LVMH

MOËT HENNESSY . LOUIS VUITTON

# Presentation of IFRS impact on LVMH Financial Statements

**Analysts Meeting**

**March 31, 2005**

# Disclaimer

The information contained in this document is based on the International Financial Reporting Standards (IFRS) known today. However the standards established by the IASB and approved by the European Union could change and the treatment of certain operations could be modified.

The selected options and the applied accounting treatments have been reviewed by LVMH's auditors who judged them to be in line with IFRS.

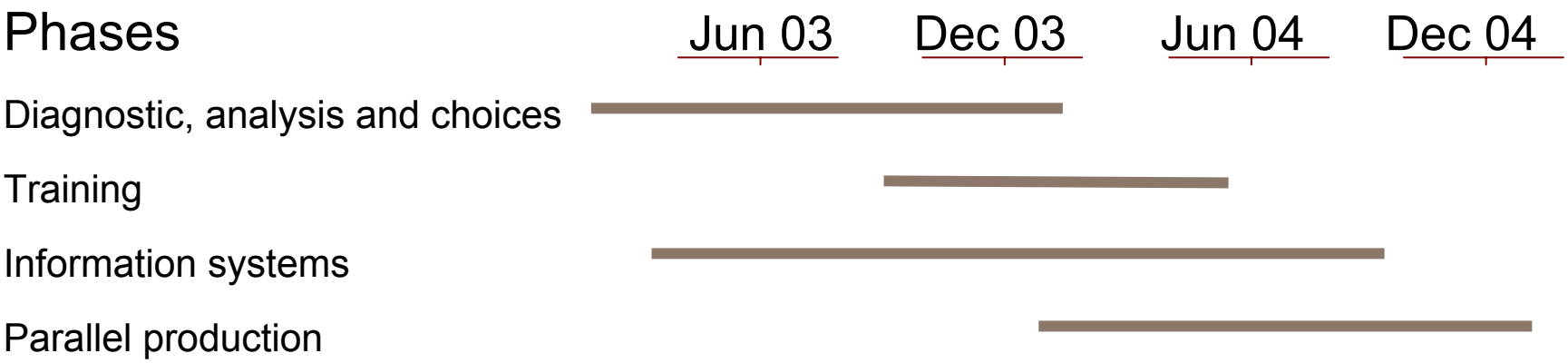
The present document is intended to analyse the principal impacts from the application of IFRS. It therefore not intended to be exhaustive.

# The IFRS Project at LVMH

## A wide-ranging project….

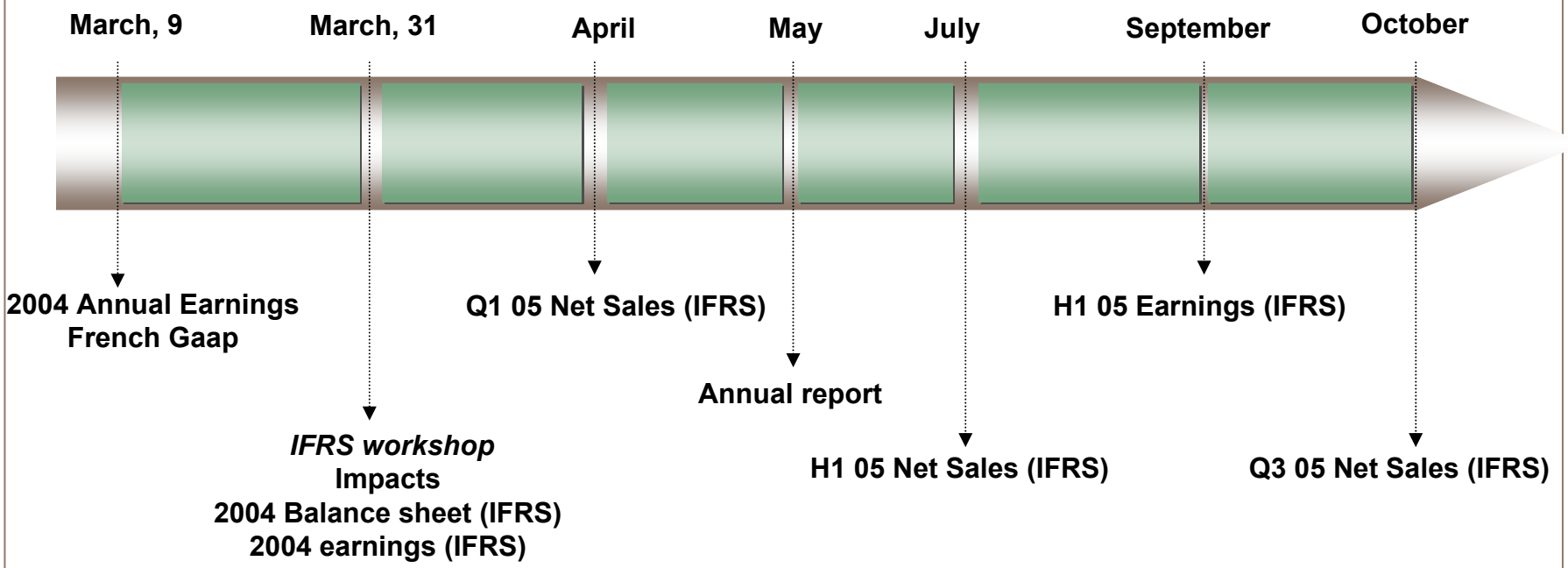
- Multi-sector : 5 business groups
- Multi-disciplinary
- Multi-national accounting
- Multi-systems and multi-organisational due to the strong decentralisation of the Group

## …. Over two years



# Timetable

## 2005



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# Presentation of IFRS impact on 2004 Income Statement

