

The Impact of Profit Quality on Enterprise Valuation: Taking LVMH as a Case

Zhifei Chen

*Nottingham University Business School China, University of Nottingham Ningbo China (UNNC),
Ningbo, China
biyzc32@nottingham.edu.cn*

Abstract. Profit quality constitutes one of the important elements in enterprise valuation. Issues concerning the sources of revenue stability, the genuineness of accounting profit, and the effectiveness of cash generation flows are related to it. For firms in the luxury sector, including LVMH, defining Profit and Earnings Quality is especially relevant. This paper takes LVMH as an example to study the connection of profit quality with enterprise valuation by using plenty of methods, including financial reporting, various financial ratios, the cash flow to earnings ratio, accruals ratio, and return on assets, which measure profit quality, to analyze their impact on multiples and discounted cash flow analysis. The results indicate that the most important factors are accrual quality and cash conversion, which link directly to the valuation. The findings, in particular, have implications for investors and managers in the luxury sector. For investors, a better appreciation of the driving forces behind the quality of profits may provide better assessments of reality and perceived risk in investment in luxury companies. For managers, this study could contribute to improving a firm's market position by focusing on enhancing profit quality through better management of its cash flows and accruals.

Keywords: Profit, Valuation, LVMH

1. Introduction

The notion of profit quality, sometimes described as earnings quality, remains a central theme in financial research because it determines how well reported profits mirror the underlying economics of the business. Investors often rely on net income as the key signal of performance, but these figures are shaped by managerial judgment, accounting estimates, and recognition policies. When profit quality is high, the information environment improves, making it easier for markets to assess risk and value firms appropriately. When it is poor, the cost of capital tends to increase, and valuations may be distorted [1].

In the luxury sector, the issue is even more pronounced. A company such as LVMH Moët Hennessy Louis Vuitton SE operates across several different business lines, including fashion and leather goods, wines and spirits, perfumes and cosmetics, watches and jewelry, and selective retailing. Each segment comes with distinct cost structures and accounting practices. For example, revenue recognized from wholesale channels can carry different risks and timing effects compared

to revenue generated through directly operated retail stores. Analysts and scholars alike argue that the quality of reported earnings plays a role in explaining why luxury firms often command valuation premiums [2].

Recent financial results provide useful context. In 2024, LVMH generated €84.7 billion in revenue, an operating profit from recurring operations of €19.6 billion, which represented a margin of just over 23 percent, and free cash flow of €10.5 billion. In the first half of 2025, the group reported €39.8 billion in revenue and €9.0 billion in operating profit, keeping margins around 23 percent despite global economic uncertainty. These figures underline the resilience of LVMH, but they also raise the key question of whether its market premium reflects only brand strength or whether it can also be traced to the quality and persistence of reported profits.

This paper therefore asks: to what extent do measurable attributes of LVMH's profit quality explain its valuation? The approach taken is not to design new indicators, but to apply established measures of accrual quality, cash flow stability, and persistence of earnings to LVMH's financials, before examining their impact on multiples and discounted cash flow analysis.

2. Literature review

Because earnings quality is multi-faceted, researchers have developed a variety of proxies. The most influential are accrual-based measures, where abnormal accruals, the portion of accruals not explained by standard models, are interpreted as a signal of lower quality. The idea is that larger unexplained accruals mean more managerial discretion and thus less reliability. Later refinements examine the variability and reversals of accruals, which can reveal the extent of estimation error [3].

Another set of measures focuses on persistence and predictability. If current earnings strongly forecast future earnings, quality is assumed to be high, while volatile and erratic profits indicate weak quality. Smoothness is sometimes taken as another indicator, though it is controversial: while smoother earnings can make forecasting easier, overly smooth figures might also suggest manipulation.

Cash flow tests are also important. If operating cash flow moves closely with reported net income, it signals that earnings are grounded in real economic activity. Finally, conservatism and timely loss recognition are newer dimensions, where early recognition of bad news is considered a mark of transparent and credible reporting [4].

Why earnings quality matters become clear when people look at its financial consequences. Poor quality increases information asymmetry between managers and investors, which raises the risk premium demanded by shareholders. Studies show a consistent negative relation between earnings quality and the cost of equity: firms with better quality enjoy cheaper capital [5,6]. Stronger audit oversight can even amplify this effect, because higher audit quality reassures investors that profits are not inflated [7].

In terms of valuation, markets appear to reward firms with credible and persistent earnings. Relevant researchers using data from 38 countries found that companies with higher measured earnings quality received higher valuation multiples, especially when they had growth opportunities. More recent work in the European context reinforces this finding: after controlling for governance and macroeconomic conditions, firms with higher composite quality measures consistently traded at valuation premiums. These results imply that accounting numbers are not neutral backdrops; they actively shape how much investors are willing to pay for a firm's shares.

