

Research Brief

Wirecard AG (WDI.DE)

Tremors before “The Big One”: Timely ESG signals warned investors

Jun. 29, 2020

ESG controversies often have warning signs, and timely data can offer a flashing red light

While there are many important uses for ESG data, one of the most important is watching for early signals of a crisis. ESG can offer a different view of a company’s risk profile than fundamental data and general news monitoring. A classic example is Volkswagen’s Dieselgate scandal, which Truvalue Labs data captured before the full-blown scandal cratered the German automaker’s stock price. Another example is Monsanto, which saw steady declines in timely ESG scores before a major court judgment in 2019 and a \$10 billion settlement this week (research brief [here](#)). This week, Wirecard’s former CEO was arrested and the firm filed for insolvency, marking a new chapter in a saga charted in timely ESG data, and in some cases, not incorporated by classic ESG raters.

Wirecard scandal unfolded in a classic drip of news that caused steady declines in ESG scores

Wirecard’s conduct was called into question by a high-profile [reporting series](#) in *The Financial Times* in 2015. By 2017, with a clean audit from EY in place, shares soared. ESG data for the company also outperformed peers in that period. But then in November 2018, the timely Pulse score for Wirecard fell sharply with the news of a class action lawsuit. One such suit alleged that the company had made materially false and misleading statements about forgery and account falsifications that took place over a period of several years. Over the next two years, continuing bad news captured as ESG data drove the firm’s score far below its peers, as seen below. The data was concentrated in the SASB category of Business Ethics, which claimed 84% of TTM volume and for which the company was ranked in the 14th percentile in its industry of Consumer Finance. That was a massive red flag that highlighted a critical emerging issue in our Dynamic Materiality™ view (see chart at top of next page). The signals in timely ESG data were not captured by several major ESG raters that rely on self-reported data as a key ingredient in ratings that are determined by analysts.

Wirecard’s long-term ESG Insight Score, long above the Consumer Finance industry average, crossed beneath that mark in late 2018 with a steady drumbeat of negative fraud coverage



Source: Truvalue Platform

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Research Briefs highlight material events that move Truvalue Labs scores and may shape future company valuation.

AT A GLANCE

Wirecard AG (WDI.DE)

Insight Score	35
Industry Percentile	1 st
Momentum Score	27
Industry Percentile	20 th
NTM P/E	1.9x
Peers	34.3x
NTM EV/EBITDA	-0.5x
Peers	19.7x
Top Score Drivers- TTM	Impact
Business Ethics	84.6%
Competitive Behavior	4.4%
Data Security	2.7%

For all scores in this section, SASB’s Materiality lens is turned off. Valuation as of June 25, 2020. Valuation Source: Refinitiv

Evidence

Dynamic Materiality view of ESG categories showed Business Ethics as overriding concern for German fintech giant

CATEGORY	DYNAMIC MATERIALITY ⓘ ↓	SPOTLIGHTS EVENTS TTM ⓘ	INSIGHT	INSIGHT INDUSTRY PERCENTILE
Business Ethics	84%	13	25	14th
Competitive Behavior	4.7%	4	39	64th
Data Security	2.7%	3	21	11th
Labor Practices	1.7%	1	60	80th
Access & Affordability	1.6%	2	57	46th
Product Quality & Safety	1.5%	0	44	18th
Supply Chain Management	0.6%	0	52	35th
Employee Engagement, Diversity & ...	0.5%	0	50	18th
Product Design & Lifecycle Manage...	0.5%	0	54	31st
Selling Practices & Product Labeling	0.5%	0	22	11th

Source: Truvalue Platform

Two-year chart shows timely Pulse score established new, dramatically lower range that equity price took years to match



Source: Truvalue Platform. Pulse score in dotted purple, stock price in dark purple

The Pulse score for Wirecard fell from 50 to 12 on November 26, 2018, marking the end of a period of outperformance.

The Pulse score for Wirecard dropped from 50 to 12 on November 26, 2018, marking the end of a period of industry outperformance compared to other Consumer Finance firms. While the company's Pulse score ticked upwards at times in the ensuing two years, it spent only a few days in that timespan above the score of 50, which represents a line of neutral sentiment in Truvalue Labs' natural language processing. The Nov. 26, 2018 data point, seen below, was a class action lawsuit laying out a case of prolonged bad behavior and forgery by Wirecard employees, and a misleading response from the company in its wake.

