

Integration of PRI Guidelines

DEC 2019:

Adyen

# Executive Summary

**Adyen is a global payments company that offers an integrated platform with full stack services including payment gateway, processing, risk management, acquiring, issuing and settlement. Adyen is a leading provider of unified commerce. We opened our position in the company in December 2019. The company exhibits strong fundamentals and a good business model.**

However, in completing our ESG analysis process some concerns have arisen that demand our attention, in particular:

- There is a lack of broader ESG alignment with no pollution control efforts disclosed.
- Lack of diversity amongst management.
- Minimal to no disclosure around certain financial data points such as the cash flow statement.

Despite these concerns, we are confident in our fundamental analysis of Adyen as it draws alignment with sustainable ESG trends of:

- Enabling a seamless global payments system.
- Enabling unified commerce.
- Digitising resource planning for merchants.
- Reducing fraud for merchants.
- Reducing payment friction.
- Facilitating the transformation to cashless societies.

We believe that Adyen is a central figure in these tailwinds and that the company has a long wave of growth ahead of it. Our ESG analysis strengthens our conviction in the investment.

*“Sustainability – in the truest sense of the word – has always been key to Adyen’s decision-making.”* - 2018 Annual Report

## Strategy

*This section focuses on ESG issues emanating from communications around the company’s strategy of exploiting opportunities and managing risks. The rise of shareholder activism, public and media attention on corporate responsibility, and increasingly informed consumers requires companies to actively consider and manage ESG risks in order to successfully execute on their given strategy. We think in terms of fundamental company strategy.*

## HIGH LEVEL ESG RECOGNITION

### **How does the company act as a positive force for environmental concerns?**

*A list of significant issues that relate to maintaining and creating sustainable environmental outcomes. Examples include sustainable power use, reduction and reuse of water, sustainable end of product life considerations, and pollution mitigation during manufacturing processes.*

Not enough data.

### **How does the company not act as a positive force for the environment?**

*This is a list of material outcomes that result in the company detracting from a sustainable environment and include examples opposite of those mentioned above.*

- No mention of their physical properties using renewable energy, recycling water, etc.
- By not providing sufficient ESG data to the market.

### **How does the company act as a positive force for social concerns?**

*Here we focus on sustainable outcomes for people. Does this company act for the betterment of individuals and society? These are broad ranging issues and topics, but some examples include improving mental health, providing engaging workplaces and appropriate remuneration, improving financial outcomes for customers, improving learnings outcomes, improving general health outcomes for customers, increasing access, and allowing human expression at a higher level.*

- By enabling unified commerce, improving convenience and access to discounts for consumers and productivity for merchants.
- By removing transactional friction from the charitable giving process, launching a new extension of its core payment offering in Q2 2019: Adyen Giving.
- By focusing on data security and protection through the implementation of processes and controls in relation to the European General Data Protection Regulation.
- Adyen Giving: Frictionless addition to the shopper flow, post-transaction, wherein a charitable donation can be inserted post-completion in a single click by the shopper. Adyen processes the additional transaction at no extra cost.
- Adyen has continued to build a scalable solution to meet obligations arising out of Anti-Money Laundering (AML), Counter-Terrorism Financing (CFT) and Sanctions regulation, with a particular focus on machine learning to real time and post-event monitoring of merchants and transactions.
- Policy of treating each other equally regardless of gender, age, race, nationality and/or sexual orientation.
- People from all walks of life and various backgrounds welcome, with 60+ nationalities working at Adyen offices around the world.

*"We focus on three key areas of inclusion: equal chance, equal pay, and normal course of life."*

### **How does the company not act as a positive force for social concerns?**

*Here we consider how the company meaningfully detract from the betterment of the individual and society over the long-term. For a business model to be successful it must act as a force for good. Items in this list are a real concern for us. Some examples include business models that serve to disconnect people from physical socialisation, are detrimental to physical health, or that disempower employees.*

- No data to support how the company is acting against the best interest of society.