Luxury companies make this image complicated. Their brand strength and intangible resources already move valuations upwards, and therefore the additional influence of the quality of earnings may be less apparent or more difficult to isolate. Nevertheless, the literature suggests that investors

still pay attention to accounting credibility. In markets where brand strength is similar, the firm with clearer, more reliable earnings reports may still command the superior multiple.

The analysis will use LVMH's past financial data, market indicators, and industry reports. It focuses on revenues, profits, cash flows, and market metrics like Price-to-Earnings Ratio (P/E) and Enterprise Multiple (EV/EBITDA) ratios. Peers like Hermès, Kering, and Richemont are used as benchmarks, and industry context is provided by reports on luxury market trends.

Two methods will be applied: relative valuation and Discounted Cash Flow (DCF) analysis. Relative valuation compares LVMH's multiples with peers to see if profit quality justifies premium levels, using regression to test correlations. DCF analysis adjusts cash flows or discount rates based on profit quality metrics, reflecting risks and uncertainties.

The empirical design includes cross-sectional regressions, controlling for firm size, growth, and leverage, and time-series checks to see if quality shifts affect stock returns. Robustness is ensured through alternative models and sensitivity tests. Though limited by focusing on one firm, the combination of peer comparison, regression, and adjusted DCF offers meaningful insights.

3. Descriptive facts and profit-quality measurement

3.1. Profit-quality metrics: definitions and calculations

LVMH Moët Hennessy Louis Vuitton SE is the world's largest luxury conglomerate, integrating about 75 Maisons across fashion, leather goods, wines and spirits, perfumes and cosmetics, watches and jewelry, and selective retailing. The group reports under International Financial Reporting Standards (IFRS) with consistent disclosures, enabling multi-year comparisons.

As shown in Table 1, four dimensions are assessed: accrual quality, cash flow alignment, persistence and predictability, and conservatism.

Table 1. Selected financial data, LVMH (2019–2024)

Year	Revenue (€m)	Profit Recurring Ops (€m)	Net Profit (€m)	CFO (€m)	FCF (€m)	Total Assets (€m)
2019	53,670		7,171			
2020	44,651	8,300	4,700			
2021	64,215	17,151	12,036	18,648	13,531	125,311
2022	79,184	21,055	14,084	17,833	10,113	134,646
2023	86,153	22,802	15,174	18,400	8,104	143,694
2024	84,683	19,571	12,550		10,478	149,190

Data Source: LVMH consolidated statements.

Accruals are defined as net income minus cash flow from operations, scaled by average assets. Negative ratios suggest conservative recognition.

$$2022 : (14084 - 17833) \div [(125311 + 134646) \div 2] = -0.029 (-2.9\%) \quad (1)$$

$$2023 : (15174 - 18400) \div [(134646 + 143694) \div 2] = -0.023 (-2.3\%) \quad (2)$$

Both ratios are negative, yet this pattern raises questions. Why would cash consistently exceed reported earnings during strong growth years? This could indicate either conservative accounting or deliberate profit suppression. The timing matters: these metrics occur just before the sector downturn, suggesting possible earnings management rather than structural conservatism.

3.2. Multiples approach

Relative valuation remains the most immediate way to position LVMH against peers. For luxury equities, the price to earnings ratio and enterprise value to EBITDA are the headline measures, while price to book is secondary given the weight of intangibles on balance sheets. As of late September 2025, LVMH traded at a trailing price to earnings near 23 and an enterprise value to EBITDA near 11, with enterprise value to revenue around 3.4. Hermès traded at markedly higher levels, with a trailing price to earnings near 48–50 and an enterprise value to EBITDA around 29–31, consistent with exceptional profitability and brand scarcity [8]. Kering’s multiples were lower, with forward price to earnings around 28 and an enterprise value to EBITDA near 12, reflecting earnings pressure through 2024 [9]. Richemont’s enterprise value to EBITDA stood in the mid-teens, and the trailing price to earnings was in the mid-20s, based on recent disclosures and market data [10].

Table 2. Selected 2025 valuation snapshots, main peers (as of late Sep 2025)

Company	Trailing P/E	Forward P/E	EV/EBITDA	Comment
Hermès	~48–50	~43–45	~29–31	Ultra-premium brand and margins
LVMH	~23	~21	~11	Diversified leader with strong cash conversion
Kering	~46	~28	~12	Recovery in progress after 2024 reset
Richemont	~24		~14–15	Jewelry heavy mix, solid margins

Data Source: Yahoo Finance tickers.

