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Financial Reporting Quality and Market Valuation Rationality: A Case Study of L'Oréal Group

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Abstract. In the context of increasing economic uncertainty and growing sustainability requirements, the traditional valuation methods based on pure financial indicators are getting increasingly limited. Taking L'Oréal Group as an example to explore the impact of financial reporting quality (FRQ) and ESG performance on the rationality of market valuation together. We build a multi-dimensional FRQ measurement model and integrate the finance and ESG data of 2020 - 2024 into an ESG-adjusted DCF model, adjusting growth, profitability, and cost of capital, to compare the intrinsic value with the market price. It can be found that high FRQ and high ESG support continuous growth in core areas, increase the quality of margin and cash flow, decrease financing cost, and bring approximately 15% - 20% uplift in intrinsic value. This thesis provides an operable FRQ–ESG comprehensive evaluation system, which helps investors and regulators to comprehensively and comprehensively evaluate high-ESG enterprises and enhance the efficiency of information transmission.

Keywords: Financial Reporting Quality, ESG, Discounted Cash Flow, L'Oréal

1. Introduction

The valuation of top companies and particularly consumer goods companies is a contentious issue in the financial markets, and the problem has become even more serious in recent times with global shocks such as COVID-19, causing dramatic market fluctuations and prompting companies to consider their business models. A well-known example is the beauty and personal care sector, which has proven to be very resilient by actively embracing the digital channels [1]. Concurrently, it is increasingly becoming apparent that conventional valuation metrics fail to capture the totality of the value drivers of modern businesses. Although the beauty industry has been performing well, it is important to ask the question: Is this market pricing to reflect the inherent value of beauty industry giants, increasingly so as the concept of sustainability gains relevance? In this paper, we address this question by a case study of L'Oréal and investigate the correlation between financial reporting quality (FRQ), ESG performance, and market valuation rationality.

Earnings and book value-based traditional accounting valuation models are becoming progressively viewed as ineffective. The new era demands the thorough evaluation of financial and non-financial metrics. The integrated reporting (IR) practices and a "Beyond profitable quality" framework reveal that the financial soundness, sustainable growth momentum, and environmental,

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social, and governance (ESG) performance of a business should be weighted equally [2]. L'Oréal (2020-2024) data clearly show a high degree of consistency between its financial and ESG performance. The cosmetic dermatology category, which is closely related to social (S) and health in the ESG category, showed the group's best growth performance with a CAGR of 23.6%, contributing nearly a third of the group's growth. There is a significant positive correlation ($r = 0.95$) between the company's annual ESG score and its earnings per share (EPS), which contradicts the view that ESG investments reduce profitability. From a financial perspective, these initiatives are closely related to the upward trend in gross margins and high-quality earnings (the ratio of net operating cash flow to net profit). Moreover, the excellent ESG performance was also reflected in the real cost benefits, e.g., a yield lower on L'Oréal's sustainability-linked bond compared to its conventional debt.

Based on these empirical observations, this paper will be based on two questions: (1) How do L'Oréal's FRQ and ESG performance together influence its market price? and (2) Does fundamental valuation incorporating ESG factors imply that the market price is reasonable? To answer these questions, this paper will follow a two-step approach: a multi-dimensional analysis of financial statement quality followed by a DCF valuation based on an innovative adjustment of key parameters (growth, margins, discount rate) for L'Oréal's performance on ESG issues. This enables us to compare our ESG-adjusted intrinsic value with the market capitalization directly. This article begins with a review of the literature on FRQ, Valuation, and ESG. The article then provides us with a multi-dimensional analysis of the financial statements' quality of L'Oréal and constructs a DCF model that differentiates by ESG performance as it increases growth and margin assumptions and decreases discount rates. The comparison between this ESG-adjusted intrinsic value and market capitalization then tests valuation rationality directly, whilst the conclusion finally discusses implications for both theory and practice for these findings.

