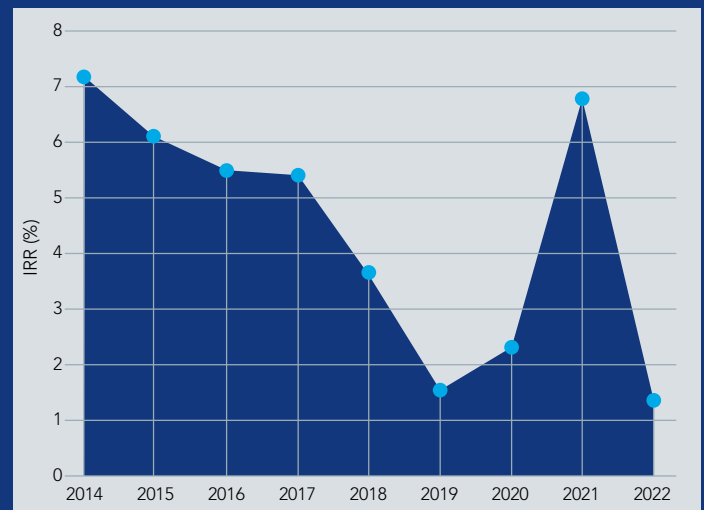
The returns on research and development (R&D) investment at big pharma have been steadily declining over the past 30-40 years. The 1980s and 1990s were marked by a steady flow of significant discoveries that saw wave after wave of exciting new drugs and treatments enter the market. However, with each new discovery, the incremental market opportunity has become smaller, while the bar for taking forward a new drug has had to be set higher.

**At the same time as the market opportunity is shrinking, researchers are having to work harder and invest more resources to isolate potential candidates for commercialisation.**



At the same time as the market opportunity is shrinking, researchers are having to work harder and invest more resources to isolate potential candidates for commercialisation. As a result, the sort of price deflation usually seen with technological advancement has not been in evidence in the drug market. However, AI has the potential to change that.

**Figure 3:** R&D returns have fallen to pre-pandemic levels



Source: 'Deloitte: Seize the digital momentum', as at 2022.

**A new approach to drug discovery**

Over the past few years, a handful of innovative companies have taken an entirely new approach to the problem of diminishing returns on investment in drug research. These firms aim to replace big pharma's traditional, labour-intensive approach to R&D with a tech-focused business model that harnesses the power of big data and machine learning. Rather than huge teams of researchers working in industrial laboratories, a large proportion of their employees are data scientists and IT experts.

These companies' sophisticated tech platforms can be harnessed for digitally driven drug discovery to solve big pharma's most intractable problems. Their business models combine upfront payment for projects with royalties to received throughout the lifetime of the product, providing both short- and long-term revenue streams.

The potential of this type of digitally driven medical research was demonstrated at the start of the Covid epidemic. Biotech firm AbCellera (see case study below) beat every big pharma company to identify the first ever Covid-19 antibody, bamlanivimab, in just 90 days – an unprecedented speed for the industry.

### A healthy dose of big data

In carrying out drug discovery projects for big pharma, companies like AbCellera are building up an invaluable resource of petabytes of data. Meanwhile, thanks to machine learning, with each project their AI-driven drug discovery platforms become smarter.

### In carrying out drug discovery for big pharma, companies are building up an invaluable data resource.

The careful tagging and structuring of supplied and derived information can create a unique data architecture, enabling the identification of inferential patterns and grouping of molecules based on multiple characteristics. Effective collection and curation of such data will be a key differentiator that decides who wins out in the biotech and wider pharma sector over the long term. As these new tech-enabled businesses run more discovery campaigns, they build up their data libraries and refine their algorithms; this becomes a competitive advantage to drive more business through the platforms, creating a powerful flywheel effect.

### Data becomes a competitive advantage to drive more business through the platforms, creating a powerful flywheel effect.