### **How does the company act as a positive force for governance concerns?**

*Good corporate governance is essential to long-term performance. Here we look at the structures of committees and oversight, and remuneration policy and its links to fundamental performance. High-level, meaningful issues are listed here.*

- A comprehensive and honest risk assessment in the annual reports that highlights many risks uncovered through our independent research.
- Adopted the three-lines-of-defence model in-line with European Banking Authority (EBA) guidelines on Internal Governance:
  - Segregation between operations (first line).
  - Risk management and compliance functions (second line) and
  - Independent internal audit function (third line).
- Internal controls over financial reporting have been set and reviewed by the internal auditor.
- Remuneration is set below market rates (see Table 5).
- The Risk Committee and the Compliance Committee report to the Management Board at least quarterly, their observations, recommendations, and deliberations on findings regarding compliance, risk management, and internal control.
- Promotes good company culture through the Adyen formula: teamwork, good choices, empowerment, and individual responsibility to protect Adyen's brand and reputation.
- Two-tier board structure consisting of the Management Board and the Supervisory Board. The Supervisory Board supervises the conduct and policies of the Management Board and the general course of affairs of Adyen and its operations.
- The Supervisory Board currently consists of three members: Piero Overmars (chairman), Delfin Rueda and Joep van Beurden. All three members are independent from the company and are well-experienced and qualified for their positions.
- Adyen operates under the four eyes principle: at least 2 Managing Directors must sign off on any significant business decision for it to be approved.

#### **How does the company not act as a positive force for governance concerns?**

*Examples of points that might go here include appropriate remuneration both in terms of total amount and or incorrect alignment of incentives. We also look at the strength of the board and power of the CEO to influence governance. Another significant area is the appropriateness of response by management and the board to environmental and social issues as they arise.*

- Inadequate notes to the cash flow statement.
- Certain large merchants provide a significant share of Adyen's net revenue.
- Article 2:166 of the Dutch Civil Code states that each of the Management Board and the Supervisory Board should consist of at least 30 per cent female and 30 per cent male members. Adyen currently does not reach these targets.

#### **What external ESG factors affect the company?**

*This includes domestic and international government policy, market competition forces, and micro and macroeconomic drivers.*

Major influencing factors include:

- Global government policy and incentives set largely towards transitioning to a sustainable economy and meeting the targets as set out by the Paris Agreement.
- Internal practices, governance control policies and general compliance of technology partners.
- Increase in competition and technical innovation by competitors.
- Increasing government regulation regarding digital payment, and software architecture and privacy. For example, General Data Protection Regulation (GDPR) is a replacement for the 1995 Data Protection Directive in the EU. It was brought into effect in May 2018 and is intended to bring sweeping changes in the way every company operating in the EU handles user data and privacy.
- Greater demand for cross-border payment methods.

- Global increase in e-commerce trend (growing at over 15% CAGR to 2023).
- Increasing sophistication in digital money theft.
- Increasing fraud sophistication.
- Increasing requirements for KYC (Know Your Customer) to prevent digital fraud.
- Shift from traditional bank accounts to electronic accounts (e-wallets expected to become leading payment method globally in 5 years and are already the leading e-commerce payment method in Asia Pacific and EMEA).
- Demand from the consumer for a frictionless customer experience from offline to online.
- High growth in payments revenue in APAC and North America.
- Fragmentation of payment methods (over 140 payment methods).
- Shift to a cashless society (use of cash is in decline in every global region and is being supplemented by debit cards that are the leading POS payment method).
- Demands from merchants for faster payment settlements.
- Demands from merchants for all in one solution that provides payment gateway, risk management, processing, acquiring, and settlement.

**How has the company demonstrated its awareness of ESG factors in the economy and within its industry?**

- By linking its strategy to major ESG trends.

Strategy	Link to ESG Trend
Leverage existing client growth	Rise in global e-commerce, cashless payments, digital banking, cross-border commerce.
Deepen product offering	Demand from merchants for fast settlement, risk protection, data insights, frictionless customer experience, reporting, regulatory compliance.
Acquire new merchants across different verticals and geographies	Global percentage of the unbanked is decreasing. Internet availability is increasing in developing countries, which is leading to greater demand for online payments in those regions.
Capitalise on evolution in business models	Increasing demand from merchants for integrated solutions to make the payment process more efficient.
Increase unified commerce footprint	Global shift towards unified commerce with emphasis on improved customer experience.
Expand into mid-market	Increasing demand for a single platform solution with low onboarding costs that can accommodate anything from large global entities to small-to-mid-cap companies

- By making it easy for merchants to be compliant with local government regulations.
- Adyen has a European banking licence and is working towards a US licence as well. They always try to maintain compliance with both global and local regulatory shifts. They also maintain partnerships with local payment providers in different regions where Adyen cannot apply for a licence themselves.
- Comprehensive reference to major internal and external ESG factors in listing risk factors in the Prospectus and Annual Report. Significant points include:
  - Negative publicity about Adyen could adversely affect its reputation and customer loyalty.
  - Increased competition could lead to lower growth, market share and net revenue.

