EQUITY VALUATION AND FINANCIAL STATEMENT ANALYSIS

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LVMH

Introduction

The present assignment looks to critically analyse the financial situation of Louis Vuitton Moët Hennessy (LVMH). This will be achieved through the use of a detailed financial analysis and comparison of the company with the wider market for luxury retail. The analysis is completed from the perspective of a hedge fund investor, looking to determine whether or not LVMH would represent a strong choice for a diversified equity portfolio (Pike et al, 2012). This assignment thus considers and analyses the company from a strategic and financial perspective. The work begins by outlining the broad business area of the company, its competitors and the nature of the industry it operates within, before providing an overview of the company's corporate strategy and the key risks of the company's strategy. This is followed by an analysis of the company's financial statement to cover all major categories of ratios, and also an evaluation of the selected company's ratios for the past five years, making use of both financial statement data and segment data (Berk and DeMarzo, 2010).

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Following this, the work also comments on the firm's accounting policies, including whether there has been any change to the accounting policies in the last five years, and also any impact of such changes in accounting policies on the selected company's financial performance and financial statements for the selected period. The work then looks to discuss the primary drivers of the company's performance, and how the company's performance compares to those of similar companies within its industrial sector of personal luxury retail. Taking into account the five-year analysis and the wider discussion of the performance of LVMH, the work then comments on the suitability of the company as a potential investment for an international hedge fund, including commenting on any relevant information to assist the hedge fund manager in his decision making, including profitability, liquidity and market risks. Finally, the work comments on the company's disclosure of ethics and corporate governance, and the implications of these for any potential investment in the business.

Company, competitors and industry

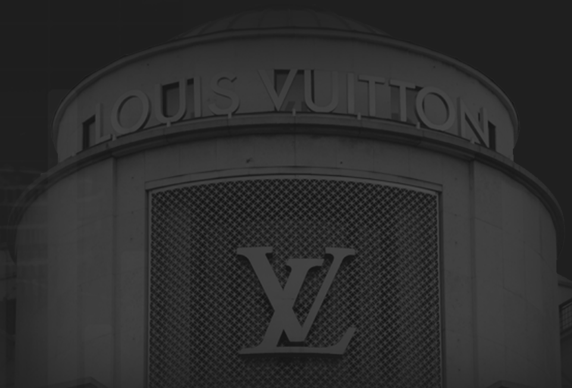
In general, LVMH is a French multinational luxury goods conglomerate, which was formed from the merger of Louis Vuitton, the luxury fashion brand, and Moët Hennessy, the luxury drinks brand. Following this merger, and the combination of the brand families of the two-component firms, the company has grown further through organic expansion and also through acquisitions. As such, the company now controls 60 subsidiaries and manages 75 luxury brands, including Louis Vuitton and Moët Hennessy as well as brands including Bulgari, Christian Dior, Fendi, Givenchy, Marc Jacobs, Sephora, Stella McCartney, TAG Heuer and Tiffany & Co (LVMH, 2023). The company has pursued a strong focus on growth and this has enabled LVMH to become the world's largest luxury group, as well as the most valuable company in Europe (Cormack, 2021).

Company, competitors and industry

With regards to competitors, LVMH competes on a global scale across multiple markets and in numerous sections of luxury fashion and luxury goods. As such, it has a wide array of competing businesses and brands, including Burberry, CHANEL, Estee Lauder, Hermes, Kering and Richemont (Taplin, 2019). Each of these businesses competes with LVMH to varying degrees across different segments, markets and brands, and using different products and bases for competition. As a result of this, the luxury goods industry is broadly fragmented across segments and markets, and this is particularly relevant for LVMH given its presence in areas such as luxury fashion, luxury beverages, and luxury jewellery. Overall, the industry is driven by a strong focus on marketing and quality, with the nature of the luxury products encouraging differentiation and also high levels of spending on marketing in an effort to create and disseminate strong and positive brand messages. In this regard, LVMH has a strong competitive advantage as the world's largest luxury group and the most valuable company in Europe, with the resulting economies of scale enabling a high level of spending on brand development, and also supporting the acquisition of erstwhile competitors such as Bulgari and Tiffany & Co (Cormack, 2021).

Corporate strategy

Broadly, the company's key corporate strategy is to provide the highest levels of luxury to the widest range of exclusive consumers. This can be seen in the company's mission statement, which identifies a clear strategic goal focusing on being the world leader in luxury and focusing on creative momentum and a constant quest for excellence (LVMH, 2023). As part of this, LVMH is continually looking for growth as a key element of its strategy, aiming to use creativity and marketing to dominate the markets and segments it competes in, ensuring a high level of market share and thus generating strong profits over time. This in turn has supported a strategy of hybrid growth, with the company looking to use aggressive marketing to grow brands that have promise, whilst also being willing to use numerous acquisitions of other brands in order to gain access and expertise in desirable markets where its present offerings enjoy limited success (Chen, 2021).



