



UNIVERSIDADE CATÓLICA PORTUGUESA

The impact of financial and tax due diligence on the valuation of transaction and the SPA

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Católica Porto Business School
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Resumo

A due diligence financeira e fiscal é um dos processos mais importantes na fase de fusões e aquisições, capaz de influenciar a continuidade da transação e os termos em que esta será realizada. Além disso, a sua importância estende-se ao período após a transação, onde uma due diligence deficiente pode levar a surpresas desagradáveis. Ao incluir um elemento quantitativo que fornece uma visão sobre o impacto que não é bem compreendido na literatura, o estudo procura investigar como a due diligence financeira e fiscal é realizada e como isso afecta o preço, o modelo financeiro e o SPA. O estudo foi realizado através de uma análise quantitativa de um estudo de caso de due diligence financeira e fiscal de uma transação envolvendo a aquisição de duas empresas. Os resultados fornecem uma série de detalhes significativos sobre os ajustamentos relativos ao EBITDA, o fundo de maneiio, a dívida líquida e os riscos fiscais. Além disso, a equipa de due diligence fez recomendações para o comprador incorporar no SPA.

Palavras-chave: due diligence, due diligence financeira, due diligence fiscal, fusões e aquisições, SPA

Abstract

Financial and tax due diligence is one of the most important processes in the M&A (Mergers and Acquisitions) phases, capable of influencing the continuity of the transaction and the terms under which it will be carried out. Additionally, its importance extends to the period after the transaction where a bad due diligence can lead to unwelcoming surprises. By including a quantitative element that provides insight into the impact that is not well understood in the literature, the study seeks to investigate how financial and tax due diligence is carried out and how this affects the pricing, the financial model, and the SPA. The study was conducted through an analysis of a case study of financial and tax due diligence of a transaction involving the acquisition of two companies. The findings provide a number of significant details regarding adjustments related to EBITDA, working capital, net debt, and tax risks. Additionally, the due diligence team made recommendations for the buyer to incorporate into the SPA.

Keywords: due diligence, financial due diligence, tax due diligence, Mergers & Acquisitions, SPA

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List of abbreviations and acronyms

APP	Average Payment Period
ARP	Average Receipt Period
CRS	Common Reporting Standard
EBITDA	Earnings Before Interests, Taxes, Depreciation and Amortization
FATCA	Foreign Account Tax Compliance Act
GAAP	General Accepted Accounting Principles
GIT	Government Income Tax
IFRS	International Financial Reporting Standards
MAE	Material Adverse Events
SIFIDE II	Sistema de Incentivo Fiscal à Investigação e Desenvolvimento Empresarial
SPA	Sales and Purchase Agreement
VAT	Value Added Tax
TA	Tax Authority

Introduction

Financial and tax due diligence have become increasingly important in transactions, directly affecting the price and SPA (Sales and Purchase Agreement) terms. In today's dynamic and uncertain markets, risk identification and transparency are crucial for decision-making. Financial and tax due diligence plays a critical role in M&A, as an inadequate assessment can result in significant post-transaction problems. According to Barbosa (2023), poor due diligence can lead to errors in assessing the real value of the acquired company, underestimation of hidden liabilities and difficulties in the financial integration of the new entity.

Although the existing literature emphasises its importance, due diligence is usually not observable, which means that the conclusions drawn are only financial and operational associations verified after the transaction (Wangerin, 2018). This research aims to analyse the financial and tax adjustments and risk identification in due diligence, adding a quantitative component to measure its effects on price and SPA. A quantitative approach is applied through a case study on financial and tax due diligence in a transaction.

Chapter 1 reviews the literature and provides background on the topic. Chapter 2 outlines the research methodology, highlighting its advantages and limitations. Chapter 3 presents the case study, detailing the due diligence process, risk assessments, and their effects on price and SPA. Finally, Chapter 4 summarizes the conclusions based on the study and literature review.

Organisational Framework

During my internship at VC Partners, I gained practical experience in a firm specializing in administrative services, strategic management support, tax advisory, and transaction monitoring.

I was involved in developing business plans for financing, assessing and implementing tax benefits (RFAI (Regime Fiscal de Apoio ao Investimento), SIFIDE II (Sistema de Incentivo Fiscal à Investigação e Desenvolvimento Empresarial), employment incentives, conducting due diligence, and supporting corporate restructuring processes. Additionally, I assisted in applications for funding programs such as PT2030's SI Inovação and Banco de Fomento Português funds.

This experience enhanced my organizational skills, financial projections expertise, knowledge of tax regulations, problem-solving abilities, and client communication. It also reinforced the importance of adaptability and precision in financial consulting, contributing to both my professional and academic growth.

Chapter 1

Literature Review

1. Due diligence impact on the valuation of the transaction and SPA

Due diligence is the investigative process conducted before finalizing an acquisition, enabling the buyer to assess risks and potential benefits. It includes regulatory due diligence, focused on compliance and operational continuity, and strategic due diligence, which evaluates synergies and business alignment. Other forms such as financial, commercial, tax, environmental, legal, and human resources due diligence examine various aspects of the target to validate key assumptions and mitigate risks. Due diligence findings often result in price adjustments or contractual safeguards (Brandt et al., 2006). This research focuses on financial and tax due diligence.

Financial due diligence involves a thorough and objective verification of the information presented in the financial statements, assessing financial results as well as an evaluation of the future financial prospects of the target company (Ulian, 2024). This process is key to reduce the risk associated with asymmetry of information (Savovic and Pokrajcic, 2013) and a valuable tool for identifying risks, assessing operational and financial efficiency. The insights offered by due diligence can impact the success of mergers and acquisitions transactions and the strategy behind the acquisition by allowing the acquirer to be aware of the challenges ahead through improvement of the quality of financial statements and the financial model (Wangerin, 2018).

Tax due diligence guarantees adherence to tax regulations, spots possible tax liabilities and arranges the deal in a way that minimizes taxes. This procedure is accomplished through the review of tax returns, tax positions and possible vulnerabilities to audits or tax claims (Davis, 2007), offering the possibility to optimize position of combined business (Savovic and Pokrajcic, 2013). Ulian (2024) found that the strategic choice of jurisdiction of the new entity after the merger of two companies is a crucial decision as it leads to substantial tax savings. Also, she states that the tax planning should go side by side with tax due diligence as a measure to improve the preparation and selection of the appropriate method of reorganization. The importance of tax due diligence has increased mainly to prevent cases of tax evasion like the UBS case¹. Through mechanisms such as FATCA² (Foreign Account Tax Compliance Act) and CRS³ (Common Reporting Standard), the tax due diligence practices have become more rigorous to verify tax compliance and a failure to do so implies significant penalties (Avi-Yonah and Mazzoni, 2018). These mechanisms contribute to more effective tax due diligence and provide buyers with reliable and critical information about future tax compliance or potential liabilities, impacting the valuation of the target or introducing clauses to the SPA to protect the acquirer.

Moles (2003) says that due diligence should focus on integration and on how value can be extracted from the transaction but without forgetting to validate that

¹ The UBS tax evasion case involved the Swiss bank UBS, which was convicted in France for assisting clients in evading taxes by hiding assets in Swiss accounts. Initially fined €4.5 billion in 2019, the penalty was reduced to €1.8 billion on appeal in 2021. (<https://www.reuters.com/article/business/ubs-to-appeal-after-fined-45-billion-euros-in-french-tax-fraud-case-idUSKCN1Q91DR/> / <https://www.reuters.com/article/business/ubs-faces-fine-of-up-to-6-3-billion-in-french-tax-probe-paper-idUSKCN0HS0LS/>)

² U.S. law that requires foreign financial institutions to report information on accounts held by U.S. taxpayers to U.S. tax authorities, aiming to combat tax evasion.

