

## Growing to profit

Novatti's FY21 result was a record of the sizeable progress achieved by the company over the past year. The result was a tad better than expected in many respects, with revenues in line, better than expected cost control, offset by higher-than-expected tax leading to a very modest NPAT miss.

## Divisional details

Updated disclosures, reflecting its current division of Technology, Business Automation, Acquiring, Alternative Payments, Banking Services and Issuing, and head office, provide us with a greater appreciation of the different growth rates and profitability within its businesses. While only one of these divisions, Alternative Payments, is currently generating a pre-tax profit, we expect that Issuing may be the next division to achieve profitability, potentially within the next year. In contrast, the two divisions awaiting licence approvals (and thus pre-revenue), Acquiring and Banking Services, may take longer to achieve profitability, although we believe Acquiring could receive a boost if Novatti is successful in engaging Reckon to integrate Novatti's payments functionality into its products. The ongoing impacts of COVID lockdowns are a wildcard and will distort performance.

## More licences in the next 3 months

Novatti's outlook included the aim to achieve its acquiring licences from Visa and Mastercard within the next month (i.e. September), and its ADI licence from APRA within the next three months (i.e. by the end of November). These additional licences are further barriers to entry by new fintech competitors, increasing the moat around Novatti's business. Novatti does not plan to stop there, seeking additional regulatory licences in the EU (e-Money) and Singapore (major payment institution) as it continues to globalise its payments infrastructure.

## Earnings and valuation changes

We lift our EPS estimates: FY22E: 21%, FY23E: 59%. These changes may appear large, but are off a small base, and represent estimates of slightly smaller losses. We also introduce our FY24E earnings forecasts for the first time, expecting Novatti to turn profitable after several years of heavy investment.

We value NOV at A\$0.86 (up from 80cps), using a DCF on free cash flows to equity with a cost of equity of 6.5%, referencing peer multiples to validate reasonableness. At the current share price, NOV is trading on 5.3x FY22 EV/revenue and 2.4x FY22 price to book, a considerable discount to its partner and peer comparative MQ. Full details are within.

# Novatti

Novatti is a leading digital banking and payment: fintech. It enables business to pay and be paid, from any device, anywhere. It does this by leveraging its 'ecosystem', which includes technology and platforms, extensive regulatory licences, and global commercial partnership.

Its services capture the entire payments value chain. This includes issuing, such as prepaid Visa cards acquiring, enabling merchants to accept payments from financial institutions, and processing, including cross-border transfers and automated invoicing.

Stock	NOV.ASX
Price	A\$0.515
Market cap	A\$155m
Valuation	A\$0.86

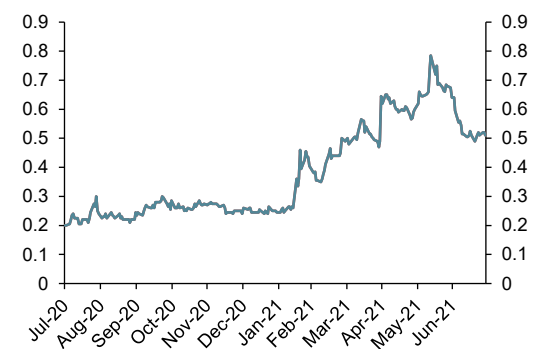
### Company data

Net cash:	~A\$26.3m
Shares on issue:	300.2m

### Next steps

FY21 result	August 2021
Visa and MC acquiring licences	September 2021
RADI licence approval	November 2021
AGM	November 2021