- Rapid technological advancements in the industry may be superior, competitively priced, or render Adyen's product offering obsolete. Adyen needs to provide enhancements and new features that keep pace with the evolving industry and gain market acceptance.
- Adyen needs to have current operating licences or relationships with local providers to continue uninterrupted operations in different geographical areas.
- There are some large merchants that contribute to a significant portion of Adyen's net revenue. These contracts being terminated or impaired in any way could lead to lower processed volumes and revenues.
- Unforeseen global or regional economic events could result in lower spending by customers, which could have an adverse impact on demand for Adyen's products and services. For example, Brexit could have caused shifts in the regulatory environment of the UK and adversely affected Adyen's ability to process transactions in the UK under the European banking licence, requiring Adyen to get separate licensing.
- Frequent or persistent interruptions in Adyen's services could damage Adyen's reputation and cause merchants to switch to a competitor.
- Adyen collects large amounts of user data as part of its platform use and could be vulnerable to cyber-attacks, digital fraud, or even physical breaches that may put the user data at risk. Any such successful attack or breach would adversely affect Adyen's brand and reputation.

#### **Where has management demonstrated its commitment to addressing ESG challenges?**

Through its exceptional governance standards such as:

- Two-tier board structure consisting of the Management Board and the Supervisory Board. The Supervisory Board supervises the conduct and policies of the Management Board and the general course of affairs of Adyen and its operations.
- All three members of the Supervisory Board are independent from the company and are well-experienced and qualified for their positions.
- Adyen operates under the four eyes principle: at least 2 Managing Directors must sign off on any significant business decision for it to be approved.
- At least one board member sees every single new employee before they're hired.
- Very conservative executive remuneration compared to market standards (See Table 5).

Through its insistence of a high cultural standard, as shown in the Adyen Formula; that is to:

- Build to benefit all merchants (not just one).
- Make good choices to build ethical business and drive sustainable growth for merchants.
- Launch fast and iterate.
- Winning is more important than ego.
- Don't hide behind emails, pick up the phone.
- Talk straight without being rude.
- Include different people to sharpen ideas.
- Create your own path and don't be slowed down by "stewards."

"It's very important to grow this company in a responsible way and in such a way that you can maintain culture. And that has always been for us the rate of growth." - Pieter van der Does, Cofounder and CEO (Source: FactSet).

#### **How has management demonstrated its knowledge on the company's ESG risks?**

*Examples and quotes of management addressing relevant ESG risks.*

- Compliance with regulatory shifts is a key point in earnings calls.

*“Regulatory shifts increased complexity for merchants. One example is PSD2. Solving for all this complexity is what we are good at. We pride ourselves on preemptively clearing these hurdles for our merchants.” - Pieter van der Does, Cofounder and CEO (Source: Q2 2019 Earnings Call)*

- By insisting that the company grows no faster than its culture allows. Adyen prides itself on its entrepreneurial culture which fosters innovation and talent. They would like to maintain that culture going forward, which may not be possible if they grow too fast.
- Through its implementation of three-lines-of-defence. Adyen has adopted the three-lines-of-defence model in line with EBA guidelines for internal governance. This imposes segregation between operations (first line management), compliance functions and risk management (second line), and independent internal audit (third line). Adyen believes in their strong culture as a safety net in people making good decisions. The Adyen formula (teamwork, good choices, empowerment, and individual responsibility) reinforces the cultural safeguard.
- Through its Business Continuity Management and Recovery Frameworks, which describe the governance and response measures needed to return to a business-as-usual state in case there is a major incident or disaster that adversely impacts Adyen.
- By aligning risk appetite with strategy. These are not developed linearly, one after the other, but rather they are developed parallel to each other. Any change in strategy would require a reassessment of associated risks.
- By clearly defining its risk appetite and knowing what risk it is and isn't willing to accept. Adyen recognizes that there will always be risks associated with achieving its business goals and has therefore set up policies, procedures and systems that actively mitigate risks that could adversely affect Adyen's reputation or brand, lead to compliance breaches, or endanger its future existence.
- By using stress testing to understand the impact of stress events on its overall risk profile.
- By performing a top-down company-wide risk assessment on an annual basis.