# Impact on Net Sales

## French Gaap

- Recording of net sales mainly driven by legal factors

## IFRS

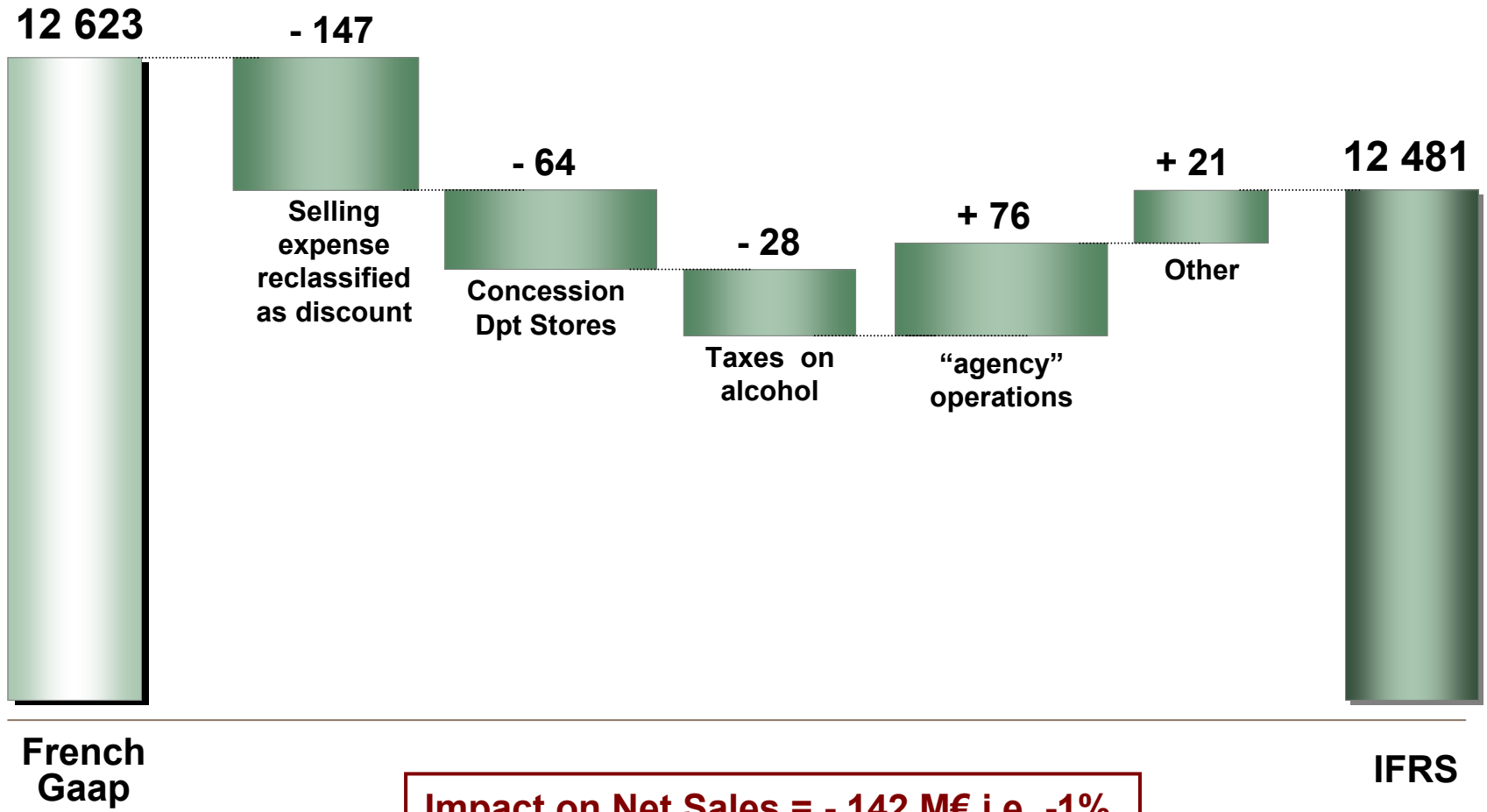
- Substance over form

**➔ Reclassification without an impact on operating income**

- ➔ Selling expenses (placement and entrance fees, promotional expense paid to retailers) analyzed as discounts and deducted from net sales
- ➔ Taxes on alcohol deducted from net sales
- ➔ Recognition of sales and cost of sales for “agency” operations
- ➔ Department stores « concession» income (Bon Marché, Samaritaine) analyzed as positive service cost

# 2004 Net Sales Adjustments

*EUR millions*




**Impact on Net Sales = - 142 M€ i.e. -1%**

# From Income from Operations (French Gaap) to Current Operating Income (IFRS)

## Under French Gaap

- LVMH previously communicated on its « Income from operations », which excluded net financial expense, dividends, other income and expenses, and income taxes

## Under IFRS

- LVMH will principally communicate on « Current operating income », i.e. excluding « other operating income and expenses »
  (in compliance with recommendation 2004-R02 from French standard setter « CNC »)

**Income from Operations (FG) ➔ Current Operating Income (IFRS)**

# Impacts on Current Operating Income

## Stock options

- Black-Scholes measurement of fair value of granted options, recognized in expenses on a straight line basis over the vesting period (3 or 4 years)
- Increase in equity equal to the loss of income ➔ no impact on stockholder's equity