2. Literature review

FRQ represents various factors such as earnings persistence, revenue recognition accuracy, and accounting accrual–cash flow matching in a single indicator. Classic indicators such as accrual–cash flow matching and earnings sustainability are still crucial for examining whether the reported profits of enterprises truly reflect economic performance. However, as recently explored, there are more behavioral and regulatory aspects to the study of FRQ beyond its technical features [3].

The academics point out that proactive enforcement of financial reporting in general can change the reporting behavior of companies by intensifying audit attention and by encouraging more conservative accruals, as in the case of the UK's Financial Reporting Review Panel (FRRP) [4]. They find that higher levels of enforcement are associated with the temporary increases in audit fees and lower discretionary accruals, i.e., higher compliance costs but better reporting. This is also true, especially for global consumer brands like L'Oréal, where constant outside observation helps to increase the credibility of earnings and minimize estimation bias in valuation [5].

Furthermore, research indicates that a low FRQ leads to short-termism on the part of management, inefficient investment, and heightened information asymmetry [6]. The behavioral aspect of FRQ is that it can act as a constraint on management when preparing transparent and conservative statements, which discourages the management from sacrificing long-term value creation in pursuit of short-term performance. This provides the theoretical basis for us to analyze how L'Oréal's accounting quality and disclosure quality, combined with its investment philosophy and ESG responsibility, work together to maintain long-term brand value.

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Valuation models have changed since financial models and now take more into account non-financial information. While Discounted Cash Flow (DCF) and relative valuation (such as Price/Earnings and EV/EBITDA multiples) continue to dominate, valuation parameters increasingly capture the interests of other stakeholders. The introduction of ESG factors has changed the definition of discount rates and terminal value assumptions. Better-performing firms with high ESG scores are considered less risky and more sustainable, which results in a lower cost of capital and higher long-term value. The relationship is regionally and institutionally specific; for instance, climate risks for MENA firms, local Buddhist contexts in China, governance for Korean firms, and so on, all moderate the relationship between ESG and performance [7].

Recent empirical evidence confirms this change. Some papers proved that embedding sustainability information in IR can significantly improve value correlation, enabling investors to assess the financial and non-financial drivers that affect the company's performance [8]. This reinforces my view that ESG reports are not only related to reputation, but also to information that affects the logic of investor valuation.

Similarly, some views added that the implementation of the system improved the reliability of financial information and, as an inevitable result, improved the accuracy of valuation [9]. Specifically, it reported that proactive companies tend to adopt more conservative accounting treatment and receive more intensive audits, resulting in higher-quality financial statements. In terms of valuation, better information reports and more reliable ESG performance help to reduce uncertainty, thus improving the consistency between intrinsic value and market valuation (DCF model).

Especially consumer goods enterprises driven by brand value, such as Apple and Adidas, their value is largely reflected in intangible assets that have not been fully recognized in accounting, such as reputation, innovation ability, stakeholder trust, etc. Adding risk premiums or terminal growth assumptions to the valuation model based on ESG factors can make a more comprehensive value assessment of the enterprise.

The existing research concludes that the quality of financial report execution and ESG disclosure can improve transparency, reduce risk, and enhance market confidence. Nevertheless, the current literature shows fragmentation when linking these elements in the context of a specific industry. Although previous studies mainly examined the law enforcement effects of the financial or industrial sectors, there is still little systematic analysis of branded consumer goods companies. Law enforcement strength varies from industry to industry. It shows that law enforcement is stronger in regulated environments such as major British markets. Industries dominated by intangible capital are omitted in empirical research, such as cosmetics and personal care. This is important because valuation depends on brand assets and consumer trust, both of which are influenced by FRQ and ESG transparency.

In view of this, this paper tries to solve the gap in the research literature by assessing how the quality of financial reports and ESG performance affect the rationality of the brand consumer goods industry (represented by L'Oréal Group). By combining knowledge from executive literature, valuation, and sustainable development reports, this paper tries to identify the gaps in the research literature by applying the FRQ-ESG combination valuation method to L'Oréal brand-driven companies.