### NOV Share Price (A\$)



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# Financials

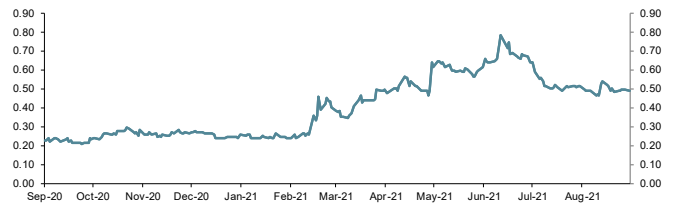
## NOVATTI GROUP LIMITED

**NOV-AU**

Year end 30 June, AUD unless otherwise noted

**MARKET DATA**

<b>Price</b>	\$	0.51
<b>Valuation</b>	\$	0.86
52 week high / low	\$	0.21 - 0.79
<b>Market capitalisation</b>	\$m	165.0
Shares on issue (basic)	m	323.5
Options / rights / ESP / LTIP	m	35.4
Other equity	m	0.4
Shares on issue (fully diluted)	m	359.3
Out of the money options	m	1

**12-MONTH SHARE PRICE PERFORMANCE**

**INVESTMENT FUNDAMENTALS**

		FY20A	FY21A	FY22E	FY23E	FY24E
Reported NPAT	\$m	(10.7)	(11.3)	(7.7)	(1.0)	1.3
<b>Underlying NPAT</b>	<b>\$m</b>	<b>(10.7)</b>	<b>(11.3)</b>	<b>(7.7)</b>	<b>(1.0)</b>	<b>1.3</b>
Reported EPS (diluted)	¢	(6.2)	(4.9)	(2.2)	(0.3)	0.4
<b>Underlying EPS (diluted)</b>	<b>¢</b>	<b>(6.2)</b>	<b>(4.9)</b>	<b>(2.2)</b>	<b>(0.3)</b>	<b>0.4</b>
...Growth	%	148%	(21%)	(54%)	(88%)	(229%)
<b>PER underlying</b>	<b>x</b>	<b>(8.2)</b>	<b>(10.4)</b>	<b>(22.7)</b>	<b>(186.3)</b>	<b>143.9</b>
Operating cash flow per share	¢	(0.7)	(2.4)	(1.4)	0.6	1.2
Free cash flow per share	¢	0.5	(3.8)	(7.4)	0.4	1.1
<b>Price to free cash flow per share</b>	<b>x</b>	<b>1.0</b>	<b>nm</b>	<b>nm</b>	<b>1.1</b>	<b>0.5</b>
FCF yield	%	1.0%	(7.5%)	(14.5%)	0.9%	2.1%

<b>Dividend</b>	¢	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Payout	%	0.0	0.0	0.0	0.0	0.0
<b>Yield</b>	<b>%</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Franking	%	0.0	0.0	0.0	0.0	0.0

<b>Enterprise value</b>	<b>\$m</b>	<b>168.0</b>	<b>161.1</b>	<b>141.2</b>	<b>139.5</b>	<b>135.7</b>
EV/Revenue	x	15.3	9.8	6.7	4.9	3.8
EV/Underlying EBITDA	x	-40.8	-30.9	-19.2	-2508.1	60.9
Book value per share	¢	-0.3	3.6	15.5	15.9	16.6
Price to book (NAV)	x	-339.8	18.5	3.2	3.2	3.0
Net tangible assets per share	¢	-3.3	1.6	14.0	14.4	15.1
Price to NTA	x	-26.7	42.2	3.6	3.5	3.3

**KEY RATIOS**

		FY20A	FY21A	FY22E	FY23E	FY24E
Net debt / (cash)	\$m	3.0	(3.9)	(23.8)	(25.5)	(29.3)
Interest cover (Operating NPAT / net interest)	x	(3.4)	(1.7)	(13.3)	(0.7)	3.2
Gearing (net debt / underlying EBITDA)	x	nm	0.7	3.2	457.6	nm
Leverage (net debt / (net debt + equity))	x	1.2	nm	nm	nm	nm

**DUPONT RATIOS**

		FY20A	FY21A	FY22E	FY23E	FY24E
Return on Assets	%	nm	nm	nm	nm	0.38
Financial Leverage	x	-67.6	7.2	2.8	4.3	6.2
<b>Return on Equity</b>	<b>%</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>2.37</b>