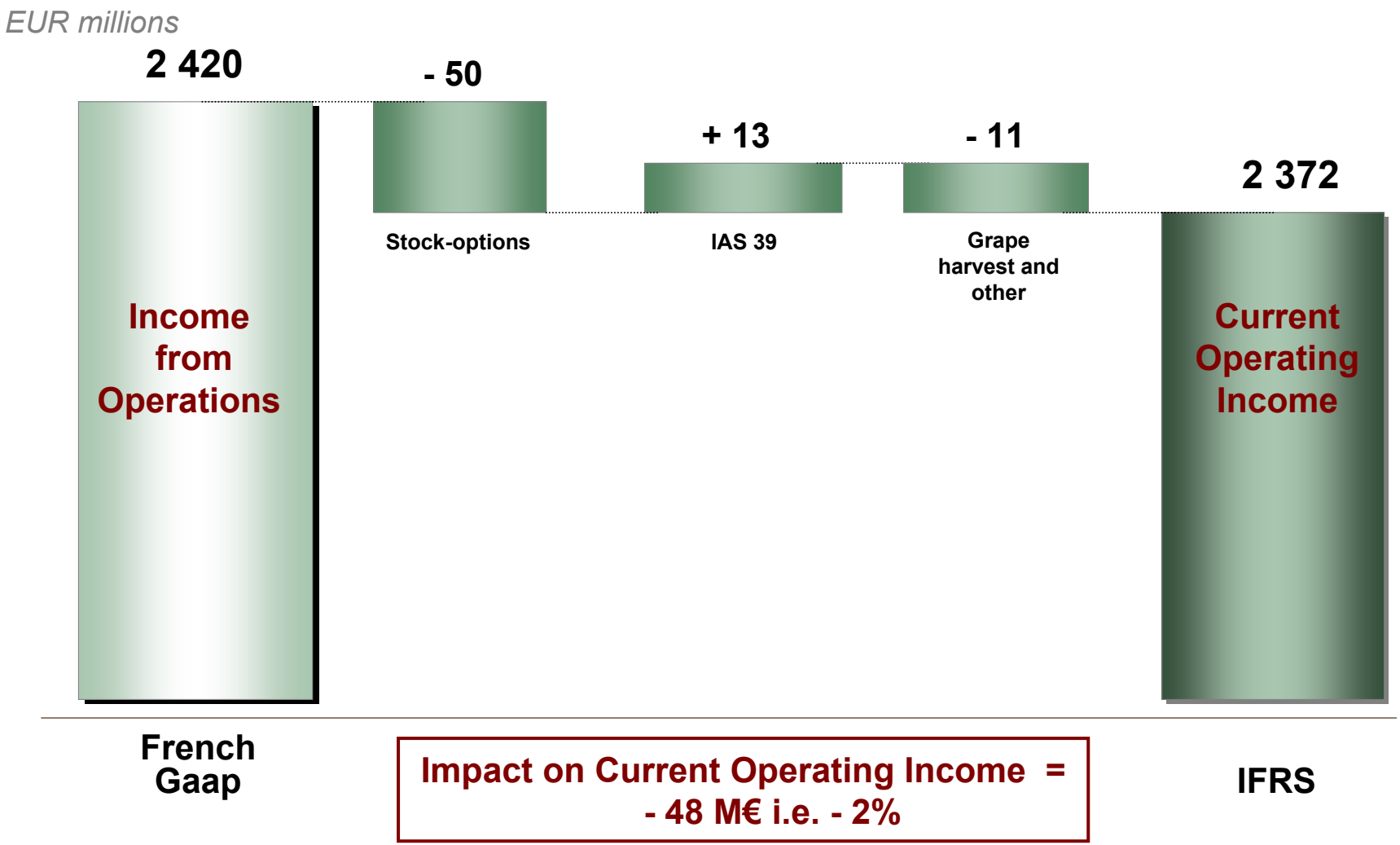
## IAS 39: foreign exchange risk

- Continuation of hedging accounting (impact on operating income)
- Financial cost of hedging derivatives recorded in financial expense

## Harvested grapes recorded at market value

- The difference between market value and internal cost of harvested grapes is recorded as a profit in the harvest year
- These differences are booked in inventory and released in cost of sales under FIFO method
- The period's income statement shows the net impact of these two effects

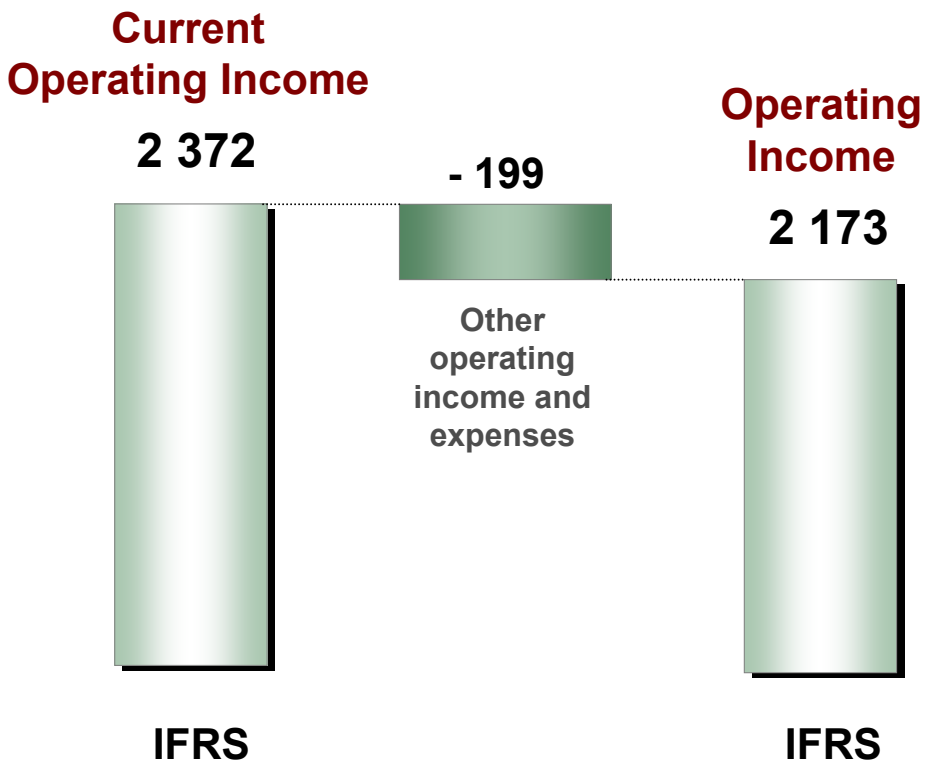
# Adjustments to 2004 Current Operating Income



