



INTEGER WEALTH FINANCE

DEFINING PP&E (Property, Plant and Equipment) as an Asset Class

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Property, plant, and equipment (PP&E) are long-term assets vital to business operations and not easily converted into cash. Property, plant, and equipment are tangible assets, meaning they are physical in nature or can be touched. The total value of PP&E can range from very low to extremely high compared to total assets.

Key Takeaways

- Property, plant, and equipment are also called fixed assets, meaning they are physical assets that a company cannot easily liquidate.
- PP&E are long-term assets vital to business operations and the long-term financial health of a company.
- Purchases of PP&E are a signal that management has faith in the long-term outlook and profitability of its company.

1. Understanding Property, Plant, and Equipment (PP&E)

Property, plant, and equipment are also called fixed assets, meaning they are physical assets that a company cannot easily liquidate or sell. PP&E fall under the category of noncurrent assets, which are the long-term investments or assets of a company. Noncurrent assets like PP&E have a useful life of more than one year, but usually, they last for many years. Noncurrent assets are the opposite of current assets. Current assets are short-term assets, which are assets on the balance sheet that are likely to be converted into cash within one year, such as inventory.

Examples of property, plant, and equipment include the following:

- Machinery
- Computers
- Vehicles
- Furniture
- Buildings
- Land

Investment analysts and accountants use the PP&E of a company to determine if it is on a sound financial footing and utilizing funds in the most efficient and effective manner.

$$\text{Net PPE} = \text{Gross PPE} + \text{Capital Expenditures} - \text{AD}$$

where: AD=Accumulated depreciation



To calculate PP&E, add the amount of gross property, plant, and equipment, listed on the balance sheet, to capital expenditures. Next, subtract accumulated depreciation from the result. In most cases, companies will list their net PP&E on their balance sheet when reporting financial results, so the calculation has already been done.

A company investing in PP&E is a good sign for investors. A fixed asset is a sizable investment in a company's future. Purchases of PP&E are a signal that management has faith in the long-term outlook and profitability of its company. PP&E are a company's physical assets that are expected to generate economic benefits and contribute to revenue for many years. Investment in PP&E is also called a capital investment. Industries or businesses that require a large number of fixed assets like PP&E are described as capital intensive.

PP&E may be liquidated when they are no longer of use or when a company is experiencing financial difficulties. Of course, selling property, plant, and equipment to fund business operations is a signal that a company might be in financial trouble. It is important to note that regardless of the reason why a company has sold some of its property, plant, or equipment, it's likely the company didn't realize a profit from the sale. Companies can also borrow off their PP&E, (floating lien), meaning the equipment can be used as collateral for a loan.

Although PP&E are noncurrent assets or long-term assets, not all noncurrent assets are property, plant, and equipment. Intangible assets are nonphysical assets, such as patents and copyrights. They are considered to be noncurrent assets because they provide value to a company but cannot be readily converted to cash within a year. Long-term investments, such as bonds and notes, are also considered noncurrent assets because a company usually holds these assets on its balance sheet for more than one fiscal year. PP&E refers to specific fixed, tangible assets, whereas noncurrent assets are all of the long-term assets of a company.

2. Accounting for PP&E

PP&E is recorded on a company's financial statements, specifically on the balance sheet. PP&E is initially measured according to its historical cost, which is the actual purchase cost and the costs associated with bringing assets to its intended use. For example, when purchasing a building for retail operations, the historical cost could include the purchase price, transaction fees, and any improvements made to the building to bring it to its destined use.

The value of PP&E is adjusted routinely as fixed assets generally see a decline in value due to use and depreciation. Depreciation is the process of allocating the cost of a tangible asset over its useful life and is used to account for declines in value. The total amount of a company's cost allocated to depreciation expense over time is called accumulated depreciation.

However, land is not depreciated because of its potential to appreciate in value. Instead, it is represented at its current market value. The balance of the PP&E account is remeasured every reporting period, and, after accounting for historical cost and depreciation, is called the book value. This figure is reported on the balance sheet.

3. Limitations of Property, Plant, and Equipment (PP&E)

PP&E are vital to the long-term success of many companies, but they are capital intensive. Companies sometimes sell a portion of their assets to raise cash and boost their profit or net income. As a result, it's important to monitor a company's investments in PP&E and any sale of its fixed assets.



Since PP&E are tangible assets, PP&E analysis doesn't include intangible assets such as a company's trademark. For example, Coca-Cola's (KO) trademark and brand name represent sizable intangible assets. If investors were to only look at Coca-Cola's PP&E, they wouldn't see the true value of the company's assets. PP&E only represents one portion of a company's assets. Also, for companies with few fixed assets, PP&E has little value as a metric.

4. Example of PP&E

Below is a portion of Exxon Mobil Corporation's (XOM) quarterly balance sheet as of September 30, 2018.

We can see that Exxon recorded \$249.153 billion in net property, plant, and equipment for the period ending September 30, 2018. When compared to Exxon's total assets of over \$354 billion for the period, PP&E made up the vast majority of total assets.

As a result, Exxon would be considered a capital intensive company. Some of the company's fixed assets include oil rigs and drilling equipment.

Exxon Mobil Corporation		
Condensed Consolidated Balance Sheet		
<i>(million of dollars)</i>		
	<u>Sept. 30, 2018</u>	<u>Dec. 31, 2017</u>
Assets		
Current assets		
Cash and cash equivalents	5,669	3,177
Notes and accounts receivable — net	27,880	25,597
Inventories		
Crude oil, products and merchandise	14,617	12,871
Materials and supplies	4,144	4,121
Other current assets	1,665	1,368
Total current assets	<u>53,975</u>	<u>47,134</u>
Investments, advances and long-term receivables	40,427	39,160
Property, plant and equipment — net	249,153	252,630
Other assets, including intangibles — net	11,073	9,767
Total assets	<u><u>354,628</u></u>	<u><u>348,691</u></u>
Liabilities		
Current liabilities		
Notes and loans payable	19,413	17,930
Accounts payable and accrued liabilities	41,714	36,796
Income taxes payable	4,161	3,045
Total current liabilities	<u>65,288</u>	<u>57,771</u>
Long-term debt	20,624	24,406
Postretirement benefits reserves	21,448	21,132
Deferred income tax liabilities	27,084	26,893
Long-term obligations to equity companies	4,625	4,774
Other long-term obligations	18,728	19,215
Total liabilities	<u>157,797</u>	<u>154,191</u>



5. Why Should Investors Pay Attention to PPE?

A company investing in PP&E, also called a capital investment, is a good sign for investors. A fixed asset is a sizable investment in a company's future. PP&E are a company's physical assets that are expected to generate economic benefits and contribute to revenue for many years. Purchases of PP&E are a signal that management has faith in the long-term outlook and profitability of its company.

6. How Is PP&E Accounted For?

PP&E is recorded on a company's financial statements, specifically on the balance sheet. PP&E is initially measured according to its historical cost but its value is adjusted routinely as fixed assets generally see a decline in value due to use and depreciation. However, land is not depreciated because of its potential to appreciate in value. Instead, it is represented at its current market value. The balance of the PP&E account is remeasured every reporting period, and, after accounting for historical cost and depreciation, is called the book value which is reported on the balance sheet.

7. What Are Noncurrent Assets?

Noncurrent assets are a company's long-term investments for which the full value will not be realized within the accounting year. They are allocated over the number of years the asset is used. They appear on a company's balance sheet under investment; property, plant, and equipment; intangible assets; or other assets.