³ CRS is a global standard developed by the OECD for the automatic exchange of tax information between countries, allowing governments to share data on financial accounts held by non-residents to prevent international tax evasion.

the assets in place have the values imputed to them by the financial statements and the firm's market value. The due diligence team must determine the value drivers underlying the acquisition's rationale to complete the focus mentioned above. The due diligence investigators will seek to identify and validate value drivers based on the strategic rationale. These include operating synergies, ranging from increased revenues from economies of scale or benefits from vertical integration, environmental, market, and technical synergies, which are based on increased performance capabilities from integrating technologies and know-how, market experience and organisational systems, the target's incentive systems, corporate culture and efficiency increases, which are based on better asset management or product improvements.

The phases and the way in which the due diligence process is carried out vary from team to team, but Moles (2003) walks us through some of the stages:

- planning: where the value drivers and main areas of investigation are defined;
- detailed investigation: analysis of the assets, deal break issues and the strategic fit of both companies;
- risk identification: evaluate and attempt to reduce the risk areas and level of risk that could jeopardise the acquisition's feasibility;
- validation: confirmation of the value drivers, deal break issues.

Reconciliation of information between management and accounting teams is a critical component of financial and tax due diligence, often uncovering key issues that impact the transaction. Savovic and Pokrajcic (2013) provide an generic example where due diligence can reveal that a target company has signed contracts imposing restrictions, such as exclusivity clauses or long-term commitments, that could undermine the acquiring company's strategic

objectives. Identifying such risks is essential, as they may lead to deal termination, price renegotiation, or the inclusion of protective clauses in the SPA.

1.1 Limitations of due diligence

Due diligence is most effective when supported by favorable legal, accounting, and financial conditions. Otherwise, its impact on transactions is diminished, as seen in China, according to Büttner and Meckl (2017). While Western countries have established rigorous processes for evaluating targets before acquisitions, investors in China face significant challenges due to the lack of complete and transparent financial information. Representations and warranties are also difficult to enforce due to the complexities of China's legal system. These factors necessitate additional time and resources for due diligence, yet the process remains imperfect and retains many risks associated with mergers and acquisitions. Thus, while due diligence is crucial, its effectiveness depends on legal and transparency conditions to significantly impact valuation and the SPA of a transaction.

Further limitations of due diligence relate to its approach and time constraints. A key limitation is in the stand-alone approach that focus on the target, often led by accountants and lawyers who may overlook strategic value drivers. This approach underemphasizes future synergies, neglects critical aspects such as sales, costs, and taxation, and fails to assess the acquisition's impact on the value chain. Additionally, due diligence findings are frequently not integrated into post-merger planning, reducing the acquisition strategy's effectiveness. Moles (2003) highlights that stand-alone approach disregards future plans and expected value gains from the transaction as insufficient analysis of the value chain results

in a lack of clarity regarding where value is added and how integration will reshape the target company.

Time constraints further limit the process, affecting the quality of outcomes. Acquirers are often under pressure to close deals quickly due to concerns that prolonged uncertainty could decrease the target's value, prompting key personnel or clients to leave (Moles, 2003).

1.2 Empirical evidence on the relevance of financial and tax due diligence on transactions

Acquisition agreements typically include assurances and guarantees that the target company's financial statements are prepared in compliance with GAAP (General Accepted Accounting Principles) in the United States, or IFRS (International Financial Reporting Standards) in Europe, and that there haven't been any "material adverse events" (MAEs) that would have an adverse effect on the target company's value (such as the loss of a significant client, product safety claims, or legal action). Therefore, due diligence process is conducted before the completion of the transaction to identify MAEs and verify if the provided information by the target supports the assurances and guarantees written in the acquisition agreement. If a MAE or a breach in the representation and warranties is identified the acquirer has a contractual right to terminate the transaction or renegotiate a lower purchase price (Wangerin, 2018). This shows the impact due diligence has on the success, valuation and contractual agreement of the transaction.

To this end, some existing cases described in the literature that illustrate the impact of financial and tax due diligence in M&A operations are presented

below. The first two examples demonstrate the negative impacts that inadequate due diligence can have on a transaction.

The final example highlights the significance of conducting thorough due diligence not only to improve the terms of the transaction but also to influence its success after it is finished by identifying potential synergies.

1.2.1 Autonomy's purchase by Hewlett Packard

Wangerin (2018) shows evidence about how the incapacity of the due diligence to identify a MAE or a breach can be impactful on the acquisition of Autonomy by Hewlett Packard (HP) in 2012. HP acquired Autonomy for \$11 billion and in less than a year it wrote off \$8.8 billion of the assets it acquired. The finding of accounting errors at Autonomy that significantly overstated its past earnings over the years preceding the acquisition, was the trigger for these write-downs. Many believe that HP would have valued Electronic Autonomy significantly less than \$11 billion or would have terminated talks before reaching an acquisition deal if these accounting errors had been discovered during the due diligence process.

1.2.2 CanSemi's acquisition of IndSemi

The acquisition of IndSemi by CanSemi is yet another case where a poor due diligence procedure results in issues following the deal (Kuppili and Reddy, 2013). In this case, the challenges come from the inability of IndSemi to provide technical documentation, which made it difficult to integrate technology. The accountants' methods were incompatible, which resulted in the loss of crucial

data and overestimated unrealised synergies that could have been avoided with more thorough and effective financial due diligence.

1.2.3 Acquisition of Adams by Cadbury Schweppes

Perry and Herd (2004) evidence a case of a successful transaction where a very well conducted due diligence helped to an easier integration and better knowledge of the target to be acquired. In 2002, Cadbury Schweppes, a multibillion-dollar confectionery and beverage company, wanted to acquire Adams who was owned by Pfizer. The acquirer had previously undertaken smaller acquisitions; however, this was a billionaire transaction. To ensure success, they sought the expertise of the consulting firm Kearney to guide them through the entire process, including due diligence phase. Through an improved and robust due diligence, it was possible to identify valuable synergies such as the integration of strong brands like Trident and Halls, the complementarity of Adams and Cadbury products, market expansion and enhanced competitive position. More than identifying synergies, they thoroughly examined how they could guarantee that they were met, ultimately developing a system of rigorous synergy measurement where teams are financially rewarded for beating the model, or performing better than first projected (Ficery, Herd and Pursche, 2007).

1.3 Literature review summary and research gaps

Financial and tax due diligence play a crucial role in M&A by identifying risks, ensuring compliance, and optimizing transaction value.

Ulian (2024), Savovic and Pokrajcic (2013), and Wangerin (2018) highlight how financial due diligence mitigates information asymmetry by verifying financial statements, assessing future prospects, and identifying value drivers and risks. Meanwhile, Davis (2007) and Avi-Yonah and Mazzoni (2018) emphasize that tax

due diligence ensures regulatory compliance, uncovers liabilities, and facilitates tax-efficient structuring.

Effective due diligence impacts valuation and negotiations by identifying MAEs (Material Adverse Events) and shaping SPA clauses (Wangerin, 2018). However, its effectiveness can be hindered by factors like regulatory environments, transparency issues (Büttner & Meckl, 2017), and time constraints imposed by buyers or sellers (Moles, 2003). Additionally, traditional due diligence often neglects post-merger synergies and strategic value drivers, limiting value creation (Moles, 2003).

Despite research on due diligence's role in risk identification and post-merger integration, its direct influence on M&A negotiations remains underexplored. Literature focuses on post-transaction impacts rather than how due diligence findings shape price adjustments and contractual protections. This study aims to fill this gap by quantifying the impact it can have on valuation, on the terms of the SPA and on the preparation of information for post-transaction conditions.

Chapter 2

Methodology

2. Methodology

Hyett, Kenny, and Dickson-Swift (2014) highlight that case study research is a widely adopted approach among investigators, as it provides methodological flexibility and enables the capture of the complexity of a given phenomenon within its real-world context. According to the authors, this approach is particularly valuable when the objective of the research is to comprehend a complex phenomenon or to examine the interactions between the context and the phenomenon itself.