# IFRS : from 2004 Current Operating Income to 2004 Operating Income

*EUR millions*

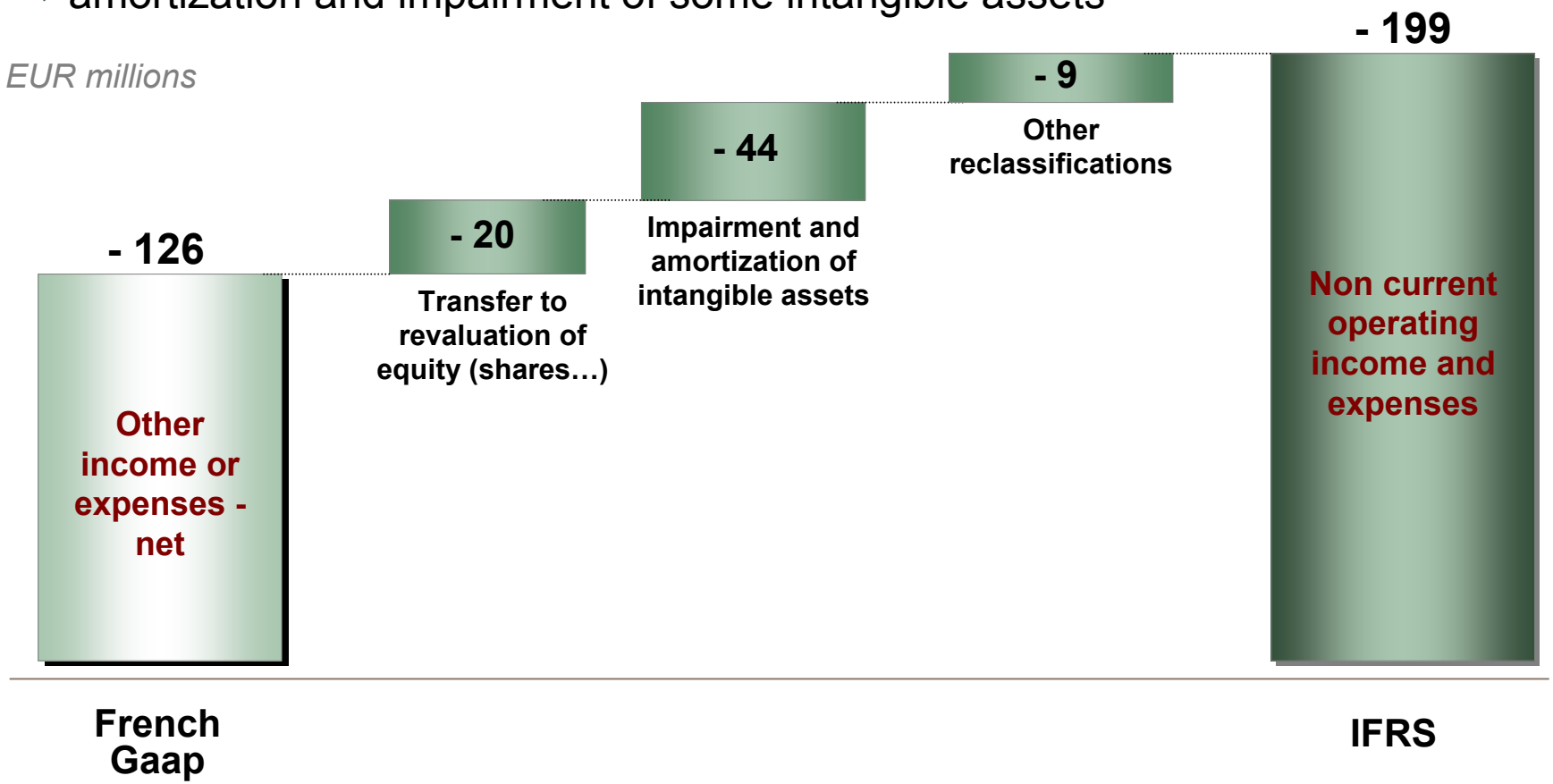
Current operating income
- Other operating income and expenses
= Operating Income



# From « Other Income or Expenses – Net » to « Other Operating Income and Expenses » IFRS

Non current operating income and expenses include

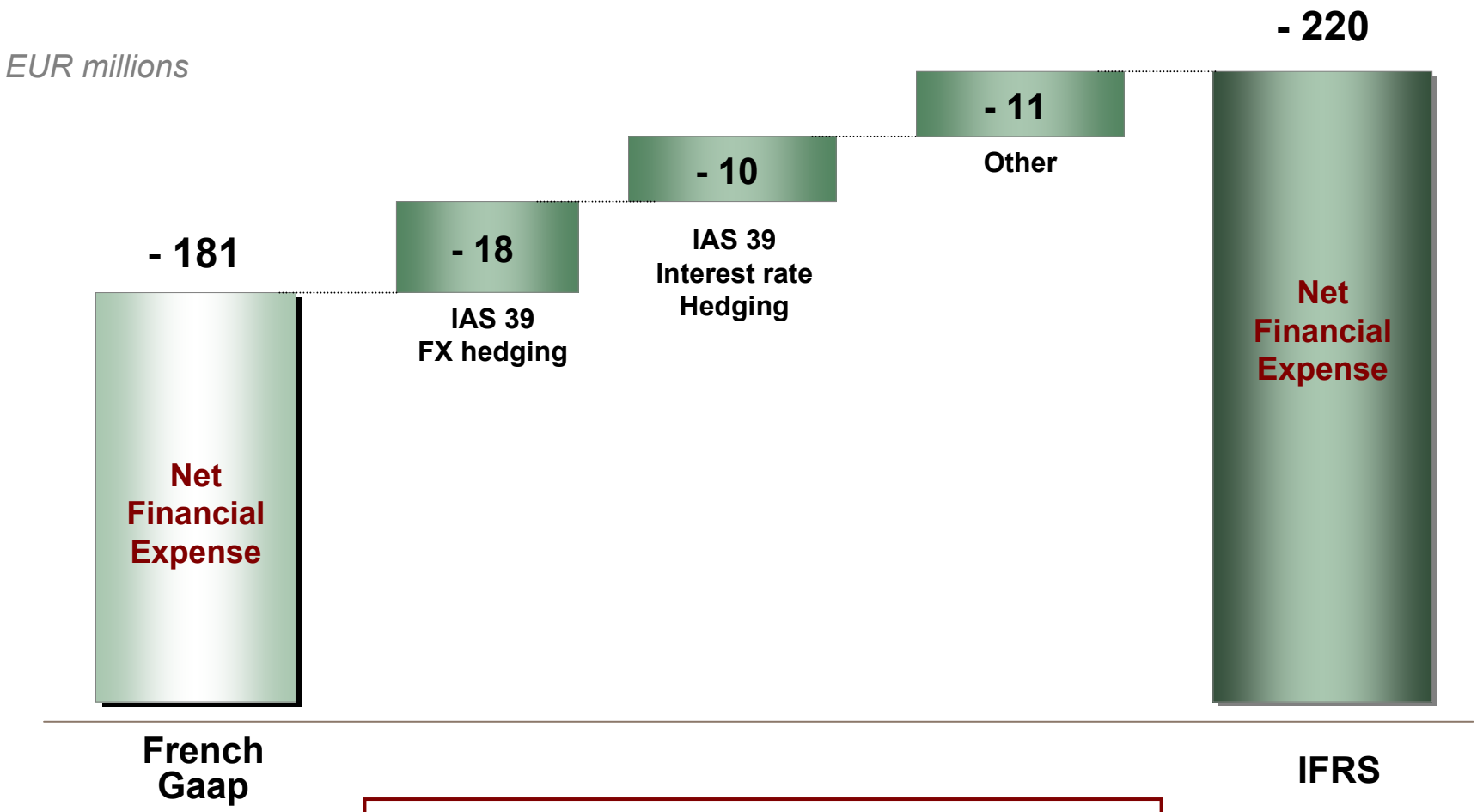
- income or expenses not related to current activities
- amortization and impairment of some intangible assets



