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The Impact of Capital Expenditures on the Income Statement



By INVESTOPEDIA | Updated Jun 27, 2019

What Is a Capital Expenditure (CAPEX)?

A capital expenditure (CAPEX) is an investment in a business, such as a piece of manufacturing equipment, an office supply, or a vehicle. A CAPEX is typically steered towards the goal of rolling out a new product line or expanding a company's existing operations. Money spent on CAPEX purchases is not immediately reported on an income statement. Rather, it is treated as an asset on the balance sheet, that is deducted over the course of several years as a

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CAPEX and the Income Statement

Every year in which this depreciation expense is reported on the income statement effectively reduces a company's profit. To cite an example, if a flower shop owner purchases a delivery van for \$30,000, that vehicle is recorded as an asset on the balance sheet that same year, but that year's income statement remains unaffected by the purchase.

Let us further assume that the store owner plans to use the van for six years, where the vehicle annually depreciates by \$5,000. Under this set of circumstances, the following year's income statement would report a \$5,000 expense. To reiterate: a CAPEX does not directly affect income statements in the year of a purchase, but for each subsequent year for the expected useful life of the asset, the depreciation expense affects the income statement.

CAPEX-Related Expenses

There are often purchases related to a CAPEX, that do in fact, immediately affect an income statement, depending on the type of asset acquired. Using the flower shop example, although the purchase price of the van is not recorded on the income statement for that year, ancillary costs such a gas, auto insurance and vehicle maintenance bills are considered business expenses, that would show up on the company's income statement. However, it is worth noting that these expenses may be offset by the increase in revenue that could potentially result from increased sales activity, due to expanded delivery capability.

CAPEX Versus Operational Expenses

While CAPEX refers to the money spent on tangible assets that will be used for longer than twelve months, operational expenses refer to money spent on the usual operations of a company. While CAPEX investments appear on the cash flow statement under the investing section, operational expenses appear on the income statement as expenses, with the corresponding amount appearing on the balance sheet, either as a cash reduction or accounts payable increase.

Free Cash Flow and CAPEX

Although CAPEX is often laid out in the cash flow statement, there is a great value to understanding all the components. To that end, an investor may calculate a period's CAPEX with the following formula:

CAPEX = PPE_c - PPE_p + DE

where:

PPE = Plant, property, and equipment

PPE_c = PPE for the current period

PPE_p = PPE for the previous period

DE = Depreciation expense

In essence, CAPEX reduces free cash flow, which is calculated as operating cash flow, less CAPEX. However, CAPEX is seen as an investment, used to purchase or improve an existing asset.

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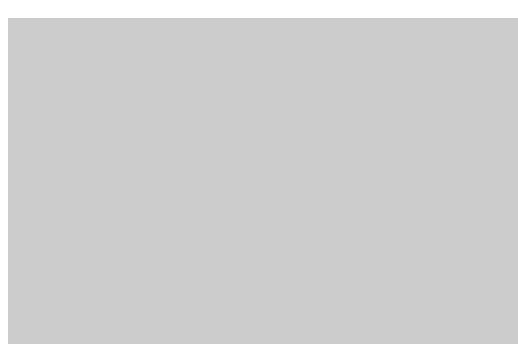
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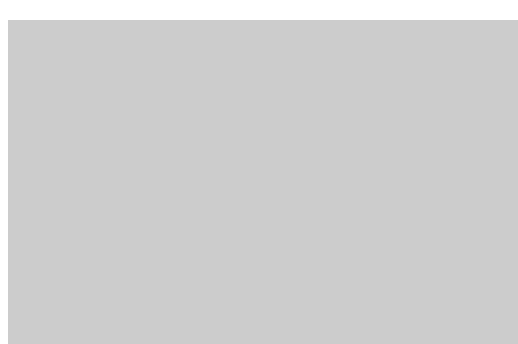
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Capital Expenditures: What You Need to Know

Capital expenditures, or CapEx, are funds used by a company to acquire or upgrade physical assets such as property, buildings, an industrial plant, or equipment. more

Earnings Before Interest, Taxes, Depreciation and Amortization – EBITDA Definition

EBITDA, or earnings before interest, taxes, depreciation and amortization, is a measure of a company's overall financial performance and is used as an alternative to simple earnings or net income in some circumstances. more

Cash Flow From Investing Activities

Cash flow from investing activities reports the total change in a company's cash position from investment gains/losses and fixed asset investments. more

Cash Flow From Operating Activities (CFO) Definition

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Impairment Definition

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Capitalized Cost Definition

A capitalized cost is an expense that is added to the cost basis of a fixed asset on a company's balance sheet. more