#### The impact opportunity

Alongside the obvious commercial opportunity, digitally driven drug discovery offers several key advantages over traditional drug research that should benefit society as a whole:

- **Reduced cost:** Automating drug research significantly lowers the cost of developing new medicines, reducing the financial burden on national health services and opening up new cures to far more of the global population.
- **Increased competition:** AI makes it possible to build a significantly enhanced and more widely accessible R&D capability in the pharma sector, creating a more competitive market.
- **Greater innovation:** Using AI, it should be possible to crack health problems that have hitherto remained beyond the reach of traditional medical researchers.

Taken together, we believe these factors provide a clear argument for the inclusion of digitally driven drug discovery in our Impact Opportunities Strategy.

### Using AI, it should be possible to crack health problems that have hitherto remained beyond the reach of traditional medical researchers.





CASE STUDY

## AbCellera

**AbCellera is a Canadian biotechnology company focused on accelerating antibody discovery and resolving the toughest problems in drug development. Using its proprietary engine, it partners with drug developers of all sizes to push therapeutic programmes forward and fight disease.**

### Impact themes:

Health & Wellbeing  
Impact Enablers

AbCellera is shaping up to be a key disruptor in the pharmaceutical sector. The firm has built an end-to-end antibody discovery engine with its own data handling and visualisation architecture, known as Celium™. The differentiation in its business model is demonstrated by the fact that a quarter of its employees are data scientists and engineers.

### A quarter of all AbCellera's employees are data scientists and engineers.

In its 10-year history, the company has arguably built out the most advanced antibody discovery capabilities in the entire pharmaceutical industry. This is illustrated by several recent successes:

**Covid-19:** AbCellera discovered the first Covid-19 antibody within 90 days, the speed of which was unprecedented.

**T-cell engagers:** It has created a menu of more than 500 artificial antibodies from which drug developers can select candidates for use as anti-cancer treatments.

**GPCR:** Partnership with major biotech firm, Regeneron, in progressing a drug candidate for a target known as G protein-coupled receptors (GPCRs) to Phase 1 clinical trials. GPCRs are important because they mediate most cellular responses to hormones and neurotransmitters, but until recently they had proven an intractable problem for the industry. Despite arguably having the strongest antibody capabilities in the industry, Regeneron chose to partner with AbCellera on GPCR research – a huge vote of confidence in AbCellera's capabilities.

### AbCellera discovered the first Covid-19 antibody within 90 days.

## Why we're invested

We see massive potential in AI-powered drug discovery and believe investors have yet to wake up to the full scale of the opportunity. Within this new discipline, we believe AbCellera stands out for several reasons:

- **Leading IP:** Born from the research of its founder, AbCellera has leading intellectual property rights in the key fields of micro-fluidics and single-cell sequencing.
- **Proprietary technology:** The firm's unique end-to-end platform is transforming access to digitally driven drug discovery, generating an enormous amount of value potential.
- **Unique data assets:** The company has unparalleled data handling expertise and is building up a wealth of proprietary data on antibody discovery to further enhance its competitive advantage.
- **Strong pipeline:** The business has an impressive client list, with nearly 180 contracts signed for antibody discovery and nine molecules already in clinical trials.
- **Proven results:** As well as discovering the first Covid-19 antibody, in a single screening campaign lasting a few weeks, AbCellera's engine identified 12 antibodies against a tumour cell target – only two had been discovered via traditional research in the previous 40 years.
- **Future returns potential:** The company's revenue model is based on downstream participation in the drugs it helps develop, creating the potential for ultra-high returns from a diversified stream of royalties across its partner base.
- **M&A catalysts:** Recent M&A activity highlights the significant value that is sitting in the host of pre-partner programs that AbCellera has successfully initiated. The company has hundreds of molecules which could be monetised for amounts in excess of US\$100m.

## AbCellera in numbers

1/4

Proportion of all AbCellera employees who are data scientists and engineers

500

Number of molecules in the firm's T-cell engager platform 'menu'

177

Number of signed contracts with clients for antibody discovery

12

Number of antibodies discovered against a tumour cell target in a single screening campaign (in the past 40 years the entire industry has discovered just two)

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Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and, where possible, to contribute to positive outcomes that benefit the wider world.

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