Corporate strategy

In addition to this, LVMH has pursued a strategy of geographic growth and expansion, looking to enter new markets and fill geographic gaps in its portfolio. This particularly involves the frequent use of mergers and acquisitions of other luxury goods groups in order to gain access to new markets, distribution networks and retail expertise, enabling the wider globalisation of the LVMH brand family (Lu, 2022). Such an approach has enabled LVMH to grow strongly and obtain additional brands and retail outlets worldwide, creating a significant and beneficial impact on the globalisation of the core LVMH brand. Most recently, this strategy saw LVMH acquire Tiffany & Co for $15.8 billion in November 2019, as part of the company's growth and consolidation strategy. Whilst this acquisition was significant and expensive to LVMH, it was part of a strategy of ensuring stable and continuous growth through the creation of synergies and the acquisition of retail and branding experience, contributing to the LVMH portfolio (Brunelli, 2021). This hence shows that the company has a focused strategy, but also a bold and ambitious strategy that it is willing to commit a significant level of financial and organisational resources to achieve .

Corporate strategy

Whilst this strategy has been effective, it is not without risk and potential drawbacks. In particular, a strategy of acquisitions and continuous expansion can place significant burdens on the cash flows of a business, with the resulting acquisitions either having to be funded from internal cash or through the issuance of debt (Brealey et al, 2009). As such, there can be important challenges around maintaining cash flows, particularly for retail businesses where much of their assets can be tied up in illiquid inventory for long periods of time. At the same time, whilst this strategy offers a superior return potential through economies of scale, it also opens LVMH up to additional levels of competition across multiple markets, creating challenges for marketing and branding activities and increasing the risk levels associated with these returns (Atrill and McLaney, 2019). It also increases the risk of the company overpaying for acquisitions, as targets are aware of its strategy and prepared for it to approach them, thus in turn creating significant challenges and potentially limiting how far this strategy can take the company going forwards .

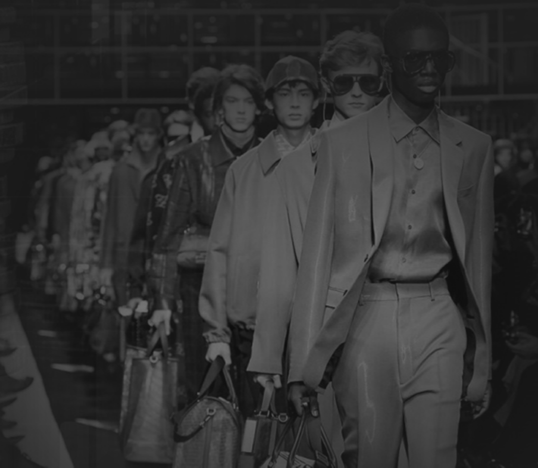
Financial statements, analysis and evaluation

LVMH	2018	2019	2020	2021	2022
Profitability (%)	**2018**	**2019**	**2020**	**2021**	**2022**
Gross Margin	66.6%	66.2%	64.4%	68.3%	68.4%
Operating Margin	21.1%	21.0%	17.9%	26.7%	26.5%
Net Margin	13.6%	13.4%	10.5%	18.7%	17.8%
Return on Assets	13.3%	11.7%	7.3%	13.7%	15.6%
Return on Equity	19.7%	19.6%	12.6%	25.5%	25.6%
Efficiency (x)	**2018**	**2019**	**2020**	**2021**	**2022**
Receivables Turnover	14.53	15.56	16.20	16.96	18.60
Inventory Turnover	1.25	1.32	1.22	1.23	1.23
Payables Turnover	2.94	3.12	3.12	2.87	2.84
Asset Turnover	0.63	0.56	0.41	0.51	0.59
Days of Inventory on Hand	291.65	275.99	298.89	296.75	296.80
Days of Sales Outstanding	25.11	23.46	22.53	21.53	19.63
Days of Payables Outstanding	124.14	116.98	117.07	127.06	128.37
Cash conversion cycle	192.63	182.47	204.35	191.21	188.06
Liquidity	**2018**	**2019**	**2020**	**2021**	**2022**
Current Ratio	1.40	1.17	1.58	1.23	1.26
Quick Ratio	0.66	0.57	1.06	0.63	0.62
Leverage	**2018**	**2019**	**2020**	**2021**	**2022**
Interest cover	84.42	28.40	25.23	70.89	77.49
Total Debt / Total Assets (%)	8%	16%	23%	19%	17%
Total Debt / Total Equity (%)	19%	42%	66%	51%	42%