**GROWTH PROFILE**

		FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	%	30.7	49.8	28.1	34.4	27.1
Underlying EBITDA	%	86.9	26.5	41.3	(99.2)	Large
NPAT	%	165.4	5.5	(31.6)	(87.1)	(229.5)
Underlying Profit	%	165.4	5.5	(31.6)	(87.1)	(229.5)
Underlying EPS	%	147.8	(21.0)	(54.3)	(87.8)	(229.5)
DPS	%	n/a	n/a	n/a	n/a	n/a

**HALF YEARLY DATA**

		1H21A	2H21A	1H22E	2H22E	1H23E
<b>Revenue</b>	<b>\$m</b>	<b>7.4</b>	<b>9.1</b>	<b>9.8</b>	<b>11.3</b>	<b>13.4</b>
Other income	\$m	1.0	0.9	0.6	0.7	0.6
Cash expenses	\$m	-9.9	-13.7	-16.2	-13.6	-14.7
<b>Underlying EBITDA</b>	<b>\$m</b>	<b>-1.6</b>	<b>-3.6</b>	<b>-5.8</b>	<b>-1.5</b>	<b>-0.8</b>
EBITDA	\$m	-2.2	-4.1	-6.0	-1.7	-1.0
Depreciation, amortisation and impairment	\$m	-0.7	-0.7	-0.7	-0.7	-0.7
<b>EBIT</b>	<b>\$m</b>	<b>-2.9</b>	<b>-4.9</b>	<b>-6.8</b>	<b>-2.5</b>	<b>-1.7</b>
Associates and JVs	\$m	0.0	0.0	1.5	0.0	1.5
Net interest	\$m	-0.2	-4.3	-0.3	-0.3	-0.3
<b>PBT</b>	<b>\$m</b>	<b>-3.1</b>	<b>-9.1</b>	<b>-5.5</b>	<b>-2.8</b>	<b>-0.5</b>
Income tax	\$m	1.0	0.0	0.6	0.0	0.0
<b>NPAT</b>	<b>\$m</b>	<b>-2.2</b>	<b>-9.1</b>	<b>-4.9</b>	<b>-2.8</b>	<b>-0.5</b>

Source: Company reports and MST Access estimates

**PROFIT AND LOSS**

		FY20A	FY21A	FY22E	FY23E	FY24E
<b>Revenue</b>	<b>\$m</b>	<b>11.0</b>	<b>16.5</b>	<b>21.1</b>	<b>28.4</b>	<b>36.1</b>
Other income	\$m	0.8	1.9	1.3	1.3	1.3
Cash expenses	\$m	-16.0	-23.6	-29.8	-29.7	-35.2
<b>Underlying EBITDA</b>	<b>\$m</b>	<b>-4.1</b>	<b>-5.2</b>	<b>-7.4</b>	<b>-0.1</b>	<b>2.2</b>
EBITDA	\$m	-4.3	-6.3	-7.8	-0.5	1.8
Depreciation, amortisation and impairment	\$m	-3.9	-1.5	-1.5	-1.5	-1.5
<b>EBIT</b>	<b>\$m</b>	<b>-8.2</b>	<b>-7.8</b>	<b>-9.2</b>	<b>-1.9</b>	<b>0.3</b>
Associates and JVs	\$m	0.0	0.0	1.5	1.5	1.5
Net interest	\$m	-2.4	-4.5	-0.6	-0.6	-0.6
<b>PBT</b>	<b>\$m</b>	<b>-10.6</b>	<b>-12.2</b>	<b>-8.3</b>	<b>-1.0</b>	<b>1.3</b>
Income tax	\$m	0.0	0.9	0.6	0.0	0.0
<b>NPAT</b>	<b>\$m</b>	<b>-10.7</b>	<b>-11.3</b>	<b>-7.7</b>	<b>-1.0</b>	<b>1.3</b>