With this in mind, and based on the literature review, the proposed objectives, and the experience gained during an internship at VC Partners, which provided direct exposure to a financial and tax due diligence, the chosen methodology ultimately consisted of a quantitative analysis conducted through a case study focused on these two types of due diligence. This methodological choice was made following a comprehensive review of the literature, which supported its suitability.

The case study emerged as the most appropriate methodological strategy, as it not only provides relevant insights into the typical targets of adjustments in due diligence processes and the methods by which these adjustments are carried out but also allows for the quantification of these adjustments, particularly in terms of pricing and the value or terms of the clauses included in SPA. As Yin (2018) argues, research utilizing a case study approach must be grounded in theoretical foundations, necessitating the integration of literature and practice to

identify conceptual and empirical gaps. In this regard, the case study under analysis helps bridge this gap in literature, offering a more comprehensive understanding of the modifications introduced by due diligence throughout the transaction process.

2.1 Research Type

The study's foundation is the use of a quantitative methodology to evaluate and measure the tax and financial modifications found during the due diligence procedure. The quantitative approach is an organised research methodology that aims to measure variables and determine their objective relations. This approach, which centers on the collection and analysis of numerical data, enables the accurate measurement of phenomenon and the recognition of patterns (Creswell & Creswell, 2018).

The study specifically assesses the effects of adjustments made to Net Debt, working capital, and EBITDA in addition to the transaction's tax risks. Since these effects are quantified, it is possible to assess the influence of financial and tax due diligence on the value of the transaction and on the impact that the clauses imposed, due to the discoveries made during the process, on the SPA may have on the price of the transaction even after it has been concluded.

2.2 Limitations of the case study method

The case study method, while effective for theory development, has notable drawbacks. Eisenhardt (1989) highlights two key limitations: excessive complexity and the lack of quantitative validation.

The first stems from the intensive use of empirical evidence, which may result in overly detailed theories, making it difficult to establish a clear framework. Overemphasizing data richness can obscure broader patterns. The second

concerns the absence of quantitative validation, as case studies rely heavily on qualitative data, making it challenging to determine the most relevant findings.

Hyett, Kenny, and Dickson-Swift (2014) note that case selection may introduce bias, leading to subjective interpretations. They emphasize that the method's effectiveness depends on context, and inadequate context description can undermine validity.

Despite its inherent limitations, the application of the case study method with a quantitative approach offers significant advantages for the present research. Notably, it enhances the precision in assessing the impact of specific variables (Eisenhardt, 1989), such as the financial and tax adjustments implemented throughout the case. Furthermore, the inclusion of a numerical component in the analysis strengthens the empirical foundation of the findings, providing managers and investors with a more robust and data-driven basis for strategic decision-making.

2.3 Data collection and analysis

During my internship at VC Partners, the data collection process was obtained from multiple sources, including the management department of the target companies, an external accounting firm responsible for the target's financial records and VC Partners with the due diligence process. Additionally, supplementary data was collected, primarily from the buyers, concerning the terms and conditions of the transaction. The dataset comprised financial statements, as well as management and personnel reports. The analysis of this data occurred throughout the process following a content analysis approach, focusing on the identification of typical financial and tax due diligence adjustments, that can derive, for example, from misalignment between the information provided by accounting and management, and ensuring their alignment with the terms and conditions of the transaction. However, a

quantitative dimension was present as the adjustments were measured in numeric terms, so we know exactly the impact each item adjusted has mainly on price but also SPA. This approach allows to not only say what can due diligence change in a transaction but also to have a real measure of those changes.

Chapter 3

Case Study and Results

3. Acquisition of Company X and Company Y by a Portuguese venture capital fund

3.1 Contextualisation

In the context of M&A, due diligence can significantly impact the valuation of the transaction, the clauses included in the SPA and even the completion of the deal. To show its impact, a case study focused on the financial and tax due diligence was conducted. Due to non-disclosure agreements, the real names of the companies, partners and workers involved cannot be revealed being substituted by other names, so it is easier to understand the case study.

This case involves a Portuguese venture capital fund interested in acquiring a majority stake in two companies whose main activity was credit and insurance intermediation related to housing, operating under a profit sharing system. Let's

call the first company, company X and the second company, company Y. Both businesses were franchises of a third party, which we will refer to as Company Z. They used Company Z's network, contacts, and business conditions to improve their contractual conditions with banks and insurance companies and gain greater market recognition. Companies X and Y pay royalties to company Z for using its network, but they also get the rappel that company Z guarantees with banks and insurance providers.

The credit intermediation contract between company X and company Z was terminated in 2024, which means that while company X will no longer get rappel, it will no longer pay royalties. Nonetheless, the relationship that existed until the contract's termination is crucial to the analysis carried out.

See Figure 1 to better understand the relations between companies.

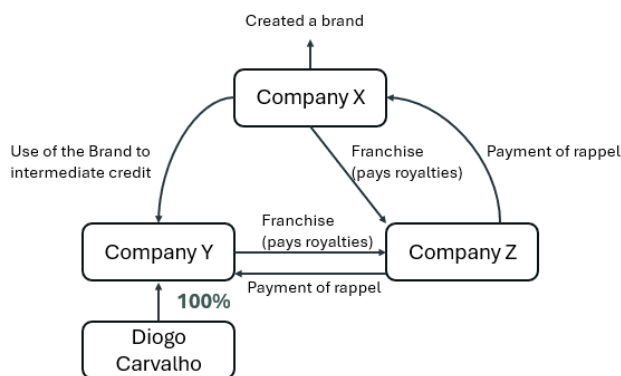


Figure 1 - Group Scheme

Company X generates revenue primarily from commissions earned by intermediating deals between clients and financial institutions, as well as rappel. Their main role is negotiating credit amounts, conditions, and commission fees with banks. Most contracts stipulate a 1.5% commission, except for one bank that applies 1% for credit transfers and 1.25% for new credit. Company X has five

employees and several commissioned credit managers, who receive 65% to 80% of the commissions before royalty payments to its franchisor, Company Z.

Company Y was founded by Diogo Carvalho, a former top-performing credit manager at Company X. While operating independently, Company Y functions as Company X's cost center, exclusively sourcing clients under its brand. Their partnership follows a profit-sharing model, splitting EBITDA equally.

Under the transaction terms, Company Y was to be merged into Company X, with a Portuguese venture capital fund acquiring a majority stake in Company X and Diogo Carvalho becoming a minority shareholder. The transaction price was set at 5 times EBITDA (2023) minus Working Capital and Net Debt. The buyer conducted financial and tax due diligence to assess the companies' financial health, tax compliance, and potential risks before finalizing the deal.

3.2 Process limitations

The due diligence process carried out faced limitations related to time constraints, the availability and quality of information, and certain procedures that impacted the overall analysis. The target companies lacked a computerized system for recording and managing invoices and costs (including loan and insurance details, collected and paid commissions, and financial institution transactions by employee, credit manager, or partner). This absence affected the quality of financial and accounting reporting, leading to:

- reconciliation issues: management data did not fully align with reported accounting figures, particularly in invoicing and commission payments;
- specialisation errors: Discrepancies arose due to delays between service provision, data processing, and invoicing (typically 1-2 months later), as financial data relied on statements from institutions and the CRM platform;

- lack of operational control: manual data entry in operational records led to inaccuracies, limiting effective oversight.

Another difficulty that limited the quality of the analysis in the due diligence process was the fact that the accounting for the target companies (Company X and Company Y) was done externally. This way, it was not always possible to obtain full explanations for the questions posed in the Q&A for all the situations requested. Finally, time restrictions further impacted the quality of the analysis, since there are some additional points that could have been reported if the time for this process wasn't restricted to 4 to 5 weeks.

3.3 Financial due diligence

The agreed transaction price was set at five times EBITDA minus Working Capital and Net Debt. Accordingly, adjustments were made to these components to accurately reflect the business' value.

EBITDA was adjusted for turnover, primarily commissions earned and rappel, selling, general and administrative expenses, and gross margin. Net debt adjustments included GIT (Government Income Tax) and other potential price adjustment mechanisms related to not yet reflected costs but were recommended to the buyer, which will be examined in detail later. Working capital was adjusted for non-operating assets, accrued income and expenses, and balances with related parties.