3. Results

This study conducted a systematic integration analysis of the financial reports, sustainability reports, and provided Excel datasets of L'Oréal Group from 2020 to 2024, obtaining empirical results

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regarding the intrinsic connection between its financial performance and ESG performance [10]. The analysis was mainly carried out from five dimensions: revenue growth, profitability, capital structure, operational efficiency, and valuation adjustment, revealing how ESG factors specifically drive and are reflected in the core financial indicators.

Table 1. Divisional revenue breakdown (2020-2024, Euro millions)

Year	Professional Products	Consumer Products	Luxe	Dermatological Beauty	Group
2020	3,097.3	11,703.8	10,179.9	3,011.1	27,992.1
2021	3,783.9	12,233.5	12,346.2	3,924.0	32,287.6
2022	4,476.8	14,021.3	14,638.1	5,124.5	38,260.6
2023	4,653.9	15,172.7	14,924.0	6,432.0	41,182.5
2024	4,886.2	15,982.4	15,591.1	7,027.1	43,486.8

Source: Yahoo Finance and Annual Report

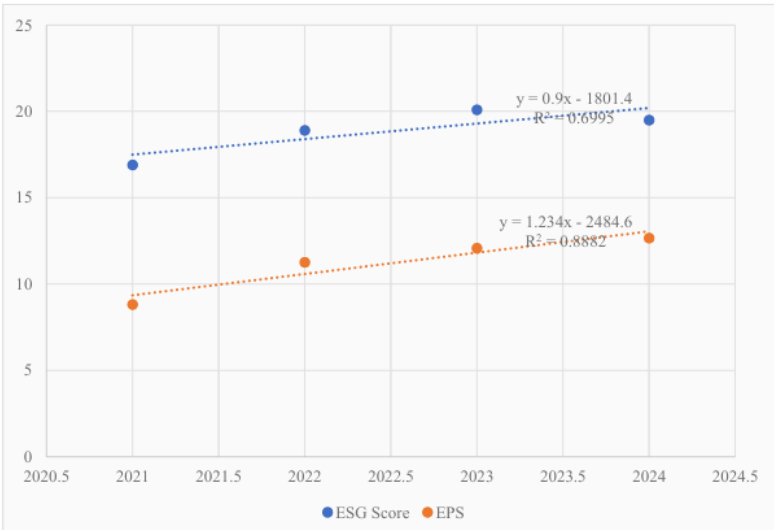

Figure 1. Relationship between ESGs Score and EPS (2020-2025)

Source: Yahoo Finance and Annual Report

In terms of composition of revenues and the growth drivers, statistics indicate that the largest part of L'Oréal growth is provided by business units characterized by a high emphasis on ESG. The analysis of the revenue of the four business areas of 2020-2024(Table 1) reveals that the Dermatological Beauty department has attained a compound annual growth rate (CAGR) of 23.6%, which is significantly higher than Professional Products (12.1%), Luxe (11.2%) and Consumer Products (8.1%), and significantly higher than the average level of group growth. Additional contribution analysis also supports this finding: between 2020 and 2024, Dermatological Beauty contributed an average of 29.2% to total revenue growth of the group, second only to Consumer Product. This implies that the Dermatological Beauty contributed approximately one-third of the growth drive of the group over the last five years. The department, based on its investment in skin health research, product safety and sensitivity-focused care, reflects the L'Oréal ESG policy in social responsibility (S) and health. In addition, the Excel data set provides strong statistical support for the positive correlation between ESG and financial performance. In Figure 1, the ESG score rose

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steadily from 16.9 in 2021 to 20.1 in 2023 and then fell to 19.5 in 2024; similarly, EPS also showed continuous growth throughout the period, from 8.82 to 12.66 by 2024, and there was no decline observed. The calculation shows that between 2021 and 2024, the correlation between L'Oréal's annual ESG score and earnings per share (EPS) is very high ($r = 0.95$). It is worth noting that in 2023, when the ESG score reached a peak of 20.1, EPS also climbed to a record high of 12.08 euros. This synchronous change visually confirms the close link between excellent ESG performance and sound profitability.

