Adyen and the New Age of Global Payments Processing: Part I

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Dutch payments processor **Adyen N.V.** is in the limelight just as the payments business has gotten hot. Ant Financial just raised the biggest private funding round ever—$14 billion at a $150 billion valuation, in part on the back of its Alipay unit.

These are new and nontraditional entrants. The old guard is upping its game, too, while digital wallets, cryptocurrencies, real-time interbank payments and a host of plucky, and putatively disruptive, fintechs are percolating.

Payments fundamentals still apply. Upending well-entrenched systems is hard. There can, however be enormous value in modest improvements within reigning payments ecosystems.

Adyen is a case and point.

Profitable since 2011, the Dutch payments unicorn IPOed on the Euronext Amsterdam exchange on June 13 with a nose-bleed valuation of 23.9 times annualized first-quarter revenue, then surged 100% to 58.5 times revenue before settling at a stratospheric close of 43.3 times revenue and 178 times 2017 income. Rather than raising capital, the IPO enabled existing investors to cash out.

Adyen is a merchant acquirer and processor started in 2006 by the founders of Bibit, a Dutch e-commerce payment processor acquired by Worldpay in 2004 for $100 million. It launched in the United States in 2008, and today it's active on five continents.

The company represents a strong, albeit inevitably slowly decelerating, growth story. In 2017, payment volume, transactions, and revenue increased year-over-year 63%, 61%, and 38% respectively. In the first quarter of 2018, year-over-year payment volume, transactions, and revenue increased 41.9%, 50%, and 67.2% respectively.

Traditional processors with more modest growth trajectories have more terrestrial valuation multiples. Take EVO, for instance. A portfolio of European and North American acquirers, EVO IPOed in May at $1.234 billion, 2.44 times 2017 revenue. Lumbering processing behemoth First Data trades at 2.24 times revenue and 4.34 times enterprise value, Total System at 3.22 times sales and 3.75 times enterprise value, Worldline at 4.2 times revenue and 3.9 times enterprise value, and Global Payments at 4.7 times sales and 5.4 times enterprise value.

The market loves growth, sticky clients, and defensible revenue streams. With its e-commerce and integrated-payments franchises, Worldpay enjoys richer valuation multiples of 6.5 times sales and 7.6 times enterprise value. Money-losing Square Inc. in the first quarter grew payment volume and revenue 31% and 45% respectively. It trades at a heady 11.2 times revenue and 8.2 times enterprise value.

While Adyen is no Alipay or Mastercard, it’s distinctive.

It provides payments acceptance and earns volume-tiered fixed and ad valorem transaction fees, employing an interchange-plus pricing structure. When it can, it acquires; when it can’t, it works with local acquirers.

Adyen’s culture is direct, open, no-nonsense, and commercially practical, that is, Dutch.

Serving merchant Gargantuas is a scale game where net merchant discount rates are thin gruel. Notwithstanding higher origination and unit-servicing costs, lucrative fees and opportunities to sell services around payments makes plumbing for growth among tens of millions of small-and-medium-size enterprises attractive for most acquirers.

In contrast, the Dutch processor targets large, sophisticated, and demanding multinational merchants, where, net of interchange and network fees, it reaps roughly 22 basis points. Its clients include eBay, Netflix, Microsoft (Linkedin), Uber, Facebook, Shopify, Etsy, and Tinder, plus airlines SAS and KLM. Marquee names like these give Adyen a kind of Good Housekeeping seal of approval.

Merchants often use multiple platforms and acquirers for different channels and countries. Everything else being close to equal, however, merchants prefer fewer processors (ideally, one) across all channels and geographies. While it doesn't acquire for every merchant and in every market, Adyen employs one integrated delivery system end-to-end, incorporating the gateway, risk management, and front- and back-end processing for all channels worldwide.

It enjoys significant operating leverage. Delivery-system costs, conceptually, are fixed. They're largely people supporting the platform. Revenue, however, is variable. Incremental costs for its next $100 billion in payment volume should be de minimis, while revenue will nearly double.

The Dutch processor has an almost contrarian philosophy of building rather than buying to create value. Most of its larger competitors routinely acquire assets to enrich their product suites, build scale, and expand delivery footprints. Organic growth can be slower, but processors buying to expand and add capabilities face challenges rationalizing redundant platforms.

PayPal is acquiring Swedish Square-copycat iZettle, with 450,000 merchants across a dozen countries, for a sizzling 20 times revenue. The e-commerce phenom's attempts to go to the physical point of sale thus far have failed. It will have to give consumers and merchants compelling incentives to change behavior and create clusters of PayPal use at the physical POS. Perhaps this time will be the charm.

Continental Europe's largest processor, Worldline, continues to roll up processors—Banksys, Equens, Digital River World Payments—and, in May, it agreed to acquire Six Payments, building scale and deepening and extending its footprint.

While building Alipay acceptance abroad through acquirers, in parallel, Ant Financial has acquired and invested in a portfolio of payments assets in East, Southeast, and South Asia. If it can stitch them together, it would be the start of a formidable multinational payments and financial-services ecosystem.

(Tomorrow, Part Two will look at the competitive advantages Adyen enjoys—along with the risks it faces.)

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