Weighted average diluted shares on issue m 171.3 228.8 342.8 363.7 363.7

**BALANCE SHEET**

		FY20A	FY21A	FY22E	FY23E	FY24E
Cash & equivalents	\$m	2.6	8.8	23.8	25.5	29.3
Trade & other receivables	\$m	2.8	4.1	4.4	4.7	4.9
Financial assets - funds in trust	\$m	17.5	39.0	82.0	160.8	271.7
Investments accounted for using the equity method	\$m	0.0	0.8	3.1	3.1	3.1
Other investments	\$m	0.9	1.0	1.0	1.0	1.0
Net Property Plant And Equipment	\$m	0.6	0.5	0.5	0.5	0.5
Right of use assets	\$m	2.2	1.9	1.9	1.9	1.9
Intangibles	\$m	5.7	5.0	5.0	5.0	5.0
Deposits	\$m	0.2	2.2	21.7	20.8	18.3
Other	\$m	0.4	0.3	0.3	0.3	0.3
<b>Total Assets</b>	<b>\$m</b>	<b>32.8</b>	<b>63.8</b>	<b>143.9</b>	<b>223.6</b>	<b>336.2</b>

Trade and other payables	\$m	5.9	6.8	7.2	7.7	8.1
Settlement and remittance funds payable	\$m	17.5	38.6	81.2	159.1	268.9
Lease liabilities	\$m	2.5	2.2	2.2	2.2	2.2
Unearned revenue	\$m	0.2	0.2	0.2	0.2	0.2
Convertible note facilities	\$m	5.6	4.9	0.0	0.0	0.0
Employee benefits	\$m	1.0	1.5	1.5	1.6	1.7
Other	\$m	0.6	0.6	0.6	0.6	0.6
<b>Total liabilities</b>	<b>\$m</b>	<b>33.3</b>	<b>54.9</b>	<b>93.0</b>	<b>171.5</b>	<b>281.8</b>
Net assets	\$m	-0.5	8.9	50.8	52.1	54.4

Contributed equity	\$m	26.7	44.1	87.1	87.1	87.1
Reserves	\$m	2.4	3.8	3.8	3.8	3.8
Retained earnings	\$m	-29.5	-41.0	-42.0	-40.7	-38.5
<b>Shareholder's equity</b>	<b>\$m</b>	<b>-0.5</b>	<b>8.9</b>	<b>50.8</b>	<b>52.1</b>	<b>54.4</b>

Basic shares on issue m 185.2 244.2 327.9 327.9 327.9

**CASH FLOW**

		FY20A	FY21A	FY22E	FY23E	FY24E
Net Income (Cashflow)	\$m	-11.0	-11.3	-7.7	-1.0	1.3
Depreciation & Amortization	\$m	0.9	1.5	1.5	1.5	1.5
Change in Net Operating Assets	\$m	2.5	-2.8	-0.7	-0.8	-0.8
Other Non-Cash Items, Total	\$m	6.3	5.2	2.3	2.3	2.3
Other	\$m	0.0	1.9	0.0	0.0	0.0
<b>Operating cash flow</b>	<b>\$m</b>	<b>-1.2</b>	<b>-5.4</b>	<b>-4.6</b>	<b>2.0</b>	<b>4.3</b>
Capital expenditure	\$m	-1.3	-2.4	2.7	-0.3	-0.3
Acquisitions/divestment/other	\$m	-0.2	-0.3	-23.3	0.0	0.0
<b>Investing cash flow</b>	<b>\$m</b>	<b>-1.5</b>	<b>-2.6</b>	<b>-20.6</b>	<b>-0.3</b>	<b>-0.3</b>
Equity	\$m	0.1	15.1	40.4	0.0	0.0
Debt (including convertible)	\$m	3.8	-0.4	0.0	0.0	0.0
Leases	\$m	-0.2	-0.3	-0.1	-0.1	-0.1
<b>Financing cash flow</b>	<b>\$m</b>	<b>3.7</b>	<b>14.4</b>	<b>40.2</b>	<b>-0.1</b>	<b>-0.1</b>
<b>Net cash flow</b>	<b>\$m</b>	<b>1.0</b>	<b>6.3</b>	<b>15.0</b>	<b>1.6</b>	<b>3.9</b>
Free cash flow	\$m	0.8	-8.7	-25.3	1.6	3.9