Source: LVMH (2022)

This section presents an evaluation of the selected company's ratios for the past five years, making use of both financial statement data and segment data. Overall, the results from the analysis indicate that LVMH's growth strategy has supported a higher level of profit margin over the period of the study. This has seen the gross margin rise by around 2% from 2018 to 2022, albeit with a small fall during the COVID-19-affected period in 2020, but with the operating and net margins seeing much higher increases over time. This indicates that LVMH's acquisition strategy appears to have earned the company much greater economies of scale on the products that it sells, helping to justify the cost of acquisition of the additional brands and products as part of the growth strategy (Dyson, 2010). It also helps to alleviate concerns around the risk of the strategy, in terms of the potential for overpaying and thus undermining the overall ability of the business to generate profits from the acquired assets and businesses.

At the same time, the company has also increased its return on assets and return on equity over the study, both of which have risen notably from 2018 to 2022, thus showing that positive synergies have been developed over this time. However, segment data from the financial accounts indicate that the majority of these profits are generated from the company's fashion and leather goods offerings, particularly its core Louis Vuitton and Christian Dior brand, with the other segments, including watches and jewellery, having a lower profit level (LVMH, 2023). This in turn indicates that much of the improvements in performance may primarily come from the company's strong fashion brands, rather than from its acquisitions, and thus the growth strategy may not be driving returns to a significant extent. However, it is important also to acknowledge that these acquisitions may be playing a role in terms of their ability to support the core clothing and fashion offerings and to generate synergies and cross-selling opportunities which benefit the group as a whole.



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When considering the efficiency of the business, it is important to acknowledge that there has been a fall in asset turnover over the course of the study. This indicates that the total assets of the business have increased at a faster rate than its revenue from 2018 to 2022. Such a finding highlights the potential issues around using profits and capital to fund acquisitions of other businesses, as whilst this can be a valuable source of internal finance for growth, it also increases the overall asset base and requires ever-increasing revenues to justify this (Lumby, 2004). However, the overall fall in this area has been small, and thus it does not appear to be a significant cause for concern. At the same time, the company's overall efficiency appears to be reasonably stable. This is reflected in the fact that the days of inventory on hand and the days of sales and payables outstanding have not changed markedly over the course of the study, with the cash conversion cycle also being broadly stable, other than a jump in 2020 which can be linked to the COVID-19 pandemic. This indicates that the business has reached an optimal level for the industry, taking around four months to pay creditors, turnover over inventory in around ten months, and collecting sales in around 20 days (Maynard, 2013). However, this does create some risks, given that it takes around six months for purchased inventory to generate cash from the sales of this inventory.

This long cash conversion cycle is of relevance to the consideration of the company’s liquidity. In this regard, the business appears to have somewhat reduced its liquidity over the period of the study, with the current ratio falling from 1.40 to 1.26 and the quick ratio falling from 0.66 to 0.62. This may be an issue for LVMH, with the quick ratio some way below the 1.00 safe level, meaning that the company cannot cover all short-term liabilities from short-term assets without using its illiquid and slow-moving inventory (Parkinson, 2000). This issue is not uncommon for retail businesses, most of which generate large amounts of cash on a regular basis from sales and thus may not need quite as much of a buffer of current assets over current liabilities. However, it does appear to be more relevant for LVMH, with the luxury nature of its inventory meaning slower turnover, particularly in areas such as drinks and jewellery, with segment data showing a high level of inventory in these segments, indicating that it may be difficult to liquidate any inventory quickly. At the same time, the business does have very high gross margins, thus indicating that even if inventory moves slowly, it is likely to generate sufficient cash from sales to cover this slow rate of turnover.

Finally, with regard to leverage, the interest coverage ratios for the business is very high, showing that the company tends to spend less than 2% of its total earnings before interest and tax on paying interest. Whilst the coverage ratio fell sharply during 2019 and 2020, it has since recovered, indicating that LVMH has extremely high levels of debt coverage, and is not at any risk of facing an imminent debt default or other adverse events due to its levels of debt (Ryan, 2004). At the same time, it is important to note that LVMH saw a notable increase in its gearing ratios over the course of the study. Some of this was due to COVID-19, particularly the increase from 2019 to 2020, but this has now reverted to the 2019 level. This indicates that LVMH increased its debt level to cope with the pandemic, but has now moved back towards a target level of gearing, which it appears to have reached following the issuance of debt to support the acquisition of Tiffany & Co (Drury, 2005). This indicates a target debt level of 42% of total equity, which appears sustainable for the business, given the high level of interest cover that results.