3.3.1 EBITDA Adjustments

3.3.1.1 Revenue Adjustments

The first item to be adjusted were revenues which were specialised. Revenues included commissions gained from the credit raised from financial institutions (credit and insurance) and rappel. The commissions received from the banks

were usually fixed at 1.5% for each euro of credit granted, but insurance-related income had different nuances that involved company Z. As said before, Company X is a franchise of Company Z meaning that it uses its brand to carry out insurance mediation activities. The contract between company X and company Z states that company X owes company Z 6% of the commissions it earns from financial institutions and 5% for loans higher than €200 000 (see Figure 2). For insurance mediation, the insurer pays 65% of the insurance premium for first-year insurance and 20% in the event of renewal to company Z, which then pays company X 95% to 96% of the commission received, keeping the rest for them (see Figure 3).

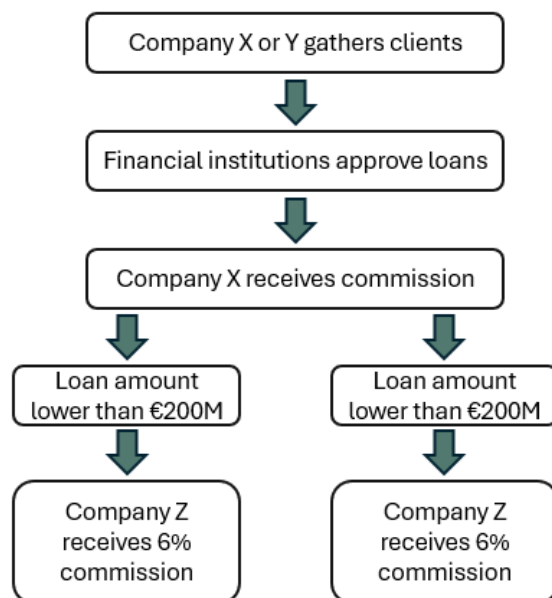


Figure 2 - Commission distribution scheme (Financial Institutions)

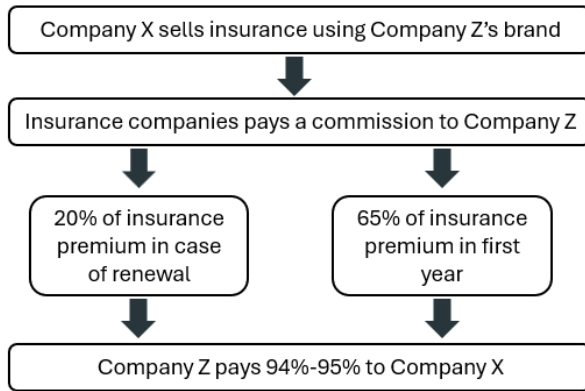


Figure 3 - Commission distribution scheme (Insurance companies)

Because of the scale it attains through its network, Company Z has access to a *rappel* from financial institutions, which it distributes to its franchisees in proportion to the turnover over the entirety of Company Z's network. The details of the terms agreed upon between Company Z and the financial institutions, as well as the distribution of the *rappel* to the target companies, were not available.

The primary cause of the revenue specialisation was that Company X and Company Y did not perform any type of specialisation during the period under study and only recorded sales at the time the invoice was issued, which was one to two months behind the actual conclusion of the contract (credit, insurance, or *rappel*). Intra-group sales were also subject to adjustments because company X specialised year-end costs (as expenses for 2022 and 2023), while company Y did not specialise the corresponding revenues, which creates consolidation differences that require adjustments to align the discrepancies between the two companies. A portion of the commission and *rappel* (though this one was harder to figure out) was invoiced late and assigned to the incorrect year, which is the primary cause of the discrepancies you can observe in better detail in Figure 4. In 2023, this procedure led to a total revenue change of - €266 000, from €3 493 000 to €3 227 000.

Ceteris paribus, this change would result in a change in the transaction price of around - €1 300 000 due to the EBITDA multiple agreed for the transaction.

Thousands of €	2021	2022	2023
Specialisation Adjustments			
Intragroup Sales	11	-92	-33
Credit Comissions	341	-134	-221
Rappel	122	-124	-12
Total	474	-351	-266
Reported Revenues	1417	2800	3493
Adjusted Revenues	1916	2449	3227

Figure 4 - Revenue Adjustments per source of revenue

After all the adjustments in revenues, the due diligence team recommended that, in the event of a transaction, the procedures for controlling and reporting management and accounting information are reviewed and that any tax contingencies that may arise from these procedures are provided for in the SPA.

3.3.1.2 Costs adjustments

The next adjustments relate to variable direct costs, namely direct costs related to sells (commissions to credit managers, royalties to company Z and variable costs directly related to sales, such as travel and accommodation), who are the biggest components of costs in the group (company X and company Y). As mentioned at the beginning, the due diligence team was informed by the management that credit managers receive between 65% and 80% of the credit commissions obtained from financial institutions before paying royalties to Company Z. But with the detailed information provided, evidence was found to

suggest that for some managers these commissions were as high as 90%. The other part of the costs associated with sales is made up of the 6% owed by Company X to Company Z for credit commissions and the 5% to 6% for insurance intermediation. Just like revenues, costs were also specialised for the same reason although there has been greater rigour in the accounting procedures related to costs who also impact the EBITDA directly but this time the specialisation didn't have the same impact as on revenues, since that in 2023, the year for which EBITDA is taken into account in the transaction price, it resulted in a change of €44 000 in total costs. To provide a clearer understanding of the process, the adjustment led to the allocation of 2022 costs, which were recorded as 2023 costs to 2022, as well as the inclusion of 2023 costs, which were recorded in the 2022 costs. The net amount, that is, the difference between the cost allocation for 2022 and the costs incorporated into 2023, resulted in an increase in costs in 2023 of an amount equivalent to €44 000, which, being a cost, is deducted from EBITDA.

If assumed no other changes in items that impact EBITDA, the specialisation of costs alone would decrease the price of the transaction by €220 000, which is still impactful.

Figure 5 shows the differences before and after the adjustments in the period in analysis.

Thousands of €	2021	2022	2023
Specialisation Adjustments			
Company Z's commissions	-16	16	-20
Credit Managers commissions	N/A	249	-24
Total	-16	265	-44

Figure 5 - Cost Adjustments

Following all cost adjustments, the due diligence team suggested that, should a transaction occur, the processes for reporting and controlling accounting and management data be examined, and that any potential tax implications be covered by the SPA.

3.3.1.3 Relevant non-quantified cost adjustments

Some important details were not taken into adjustments but affected the way gross margin of the credit intermediation activity, this is, the commissions received less the commissions owed to credit managers (which worried the buyer) was interpreted, which we will see in more detail. The reported gross margin of the intermediation activity was 53% in 2022 and 46% in 2023 and 43% until March 2024. In this case, the margin is still high if we consider how much it is being paid in commissions to credit managers (typically 65% to 80% and some 90% as discovered by due diligence team). There are two facts that explain why the margin is still this high:

First, commission costs exclude those related to Diogo Carvalho, who accounted for 21% of credit agreements in 2022 and 13% in 2023. His commissions would add approximately €364,000 in 2022 and €303,000 in 2023 to operational costs.

Second, the management accounts do not include the fixed salaries of credit managers employed by the Target Companies, only their variable pay through mileage and expense allowances. Management states this variable component represents 0.05% of a fixed 1.5% fee for credit originating via Company Y or 1% for self-sourced credit. The gross margin for agreements sourced by these managers is higher.

Diogo Carvalho's commissions were not adjusted in EBITDA, as they are part of his post-Transaction remuneration package. Management intends to replace his credit sourcing role with in-house managers from the Target Companies' payroll.

The gross margin decline is mainly due to rising commissions for top-performing credit managers. Although these factors were not directly

considered, disclosing this information provides the buyer with a clearer understanding of the company and influences their decision-making.