# Impacts on Net Financial Expense (IAS 39)

- Foreign exchange hedging : changes in fair value of the ineffective portion of hedging derivatives
- Interest rate hedging : changes in fair value of related derivatives
- Revaluation of financial assets, discounting of non-current assets and liabilities…

# Impacts on 2004 Net Financial Expense




**Impact on Net Financial Expense = - 39 M€**

# Impact on Net Income

## Amortization of goodwill

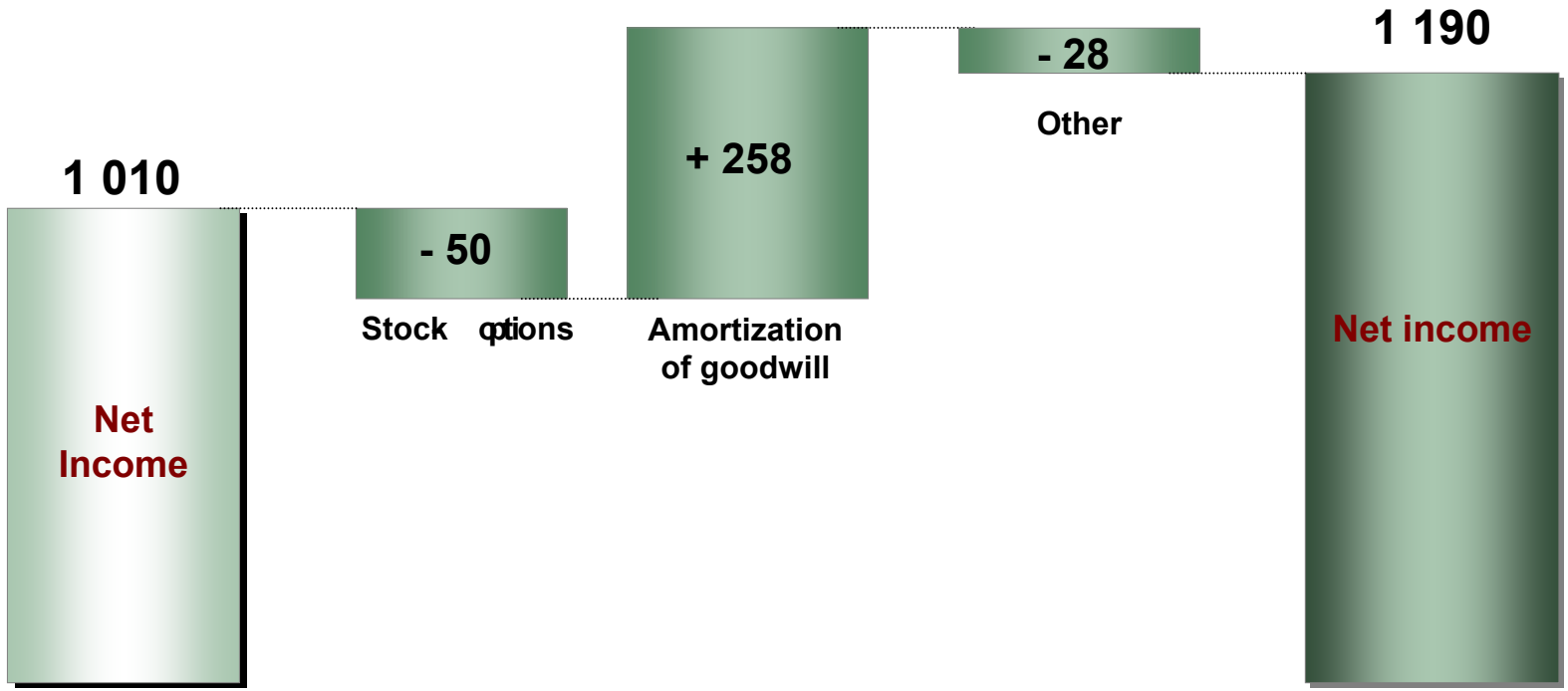
- Reversal of goodwill amortization

## Taxes and Minority interests

- « Mechanical » effects on taxes and minority interests of all impacts recorded on other lines of the income statement

# Impacts on 2004 Net Income

*EUR millions*




**Impact on Net Income = + 180 M€ i.e. + 18%**

# 2004 Income Statement Reconciliation Schedule

| *EUR millions* | French Gaap | IFRS | Variance |
|---|---|---|---|
| **Net Sales** | **12 623** | **12 481** | **(142)** |
| Cost of sales | (4 493) | (4 373) | 120 |
| Selling and administrative expense | (5 710) | (5 736) | (26) |
| **Current operating income** | **2 420** | **2 372** | **(48)** |
| Other operating income and expenses | (126) | (199) | (73) |
| **Operating income** | **-** | **2 173** | **n/a** |
| Net financial expense | (181) | (220) | (39) |
| Income taxes | (603) | (537) | 66 |
| Equity method | (14) | (14) | - |
| Amortization of goodwill | (284) | 0 | 284 |
| Minority interests | (202) | (212) | (10) |
| **Net income** | **1 010** | **1 190** | **180** |

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# Presentation of IFRS impact on Balance Sheet as of December 31, 2004

# Main Factors Impacting the Balance Sheet

- Minority interests purchase commitments
- Treasury shares
- Restatement of past acquisitions
- Brands, trademarks and goodwill
- Financial instruments
- Vineyards
- Grape harvest

# Minority Interests Purchase Commitments

## Principle

- Off balance sheet commitments are recorded as balance sheet items
- Main investments: 34% in Moët Hennessy held by Diageo, 30% in Millennium, 20% in BeneFit, 6% in Fendi