Nov. 2018–April 2019: For 6 months, class action lawsuits gather steam

Wirecard AG (OTCMKTS: WRCDF)

Class Period: April 7, 2016 - February 1, 2019

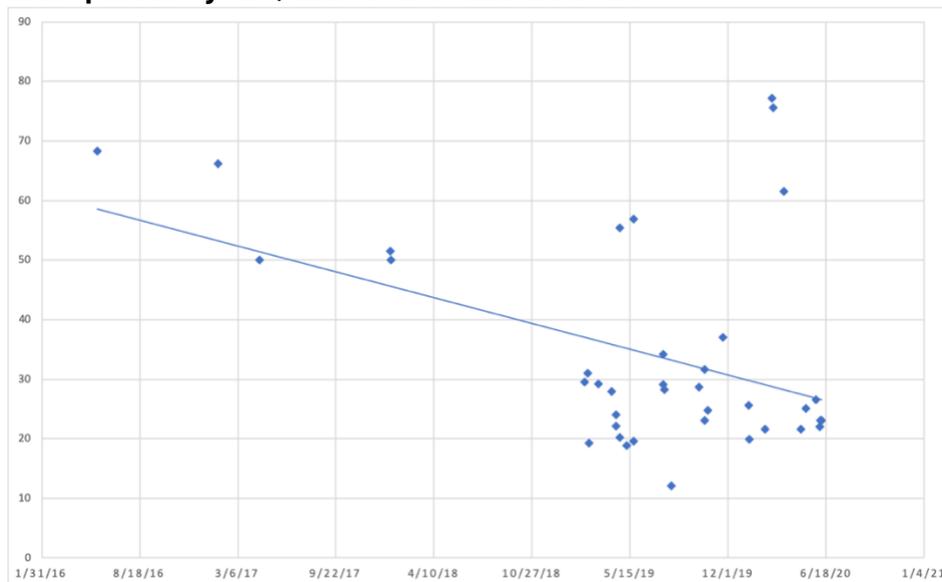
Lead Plaintiff Deadline: April 9, 2019

Join the action: <https://www.zlk.com/pslra-1/wirecard-ag-loss-form?wire=3>

The lawsuit alleges that, during the class period, Wirecard AG made materially false and/or misleading statements and/or failed to disclose that: (1) for the period spanning from 2015 to 2018, a senior Wirecard executive in Singapore had been accused of forging and backdating contracts, including falsifying accounts and money laundering; (2) an external law firm commissioned to investigate Wirecard's Singapore office had reportedly found evidence of "serious offences of forgery and/or of falsification of accounts"; (3) Wirecard had downplayed weaknesses in its internal controls over financial reporting and failed to disclose the true extent of those weaknesses; and (4) as a result, defendants' statements about Wirecard's business, operations and prospects were materially false and misleading and/or lacked a reasonable basis at all relevant times.

Source: Truvalue Platform

Truvalue Labs' algorithmic Spotlight Events had negative scores (vertical axis) in the past two years, with clear downward trend



Source: Truvalue Spotlight Event Data Feed

Considering Wirecard from a credit risk standpoint: As late as August 2019, its bonds were considered investment grade by one of the big three ratings firms.

Wirecard, credit risk, and ESG data

On the credit risk side of the equation, Wirecard also escaped critical attention from major ratings agencies. As late as August 2019, debt issued by Wirecard was considered investment grade by one of the big three ratings firm. Truvalue Labs' Business Ethics category data for Wirecard portrayed a very different view of the company: That it was a risky proposition to own their bonds.

Creditors are now scrambling to consider options. That includes extending repayment obligations, as [described by Bloomberg](#), who cited persons familiar with the matter in reporting that Wirecard has drawn about 90% of an outstanding revolving credit facility of 1.75 billion euros.

This is not a unique case of timely ESG data providing a powerful lens for credit risk analysis. For more on that topic, read the Outlook section below, with peer-reviewed academic findings on the correlation between Truvalue Labs data and credit risk.

Outlook

Wirecard is not an outlier: Timely ESG data can help mitigate risk

Wirecard's insolvency was foreshadowed by timely ESG data, and it is not alone in that respect.

[A 2019 study](#) by Witold Henisz from the University of Pennsylvania's Wharton School, published in *The Journal of Applied Corporate Finance* found a link between weak ESG performance and heightened material credit risks.

"We found that Truvalue Labs' ESG scores capture timely and material events such as regulatory inquiries, investigations and lawsuits, which are correlated with credit risk and the likelihood of default," said Henisz at the time.

His study, "ESG, Material Credit Events, and Credit Risk," describes cases of companies with relatively weak ESG performance, as indicated by Truvalue Labs' data at a moment in time, that subsequently experience high-profile negative ESG events leading to measurable increases in credit risk. Such cases include Volkswagen's emissions scandal, Boeing's 737 MAX and Wells Fargo's sales practices.

Henisz and McGlinch analyzed data for a sample of 342 companies from 13 industries, excluding financial services, over the period of 2009 to 2017.

The study found "clear evidence that higher-performing companies on ESG criteria experienced subsequent lower incidence of adverse material events. Companies with lower performance relative to their peers in their industry based on material ESG criteria as defined by the Sustainability Accounting Standards Board (SASB), experienced a higher incidence of adverse material events."

Continuing emergence of high-profile examples such as Wirecard underscore the importance of ESG data for all investors.

About Truvalue Labs

Truvalue Labs is the first company to apply AI to uncover timely ESG data on a variety of asset classes. The company's mission is to deliver increased transparency to investment professionals by providing data and analytics that go beyond traditional fundamentals.

Visit www.truvaluelabs.com to learn more about the SaaS and API products.

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