Source: Company reports and MST Access estimates

## Result Analysis

### Outlook commentary

Figure 1 –Outlook guidance

## What to expect in FY22

- Main ambition – grow top line revenue
- \$40m+ capital raising enables Novatti to expand its growth strategy:
  - Increase presence in existing markets
  - Enter new markets (and replicate ecosystem model)
  - Pursue a range of acquisition opportunities
- Open opportunities to explore synergies with Reckon
- Aiming for Visa and Mastercard Acquiring Licences before end of September 2021
- Aiming to achieve restricted banking licence approval before end of November 2021

Source: Company reports

In respect of entering new markets, Novatti is applying for an e-money licence in the EU and a major payment institution licence in Singapore, as it looks to build out its global network of licences to replicate the success it has achieved in New Zealand with Afterpay, leveraging its existing assets and relationships.

### Actual result vs prior estimates

Figure 2 –Actual result vs prior estimates

PROFIT AND LOSS		FY21E	FY21A	Difference	Difference %
<b>Revenue</b>	<b>\$m</b>	<b>16.5</b>	<b>16.5</b>	<b>0.0</b>	<b>0%</b>
Other income	\$m	0.0	1.9	1.9	39871%
Cash expenses	\$m	-23.1	-23.7	-0.6	-3%
<b>Underlying EBITDA</b>	<b>\$m</b>	<b>-6.7</b>	<b>-5.3</b>	<b>1.4</b>	<b>21%</b>
EBITDA	\$m	-9.6	-8.9	0.8	8%
Depreciation, amortisation and impairment	\$m	-1.5	-1.5	0.0	0%
<b>EBIT</b>	<b>\$m</b>	<b>-11.1</b>	<b>-10.4</b>	<b>0.8</b>	<b>7%</b>
Associates and JVs	\$m	0.0	0.0	0.0	46%
Net interest	\$m	-1.8	-1.5	0.3	16%
<b>PBT</b>	<b>\$m</b>	<b>-12.9</b>	<b>-11.8</b>	<b>1.1</b>	<b>8%</b>
Income tax	\$m	1.9	0.0	-2.0	-101%
<b>NPAT</b>	<b>\$m</b>	<b>-11.0</b>	<b>-11.8</b>	<b>-0.9</b>	<b>-8%</b>
Adjustments	\$m	0.0	0.0	0.0	n.a.
<b>Underlying Profit</b>	<b>\$m</b>	<b>-11.0</b>	<b>-11.8</b>	<b>-0.9</b>	<b>-8%</b>
Weighted average diluted shares on issue	m	244.6	228.8	-15.7	-6%
<b>Underlying EPS (diluted)</b>	<b>¢</b>	<b>(4.5)</b>	<b>(5.2)</b>	<b>(0.7)</b>	<b>-16%</b>

Source: Company reports, MST Access estimates

## Earnings estimate changes

Following Novatti's FY21 result, we make the following changes to our earnings estimates for NOV:

Figure 3 – Earnings estimates for Novatti

		FY22E			FY23E		
		Old	New	% chg	Old	New	% chg
Revenue	A\$m	23.9	21.1	-11.5%	23.9	28.4	19.0%
Underlying							
EBITDA	A\$m	-9.6	-7.4	23.0%	-1.5	-0.1	96.3%
EBIT	A\$m	-11.4	-9.2	19.2%	-3.4	-1.9	42.5%
Profit before tax	A\$m	-10.5	-8.3	21.0%	-2.4	-1.0	59.2%
NPAT (reported)	A\$m	-9.9	-7.7	22.3%	-2.4	-1.0	59.2%
EPS (underlying)	cps	-2.9	-2.2	21.5%	-0.7	-0.3	58.6%
EPS (reported)	cps	-2.9	-2.2	21.5%	-0.7	-0.3	58.6%
DPS	cps	0.0	0.0	n.a.	0.0	0.0	n.a.