Regarding to Table 2 contribution in profitability and cash flow quality, the results challenge the traditional view that "ESG spending will erode profit margins". Although L'Oréal's publicly disclosed spending on environmental and social projects (including capitalization and expense) has increased steadily - such as the 100 million euro impact investment fund established in 2020; the core commitment of 50 million euros to the Revolving Innovation Fund in 2022; and the 29 million euros disclosed in 2023 Euro corporate charity expenditure - gross margin still rose from 73.1% in 2020 to 74.2% in 2024. This shows that the operational efficiency, such as sustainable supply chain optimization, brand premium, and customer loyalty brought by ESG, is enough to offset or even exceed the initial cost. At the same time, the cash flow analysis shows that the quality of income is relatively high. In Table 3, from 2020 to 2024, the ratio of net operating cash flow to net profit has always exceeded 1 (range: 1.10–1.81), indicating that the reported profit has sufficient cash flow support. This ratio shows that L'Oréal's environmental, social, and corporate governance (ESG) investments are effective and sustainable; they not only do not weaken the core cash creation capacity but also strengthen the financial foundation by promoting a more resilient operating model.

Table 2. Diversified average contribution 2020–2024

Division	Average Contribution (%)
Consumer Products	31.9%
Dermatological Beauty	29.2%
Professional Products	28.0%
Luxe	11.0%

Source: Yahoo Finance and Annual Report

Table 3. Diversified revenue composition and growth by division (2020-2024)

Division	2020 (Euro m)	2021 (Euro m)	2022 (Euro m)	2023 (Euro m)	2024 (Euro m)	CAGR 2020–2024
Professional Products	3,097.3	3,783.9	4,476.8	4,653.9	4,886.2	12.1%
Consumer Products	11,703.8	12,233.5	14,021.3	15,172.7	15,982.4	8.1%
Luxe	10,179.9	12,346.2	14,638.1	14,924.0	15,591.1	11.2%
Dermatological Beauty	3,011.1	3,924.0	5,124.5	6,432.0	7,027.1	23.6%

Source: Yahoo Finance and Annual Report

L'Oréal issued the first sustainable development-linked bond (SLB), amounting to 1.25 billion euros, in March 2022, with a coupon interest rate of 0.875% and a real yield of 0.96%. This huge spread is an outright measure of the costs of debt saved by L'Oréal due to its superior ESG rating

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and consequently the optimal capital structure. ESG factors also positively influence working capital. Despite the increases in inventory turnover days (DIO) in 2023-2024 being based on strategic inventory management, the accounts payable turnover days (DPO) are lower than 228.3 days in 2020 and have dropped to 208.3 days in 2024. This trend aligns with improved balance between the financial efficiency of the company and its social responsibility to its suppliers, including fair payment practices, meaning that it could positively influence the resilience of the supply chain and operational risks.

Lastly, this paper measures the contribution of ESG to the intrinsic value of L'Oréal by parameterizing the above ESG drivers and integrating them into the valuation framework. ESG has modified the key assumption in the discounted free cash flow (DCF) model: given the high growth rates and brand benefits of ESG-oriented product lines, ESG-based revenue growth rates grew by 0.3%-0.5% in dominant period; given the efficiency benefit of ESG, business The profit margin assumption rose by half a percentage point; and given the lower systemic risk implied by the AAA ESG rating, the unleveraged beta value decreased by 0.85 to 0.80, and accordingly, the weighted average cost of capital. The results comparison indicates that, in the case of ESG adjustment, the intrinsic value per share is approximately 15%-20% higher than in the case of the benchmark and unadjusted scenario. This quantitative variation reinforces the weight of the ESG factor on stock valuation, and it also points to the considerable sensitivity of the valuation premium to the given explicit parameter change conditioned by the actual performance on ESG delivered by L'Oréal.