#### **How does strategy align with ESG opportunities?**

*A broad look at how underlying strategy fits or does not fit with ESG trends. For example, a battery manufacturer aligns with the movement towards stored energy, an online retailer aligns with the movement from instore to online purchases.*

- Increased unified commerce footprint following the global shift towards unified commerce with emphasis on a seamless customer experience.
- Mid-market shift - full Adyen solution available to more businesses and sellers. Educating merchants to get the most out of the platform. There has been increased demand from smaller businesses and merchants for an all-in-one solution providing payment gateway, risk management, processing, acquiring, and settlement.
- API integration helping merchants follow the payments trend from cash to cashless.
- Increase in demand for cross-border payments. Adyen supports payments in all currencies.
- Large increase in multitude of different payment options. Adyen accepts more than 140 payment methods across various geographies.
- More Chinese tourists requiring acceptance of Chinese payment methods. Partnership with Alipay ensures that Chinese payments methods are accepted outside China as well.

#### **Is there evidence of the company reporting highlighting future ESG risks and does the strategy allow for these anticipated risks?**

Both internal and external risk factors are listed comprehensively in the annual report and the prospectus, and risk management policies are updated to make sure any risks arising from change in strategy are well within Adyen's risk capacity. For example:

- *“Adyen and its merchants, partners and others who use its services, obtain and process a large*

*amount of sensitive data. Any real or perceived privacy breaches or improper use of, disclosure of, or access to such data could harm Adyen's reputation as a trusted brand, as well as have a material and adverse effect on its business, financial condition, results of operations and prospects." - IPO Prospectus 2018.*

- Increased investment in improved data security.
- Increased investment in fraud detection and mitigation. Global card fraud losses totaled nearly \$23 billion in 2016 and is rising 12% per annum (McKinsey, 2016). Adyen's efforts to bolster fraud detection and prevention are aimed squarely at this ESG risk.

#### **What is the extent of ESG performance reporting?**

Minimal.

- There is no information regarding internal sustainability reports.
- No reference to pollution control or mitigation.

#### **Do reports link ESG factors to financial performance?**

No.

#### **What is the company's position in relation to current and potential operational licences, supply chain, and resource bottlenecks?**

*We must consider these constraints as they represent a significant risk to business operations. Has the company given these current and or potential bottlenecks due consideration? Can we see any concerns?*

- They have a European banking licence.
- Working on the application for a US banking licence.
- Might look into getting more banking licences in the future.

#### **What is the extent of management involvement of customers, employees, government, and other stakeholders? How do they gather data on their sentiment/opinion?**

*Considers how well management engages these parties in seeking their input and feedback on ESG issues. In the second part we consider the mechanism for how this data is gathered.*

- Adyen's merchant satisfaction is demonstrated by a high net promoter score (NPS) and customer satisfaction scores and an increase in resolved support tickets per day.
- Tracking NPS for merchants rolling out unified commerce. Adyen is tailoring a product for these merchants that is seeing positive early results based on the NPS and transaction volumes.

#### **How responsive is the company to investor engagement?**

Metric hard to ascertain, however management is quite forthcoming in answering all questions posed on earnings calls.

#### **Does the board support ESG issues?**

*How supportive and engaged is the board on ESG issues? Without their support it will be very hard for management to progress on ESG issues.*

Yes.

- Via its approach to high governance standards.
- Major focus on compliance with regulatory shifts.
- Every new employee meets with one of the board members before being hired.
- Conservative remuneration according to market standards.



# Financial Reporting

## INCOME STATEMENT

### REVENUE

#### **Identify the main drivers of revenue for both volume and price.**

- Number of transactions processed.
- Number of merchants.
- Growth in unified commerce.
- Platform innovations and new business models.
- Global trend towards cashless societies.
- Global growth in e-commerce.
- Global growth in e-wallets.
- Innovation and automation in compliance & internal reporting.

