

# INVESTMENT RECOVERY FOR PHARMA EQUIPMENT

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This article is the first of a two-part article written for Pharma's Almanac discussing the unique value proposition of pharmaceutical manufacturing equipment. All manufacturing organizations need to responsibly manage assets, but pharmaceutical equipment requires unique strategies to manage and recapture the value of equipment.

**M**ergers and acquisitions among pharmaceutical companies, as well as an ever-changing product mix, lead to surplus capital equipment among pharmaceutical manufacturing facilities. Often these surplus inventories occupy valuable manufacturing and lab space, or are in storage facilities or "bone yards." An effective capital equipment investment

recovery strategy can help turn idled equipment into money-making assets through sales that generate cash, network redeployments that save time and money, and tax deductible donations. There are multiple approaches to viable equipment investment recovery strategies. Regardless of whether equipment investment recovery is handled project-by-project, through a third party or through a formal department, there are some basic best practices for a pharmaceutical manufacturer to consider.

Investment recovery best practices, specific to the pharmaceutical manufacturing industry, can be grouped into the following topics:

- [1] Inventory identification
- [2] Valuation of the inventory
- [3] Internal uses, or redeployment
- [4] Removal
- [5] Sale

## INVENTORY IDENTIFICATION

Identifying surplus inventory is time consuming. If the equipment is installed in a production facility, a solid asset list for the area is the best starting point for an equipment inventory. Typically this is available from the finance department in the form of a fixed asset list, based on the cost center. Robust preventative maintenance programs are also good sources for equipment lists.

While a physical inventory will still be necessary, it can be done much more quickly with a list, as the team will be verifying rather than collecting information. If a list is not available, a physical inventory identifies basic information, including name plate info, internal asset tags and property numbers. Photos of the name tag and of the equipment are helpful in remembering and verifying the information later. Once a list is in hand, the finance department can properly identify the assets on hand.

The next step in inventory identification is determining what items are available for sale. There are three main considerations here:

- + Cleaning and decommissioning
- + Proprietary considerations
- + Approvals and documentation required to sell

Cleaning and Decommissioning. Equipment removed from production typically undergoes a cleaning protocol and decommissioning plan. Always confirm that these have been completed according to standard operating procedures. This may require a sign-off from the Environmental, Health and Safety manager to verify that the equipment has been cleaned and does not contain any residual product or residue. There may also be a sign-off from the compliance department to make sure that



the decommissioning plan has been properly executed. The decommissioning plan should remove any batch-related and proprietary information from the equipment.

**Proprietary Considerations.** Part of making this equipment available for sale will be considering whether the equipment is specific to a proprietary process or product. All proprietary information must be removed, including batch information and process steps. Careful consideration should be given as to whether the equipment itself is part of a proprietary process. If the equipment was designed or customized for a specific process or product, that design or customization may be confidential or a business secret. While this is often unlikely, it is definitely a factor that must be taken into consideration when deciding to sell equipment outside the company.

**Approvals and Documentation Required to Sell.** Most firms require some documentation of the sale for accounting and regulatory purposes. Usually fixed-asset disposal forms are available from the finance department. If not, users need to document the asset number, sale or income amount, buyer and the date. The asset-disposal report docu-

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ments the sale and the decision to sell. The person assigned to sell surplus equipment will usually want to ensure the cost center owner, or other management, has approved the decision to sell; this anticipates the possibility of someone later deciding that they had been saving that particular piece of inventory. The forms are also used to document the value of the sale for accounting, finance and tax purposes.

### **VALUATION**

Establishing equipment value involves both internal and external research.

Every capital asset should have two values in the accounting records:

#### **[1] Purchase price**

#### **[2] Net book value**

The purchase price equates to what was paid for the equipment when it was purchased. Often the “price” or original cost used by accounting reflects a project that could have more than one equipment asset or associated construction and facilities costs. In these cases, additional research will probably be required to unravel all of the project’s costs.

The net book value is the current value of the equipment according to accounting. Capital assets are generally depreciated over time. The net book value reflects the amount left to depreciate. This amount will be eliminated if the asset is sold or other-

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wise disposed. Interestingly enough, neither the purchase price nor the net book value has any bearing on the other valuation of the equipment's fair market value.

