LEVERAGE STRATEGIC

QUALITY OF EARNINGS · EXECUTIVE SUMMARY

Luminos Skin Co.

D2C Prestige Skincare · Buy-Side Advisory · Engagement Ref. LS-2025-047 · Q2 2025

Prepared For	Prospective Acquirer (Search Fund)
Reference Period	27 months ended March 31, 2025
Status	Final · Confidential

Luminos Skin Co. is a fictional entity created for illustrative and portfolio purposes only. This document does not describe a real company, transaction, or set of financial results.

Luminos Skin Co. is a direct-to-consumer prestige skincare brand generating LTM revenue of approximately $10.84M, blended gross margins of approximately 60.0%, a 42% subscription attachment rate across an estimated 4,100 active subscribers, and revenue growth of 3.6% versus FY2024 (16.0% on a Q1'25 vs. Q1'24 basis). Leverage Strategic was engaged on a buy-side Quality of Earnings review covering the 27-month period ended March 31, 2025. This summary reflects our conclusions as of the report date and remains subject to confirmatory diligence on the open items detailed in Section 3 and the accompanying Management Request List.

$10.84M	~60.0%	$1.76M	$1.66M	~15.3%	$(104K)
LTM Revenue (Mar-25)	LTM Gross Margin	Reported EBITDA	LS Normalized EBITDA	Normalized Margin	Net Adjustments

01 Key Findings

Revenue Quality — Moderate to High, Subject to Open Items

The DTC subscription base (approximately 42% of DTC orders, ~4,100 subscribers) appears recurring and reasonably well-distributed, based on the subscriber summary management provided. Wholesale revenue (18.3% of LTM revenue) is concentrated in a single counterparty, Revolve Group, under a purchase order that expires December 2025 and remains unrenewed as of the report date. Amazon Marketplace (18.5%) carries platform risk rather than counterparty risk. We were unable to independently test refund and chargeback activity because order-level return data was not made available during this phase of review (Finding F-04) — our revenue quality conclusion is provisional pending that data.

> **MANAGEMENT REPRESENTATION — MAY 2025 DILIGENCE CALL · NOT INDEPENDENTLY VERIFIED BEYOND THE PRICING SCHEDULE REVIEWED**
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> *“The Cosmax pricing step-up has now been fully absorbed into our cost base, and we don't expect further increases before the Q3 2025 renegotiation window.”*

EBITDA Adjustments — $(104K) Net, Five Accepted, One Contested

Reported EBITDA of $1,762K is reduced to $1,658K LS Normalized EBITDA under our base case. The principal drivers: $(180K) below-market owner compensation normalization; $(117K) net incremental run-rate cost of the incoming COO; and three addbacks totaling $193K for the one-time influencer campaign, trademark settlement, and marketing agency onboarding fee. A sixth, management-proposed adjustment ($42K, founder product-development capitalization) has not been accepted into the base case — see Finding F-05. The 25-transaction revenue cutoff sample performed for Q4 2024 came back with no exceptions (Appendix B).

Working Capital — Peg Correction Likely Required

Management's proposed NWC peg of $940K could not be reconciled to the underlying monthly balance data; the recomputed trailing-twelve-month average is $773K, a $167K variance management has not yet explained (Finding F-06). LS recommends a peg range of $735K–$810K (point estimate $773K). LS-adjusted closing NWC at March 31, 2025 is approximately $443K — a potential $330K shortfall against the recommended peg that could narrow or widen once management finalizes the restated March close balance sheet.

> **KEY QUESTION**
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> *Will Revolve Group formally renew its wholesale agreement before close, and on what pricing and volume terms? Management has described renewal talks as “informally underway” but has not produced written correspondence to substantiate that.*

> **BUYER CONSIDERATION**
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> *Given the binary nature of the Revolve renewal risk, consider structuring part of consideration as an earnout or holdback tied to confirmed revenue retention through at least one renewal cycle, rather than relying solely on a representation and warranty. See Section 4, Appendix A.*