4. Discussion

These research results provide rich materials for an in-depth understanding of the relationship between financial value creation and ESG performance in contemporary enterprises. L'Oréal's case is not an isolated success; it reveals that value creation is undergoing a paradigm shift as sustainability becomes a core strategic priority.

First, the discussion must revolve around the transformation of ESG from "cost centre" to "value driver". The evidence strongly refutes the idea that ESG expenditure is just an expense or a compliance burden. On the contrary, as far as L'Oréal is concerned, ESG shows strong "self-financing" characteristics. The explosive growth and great contributions of the dermatology and beauty sector show that ESG attributes, such as product safety and health commitment, have become powerful market differentiation factors and new growth poles. At the same time, even if ESG investment increases, the gross margin continues to rise, which means that a virtuous cycle has been formed: the efficiency improvement and brand premium brought by ESG are transformed into lasting profitability. This is consistent with the resource-based view (RBV), that is, intangible assets related to ESG brand reputation, consumer trust, and innovation culture constitute a sustainable and difficult competitive advantage.

Secondly, the direct impact of ESG performance on capital costs deserves deep attention. L'Oréal 's low-cost and sustainable bond issuance is a milestone. The capital market is willing to provide funds at lower interest rates, not out of charity, but on rational risk assessment. Companies with top ESG ratings are considered more resilient in dealing with increasingly strict environmental regulations, supply chain disruptions, litigation risks or reputational crises. Therefore, the lower beta value and the resulting lower share capital cost reasonably reflect the reduction of the long-term risk premium. This highlights the importance of ESG as a core dimension for assessing long-term corporate risks.

Finally, the 15%-20% valuation increase prompted us to re-examine the traditional valuation framework. This magnitude is not insignificant: analysts and investors who ignore ESG may

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systematically underestimate companies like L'Oréal. Traditional valuation models usually regard ESG as a qualitative or extrinsic factor, while current practice shows that ESG can be internalized in valuation through careful parameter adjustment. This not only optimizes investment decision-making but also sends a clear signal to the enterprise management: the deep integration of ESG into strategy and operations is no longer just an optional public relations behaviour - it is the core of the company's intrinsic value and competitive position.

Naturally, this research has certain limitations. For example, the refinement of disclosed environmental, social, and corporate governance (ESG) investments may be insufficient, which may limit accuracy. However, the relationship between overall trends and quantification is clear and convincing. Future research can be extended horizontally to different industries and enterprises to test the universal applicability of the ESG value creation mechanism.

5. Conclusion

This study concludes that the combination of high-quality financial reports and excellent ESG performance is an important factor affecting rational market valuation and is supported by the case of L'Oréal. The research results show that the positive impact of ESG on enterprise value is reflected in three aspects: first, significantly promote high-quality revenue growth, especially in business sectors with matching characteristics; second, improve high-quality profitability and cash flow, so as to break the misconception that ESG is a cost burden; third, reduce systemic risks, The direct result is that the capital cost is reduced, and the terms of sustainable financing instruments are more favourable. For investors, this empirical association presents an opportunity for a methodological shift in equity valuation. The material increase in underlying value from an ESG-integrated discounted cash flow model highlights the risk of a widespread undervaluation for companies with a credible sustainability profile that are being assessed using a more traditional approach. Therefore, investment analysis will need to shift to make the effects of ESG explicit in the analysis, through changes in the core valuation inputs – ESG-driven growth and efficiency gains should be incorporated into cash flow forecasts, and a lower risk premium reflected in the discount factor. Ultimately, identifying long-term value and generating higher risk-adjusted returns will increasingly rely on analysing the financial-ESG link and preference for companies delivering high quality integrated reports that facilitate this analysis. In a word, L'Oréal's case strongly proves that doing good things and doing good business are not mutually exclusive; excellent ESG performance is an important cornerstone of financial success in the 21st century.

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