#### **How do these drivers align with sustainable ESG factors?**

- Digital payments are fully traceable and can reduce the opportunity for illegal activities in commerce.
- Platform innovations include security upgrades and privacy patches that safeguard user data against cybercrime.
- The digital payments landscape eliminates the possibility of cash theft and takes away incentives for robbery.
- Unified commerce brings greater convenience and opportunity to consumers.
- E-commerce is bringing quality items to people at lower prices, improving their quality of life.
- Innovation in platforms and e-commerce is uncovering new business opportunities.
- Innovations in e-commerce and frictionless payments increase productivity by reducing time and cost of payments.
- Facilitating and automating compliance and internal reporting greatly increases possibilities to do business and greatly improves internal productivity.

#### **What are the future prospects for these drivers? Including the fundamental tailwinds that support their future growth.**

- Unified commerce is the upcoming trend in the global payments industry. Online and mobile retailers are increasingly establishing a physical presence and bricks-and-mortar retailers are increasingly pursuing an online and mobile strategy.
- The global trend towards a cashless society is strong and will continue with the use of cash declining in every global region. Cash contributed the most at 31% of POS payments in 2018. It is projected that cash will only contribute 17% by 2022, trailing behind debit cards (30%), credit cards (22%), and e-wallets (28%) (Source: *Worldpay 2018 Global Payments Report*).
- E-commerce will continue to grow with an estimated CAGR of more than 15% surpassing \$4.6 trillion globally by 2023 (Source: *2019 McKinsey Global Payments Report*). This growth can be intensively linked to the global shift towards online payments and a cashless society.

- E-wallets are replacing card-based payments as the primary method of payment. They already contributed approximately 36% of e-commerce payments globally in 2018 and are estimated to increase to 47% by 2022 (Source: *Worldpay 2018 Global Payments Report*).
- Electronic payment transactions have been growing at a rate of 22% in emerging countries over the last 5 years. It is projected to grow at 14% for the next 5 years fueled by the continuing shift from cash and increased adoption of digital payments solutions (*2019 McKinsey Global Payments Report*).
- Innovation in automation and compliance and internal reporting is set to continue. Regional complications and differences in compliance requirements will continue, and tools that facilitate and automate that compliance will remain in strong demand. Having the transactional data allows Adyen to also automate many reporting functions allowing managers to have live data feeds greatly improving efficiency and productivity. As Adyen improves and tailors this service that demand will remain and potentially increase.

#### **What major risks exist in the potential of these future prospects to not become a reality?**

- Platform innovations or industry disruptions by a competitor.
- Customer satisfaction will play a major role in the success of unified commerce.
- New payment regulations in the different geographies that Adyen operates in could negatively affect operations.

#### **How might ESG trends impact this company's core markets?**

- There is a strong demand for more stringent data security and privacy laws.
- All properties (data centres, offices, etc.) would need to be adapted for renewable energy use if they have not already done so.
- Social and governance trends across the industry act broadly as significant tailwinds to support Adyen's growth. Adyen is in many cases setting trends for the industry.

#### **What legislative or regulatory change is anticipated?**

- European-wide PSD2 directive: banks and card issuers along with merchants must enact a new set of stringent rules so as to increase security and mitigate against online card fraud. Adyen is already in compliance with this directive.

#### **Are the company's key markets sustainable in terms of resource use and disposal?**

- Adyen's key market in global payments (e-commerce, mobile and POS) are digital activities and so resource use and disposal are largely non-applicable.
- No data on whether physical properties such as data centres and offices use renewable energy or have sustainable water use.

#### **Are the company's key markets sustainable in terms of consumer preferences and social trends?**

- Global shift from cash to cashless payments supports Adyen's strategy and technology.
- Global shift towards online commerce. Unified commerce offers a seamless offline-to-online experience for customers.
- Increase in demand for cross-border transactions. Adyen has partnered with multiple payment service providers like Alipay to provide compatibility with most payment methods and accept all currencies.
- Complexity of cross-border payments is managed by the single Adyen platform simplifying the process and educating merchants on new functionality.

## COSTS

### RAW MATERIALS

*Consider the scarcity of main inputs and whether supply chain risks are appropriately managed. Is it possible that the company is paying more for sustainable products, which will increase immediate costs but reduce future costs associated with changing supplier or of supply being restricted?*

*Access to materials can be a key determinant of company earnings, depending on the industry. We assess access to materials by evaluating the strength of stakeholder relationships with, for example, suppliers, host governments, local communities, and contractors.*

#### **Is there a risk input costs will rise?**

- There will likely be a steady rise in expenses for platform operation.
- Global expansion and platform innovation represent two avenues of rising costs.