02 EBITDA Bridge, Purchase Price Impact & Uncertain Items

Adjusted EBITDA Bridge — LTM March 2025

ITEM	FY2023	FY2024	LTM MAR-25	NOTES
Reported EBITDA (Management)	$884K	$1,536K	$1,762K	Per management P&L; not independently audited
Below-Market Owner Comp.	$(165K)	$(175K)	$(180K)	CEO/CMO; benchmark ~$275K vs. $95K actual
One-Time Influencer Campaign	—	—	+$95K	Q3 2024; non-recurring per management
Legal Settlement (Trademark)	+$68K	—	+$68K	Q1 2024; resolved per counsel (F-03, Closed)
Incoming COO — Net Run-Rate	—	—	$(117K)	Effective Apr-2025; net of $68K consultant replaced
Marketing Onboarding Fee	+$30K	—	+$30K	Q4 2023 one-time setup fee
LS Normalized EBITDA (Base)	$817K	$1,361K	$1,658K	15.3% margin; five documented adjustments

All figures USD $'000. A sixth, management-proposed adjustment ($42K, product-development capitalization) is excluded from the base case pending a documented capitalization policy — see Finding F-05. If accepted, base-case EBITDA would increase to $1,700K.

Purchase Price Impact — Illustrative, at 7.0× EV/EBITDA

METRIC	AMOUNT
Reported EBITDA	$1,762K
LS Normalized EBITDA (base case)	$1,658K
Net Reduction	$(104K)
Estimated Purchase Price Impact	$(728K)

Illustrative only; the actual price impact depends on the negotiated multiple and final treatment of contested items. Excludes the potential $330K NWC shortfall discussed in Section 1, which could compound this impact.

Areas of Uncertainty — Not Yet Resolved

Two matters remain genuinely unresolved as of the report date, and we are not in a position to reach a definitive conclusion on either:

- Effective tax position. The 25% blended cash tax rate used in the supplementary free cash flow illustration (Appendix B) is an estimate; FY2022–FY2024 returns were requested but not received prior to report issuance (MRL Item 31 remains Outstanding). Actual cash conversion could differ.
- Revolve Group renewal probability. Management believes renewal is likely; we have not been able to independently verify this and cannot assign a probability to renewal absent written correspondence or a term sheet.

DILIGENCE FOLLOW-UP

Obtain (i) 12 months of order-level refund/chargeback data, (ii) FY2022–FY2024 tax returns, and (iii) any written Revolve renewal correspondence, before finalizing valuation multiples. See Appendix A — Data Request Tracker.

Findings Initially Raised, Subsequently Dismissed

Two matters flagged during fieldwork were closed with no exception after follow-up — a sign of testing depth rather than a scope gap:

- Related-party consulting line (~$14K, Q3 2024 GL). Management provided an engagement letter and invoice evidencing a market-rate, arm's-length engagement with a former advisor. Agreed to GL detail with no exception — closed (F-07).

— Apparent duplicate Shopify order entries, November 2024 export. Re-extraction confirmed a data-export artifact (a timezone rollover duplicating a subset of orders) rather than a recognition issue; order counts reconciled to the processor settlement report — closed (F-08).

03 Findings Log

The log below consolidates every matter identified during this engagement, including items resolved without exception. It is the master reference for deal-team follow-up; item numbers are cited throughout this summary and the full QoE report.

ID	ISSUE	CATEGORY	IMPACT	STATUS
F-01	Revolve Group contract renewal not yet executed	Revenue / Contract	High	**Open**
F-02	Deferred subscription liability ($155K) omitted from balance sheet	Accounting	High	**Open**
F-03	Q1 2024 trademark dispute settlement ($68K)	Legal / IP	Low	Closed
F-04	Order-level refund / chargeback data unavailable	Revenue Quality	Medium	**Open**
F-05	Founder product-dev. capitalization ($42K) proposed	EBITDA Adjustment	Medium	**Open**
F-06	NWC peg discrepancy: mgmt. $940K vs. LS $773K	Working Capital	High	**Open**
F-07	Related-party consulting line flagged in Q3 2024 GL	Related Party	Low	Dismissed
F-08	Apparent duplicate Shopify orders, Nov-2024 export	Revenue	Low	Dismissed
F-09	Inventory reserve below stated policy (4.3% vs. 5.0%)	Accounting	Low	**Open**
F-10	Founder / key-person dependency (~185K followers)	Operational	Medium	**Open**
F-11	UK trademark registration pending	Legal / IP	Medium	*Partial*
F-12	Cash tax rate unverified (25% estimate)	Tax	Medium	**Open**

Of 12 logged items, 2 are closed or dismissed, 1 is partially resolved, and 9 remain open. That distribution is broadly consistent with a buy-side QoE at the confirmatory-diligence stage.