Source: Company reports, MST Access estimates

These changes reflect:

- Novatti's FY21 result modestly altering our starting points for FY22.
- Remodelling Novatti's divisions to reflect its revised divisional disclosures, including changing our divisional growth rate assumptions.

## Valuation

We value NOV at A\$0.80 per share using a DCF of free cash flow to equity forecasting out 7 years before applying a terminal value. We assume a cost of equity of 6.5% and a terminal growth rate of 3%.

Figure 4 – MST Access valuation of Novatti

Current date	1-Sep-21																
Next balance date	30-Jun-21																
		Jun-21	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26	Dec-26	Jun-27	Dec-27	Jun-28	
Free cash flow to equity	A\$m	-6.0	-23.3	-2.1	1.4	0.2	2.8	1.1	3.3	1.5	4.9	3.3	6.1	4.7	7.9	6.9	
Discounted cash flow	A\$m	0.0	-22.8	-2.0	1.3	0.2	2.4	0.9	2.7	1.2	3.7	2.5	4.4	3.2	5.3	4.5	
Sum of discount streams	A\$m	7.4		<b>CAPM</b>													
Future value into perpetuity	A\$m	423.0		Risk free rate			2.00%										
NPV of terminal value	A\$m	275.2		Equity beta			1.5										
add adjusted net cash	A\$m	26.3		Equity risk premium			3.00%										
<b>Value of total equity</b>	<b>A\$m</b>	<b>308.9</b>		Cost of equity			6.5%										
Diluted shares on issue	m	359.3															
<b>Value per share</b>	<b>A\$</b>	<b>0.86</b>		Terminal growth			3.0%										

Source: Company reports, MST Access estimates

## Comparative Multiples

We also consider the trading multiples of a range of peers across the multiple industries in which NOV operates as reference for potential price to book and price to NTA multiples that NOV might trade on.

While Novatti currently has its primary industry classification as application service provider under software, we believe a more appropriate industry classification could be:

- internet merchant services within the information technology sector, which encompasses payment processors, payment service providers and gateways, and payment wallets, or
- electronic funds transfer and transaction services within specialised finance.

Using these industry classifications we table below a more appropriate peer group from which to compare Novatti.

Refining these screens deliver the peers and respective multiples in Figure 5.

Figure 5 – Selected Peer Valuation Multiples sorted by EV/1 year forward revenue

Company Name	EV/Forward Revenue	EV/Forward EBITDA	Forward P/E
Marqeta, Inc. (NasdaqGS:MQ)	26.1x	NM	NM
Visa Inc. (NYSE:V)	17.9x	25.2x	33.5x
Mastercard Incorporated (NYSE:MA)	16.9x	28.1x	37.3x
PayPal Holdings, Inc. (NasdaqGS:PYPL)	11.9x	41.9x	56.9x
Network International Holdings plc (LSE:NETW)	7.9x	18.8x	38.8x
Amadeus IT Group, S.A. (BME:AMS)	7.1x	21.7x	56.3x
Fidelity National Information Services, Inc. (NYSE:FIS)	6.7x	14.9x	18.0x
Payfare Inc. (TSX:PAY)	6.7x	70.3x	NM
Paymentus Holdings, Inc. (NYSE:PAY)	6.5x	101.1x	NM
Square, Inc. (NYSE:SQ)	6.4x	109.5x	138.2x
Fiserv, Inc. (NasdaqGS:FISV)	5.9x	14.7x	19.7x
Paysafe Limited (NYSE:PSFE)	5.0x	15.3x	123.7x
Worldline SA (ENXTPA:WLN)	4.8x	17.9x	27.8x
PayPoint plc (LSE:PAY)	4.6x	9.4x	13.8x
The Western Union Company (NYSE:WU)	2.1x	7.8x	9.9x
<b>International peer average</b>	<b>9.1x</b>	<b>35.5x</b>	<b>47.8x</b>
Tyro Payments Limited (ASX:TYR)	5.7x	69.1x	NM
Smartpay Holdings Limited (NZSE:SPY)	4.1x	18.8x	NM
EML Payments Limited (ASX:EML)	0.1x	0.2x	51.3x
<b>Australian peer average</b>	<b>9.9x</b>	<b>88.1x</b>	<b>51.3x</b>
<b>Novatti Group Limited (ASX:NOV)</b>	<b>6.7x</b>	<b>NM</b>	<b>NM</b>