#### **Is the company aware of these risks?**

Yes.

#### **Do cost projections take into account these risks?**

No. Risks insignificant.

**TABLE 1: GROSS INCOME AS A PORTION OF REVENUE**

Company	FY18	FY17	FY16
Adyen	15.31%	14.58%	16.74%
Wirecard	29.49%	35.38%	35.63%
Global Payments Inc.	67.47%	51.5%	52.43%

*Gross income as a portion of revenue. Source: Factset.*

Table 1 above shows that input costs for Adyen have remained steady over the past 3 years. These costs might decrease in the future depending on growth strategies and industry trends.

As for the competitors, both have a higher percentage of gross income as portion of revenue, but they are both well-established companies with reduced input costs. It is natural for a high growth company like Adyen to have higher input costs due to global expansion and platform innovation expenses.

### LABOUR

*Labour costs can account for most operating costs and careful management is required to maintain competitive advantage. Employees will consider the reputation of a company in evaluating job prospects. Company profile includes its management of social and environmental responsibilities and companies will struggle to maintain competitive advantage if talented graduates choose not to work for them. Labour efficiency is a consideration and achieved through higher productivity or lower costs and both are often achieved through non-monetary benefits. We also look at staff turnover and look at staff training spend as a percentage of gross profit. Be sure to consider the context as to the business model and extent of technology use.*

In assessing a company's efficiency in labor and spend on R&D, we use these metrics as a portion of gross income. We use gross income instead of revenue as gross income are the funds available for these investments. If we use revenue, then a company could be running at a loss compared to its profitable competitor and still spend a similar portion. However, it would not be as sustainable as its competitor as it did not use cash flow generated from its own activities for these expenses.

Labour is measured in gross income above and in general and administrative expenses in table 2 below.

**TABLE 2. PORTION OF GENERAL AND ADMINISTRATIVE EXPENSE OF GROSS INCOME**

Company	FY18	FY17	FY16
Adyen	19.73%	33.87%	28.8%
Wirecard	5.74%	22.5%	18.35%
Global Payments Inc	67.08%	72.06%	79.84%

Table 2. General and Administrative expense as a portion of gross income. Source: Factset.

Table 2 above shows Adyen's improving efficiency in labour spend as seen in the decrease in FY18. Global Payments Inc. is an example of highly inefficient labour expense.

## R&D INVESTMENT

In many industries R&D drives a company's ability to exploit ESG trends. We analyse R&D spend as a portion of gross income in order to gauge commitment to R&D and technological differentiation.

**TABLE 3. R&D SPEND AS A PORTION OF GROSS INCOME AND TOTAL (USD BILLIONS).**

Company	FY18	FY17	FY16
Adyen	% (\$)	% (\$)	% (\$)
Wirecard	17.33% (\$103)	15.2% (\$80.3)	14.44% (\$52.9)
Global Payments Inc	% (\$)	% (\$)	% (\$)

Table 3. Investment in R&D as a portion of gross income and total in millions of USD. Source Factset.

Table 3 shows that no R&D spend data has been disclosed by Adyen.

### What is the product development strategy? What is the percentage of sales from new products?

- Strategy is to constantly develop and launch new products and tools to help merchants.
- Recently launched Adyen Issuing: physical and virtual cards for businesses.
- Currently investing in uUnified commerce to provide a seamless experience to customers and simplifying onboarding of new merchants.
- Recently launched product to capture transactions that don't process the first time.
- Recently launched Revenue Accelerate and Revenue Protect aimed at improving card approval rates and risk management.

Note: Percentage of sales from new products is unknown.

### What are the pending patent applications and is there in-house venture capital?

- No data on patents provided.
- No in-house venture capital that we are aware of.

## NON-RECURRING AND EXCEPTIONAL EXPENSES

Analysis of the company's exposure to risks such as litigation or weather events to quantify the threat to future earnings.

### What are the organisational and incentive structures?

- Adyen provides strong incentives for long-term value creation for all staff, including Managing Directors.