After the specialisation procedures, due diligence carried out normalisation adjustments which is a financial correction made to reflect the true operational performance under normal or recurring circumstances by removing distortions caused by extraordinary, one-time, or non-recurring events.

3.3.1.4 Property rents

The first item to be normalised was property rents. At the time of the analysis, new conditions had been defined for the occupation of two different facilities with monthly rents of 750 and 2250 euros, both owned by partners. The total annual rent ascends to €36 000 that throughout the analysis wasn't totally reflected in the financial statements meaning that part of the real cost wasn't reflected in the results. As a result, this item was adjusted to accommodate the agreed conditions for the post transaction period and present a clearer and real vision of the operational and financial side of the business.

3.3.1.5 Shareholders remuneration

In the scenario of the transaction the shareholders will remain in the company under a new negotiated remuneration package with the buyer. The new remuneration package consists of a gross annual salary of €52 000 (plus Social Security charges), a €9 600 annual cap for cars, as well as a bonus attributed in the following terms:

- €7 000 bonus for an EBITDA between €1 000 000 and €1 500 000;
- €21 000 bonus for an EBITDA between €1 500 000 and €2 500 000;
- €28 000 bonus for an EBITDA between €2 500 000 and €3 000 000;
- €56 000 bonus for any EBITDA higher than €3 000 000.

In this sense, it is necessary to adjust the shareholder remuneration in the financial statements to match the new conditions. To this end, all amounts of salary or other remuneration, including retirement savings insurance, bonuses, representation expenses and fees, have been brought together. In terms of the adjustment itself, the old total amount of remuneration is added, since it is no longer the real cost of shareholder remuneration, and the new total amount of remuneration (adjusted to the new conditions) is subtracted. The net impact corresponds to replacing the current cost with the future cost, ensuring that EBITDA reflects the conditions agreed for the post-transaction period.

3.3.1.6 Complementary remuneration

According to management, some components of remuneration of employees who belong to Company X and Company Y, are paid through allowances (recorded in Company Y's personnel costs) and kilometres (recorded in Company X's costs for work travel and stays). These expenses include commissions for credit or insurance managers (who are included in the staff), as well as performance bonuses for administrative staff and are considered recurring and predictable. Therefore, these items were grossed up to include additional income tax and social security charges in case these expenses were incorporated into the employee's basic income wages.

3.3.1.7 Structure Employees

The next normalisation adjustment has to do with employees from the structure and it was simply the normalisation of the effect of employees departing and entering the structure over the period analysed.

3.3.1.8 Non-operational and non-recurrent costs and income

Other items typically adjusted in financial due diligence are non-recurring and non-operating costs and income which aren't part of the core business of the company or are one-time expenses/income and therefore are disregarded from the calculation of adjusted EBITDA. In this case, the adjustments related to non-recurring and non-operating costs essentially include costs associated with capital loss when an asset is sold from a partner's personal domain (costs included in Company X's financial statements in 2022) and expenses of the partner's personal sphere, recognised under the headings of specialised jobs and maintenance and repairs in Company Y's financial statements (in 2021 and 2022). On the other hand, non-recurring income adjustments come from non-recurring subsidies as it is possible to observe in better detail in Figure 6.

Thousands of €	2021	2022	2023
Non-Recurring / Non-Operational costs	87	290	10
Sale of tangible assets	1	129	0
Maintenance and repair - buildings	6	70	6
Maintenance and repair - basic equipment	20	0	4
Specialised jobs	60	91	0

Figure 6 - Detailed non-recurring and non-operational costs

3.3.1.9 Improper VAT deduction

The last normalisation adjustment to the EBITDA is associated with VAT (Value Added Tax) deduction. VAT is a consumption tax applied at each stage of the production and distribution chain, based on the added value of goods or services, ultimately borne by the final consumer. In Portugal, the bank and insurance activities are normally exempt from VAT but that exemption is considered to be incomplete because it doesn't confer the right to deduct the VAT supported in costs related to the activity of the company. However, in the period

analysed, Company X and Company Y deducted €403 000 (from 2020 to 2023) of supported VAT, even though they are exempt from VAT.

The adjustment related to VAT deduction was made to adopt a more conservative approach aligned with tax regulations, using the pro-rata method. The original cost base for deduction was recalculated to exclude invoices that, according to management, should be issued under VAT-exempt status. The original base and the pro-rata method used to calculate the deductible and non-deductible VAT are shown in Figure 7.

Thousands of €	12m21	12m22	12m23
VAT Improper Deduction	102	156	142
Costs (Deduction Base)	445	677	617
<i>Weight of exempt operations (pro-rata)</i>	69%	75%	74%
Costs (Corrected Deduction Base)*	305	508	454
Deductable VAT according to pro rata	32	39	37
Cost Increase (Non-deductible VAT)	70	117	104

Figure 7 - Cost increase due to improper VAT deduction

Initially, companies assumed full VAT deductibility on all eligible costs. However, when the pro rata adjustment was applied, the actual recoverable VAT was reduced in proportion to the company's taxable and exempt activities. Only a fraction of the VAT could be reclaimed, while the remainder became non-deductible. This portion was effectively reclassified as a cost, as it had to be borne by the company, increasing its expense burden. The adjustment ensured that VAT recovery aligned with the company's actual economic activity, preventing over-deduction in cases where input VAT related partially to exempt operations.

3.3.1.10 EBITDA adjustments summary

Figure 8 will show the differences between EBITDA before and after the adjustments.

Thousands of €	2021	2022	2023
Reported EBITDA	312	845	1235
Reported Revenues	1417	2800	3493
Specialisation Adjustments			
Revenue specialisation	474	-351	-266
Cost specialisation	-16	265	-44
Normalisation Adjustments			
Property rents	-36	-25	-12
Current shareholder remuneration	82	76	89
Post-transaction shareholder remuneration	-62	-62	-69
Gross up (kms and expense allowances)	-45	-72	-100
Structure employees	0	-5	-1
Non-recurring / Non-Operational costs	87	290	10
Non-recurring income	-6	-12	-2
VAT Deduction	-70	-117	-104
Total adjustments	408	-13	-499
Adjusted Revenues	1,891	2,449	3,227
Adjusted EBITDA	720	832	736
EBITDA Margin (%)	38.1%	34.0%	22.8%

Figure 8 - Adjustments to EBITDA

By observing Figure 8 we can see that the specialisation adjustments which included the specialisation of commissions and rappel (from credit and insurance) as well as the credit managers commissions, the normalisation of business trips and expense allowances and VAT deduction were the ones with most impact on adjusted EBITDA. The total adjustments in 2023 account for a change in EBITDA of - €499 000 with a price impact, *ceteris paribus*, - €1 996 000, a very significant impact.

3.3.2 Working Capital adjustments

Following an analysis of how the adjustments to EBITDA affected the price and SPA, it is also critical that we address the modifications to working capital and net debt, the other components that make up the price. Starting with working capital, which is made up of operating and current balances (short-term). These balances usually refer to customers, suppliers, accruals and deferrals and the State and other public entities.

3.3.2.1 Related parties balances

The first working capital adjustment was made to open balances with related parties and partners. Amounts owed to or by partners in the same group were identified under the heading of other creditors and debtors which do not represent day-to-day business cash flows, meaning they're not essential to the continuity of the business. In this sense, these balances have been adjusted as they will be settled at the time of the transaction.

3.3.2.2 Accrued costs and income

The analysis identified that certain revenues and costs had not yet been invoiced but were already reflected in the accrual accounts. The purpose of the adjustment was to ensure that these amounts were correctly recognized in relation to the provision of services and the corresponding invoice.

Two important components were the focus of the adjustment. The first step was to make sure that revenue was appropriately recognised even though the invoice had not yet been issued by making an adjustment for accrued revenues to reflect one month of invoicing to credit institutions. Secondly, the adjustment for accrued costs included two months' worth of commissions due to business

partners and credit managers, representing obligations that had already been incurred but not yet paid.