As shown in Table 2, inferences are straightforward. Hermès occupies a unique tier driven by scarcity and sustained operating margins, which pushes valuation far above the sector median. LVMH sits below Hermès but above Kering and Richemont. However, this premium alignment may be spurious. If quality metrics were truly explanatory, LVMH should trade closer to Hermès given similar cash conversion strengths. The persistent valuation gap suggests markets see through reported metrics to underlying structural differences that traditional quality measures fail to capture. Negative accruals to assets in 2022 and 2023, strong cash conversion in 2023 and 2024, and stable post pandemic earnings collectively reduce perceived information risk, and investors typically pay for that in the form of higher multiples. Differences that remain versus Hermès reflect brand exclusivity rather than accounting signals.

3.3. Discounted cash flow scenarios

Intrinsic valuation complements multiples by translating cash flow and risk assumptions into an enterprise value. LVMH reported free cash flow of approximately €10.5b in 2024, while the 2024 income statement and key figures confirm revenue of €84.7b and profit from recurring operations of €19.6b, with a group share of net profit equal to €12.6b. For discounting, a weighted average cost of capital near 9–10% is widely used for large European consumer cyclicals, and recent estimates place LVMH around 9.4%, with an implied cost of equity near 10% [11].

Two scenarios are presented. The Base Case assumes a starting free cash flow of €10.5b, 5-year growth at 6%, terminal growth at 2.5%, and a discount rate of 9.4%. The Quality Adjusted Case assumes a 5% haircut to starting free cash flow to allow for conservatism, 5-year growth at 4.5%, terminal growth at 2.0%, and a discount rate of 10%. Using standard present value formulas, the Base Case yields an enterprise value close to €180b, whereas the Quality Adjusted Case yields approximately €146b. The difference near 10–20% illustrates how modest changes in free cash flow and discount rate, prompted by profit quality judgments, can shift intrinsic value in a meaningful way.

The multiples and the discounted cash flow outcomes tell a coherent story. LVMH's valuation premium over diversified peers is not purely the product of scale and brand breadth. It is also supported by accounting signals. Operating cash consistently backed earnings in 2022 and 2023, and free cash flow remained substantial in 2024 despite macro and currency headwinds. These features lower the perceived risk of overstated earnings and justify tighter discount rates and higher relative multiples. From a risk perspective, the sensitivity of the discounted cash flow to small changes in growth and discount rates cautions against aggressive extrapolation. If the strong cash conversion and negative accruals prove cyclical rather than structural, the base case becomes overly optimistic despite seemingly conservative assumptions.

3.4. Alternative profit quality measures

An alternative proxy for accrual quality can be derived by averaging absolute accruals-to-assets ratios. In 2022 the accruals-to-assets ratio was -0.029 , and in 2023 it was -0.023 . The average absolute value is $(0.029 + 0.023)/2 = 0.026$. This level is relatively low compared with many cyclical sectors where average ratios exceed 0.05, suggesting that LVMH's reported earnings rely modestly on accruals [12]. The finding confirms the earlier conclusion that cash generation closely supports accounting income.

The discounted cash flow estimated an enterprise value of about €200b in the base case. A simple sensitivity analysis shows how modest changes in assumptions affect this outcome.

If the discount rate rises from 9.4% to 9.9%, the present value of the terminal value component falls from ~€155b to ~€140b. Combined with the 5-year free cash flow stream, the enterprise value decreases from ~€200b to ~€185b, a reduction of about €15b or 7.5%.

If the 5-year growth rate falls from 6% to 5%, the cumulative value of projected free cash flows declines from ~€45b to ~€33b. Adding the terminal value at 9.4% discount rate, the enterprise value drops from ~€200b to ~€188b. The reduction of ~€12b shows that valuation is highly sensitive to earnings growth assumptions [13].

Stress testing also illustrates resilience. LVMH reported revenue of €84.7b in 2024. A 3% contraction implies revenue of ~€82.1b. Holding margins constant, net profit would fall from €12.6b to ~€12.2b. Free cash flow, at ~€10b, would still cover more than 80% of net profit, sustaining strong conversion. This result demonstrates that even under moderate contraction, LVMH generates liquidity sufficient to maintain operations and dividends, supporting the argument that profit quality provides valuation protection.

4. Conclusion

The evidence presented shows that LVMH's valuation premium over most peers is closely tied to its profit quality. The most important signals for investors appear to be accrual quality and cash conversion, as these link directly to reliability of earnings and resilience in downturns. The findings

indicate that investors should focus more on cash-flow transparency and conservatism in recognition practices than on revenue growth and valuation multiples. Clear free cash flow disclosure and transparent reporting of nonrecurring items help maintain the valuation premium for luxury brands like LVMH. Hence, regulators and analysts should push for higher comparable disclosure standards to mitigate mispricing.

In conclusion, LVMH's valuation advantage reflects not only brand power but also a pattern of conservative, cash-backed reporting. Investors, managers, and regulators all have a stake in sustaining these practices, particularly as luxury markets enter a period of slower growth.

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