Fair market value represents what the equipment is worth in the market. There are two levels of the market to consider, wholesale and retail.

The wholesale market represents dealers and other sellers of equipment. The pricing here is generally less than what end-users would pay. That is because they are taking on the risk of buying and holding the inventory in stock for resale.

The retail market is what an end-user would pay for that same piece of equipment in the same condition.

Both prices have some art and science behind them and are a function of the overall secondary market for such items. Formal appraisals can represent both wholesale and retail pricing in different situations.

Formal appraisals are most often associated with the due diligence required for loans or mergers and acquisitions. Most often these appraisals are based on what the equipment would sell for in an orderly liquidation, which would most commonly be an auction that was not forced due to insolvency or bankruptcy. End-user buy-

ing cycles do not always allow for opportunistic buying at auctions, which causes these valuations to trend towards wholesale pricing. The impact of the valuation, both finance and fair market value, and the ultimate sale, redeployment or donation, are primarily influenced by the company policies that control the fixed-asset disposal process.

### **INTERNAL REDEPLOYMENT**

Many companies consider implementing redeployment programs within their manufacturing networks. Often the same makes and models of equipment are used in different facilities. This is especially true of lab equipment. Redeployment, or moving a piece of equipment from one facility to another within your network, is the most efficient use of idled or surplus assets. The equipment history is known and experiences are easily transferred. This all works in theory. In practice, the process can be quite cumbersome.

Too often, internal redeployment processes poorly represent the equipment available. The equipment list is simply a spreadsheet. The description is not enough to determine suitability, photos and information are hard to come by, and there can be financial consequences at the receiving site, which often ruins the cost savings that can be achieved. A web-based platform can usually help with descriptions and photos. However, the financial piece is the bigger obstacle to tackle.

Many companies transfer the equipment from site-to-site at net book value ("NBV"), or the depreciated purchase price, which remains on the books at the time of transfer. The shipping site often disposes of the asset financially by transferring the remaining to the receiving site at the remaining NBV. If the NBV is at zero-value, then the transfer is a win for both entities as only the expenses of moving the item and reinstallation and commissioning will occur. However, as mentioned above, entire projects are often rolled into the NBV of a given asset which includes the equipment, construction costs, installation, start-up, and so on, which are not generally transferred with the equipment itself. This over-inflates the actual value of the equipment on the financial books of the receiving site. That value can be inflated enough that the receiving site will not be able

to tell the difference between the costs of new equipment or receiving the used equipment. This is an unfortunate result, as the transaction is still a non-cash event for the receiving site, yet undesirable from a financial standpoint. And the equipment remains idled in a state where it is not producing income, but is only generating costs in the form of storage, utilities and so on. The solution is to adjust what value is actually being transferred.

Companies that have implemented advanced equipment redeployment policies use an "impaired value" approach to the valuation of the asset. The impaired accounting approach evaluates the loss in value of an asset that has dropped below its recorded NBV. The goal is to get an idea of the asset's true value in the market and transfer it at that impaired value rather than the NBV. Many redeployments that would be abandoned under an NBV valuation can be successfully completed using this approach. With the financial issues addressed, the other obstacles are either technical or preference.

Some companies have implemented policies requiring project engineers to consider surplus equipment prior to purchasing new equipment. If not implemented properly, these policies can become bureaucratic exercises because some project managers prefer to buy new equipment and continually write exceptions to the policy. In general, there are two considerations in regards to these policies.

The first consideration is the positioning of the mandate in the project process. The policy is more likely to be successful when the mandate is early in the capital planning process. Ideally, this occurs right after the need is identified and before any new equipment is specified.

The second consideration regarding surplus equipment is that it must be displayed in a centralized place and in a way that allows the project manager to quickly and thoroughly evaluate the equipment and associated costs, such as removal and shipping.

This completes the first of a two-part article. We have reviewed inventory identification, valuation of the inventory, internal uses versus redeployment, and the associated components involved in pursuing these elements. In the next article we will discuss the removal and sale strategies. **P**





# THINK UPGRADE

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