Source: IBES, Capital IQ, MST Access estimates

With Novatti being the Australian partner for Marqeta, we see that as its main peer, despite it being the most expensive of our peer group, trading on 26.1x 1 year forward revenue. In comparison, on our forecasts Novatti is trading on 6.7x EV/FY22 revenue.

## Company Description

Novatti is a leading digital banking and payments fintech. It provides services that enable financial transactions to take place digitally, on any device, anywhere. It does this by leveraging its 'ecosystem', which includes technology and platforms, extensive regulatory licences, and global commercial partnership.

Its services capture the entire payments value chain. This includes issuing, such as prepaid Visa cards, acquiring, enabling merchants to accept payment from financial institutions, and processing, including cross-border transfers and automated invoicing.

Novatti holds all necessary regulatory licences and registrations, including an Australian Financial Services Licence (No 448066) through its subsidiary Flexewallet Pty Ltd, registration in New Zealand as a Financial Services Provider (FSP613789) through subsidiary Flexewallet (NZ) Limited, is registered with AUSTRAC as a Remittance Network Provider, and has applied to APRA for a restricted banking licence through its subsidiary Novatti IBA Pty Ltd.

## Updated Investment thesis

With a moat provided by a trifecta of technology, licences and partnerships difficult to replicate, the ability of new entrants to join the payments industry is limited. This barrier to entry has led many existing payments providers to rest on their laurels, which Novatti is taking advantage of through its innovative offerings for digital payments.

Novatti provides investors with exposure to several fast growing areas of the banking and payments industry:

- Through investing in fintech start-ups and providing underlying payment technologies for these start-ups.
- By participating in segments of the payments industry that have seen traditional, major financial institutions become uncompetitive due to tech disruption, including general payments and also transfers and card payments for gambling companies and remittance payments.

We expect that Novatti's strong revenue growth will continue into the foreseeable future. This should see revenues rise sufficiently to lift the group to profitability within the next few years.

## Key Risks and Sensitivities

### Macroeconomic impacts

Key influences on our valuation include:

- Economic conditions, influencing exchange rates, interest rates, inflation and bad debts.
- Equity and debt markets, influencing investment returns and risk premiums.

NOV has a direct sensitivity, and an indirect sensitivity to economic conditions and financial markets and their associated risks, including liquidity, price/volatility, credit, counterparty, and duration. We discuss these briefly below, and in more detail later in the report.

The direct sensitivity is quantifiable, driven by its payments businesses, with earnings increasing and decreasing with transaction volumes. Exchange rates can vary these volumes, and lead to considerable volatility of profit.

The indirect sensitivity is potentially more significant, yet harder to quantify. Business confidence, consumer confidence and market conditions play a significant influence on lending demand, while immigration can have a significant impact on foreign investment and FX flows.