- The remuneration policy does not contain incentives that exclusively benefit Management Board members themselves.
- The Nomination and Remuneration Committee consist of three Supervisory Directors as determined by the Supervisory Board.
- Variable income in cash relates to performance in the preceding calendar year.
- On behalf of each Board member Adyen pays a contribution of 4% of the pensionable salary - being 12 times the monthly fixed salary plus holiday pay up to the fiscally allowed maximum minus a deductible - for the accrual of old age pension benefits as well as the administration costs.
- Shares awarded are to be held for at least 4 years after they are awarded.
- Share options cannot be exercised for at least 3 years after they are awarded.

#### What is the extent of stakeholder research?

Extensive.

- Adyen has a blog where employees post articles on new and upcoming technology as well as the technical workings of the Adyen platform and how it affects its users.
- Market research reports on unified commerce provided for multiple regions on Adyen's investor relations website.

#### What is the company doing to mitigate ESG risks in regards to costs?

- Investing in improved security for user data to prevent cybercrime and improve privacy.
- Investing in unified commerce to provide a seamless experience to customers and simplify onboarding of new merchants.

#### Does the company report on these risks?

Yes.

#### What is the company's capacity to sustain or improve operating efficiency?

*Are operating margins improving vs peers?*

As shown in Table 4 below, Adyen's operating margins are comparatively lower as compared to competitors. However, we would consider Adyen's significant growth compared to its peers and the investment required to support that growth and innovation. We expect Adyen's operating margins to expand as the company matures. Adyen operates its full stack service on one platform giving it economies of scale as there is no integration friction between separate products or systems.

**TABLE 4. OPERATING MARGIN.**

Company	FY18	FY17	FY16
Adyen	11%	9.5%	12%
Wirecard	23%	20%	24%
Global Payments Inc	24%	14%	11%

Table 4. EBIT/Revenue. Source: Factset.

**TABLE 5. CEO REMUNERATION FY2018**

Company & Market Val	Base Salary	Cash Bonus	Option Award	Stock Award	Other	TOTAL
Adyen (€20,819M)	€512,305	€85,000			€7,426	€604,731
Wirecard (€14,093M)	€1,600,000	€600,000	€582,000		€526,000	€3,308,000
Global Payments (\$52,650M)	\$1,000,000	\$3,958,667	\$1,875,034	\$9,950,022	\$34,837	\$16,818,560

Table 5. CEO remuneration compared to peers. Source: [www1.salary.com](http://www1.salary.com).

As seen in Table 5 above, Adyen's executive compensation is much more conservative as compared to competitors within the same industry with both a smaller and larger market value.

### **Growth in Shares Outstanding**

Diluted shares outstanding has grown at a modest 1.29% since 2015.

## BALANCE SHEET

### ASSETS

*Some balance sheet assets are easily measured and audited while others, such as intangible assets, are harder to gauge. ESG analysis helps us to provide a greater degree of certainty in relation to the fair value of some assets, e.g., the impact of energy efficiency standards on property values and the effect that changing consumer perceptions, or regulations, related to sustainability will have on the sale of inventory. ESG performance, such as employee engagement, environmental efficiency, and community investment, can indicate a company's commitment to its reputation and brand, and human capital. Integrating ESG factors highlights these issues.*

### **What percentage of total assets are intangible assets?**

**TABLE 6. INTANGIBLE ASSETS AS A PORTION OF TOTAL ASSETS.**

Company	FY18	FY17	FY16
Adyen	0.27%	0.35%	0.29%
Wirecard	23.99%	30.62%	31.70%
Global Payments Inc	66.74%	60.67%	64.63%

Table 6. Intangible assets as a portion of total assets comparison to peers. Source: Factset.

As shown in Table 6 above, Adyen is not an acquisitory company, thus intangible assets are a very small portion of total assets and are not expected to grow soon.

### **What are the environmental provisions and are they sufficient versus the company's historical costs and those of its peers?**

No data regarding any such provisions provided.

### **Do notes to the balance sheet recognise environmental risks to physical assets?**

No.

### **Do notes to the balance sheet or management discussion recognise ESG risks to reputation?**

Yes.

### **What percentage of total assets are intangible assets? To what extent do brand, reputation, human capital, management quality, and intellectual property compromise intangible capital?**

Refer table 6 above.