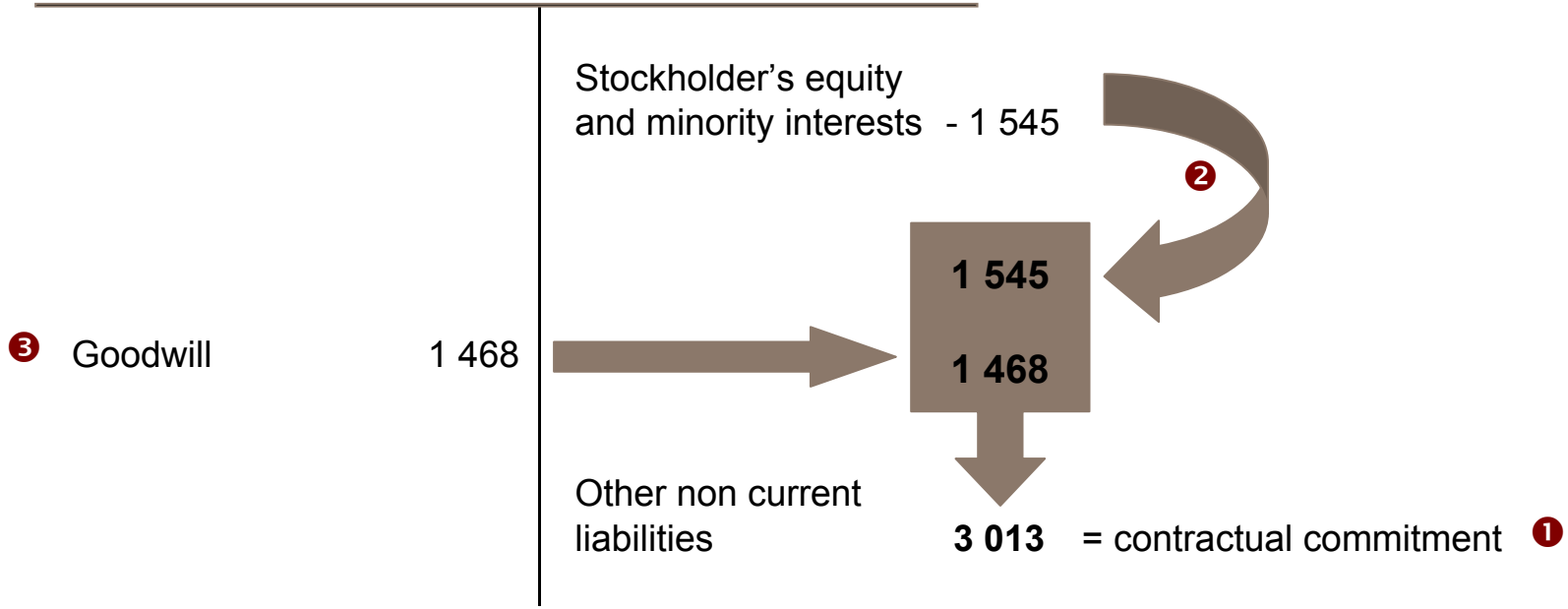
## Implementation

- Commitment, valued at balance sheet date, is recorded as "Other non current liabilities" instead of being kept off balance sheet (French Gaap)
- Related minority interests are reclassified from stockholders' equity to "Other non current liabilities"
- The difference between commitment value and minority interests is booked as goodwill
- Such accounting treatment is currently under debate and could be modified by IASB before 2005 financial statements publication

# Minority Interests Purchase Commitments

*EUR millions*

**Balance sheet as of December 31, 2004**




❶ The off-balance sheet commitment is recognized in other non current liabilities
❷ Minority interests are reversed from equity and reclassified to other non current liabilities
❸ Goodwill = (commitment – minority interests)

# Minority Interests Purchase Commitments

- Minority interests purchase commitments mainly include the put option granted to Diageo in 1994 for its 34% shareholding in Moët Hennessy

- Main terms of this agreement are:
  - Commitment value equal to 80% of fair market value
  - 6 months notice period

- The commitment towards Diageo is economically closer to a liquidity clause than a true put, since it is structurally "out of the money"

# Treasury Shares

## Principle

- All treasury shares are recorded as a reduction of stockholders' equity

## Implementation

- Treasury shares are deemed not to be issued
- Results on disposal are recorded in retained earnings instead of income statement, net of tax
- Impacts earning per share calculation

# Treasury Shares

*EUR millions*

**Balance sheet as of December 31, 2004**

| | | | |
|---|---|---|---|
| | | Stockhoder's equity | **- 883** |
| Other non current assets | - 173 | Net deferred taxes | + 5 |
| Other current assets | - 769 | Other liabilities | - 64 |
| TOTAL | - 942 | | - 942 |

# Deferred Taxes on Brands

## Principle

- All differences between consolidated and tax value of intangible assets are subject to deferred taxation
- Such principle is based on the view that separate disposal of intangible assets is possible. Low probability concerning brands

## Implementation

- Without restatement of past acquisitions, deferred tax liability would have been recorded as a reduction of net equity:
  impact = 1.3 billion euros
- Restatement of past acquisitions allowed recording of deferred tax liability against goodwill

# Restatement of Acquisitions Prior to 2004

## Principle

- Optional retrospective implementation of IFRS to acquisitions which occured prior to December 31, 2003
  - Free choice of starting date
  - But the restatement has to be exhaustive over the elected period

## Implementation

- Starting date: LV/MH merger
- Recognition of the Louis Vuitton brand in the balance sheet at its historical value, equal to the value retained by Christian Dior
- Recording of the deferred tax liability related to brands against goodwill rather than against a reduction in net equity
- Retrospective reversal of goodwill amortization (if applicable, substitution of an impairment)

# Restatement of Acquisitions prior to 2004

## Marginal impact of restatements as of December 31, 2003

| *EUR billions* | Stockholder's equity – Group share |
|---|---|
| **Positive impact on net equity** | |
| Historical valuation of the Louis Vuitton brand, net of tax | 1,3 |
| Restatement of "purchase accounting" | (0,6) |
| Other, net | 0,3 |
| | **1,0** |
| **No impact on net equity** | |
| Deferred tax liability on brands - not deducted from net equity | **1,3** |

# Brands, Trademarks and Goodwill

## Principle

- Brands
  - No revaluation for IFRS opening balance sheet
  - Brands not amortized if indefinite useful lives
  - Deferred tax liability on difference between consolidated and tax values
  - Annual impairment test: higher of value in use and fair value less costs to sell
- Goodwill
  - No amortization but annual impairment tests
  - Recorded in functional currency (DFS)
  - Reclassification to trademarks or other intangible assets where applicable