### Regulatory Requirements

As a Financial Institution, Novatti is subject to a significant number of regulatory requirements, and could suffer from adverse changes to the requirements, including in Australia:

- Anti-money laundering and counter terrorist financing requirements administered by Austrac;
- Authorised Deposit Institution regulation administered by the Australian Prudential Regulatory Authority;
- Foreign Investment restrictions administered by the Foreign Investment Review Board;
- Privacy requirements administered by the Privacy Commissioner;
- Financial Service licencing and Credit licencing requirements administered by the Australian Securities and Investments Commission (ASIC);
- Australian Consumer Law and unfair contract terms contained in the Corporations Act administered by the Australian Competition and Consumer Commission (ACCC);
- Restrictions on merchant pricing, or interchange fees, administered by the Reserve Bank of Australia (RBA) leading to fee compression;
- Taxation legislation administered by the Australian Taxation Office (ATO);
- Accounting standards required under the Corporations Act administered by the Australian Accounting Standards Board (AASB) and ASIC;
- Design and distribution obligations, several of which will be governed by contract law.

Of these, we would call out a couple of specific risks we see Novatti facing due to this regulatory framework:

- Novatti needs to keep ownership by any single foreign shareholder below 20% in order to be considered an Australian institution. Several of its investments, including its yet-to-be-licenced banking subsidiary, sit right on this threshold. Any investor over this 20% threshold needs to meet APRA's fit and proper test. This may limit its ability to raise additional finance in excess of pro-rata rights to Australian investors unless it seeks the Treasurer's approval.
- As a payment processor, Novatti has substantial regulatory compliance requirements, including with AML/CTF regulations, APRA and ASIC requirements. Failure to comply could see the company face civil and criminal prosecution, substantial fines, and potentially the loss of key licenses enabling it to operate various services.

Ultimately a significant proportion of NOV's success will be determined by the human capital within the business, therefore NOV's ability to attract and retain talent is fundamental to its long-term success as it will drive innovation across the Group.

All key management are highly aligned with shareholdings and sizeable option packages. NOV has a quality management team that is highly aligned to the future success of the business. We see this a fundamental to any business with significant growth ambitions.

### Growing pains

The challenge of managing explosive growth – including hiring people with appropriate qualifications, experience and background clearances while maintaining the company's culture, training staff to have an in depth knowledge of the company's products and features, scaling fixed infrastructure and managing customer and investor expectations can be challenging, and there are many examples where problems have emerged because growth has occurred faster than management has been able to suitably manage it. It's a high-quality problem to have, but can lead to missed expectations.

Under this category we would also include execution risks around its plans to cross sell into Reckon's customer base given the lack of prior notice to Reckon prior to acquiring a 19.9% strategic stake

### Reputational risks

Reputational risks could threaten Novatti's entire business model and social license to operate. As a payments' provider, should a prolonged disruption occur at Novatti or with its partners (as happened early this calendar year to Tyro Payments), leading to a loss of customer and/or investor confidence, this could in turn threaten its financial viability.

### Technology Changes

In addition to continued product development, Novatti will be required to also stay abreast of emerging technology platforms, competitors, and disruptions in order to take advantage of new payment methods and/or protect against direct impacts to its capabilities. Furthermore, its service offering relies on a handful of external software and hardware vendors which contribute to its capabilities, and adverse changes to the products provided by these vendors could lead to Novatti needing to impair intangible assets related to functionality or features.

### Market & Shareholder Support

As a listed company, Novatti is hostage to market conditions. In volatile markets, this can result in a lack of liquidity; which can lead to volatile trading where the shares trade at prices significantly diverged from their intrinsic value.

While our modelling suggests that NOV is likely to improve its cash position; there is a risk that should the company identify an additional high growth market it wishes to address, it might seek additional capital from the financial markets. We consider it unlikely that the company would seek to dilute existing shareholders in order to acquire additional businesses, and any acquisition is likely to instead be assessed by management as highly accretive over the long term.

The level of the company's share price is likely to also influence the approach management takes to growing the company. When the company trades on high revenue multiples, and capital is cheap, this incentivises management to aggressively chase further growth, potentially raising capital to fund investments to achieve this growth. Lower revenue multiples provide less incentive to aggressively chase sales growth. As a payments company, a large proportion of expenses are largely fixed, so greater revenue growth translates rapidly into improving operational leverage.

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