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Accounting policies

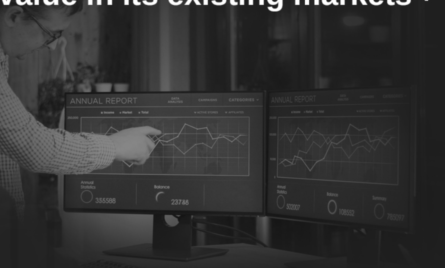
In general, the firm’s accounting policies are heavily influenced by the fact that it is a French company, with its headquarters in Paris. As such, since 2005, the company’s accounting policies have been required to be in accordance with IFRS, due to the regulations of the European Union. Overall, this has meant that the business has limited abilities to varying its policies, due to the quite prescriptive nature of IFRS, and indeed its consolidated financial statements for the fiscal year 2022 were established in accordance with IFRS, as applicable at the point of preparation of the accounts (LVMH, 2023). However, this has resulted in some changes to accounting policies over the period of the study. In particular, as of January 2019, IFRS 16 Leases was implemented by the IFRS and the EU, requiring companies to account for long-term leases on their balance sheet .

This resulted in LVMH reporting an additional 11.9 billion euros of right-of-use assets on its balance sheet in 2019, and an associated 11.9 billion euros of current and non-current lease liabilities to correspond to these assets. This has thus increased the company’s total assets, total debt and current liabilities figure for the relevant periods, which can be argued to explain some of the fall in return on assets, asset turnover and the increase in gearing ratio which occurred from 2018 to 2019 .

As such, this indicates that some of the falls in return on assets and the increased gearing levels observed in the evaluation above are in part due to these changes in accounting policies. More recently, an IFRIC agenda decision was issued in 2021 around accounting for the costs of installing software under a ‘Software as a Service’ (SaaS) contract, requiring associated changes in accounting policies. However, LVMH (2023) reported that the impact of this decision on the balance sheet of the company was non-material, and thus no adjustments or restatements were required, indicating that this has not impacted the observed and reported performance levels of the company .

Performance drivers

The primary drivers of the company’s performance are linked to its position as a luxury company, and the important role of branding and brand management in this process. As such, key performance drivers identified for LVMH include brand strategy, strategic planning, marketing effectiveness and the trade-offs around growth (Cavender and Kincade, 2014). Of these, the company’s brand strategy is largely devolved to each of the LVMH brands, with these having their own strategy for branding and targeting based on the needs and demands of their target market. However, strategic planning is largely centralised and based on decisions around how to grow the LVMH portfolio in order to achieve synergies and generate value for shareholders. Marketing effectiveness is linked to brand strategy and reflects the ability of each of the marketing teams within each LVMH brand and subsidiary to plan and execute marketing strategies to achieve revenue and profit growth. Finally, the trade-offs around growth focus on the nature of LVMH as a luxury goods company and particularly the need for the company to grow revenues whilst maintaining its exclusive luxury brand value. This thus helps explain the company’s strategy of growth including acquisitions, which is used to deliver growth in new markets, without risking too much growth that could undermine its luxury value in its existing markets .



In general, the company's performance compares well to those of similar companies within its industrial sector. Analysis of the business against two of its key competitors, namely Kering and Richemont, shows that LVMH has outperformed these businesses in terms of growth and value creation over the period of the study, including organic growth, net profit margin, return on assets and return on equity (Dias, 2022). This is linked heavily to the high level of diversification achieved by LVMH through its strategy of acquisition, enabling it to achieve higher levels of returns and growth when compared to less diversified rivals. However, it is reported that this is not just due to the pursuit of diversification, but is due to the company's clear strategy and experience, including the selection of appropriate targets for acquisition and also the strong role of strategic planning expertise in managing its overall brand portfolio (Dias, 2022) .

Suitability of the company for investment

Taking into account the five-year analysis, the company appears highly suitable as a potential investment for an international hedge fund. This is reflected in the ability of the business to generate high levels of returns and consistent growth in revenues and profits, even accounting for the turbulent performance of the global economy over the period of the study and the influence of COVID-19. As noted above, the company is a market leader, both in terms of its absolute scale and also in terms of its growth performance and ability to achieve higher levels of returns when compared to less diversified rivals. This indicates that any investor looking to gain exposure to the luxury goods market and the returns it can offer should consider LVMH to be a suitable company for investment. At the same time, LVMH has a diversified portfolio of markets from a global perspective, with investments and operations in numerous markets around the globe. This in turn highlights the value of LVMH from the perspective of an international hedge fund manager, who will be able to gain a global portfolio of brand exposure to support the needs of international investors and their demands for stable and diversified returns.