# Brands, Trademarks and Goodwill

## Implementation

- **Restatement of past acquisitions implied**
  - Revaluation of Louis Vuitton brand at historical value
  - Accounting for goodwill against deferred taxes on brands
  - Cancellation of cumulated goodwill amortization, most often substituted by an impairment expense
  - Cancellation of certain “purchase accounting” entries not permitted under IFRS
- Accounting for “Other non current liability” related to minority interest purchase commitments against goodwill
- Reclassification of goodwill (DFS, Sephora) to trademarks or other intangible assets
- Some brands will be amortized

# Brands, Trademarks and Goodwill

## Summary of Impacts on Intangible Assets as of December 31, 2004

*EUR millions*

| | | |
|---|---|---|
| **French GAAP** | | **7 059** |
| Historical valuation of Louis Vuitton brand (1) | 2 058 | |
| Increase in goodwill related to | | |
| - Deferred tax liability on brands | 1 468 | |
| - Minority interests purchase commitments | 1 468 | |
| Other | (167) | |
| | **4 827** | |
| **IFRS** | | **11 886** |

(1) Before tax

# Financial Instruments
# Foreign Exchange Hedging Risk

## Principle

- Distinction between cash-flow hedge and fair value hedge
  - Effectiveness tests must be performed to measure the correlation between the change in value of the underlying item and of the hedging instrument
  - The effective portion of the hedging transaction must be recorded in equity before the first booking of the underlying asset and then in operating income
- Cost of hedging (ineffective portion) recorded in net financial expense, depending on fair value change
  - Premium/Discount
  - Time value of options

# Financial Instruments
# Foreign Exchange Hedging Risk

## Implementation

Accounting treatment of fair value changes

| | Effective portion | Ineffective portion |
|---|---|---|
| Cash-flow hedge<br>(i.e.: forecast sales) | Equity | Change in fair value recorded in financial income / expense |
| Fair value hedge<br>(i.e.: balance sheet trade payable or receivable) | Operating income | |

# Financial Instruments
# Foreign Exchange Hedging Risk

## Balance sheet impacts

| Assets | Liabilities |
|---|---|
| | Equity |
| NC assets | NC debt |
| C assets | C debt |

Differred effective portion of FX hedging (cash flows and net investment hedges)

Fair value of FX hedging derivatives

Fair value of FX hedging derivatives

# Financial Instruments
# Foreign Exchange Hedging Risk

*EUR millions*

**Balance sheet as of December 31, 2004**

| | | | |
|---|---|---|---|
| | | Stockholder's equity | + 93 |
| | | Minority interests | + 11 |
| Other non current assets | + 44 | | **+ 104** |
| Other current assets | + 100 | Net deferred taxes | + 46 |
| | | Net debt | - 6 |
| TOTAL | + 144 | | + 144 |

# Vineyards

## Principles

- IAS 16 allows revaluation to fair value of a complete category of tangible assets
- LVMH applied such revaluation method to vineyards

## Implementation

- Fair value changes, positive or negative, are recorded in stockholders' equity in revaluation reserve when fair value is above historical cost
- If the fair value decreases below historical cost, the variation is expensed

# Vineyards

*EUR millions*

**Balance sheet as of December 31, 2004**

| | | | |
|---|---|---|---|
| Tangible assets | + 708 | Stockholder's equity | + 396 |
| | | Minority interests | + 68 |
| | | | **+ 464** |
| | | Deferred taxes, net | + 244 |
| TOTAL | + 708 | | + 708 |

# Grape Harvest

## Principles

- Harvested grapes are measured at fair value as if they had been purchased by a third party

## Implementation

- At each harvest, the difference between the cost value of grapes and market prices is recorded in operating income
- The fair value adjustment of grapes harvested before 2004 and still in inventory has been booked as a positive adjustment to equity

# Grape Harvest

*EUR millions*

**Balance sheet as of December 31, 2004**

| | | | |
|---|---|---|---|
| | | Stockholder's equity | + 39 |
| | | Minority interests | + 20 |
| | | | **+ 59** |
| Other current assets | + 90 | | |
| | | Net deferred taxes | + 31 |
| TOTAL | + 90 | | + 90 |

# Impact on the Consolidated Balance Sheet as of December 31, 2004

- Impact on stockholders' equity
- Impact on net financial debt
- Impact on summary balance sheet
- Summary - Conclusion

# Impact of IFRS on Stockholder's Equity (including minority interests) as of December 31, 2004

| *EUR millions* | **Summary** | |
|---|---|---|
| **French GAAP** | | **9 175** |
| Restatement of past acquisitions | 1 306 | |
| Minority interests purchase commitments | (1 545) | |
| Revaluation of vineyards | 464 | |
| Treasury shares | (883) | |
| Restatement of financial instruments | 104 | |
| Revaluation of harvested grapes | 59 | |
| Other, net | (5) | |
| | **(500)** | |
| **IFRS** | | **8 675** |