### **How strong is the company brand?**

Strong and getting stronger. Leading the shift in the payments industry to unified commerce.

### **What is the strength of customer satisfaction and loyalty?**

Strong.

### **Does the company have pricing power?**

Fixed pricing.

**How are employees incentivised and what is the degree of engagement and staff loyalty?**

What level of autonomy do employees have?

- Adyen has pushed authority downward to bring decision-making closer to the employees. Individual initiatives are encouraged, within limits.

Are there flat or hierarchical structures in place?

- No data provided

How is the company recruiting talented graduates?

- No data provided.

**What is the structure (relevant committees) and diversity of the non-executive board?**

- Supervisory Board Committee.
- Audit Committee.
- Nomination and Remuneration Committee.

Lack of diversity on the management board. (All males)

**How dynamic and committed is executive management?**

Very dynamic and committed.

**Are pension assets being managed by ESG aware practitioners?**

Management has shown to be aware of social and governance issues. No indication of whether that is true for environmental awareness as well.

## LIABILITIES

*Most examples more appropriately included in the cost analysis section. However, we consider these points below.*

**Are liabilities short or long-term? An ability to negotiate long-term debt agreements can signal a trusted relationship and lender confidence.**

Short-term.

**How efficiently is working capital managed?**

- DSO moved from 9.6 in 2015 to 9.9 days in 2018.
- DSI moved from 2.05 in 2015 to 2.07 in 2018.
- DSP moved from 1.77 in 2015 to 1.73 in 2018.

The above metrics indicate that working capital is well managed.

**How reliable are relationships with suppliers and customers?**

In the past relationships have been quite reliable.

**What is the extent of off-balance sheet commitments?**

No data.

**Is excessive leverage eroding stakeholder trust and raising the cost of equity?**

No. The company does not have excessive leverage.

**Do debt covenants specify any aspects of ESG risk management?**

No.

## CASH FLOW STATEMENT

Adjustments to sales, earnings and costs completed in the previous section impact directly on cash flow. To flesh this out further, we investigate how ESG factors can impact cash flows regarding operating expenses, working capital management, asset maintenance, and capital costs.

### Cash Flow From Operations

*Earnings quality: If CFFO is significantly less than net income then the income statement may have been manipulated in order to improve headline figures such as EBIT and net income growth. Earnings quality and transparency can indicate ethical and efficient business conduct.*

**TABLE 7. CASH FLOW FROM OPERATIONS (CFFO) AND NET INCOME (MILLIONS USD).**

Metric	FY18	FY17	FY16
CFFO	384.0	200.7	193.7
Net Income	131.1	71.3	97.2

Table 7. Source: Factset.

As seen in Table 7 above, CFFO is higher than Net Income every year, an indication of good earnings quality and transparency.

### Are operating expenses being reduced by investment in new resource-efficient technology?

- Merchant demand is one of the key drivers of Adyen's product development.
- Sustainable growth is the long-term target for Adyen but no data has been provided about any current investments into resource-efficient technology.

### Is capital expenditure covering asset depreciation?

Yes.

Depreciation for FY18 was EUR7.0 million and capital expenditure for FY18 was EUR13.8 million. This clearly shows that capex is covering asset depreciation and we do not expect the situation to change in the future.

### Does capex investment in operational and resource efficiency today reduce the need for capex in the future and therefore point towards improvements in free cash flows?

No data provided.

### Does due diligence on acquisition targets cover long-term ESG risks? Is there a risk that inadequate ESG due diligence results in greater than expected environmental liabilities post-acquisition?

Non-applicable.

### Are there favourable long-term debt facilities that indicate a good relationship with lenders? What are the available borrowing costs? Could the company qualify for a lower rate if it improved its management of ESG risks, specifically in the case of project finance?

Non-applicable.



# Valuation

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**Looking over the factors highlighted through the analysis above, how should the cash-flow projections be altered or what margin of safety do we require to be comfortable to make a purchase?**

ESG factors point more to greater upside than downside for Adyen. We don't see a requirement to alter cash flow projections or increase margin of safety based on this analysis.

## Who is Blue Oceans Capital?

Fundamental, value based investments.

Blue Oceans Capital is an investment fund driven to achieve exceptional results with meaningful purpose through dedication to uncovering truth and applying our understanding of what is known and not what is forecasted. We invest in listed equities across the globe.

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