Key Risks — High Priority Only

RISK	REVENUE / BALANCE SHEET IMPACT	RECOMMENDED ACTION
Founder / Key Person Dependency (F-10)	Brand and ~185K-follower influencer network tied to founder	Structure a 12–24 month earnout / retention with post-close social KPIs
Revolve Group Renewal (F-01)	PO expires Dec-2025; unrenewed; ~$1.98M ARR at risk	Confirm renewal or price-protect at signing; consider escrow
Deferred Revenue Omission (F-02)	$155K subscription liability absent from balance sheet	Require GAAP restatement as a closing deliverable

04 Limitations, Definitions & Appendices

Limitations of Review

This summary is based on information provided by Company management and third-party sources believed reliable. Leverage Strategic has not independently audited or verified all of it, and our procedures were not designed to detect fraud. Several items above remain open as of the report date (Section 3) — read this summary together with the full QoE report and the Management Request List / Data Request Tracker.

Where a conclusion is described as "moderate," "based on procedures performed," or "no exceptions noted," that reflects the scope of work completed to date and is subject to revision as confirmatory diligence proceeds. Where a management representation could not be independently corroborated — Revolve renewal status, UK trademark timeline, cash tax rate — this summary says so rather than presenting it as verified fact.

Appendix A — Definitions & Methodology

TERM	DEFINITION
LS Normalized EBITDA	Leverage Strategic's base-case adjusted EBITDA, reflecting the five accepted, evidence-supported adjustments in Section 2. Excludes the contested $42K management add-back (F-05). Not a GAAP measure.
Net Working Capital (NWC)	AR plus inventory, less AP and accrued liabilities, recomputed by LS from monthly management balance data; excludes deferred subscription revenue and prepaid marketing.
Open / Closed / Dismissed	"Open" — unresolved as of report date. "Closed" — resolved with documented support. "Dismissed" — flagged during fieldwork, investigated, found not to be an exception.

Procedures were designed as a buy-side Quality of Earnings review and do not constitute an audit, review, or compilation under AICPA or PCAOB standards. See the full QoE Report, "Methodology and Scope," for the complete procedures list.

Appendix B — Sample Testing Performed (Summary)

TEST	POPULATION / SAMPLE	METHOD	RESULT
Revenue cutoff (DTC & Amazon)	25 transactions, Q4 2024/Q1 2025 boundary	Agreed shipment date, invoice date, and GL recognition date	25 of 25 agreed, no exceptions; no evidence of bill-and-hold
EBITDA adjustment support	All 5 accepted adjustments (ADJ-01–05)	Agreed to payroll, executed contracts, settlement agreement, benchmarks	All 5 individually documented; no undisclosed residual bucket
NWC component testing	12 monthly balance sheets, Apr-24 to Mar-25	Recomputed AR + Inventory − AP − Accrued vs. management peg	Average of $773K vs. management's $940K; variance unreconciled (F-06)
Related-party / unusual GL	GL entries >$10K coded "other"/"misc," LTM	Inquiry plus supporting document request	One item followed up (F-07); closed with no exception

Appendix C — Source Documents Reviewed

Monthly management P&L (Jan-2023–Mar-2025); FY2022–FY2024 annual financial statements; bank statements (all accounts); AR/AP/inventory aging reports (Mar-25); payroll register and employment agreements; Revolve Group PO agreement; Amazon vendor agreement and 2025 amendment; Shopify order export; Cosmax supply agreement; trademark registration certificates (US/CA/EU) and Q1 2024 settlement agreement; capitalization table; corporate structure chart. Items requested but not yet received are listed in the accompanying Management Request List.

RECOMMENDATION

Proceed with diligence, subject to resolution of the Section 3 open items — in particular F-01, F-02, and F-06 — prior to final LOI or SPA execution.