# Impacts of IFRS on Net Financial Debt

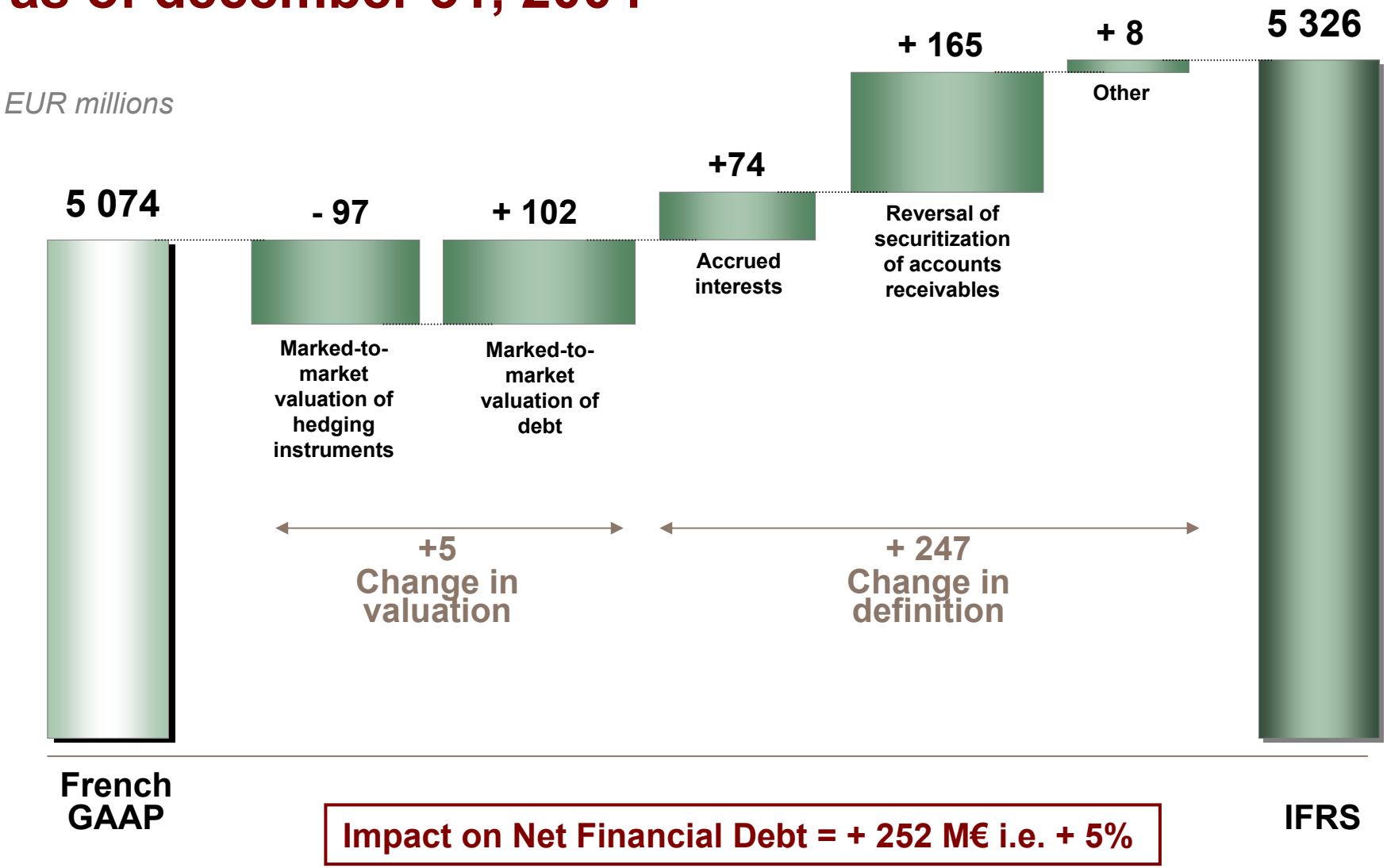
## Impacts related to hedging derivatives

- Non hedged financial debt is at historic cost
- Hedged financial debt and hedging derivatives are recorded in balance sheet at fair value, changes in fair value being recorded in Net Financial Expense
- Under French Gaap, hedging derivatives were kept off balance sheet

## Securization of accounts receivable

- Accounts receivable transferred to third party under securization agreement increase net debt

# Impacts of IFRS on Net Financial Debt as of december 31, 2004




**Impact on Net Financial Debt = + 252 M€ i.e. + 5%**

# Impact on the summary Balance Sheet as of December 31, 2004

| *EUR millions* | French GAAP | IFRS | **Impacts of IFRS** |
|---|---|---|---|
| Brands and intangible assets | 3,8 | 7,8 | + 4,0 |
| Goodwill | 3,2 | 4,0 | + 0,8 |
| Property, plant and equipment | 3,7 | 4,5 | + 0,8 |
| Other non current assets | 1,4 | 1,3 | - 0,1 |
| Other current assets and liabilities | 2,9 | 2,6 | - 0,4 |
| **Total net assets** | **15,2** | **20,3** | **+ 5,2** |
| | | | |
| Stockholder's equity – Group share | 7,5 | 7,8 | + 0,3 |
| Minority interests | 1,7 | 0,9 | - 0,8 |
| Other non current liabilities | 1,1 | 4,1 | + 3,0 |
| Deferred income taxes, net | (0,2) | 2,2 | + 2,4 |
| Net financial debt | 5,1 | 5,3 | + 0,2 |
| **Total net liabilities** | **15,2** | **20,3** | **+ 5,2** |

# Summary - Conclusion

- Limited impact on net sales
- Current operating income almost unchanged
- Positive impact on net income : +18%
- Net financial debt increases by 5%
- Slight increase in Group share of stockholder's equity

# Appendix

- Quarterly Net Sales Reconciliation Schedule
- Quarterly Net Sales Reconciliation by Business Group

# Quarterly Net Sales Reconciliation Schedule
## (unaudited)

### Summary

| *EUR millions* | Q1 04 | Q2 04 | Q3 04 | Q4 04 | FY 04 |
|---|---|---|---|---|---|
| **French Gaap** | **2 836** | **2 842** | **3 079** | **3 866** | **12 623** |
| Selling expenses reclassified as discounts | (22) | (32) | (32) | (61) | (147) |
| Paris department stores concessions | (16) | (11) | (18) | (19) | (64) |
| Taxes on alcohol | (7) | (10) | (5) | (6) | (28) |
| Third party sales agreement | 10 | 14 | 23 | 29 | 76 |
| Other | 7 | (2) | 13 | 3 | 21 |
| **IFRS** | **2 808** | **2 801** | **3 060** | **3 812** | **12 481** |

# Quarterly Net Sales Reconciliation by Business Group (unaudited)

*EUR millions*

## Summary

| | F&L | | W&S | | P&C | | W&J | | SD | | Group | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | NF | IFRS | NF | IFRS | NF | IFRS | NF | IFRS | NF | IFRS | NF | IFRS |
| Q1 04 | 1 065 | 1 067 | 437 | 430 | 473 | 475 | 112 | 112 | 756 | 730 | 2 836 | 2 808 |
| Q2 04 | 958 | 958 | 474 | 463 | 500 | 496 | 122 | 120 | 786 | 763 | 2 842 | 2 801 |
| Q3 04 | 1 081 | 1 082 | 559 | 564 | 523 | 517 | 123 | 123 | 814 | 792 | 3 079 | 3 060 |
| Q4 04 | 1 258 | 1 259 | 810 | 802 | 657 | 640 | 139 | 138 | 1 022 | 991 | 3 866 | 3 812 |
| **FY 04** | **4 362** | **4 366** | **2 280** | **2 259** | **2 153** | **2 128** | **496** | **493** | **3 378** | **3 276** | **12 623** | **12 481** |

NB: The difference between the addition of the five business groups and the total is explained by « other and inter-company »