At the same time, there are additional factors that could be considered to assist the hedge fund manager in his decision-making. In particular, the company has a high level of profitability and reasonable liquidity, coupled with a low level of gearing.

This in turn indicates that the company could improve the returns to investors by raising more debt, either for investment or to fund share buybacks and other methods of distributing funds to shareholders. Such potential is important for a hedge fund investor, who may wish to take a sizeable stake in the business and to be active in their engagement. In this case, the hedge fund investor could encourage higher levels of debt and generate strong returns and significant gains for themselves and for other investors, without harming the long-term financial viability or creating damaging ratios for the business due to the strong interest cover (Vandyck, 2006). Indeed, this is reflected in evidence that hedge funds tend to be highly activist investors who are willing to obtain and exercise power over their portfolio firms. However, this does create some risks, particularly around the potential to create conflict if a hedge fund investor is overly active, and thus creates a backlash from managers and other shareholders (Schneider and Ryan, 2011). This is particularly prevalent considering the market risks around branding in the luxury goods market, and the potential for consumers and investors to be wary in the event of any conflict in the core LVMH brand. As such, whilst any activism could create strong potential returns, it should be tempered by the associated risks to brand value and performance .

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Ethics and governance disclosures

In general, the company's disclosures on ethics and corporate governance are in line with standard provisions made by most such businesses. This includes disclosures about the role of the Board of Directors in terms of their monitoring of the company's broad strategic direction; their supervision of decision-making and strategy implementation; and their role in verifying the fair and accurate presentation of information to shareholders. The company thus discloses the members of the board and their status within the company, as well as the actions and activities taken by these individuals with regard to protecting the business and accounting for core business risks. In addition to this, LVMH highlights the role of governance systems such as the board committees, with particular reference to the Nominations & Compensation Committee, referred to as the Governance & Compensation Committee, and also the Performance Audit Committee (LVMH, 2023) .

In general, these disclosures represent the standard provision of generic information around the governance and ethical operation of the firm and are necessary to obtain perceptions of legitimacy for a business. However, it is important to note that the disclosures do not go further than what is recommended under standard corporate governance frameworks, and thus do not provide additional information with regard to the actual governance mechanisms and processes within the company (Morroni, 2009). This is thus a weakness of the reporting in this area .

Conclusion

This report has provided comments and analysis on the financial statements of LVMH. The work has outlined the broad business area of the company, its competitors and the nature of the industry it operates within, as well as providing an overview of the selected company's corporate strategy and the key risks of the company's strategy. At the same time, the work has presented an analysis of the company's financial statement to cover all categories of ratios and commented on the firm's accounting policies. Overall, the work has highlighted the strong performance of LVMH, particularly around the primary drivers of the company's performance in terms of brand management, strategic planning and marketing effectiveness. The company's performance thus compares strongly to those of similar companies within its industrial sector. In light of the five-year analysis, this indicates that the company is highly suitable as a potential investment for an international hedge fund, particularly given the potential for activist hedge fund investment in order to boost the returns of the business going forwards .

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Appendix

LVMH	2018	2019	2020	2021	2022
Income Statement					
Sales	46826	53,670	44,651	64,215	79,184
Gross Income	31201	35,529	28,756	43,860	54,196
Operating profit	9877	11,273	7,972	17,155	21,001
Net Income	6354	7,171	4,702	12,036	14,084
Interest expense	117	397	316	242	271
Balance Sheet					
Cash & Short-Term Investments	4610	5,673	19,963	8,021	7,300
Total Assets	74300	96,507	108,671	125,311	134,646
Total Debt	6005	15,474	24,730	24,052	23,156
Total Liabilities	40343	58,142	69,842	76,402	78,041
Total Shareholders' Equity	32293	36,586	37,412	47,119	55,111
Inventories	12485	13,717	13,016	16,549	20,319
Trade receivables	3222	3,450	2,756	3,787	4,258
Trade payables	5314	5,814	5,098	7,086	8,788
Current assets	23551	26,510	39,973	34,301	39,740
Current liabilities	16833	22,623	25,318	27,989	31,543
Cash Flow					
Net Operating Cash Flow	11965	16,105	10,909	18,648	17,833
Net cash flow	795	1,084	14,309	-11,989	-717

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