Amounts that had not yet been invoiced were included in the adjustment when determining the average receipt period (ARP) and the average payment period (APP). With this method, the timing of cash inflows and outflows from the time services were rendered was precisely reflected in the working capital assessment.

The change consequently directly affected the reported working capital, bringing financial statements into line with the real timing of transactions. Transparency and compliance in the transaction assessment were ensured by the adjustment, which gave a more accurate picture of the company's financial situation by acknowledging these amounts in the working capital calculation.

3.3.2.3 Non-operational assets

The last adjustment to working capital has to do with a non-operational asset (property) owned by a partner of Company X, which is recorded in the company's inventories and has been removed from working capital because it is not related to the day-to-day operations of the business.

3.3.2.4 Quantitative impact of adjustments on working capital

The impact adjustments had on working capital can be seen in Figure 9.

Thousands of €	2021	2022	2023	Mar-24
Consolidated proforma				
Working Capital				
Inventories	0	0	0	118
Clients	7	41	3	62
Suppliers	-32	-127	-31	-38
State and Other Public Entities	-32	-95	6	-135
Other debtors and creditors	29	391	685	702
Accruals and deferrals	-38	-234	202	-15
Reported Working Capital	-67	-23	865	695
Adjustments				
Balances with related parties		-391	-685	-702
Accrued Income		275	-60	275
Accrued Costs		18	-50	-321
Non-operational assets		0	0	-118
Total adjustments		-98	-795	-867
Adjusted Working Capital		-121	69	-172

Figure 9 - Working Capital Adjustments

3.3.3 Net debt adjustments

Finishing with Net Debt, which is simply short- and long-term debt minus cash and cash equivalents and gives an idea of the company's leverage level, where adjustments were made for the inclusion of the 2023 corporate income tax estimate in the sellers' sphere that wasn't reflected in the financial statements. The consolidated Net Debt of the target companies, in March 2024, includes loans and deposits of Company X and Company Y. The adjustment related to the inclusion of corporate income tax estimate involves a reduction in Net Debt of €16 000 from - €993 000 (reported) to - €977 000 (adjusted) as reflected in Figure 10.

Thousands of €	2023	Mar-24
Loans		
Company X	199	216
Company Y	0	82
Total Loans	199	298
Cash and Cash Equivalents		
Company X Deposits	536	1118
Company Y Deposits	22	173
Total Cash and Cash Equivalents	558	1291
Reported Net Debt	-757	-993
Adjustments		
Estimated 2023 Corporate Tax Income	-16	-16
Adjusted Net Debt	-741	-977

Figure 10 - Adjusted Net Debt

3.3.3.1 Net Debt related insights and recommendations

The sellers and the prospective buyer reached an agreement where the sellers could pay dividends in full of the available funds, provided that a minimum cash balance of €150 000 was guaranteed to fulfil working capital requirements. However, if a working capital normalisation adjustment was considered to cover accrued costs not yet reflected in the financial statements due to poor accounting procedures that records credit managers' services at the time of the invoice rather than the service itself, with a one to two-month lag between the two, there would be a negative impact on the net financial position at the end of March 2024 .

As the company's accounting records did not prove to be very reliable and in light of this finding, the due diligence team recommended that the agreed conditions be reviewed and renegotiated or that a price adjustment mechanism be incorporated into the SPA that provides for an adjustment to be included in the Net Debt calculation that takes into account the amount of cash available in the company on the closing date of the transaction compared to an estimate of the result generated since December of 2023 (See Figure 11 for better understanding). The price adjustment mechanism suggests the use of EBITDA Margin from 2023 as a proxy to estimate the cash generated from operations between the reference date (December 2023 and the date of the transaction).

If the date of the transaction were to be at the end of March, this would result in a discount of €564 000 on the price. The calculation made does not include

extraordinary effects or working capital variations that aren't related to the normal operation of the business (core business).

Figure 11 will show how this mechanism is done and the impact it can have on price if the buyer follows the recommendation of the due diligence team to incorporate this price mechanism adjustment in SPA.

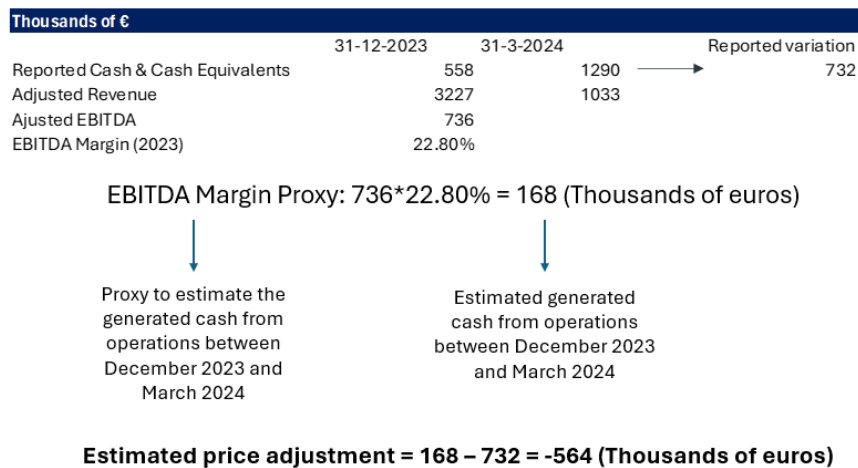


Figure 11 - Price adjustment mechanism

The recommendation given to the buyer to include a price mechanism adjustment in the SPA given the inadequate accounting practices is an extremely important finding that could have a significant impact on the transaction (price reduction) resulting from the due diligence process. Since this is merely an estimate, it is crucial to remember that this adjustment will result in direct price negotiations between buyers and sellers or the inclusion of an SPA clause with the use mechanism, depending on the potential consequences for the seller because of its subpar accounting practices.

3.4 Tax due diligence

Tax due diligence guarantees adherence to tax regulations, spots possible tax liabilities and arranges the deal in a way that minimizes taxes. This procedure is accomplished through the review of tax returns, tax positions and possible vulnerabilities to audits or tax issues.

The following assumptions were made to quantify the tax contingencies that were identified:

- a) GIT equal to 22.5%;
- b) Personal Income Tax equal to 25%;
- c) Social Security contribution equal to 34.75%;
- d) Minimum fine equal to 30%;
- e) Interests on late payments equal to 4.786% (2020), 4.705% (2021), 4.51% (2022), 5.99% (2023);
- f) Compensatory interests equal to 4%.

3.4.1 Improper Deduction of VAT

Operations in banking and insurance are exempt from VAT according to tax law, but this exemption does not grant the right to deduction. However, the companies deducted €403 000 of input VAT.

As part of tax due diligence, the team found out about that practice which is against the law and warned the companies that the tax authority can demand the devolution of the amount deducted with interest and fines which would result in a contingency of €556 000. Nevertheless, the companies could allege that part of its activity isn't exempt given that, in certain operations, VAT is being liquidated which through the pro-rata method, that is, the calculation of the proportion of deductible VAT based on the ratio between taxable receipts and exempt receipts, considering that not all business activity is exempt, would lead

to the reduction of improperly deducted VAT to €290 000 in which if we consider interests and fines, the contingency would be around €406 000.

3.4.2 Taxable profit adjustments

Through tax due diligence some other issues were found that could also lead to fines with interests and penalties. The report identified the issue, the potential fine and the level of risk of being fined. During the work carried out, several situations related to the taxable profit were detected which, if they are questioned by the TA (Tax Authority) during inspection, may lead to additional settlements for GIT purposes. These circumstances relate to non-operating costs (that is, not justified for the maintenance of the producing source, not falling within the jurisdiction of the business, or supported on behalf of and in favour of others) and errors in specialisation that resulted in a GIT calculation that was less than what would be owed. More detail in Figure 12.

Thousands of €	2020	2021	2022	2023
GIT Adjustments	2	566	308	36
Positive changes in specialisation	0	463	0	0
Non-operational expenses	1	87	290	10
Representation expenses	1	16	18	26

Figure 12 - GIT Adjustments

Adjustments to GIT impact on the taxable profit base, mainly through changes in income and expense recognition, affecting when they are included in taxable profit. The positive 2021 variation of specialisation adjustments increases taxable profit, leading to a higher GIT payment.

Non-operational expenses are adjusted as they are unrelated to the company's core activity and typically non-deductible, resulting in positive GIT adjustments. Additionally, most representation costs lack deduction limits or fiscal acceptability, requiring correction for accurate taxation.

Due to these adjustments and improper practices, tax contingencies, including fines and compensatory interests, total €226 000.

3.4.3 Remuneration complements

During the period of analysis, it was also discovered that employees from both Company X and Company Y received remuneration supplements in the form of allowances and reimbursement of kilometres in their own car intended to pay commissions arising from the work carried out. This is an illegal practice used by some companies to ease the tax burden on salaries because instead of paying salaries subject to tax and social contributions, they allocate these amounts to variable remuneration. By performing this, the companies have avoided being taxed on this remuneration, which could lead to a fine of approximately €200 000 (including interest and fines) if the tax and social security authorities conduct an inspection which is probable according to the due diligence team opinion. For more detail, see Figure 13.

Thousands of €	2020	2021	2022	2023
Expenses subject to taxation	22	61	90	125
Representation expenses	1	16	18	26
Allowances and kilometres	21	45	72	100

Figure 13 - Detailed misplaced expenses subjected to taxation

3.4.4 Related parties transactions

Company X and Company Y conducted multiple transactions with related entities without considering standard terms and conditions, particularly the arm's length principle, which requires that prices between related companies match those between independent entities. Notably, a leasing contractual position was assigned for just €1. Given the market value of such a transaction, this undervaluation could raise tax authority concerns over potential tax avoidance.

However, the impact on corporate income tax is minimal, as the company did not recognize the real or transacted value, meaning the resulting capital loss was not deducted from taxable profit. The primary risk lies with VAT, as this qualifies as a supply of services. If audited, TA could demand payment of the missing VAT, calculated based on services from which Company X was exempt—amounting to €167 000—leading to a potential tax exposure of €38 000. Despite this, the likelihood of an investigation remains low.

3.4.5 SIFIDE deductions

Between 2021 and 2023, Companies X and Y deducted amounts from SIFIDE II, which is a tax benefit granted to companies that carry out R&D activities, allowing them to recover part of the investment made. These amounts were calculated based on the investments made by subscribing to participation units in funds dedicated to investing in R&D-certified entities. The benefit that can be generated from the start of the unit subscription is only realised through the effective use of the capital invested by the R&D Funds in companies which, in turn, and during the investment period (3 or 5 years) must invest this capital in R&D expenses. Since both the investment criteria and the subsequent validation of the investment are dependent on third parties, it is not possible to guarantee that the tax benefit (€304 000 distributed between 3 years (See Figure 17)) will not have to be returned to the state. Even after the transaction, Companies X and Y will still own the units they subscribed for between 2021 and 2023, thus they will still bear the risk of the tax benefit's return at that time. Thus, the due diligence team suggested that this circumstance be appropriately protected in the SPA, either through indemnity clauses or price adjustment mechanisms until the incentives are finally validated.

3.5 Financial and tax due diligence results

3.5.1 Financial due diligence impact on the price and SPA

By observing Figure 14 it's possible to have a clear vision of the impact of the adjustments on price.

Thousands of €	2023	Mar-24
Reported EBITDA	1235	
Adjusted EBITDA	736	
Difference	-499	
Reported Net Debt		-993
Adjusted Net Debt		-977
Difference		-16
Reported Working Capital		695
Adjusted Working Capital		-172
Difference		-867
Price		
Before Adjustments		
5x EBITDA		6175
Net Debt		-993
Working Capital		695
Price Before Adjustments		6473
After Adjustments		
5x EBITDA		3680
Net Debt		-977
Working Capital		-172
Price After Adjustments		4829
Impact		-1644

Figure 14 - Financial Adjustments impact on price

According to Figure 14, the impact of the due diligence adjustments on the price can be - €1 644 000, a decrease of 25% if all adjustments made are accepted in the negotiation, which is significant. However, these figures are subject to negotiation between the two parties involved according to the findings made during the due diligence process. For example, it is not normal to write off the value of the working capital in full, which is what is suggested by the normalisation adjustments made. What is common, in these cases, is to adjust the Working Capital according to historical bases, although here it doesn't make as much sense due to the inconsistencies demonstrated in the adjustments (historical value would not correspond to the reality of the business), based on the sector, adjustment for excess/deficit based on a predefined range or, finally, based on the need for capital required to operate normally after the operation.

The financial due diligence provided buyers with critical insights into gross margin figures, including increased commissions paid to credit managers despite predefined limits. By adjusting shareholder remuneration and removing non-core assets and partner-associated accounts—common practices in Portuguese SMEs—it ensured an EBITDA that accurately reflects the business reality. Given the prevalence of such practices, due diligence plays a crucial role in uncovering unrelated costs or liabilities, preventing buyers from paying for something not related to the activity of the business.

In addition, recommendations such as improving the reconciliation of information between management and accounting are a change that buyers must strongly consider to guarantee reliability and realism in the presentation of financial statements.

Regarding the impact on the SPA, financial due diligence revealed two key factors that could significantly influence the transaction's risk allocation and negotiation dynamics. First, the recommendation to establish a price adjustment mechanism for expenses not yet recorded in the financial statements ensures that the buyer does not bear unforeseen financial obligations post-transaction. This is particularly relevant given the inconsistencies in the target's accounting practices. Without such a mechanism, the final purchase price may not accurately reflect the company's true financial position, potentially leading to post-closing disputes or additional financial strain on the buyer.

Second, to avoid operational disruptions, it is crucial to confirm contracts with credit managers and business partners. Uncertain terms could result in disagreements, the loss of talent, or unforeseen financial obligations given their role in generating revenue.

In the end, these suggestions are essential to maintaining transaction value, lowering exposure to operational and financial risks, and guaranteeing a smooth transition after the acquisition.

3.5.2 Tax due diligence impact on price and SPA

Through the tax restrictions revealed, the price can be altered by including clauses and adjustment mechanisms in the SPA so that the irregularities practised by the sellers are not supported by the price paid in the transaction by the buyer. For example, the due diligence team recommends that the amounts deducted from SIFIDE, which are not yet certain to be deducted, be protected through SPA with a price adjustment mechanism depending on whether the tax benefit is granted or not. Although this is a standard recommendation, the sellers may find it difficult to accept because they may claim that the deduction is dependent on the R&D investment funds' choices rather than on them.

Once more, the target companies' inconsistent accounting practices are problematic because they may result in inaccurate deductions and deceive the amount of profit that is subject to taxation.

The total amount of tax contingencies amounts (See Figure 15) to just over one million euros, which represents almost a third of the revenue generated in 2023, which tremendously impacts the future financial model. These contingencies directly constrain cash flow and liquidity, reducing available capital for investments and operations, potentially leading to project postponements and increased financing costs due to higher perceived risk. The business may also have to lower fixed costs to offset financial uncertainty, which could have an impact on operational growth by affecting workforce retention through layoffs or changes to compensation structures.

To mitigate these risks, the SPA should include price adjustment clauses, allowing for reductions if tax liabilities materialize post-transaction. An escrow account can also be established to withhold part of the purchase price until tax uncertainties are resolved. Indemnity clauses should hold sellers financially accountable for any additional tax liabilities arising from past irregularities,

while warranties must ensure that all tax obligations were properly disclosed and transactions with related parties complied with market standards. Additionally, reimbursement provisions can require sellers to refund a portion of the purchase price if unforeseen liabilities arise. Finally, post-transaction cooperation clauses should obligate sellers to assist in potential audits or regulatory reviews, ensuring transparency and compliance.

By integrating these provisions into the SPA, the buyer can safeguard the transaction value, limit exposure to historical financial risks, and ensure the company's long-term stability.

Thousands of €	12m20	12m21	12m22	12m23	Total
VAT Improper Deduction	3	102	156	142	403
Non current assets	0	0	29	0	29
Others goods and services	1	92	127	126	346
In favour of the taxable person	1	10	0	16	28
Subtotal	3	102	156	142	403
Compensatory interests	0	13	13	6	33
Fines	1	31	47	43	121
Tax contingency	4	146	216	191	556
<i>Weight of exempt transactions (pro-rata)</i>	90%	69%	75%	74%	73%
Reduced contingency	3	100	162	140	406
Corporate Income Tax Taxable Profit Adjustments	2	566	308	36	912
Exercise specialisation	0	463	0	0	463
Non-operational expenses	1	87	290	10	388
Representation expenses	1	16	18	26	61
GIT @22,5%	0	127	69	8	205
Compensatory interests	0	14	5	0	20
Fines	1	0	0	0	1
Tax contingency	1	142	75	8	226
IRS and SS Remuneration complements	21	45	72	100	238
Allowances and kilometres	21	45	72	100	238
IRS @25%	5	11	18	25	59
Compensatory interests	1	2	2	1	6
Minimum Fines	2	3	5	7	18
SS @34,75%	7	16	25	35	83
Interests on late payments	2	3	4	4	13
Costs and Fines	5	5	5	5	22
Tax contingency	22	41	60	78	200
Corporate Income Tax Operations with related parties	0	0	0	167	167
Taxable Asset Value	0	0	0	167	167
GIT @22,5%	0	0	0	38	38
Tax contingency	0	0	0	38	38
Total quantified contingencies	27	329	350	314	1,020

Figure 15 - Tax contingencies summary

Expiry	2024	2025	2026	2027	2028	Total
VAT Improper Deduction	4	146	216	191	0	0
Corporate Income Tax Taxable Profit Adjustments	1	142	75	8	0	0
IRS and SS Remuneration complements	8	31	50	68	44	118
Corporate Income Tax Operations with related parties	0	0	0	38	0	0
<i>Amount expiring at the end of each year</i>	13	319	340	305	44	1,020
<i>contingência viva no final de cada ano</i>	1,008	689	349	44	0	

Figure 16 - Expiry date of tax contingencies

Thousands of €	2020	2021	2022	2023	Total
SIFIDE II	0	31	50	223	304

Figure 17 - Possible deductible amount from SIFIDE

3.6 Final considerations and limitations

The findings in Chapter 3 show that identifying risks and lowering uncertainties in business transactions are made possible by financial and tax due diligence. The analysis demonstrates that due diligence improves valuation accuracy and the security of investment decisions by offering a thorough evaluation of a target company's financial statements accuracy and tax compliance. The results also imply that businesses that carry out thorough due diligence have a higher chance of avoiding unanticipated liabilities and post-transaction regulatory issues. The findings do, however, also draw attention to certain drawbacks, including restricted time, information asymmetry and the possibility of subjective analysis.

However, certain limitations impacted the depth of the analysis. Restricted access to some key documents limited the ability to provide a more detailed explanation of each adjustment made during the due diligence process. Moreover, the lack of access to post-due diligence negotiations between the parties involved affected the overall research objective, as it was not possible to assess the impact of due diligence findings on the final transaction value and the SPA contract.

Nevertheless, the case was selected because of its richness in illustrating typical financial and tax due diligence adjustments and also because of its specific characteristics, such as accounting practices, which allow for a clear observation of the impact of the due diligence process on potential price and SPA terms.

Chapter 4

Conclusions

This research analysed the financial and tax due diligence impact on the valuation of the transaction and SPA based on a case study. Its main goal was to understand how the identification of risks and financial adjustments through due diligence influenced all the transaction and to quantify it.

First off, the more restrictions that typically impact the analysis, the less effective the due diligence procedure will be. The case study demonstrated how the target companies' poor accounting practices and the misalignment of accounting and financial data between their management and accounting departments complicated and constrained the due diligence team's analysis, which was only given a little more than a month to complete the process.

Thus, the first conclusion is that the quality of the due diligence process will be worse, the more constraints you add to it, specially regarding the quality and availability of the information provided both by buyers and target companies.

As a result of financial due diligence, EBITDA, working capital, and net debt were subject to specialisation and normalisation adjustments leading to a reduction in price of €1 644 000 which may still change depending on what the buyer takes into consideration in SPA following the due diligence team's recommendations. The inclusion of a price mechanism adjustment in SPA through EBITDA margin proxy due to the costs not yet included in the financial statements can cause another reduction in price equivalent to €168.000. The buyer could be exposed to risks if the tax due diligence process was not carried out, as evidenced by the identification of tax contingencies. In that scenario, the buyer would be responsible for paying for mistakes made by the target companies' management. With the information gathered from the tax due

diligence work, the buyer can use the SPA to protect itself from paying these expenses, which could lead to future compensation from the sellers or, in the event that fines arise later, to the sellers paying them. Given the changes that have already been measured and the possible changes that could lead to a price reduction of at least €1 812 000 meaning that financial due diligence has a substantial impact on the price. The price will also be affected by the tax due diligence, but indirectly—that is, through the provisions the buyer specifies in the SPA to safeguard itself against the tax contingencies that were found, which sum more than one million euros, which is a substantial sum.

Financial and tax due diligence provide valuable information that will help shaping future projections but also to the financial adjustments made because they adjust the business into its real version. The due diligence carried out made it possible to gather a lot of important information regarding the deterioration of the gross margin, such as the percentage of commission paid to some credit managers being higher than initially agreed, the costs relating to Diogo Carvalho which are not included in the financial statements but which after the transaction will be included as part of the salary package. Additionally, all the information about tax contingencies is important because, if they are not known about or are not properly protected in SPA, it may influence future investment decisions.

The fact that this information, which was unknown, is now in the hands of the buyer, he will use it to adjust the projections. This change in projections can impact on the continuity of the transaction if it turns out that this new information changes the initial plans outlined for the transaction.

In conclusion, the financial and tax due diligence carried out in the case study brought together a set of arguments that allow us to see the impact it has on the price of the transaction and the SPA. The case study made it possible to add a quantifiable component so that there would be knowledge and a tangible indicator of how the entire due diligence process can impact the transaction. By

doing this, the study has filled a gap in the literature and given researchers, investors, and businesses looking to get involved in M&A activities a better understanding of the potential impact of financial and tax due diligence on the transaction and how it may alter all the original plans.

Furthermore, the case study allowed for the realisation that due diligence will be more effective when the typical process limitations are less stringent. This will lead to a more thorough and effective analysis that can benefit all parties involved in the transaction, but most importantly, the buyer.

Declaration of generative AI and AI-assisted technologies in the writing process

During the preparation of my internship report, ChatGPT was used for the following tasks: writing improvement and coherence, text alignment with references and APA 7 standards checks and key concept explanation, with the prompts used listed at the end of the document in the Prompts List section. After using this tool, I reviewed and edited the content as necessary, and I take full responsibility for the content of the work presented.

I also declare that I am aware of and respect the Artificial Intelligence Rules of Conduct of Católica Porto Business School.

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Prompt list section

1. Use of Tools for Writing Improvement and Coherence
 - Rewrite this paragraph to make it clearer and more direct while maintaining academic rigor.
 - Improve the coherence of this paragraph, ensuring that each sentence contributes to the development of the central argument.
2. Text Alignment with References and APA 7 Standards
 - Check if this reference is correctly formatted according to APA 7.
 - Ensure that all in-text citations are included in the reference list and vice versa.
 - Suggest adjustments to make this citation more relevant to the argument presented.
3. Prompts for Explaining Key Concepts
 - Explain the pro-rata method and provide a practical example to illustrate its importance in financial and tax due diligence.
 - Describe the role of specialization adjustments in standardizing financial reports between the acquiring and target companies.