

## Continuing to set new records

Novatti delivered yet another record quarter for cashflows in its 1Q22 and quarterly activities update, with its processing revenue more than doubling year on year, and strong performance in its other business divisions. Depending on the metric, these are now the 10<sup>th</sup> or 11<sup>th</sup> quarter of growth, highlighting the momentum within its businesses.

## Cash runway likely longer than stated

While Novatti disclosed a comfortable 4.6 quarters of cash based on its 31 December cash balance and its burn rate during the December quarter, we think its cash position is stronger than this calculation suggests.

There are a couple of adjustments we make, detailed inside including its recently completed acquisition of ATX, to roll forward Novatti's cash burn in order to get a clearer picture of Novatti's cash position able to fund its business.

This suggests cash on hand is more likely over 6 quarters of runway, similar to last quarter, which should be more than adequate for the company to grow into profitability. With continued M&A ambitions, the company might return to market to raise equity for the right strategic acquisition.

## Visa and Apple risks emerging

In line with Novatti's view of "cash to cashless", innovations such as the forthcoming Visa Acceptance Cloud and Apple's plans to facilitate payment acceptance via NFC chips in its smartphones, will further evolve payments. While this may expose potential downside risks for Novatti, opportunities for Novatti to build out its ecosystem and partnerships with global players such as Visa and Apple have become more attractive with recent market falls.

## A big month ahead

As well as its 1H22 result, Novatti appears set to receive its banking licence or return the Series A funding at the end of the month it had raised to fund its banking venture. Discussions with Reckon to integrate payments into its product and hence provide Novatti with access to its customer base are ongoing and may present further upside when completed.

## Earnings and valuation changes

Due to higher revenue growth and higher expenses we change our EPS estimates: FY22E: -11%, FY23E: -5%, FY24E: 3%. We value NOV at A\$1.00 (was A\$1.15ps), using a DCF on free cash flows to equity with a cost of equity of 7.0%, referencing peer multiples to validate reasonableness.

# Novatti

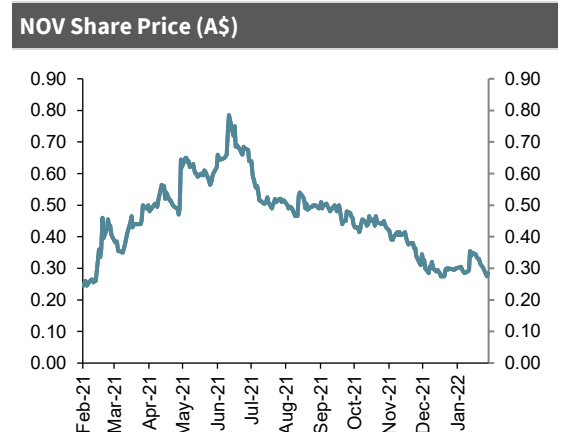
Novatti is a leading digital banking and payments fintech. It enables business to pay and be paid, from any device, anywhere. It does this by leveraging its 'ecosystem', which includes technology and platforms, extensive regulatory licences, and global commercial partnership.

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

Stock	NOV.ASX
Price	A\$0.295
Market cap	A\$99m
Valuation	A\$1.00

Company data	
Net cash:	~A\$12.8m
Shares on issue:	335.3m

Next steps	
1H22 result	Late Feb 2022
Series A funding deadline for restricted banking licence	28 February 2022
3Q22 Cashflows	Late April 2022



Glen Wellham, Senior Research Analyst

# Financials

## NOVATTI GROUP LIMITED

NOV-AU

Year end 30 June, AUD unless otherwise noted

### MARKET DATA

Price	\$	0.295
Valuation	\$	1.00
52 week high / low	\$	0.24 - 0.79
Market capitalisation	\$m	98.9
Shares on issue (basic)	m	335.3
Options / rights / ESP / LTIP	m	31.0
Other equity	m	4.0
Shares on issue (fully diluted)	m	370.3
Out of the money options	m	8

### 12-MONTH SHARE PRICE PERFORMANCE



### INVESTMENT FUNDAMENTALS

	FY20A	FY21A	FY22E	FY23E	FY24E
Reported NPAT	\$m (10.7)	(11.3)	(9.5)	(0.3)	1.0
<b>Underlying NPAT</b>	<b>\$m (10.7)</b>	<b>(11.3)</b>	<b>(9.5)</b>	<b>(0.3)</b>	<b>1.0</b>
Reported EPS (diluted)	¢ (6.2)	(4.9)	(2.8)	(0.1)	0.3
<b>Underlying EPS (diluted)</b>	<b>¢ (6.2)</b>	<b>(4.9)</b>	<b>(2.8)</b>	<b>(0.1)</b>	<b>0.3</b>
...Growth	% 148%	(21%)	(42%)	(97%)	(382%)
<b>PER underlying</b>	<b>x (4.7)</b>	<b>(6.0)</b>	<b>(10.4)</b>	<b>(305.6)</b>	<b>108.5</b>
Operating cash flow per share	¢ (0.7)	(2.4)	(1.8)	0.8	1.2
Free cash flow per share	¢ 0.5	(3.8)	(9.2)	(0.4)	(0.0)
<b>Price to free cash flow per share</b>	<b>x 0.6</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>
FCF yield	% 1.7%	(12.9%)	(31.1%)	(1.3%)	(0.1%)

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

<b>Enterprise value</b>	\$m	102.0	95.0	80.6	82.0	82.2
EV/Revenue	x	9.3	5.8	2.9	2.0	1.5
EV/Underlying EBITDA	x	-24.7	-18.2	-8.5	253.1	50.1

Book value per share	¢	-0.3	3.6	15.8	16.1	17.1
Price to book (NAV)	x	-203.7	11.1	1.9	1.9	1.8
Net tangible assets per share	¢	-3.3	1.6	14.3	14.6	15.5
Price to NTA	x	-16.0	25.3	2.1	2.1	2.0

### KEY RATIOS

	FY20A	FY21A	FY22E	FY23E	FY24E
Net debt / (cash)	\$m 3.0	(3.9)	(18.3)	(16.9)	(16.7)
Interest cover (Operating NPAT / net interest)	x (3.4)	(1.7)	(16.5)	0.4	2.7
Gearing (net debt / underlying EBITDA)	x nm	0.7	1.9	nm	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	0.04
Financial Leverage	x -67.6	7.2	2.8	26.8	42.0
<b>Return on Equity</b>	% nm	nm	nm	nm	1.75

### GROWTH PROFILE

	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	% 30.7	49.8	70.9	47.3	27.9
Underlying EBITDA	% (86.9)	(26.5)	(81.9)	103.4	405.7
NPAT	% (165.4)	(5.5)	15.2	96.4	381.6
Underlying Profit	% (264.5)	(9.5)	34.7	324.4	1,361.9
Underlying EPS	% (147.8)	21.0	42.3	96.6	381.6
DPS	% n/a	n/a	n/a	n/a	n/a

### HALF YEARLY DATA

	1H21A	2H21A	1H22E	2H22E	1H23E
<b>Revenue</b>	\$m 7.4	9.1	11.9	16.3	19.2
Other income	\$m 1.0	0.9	0.6	0.7	0.6
Cash expenses	\$m -9.9	-13.7	-20.2	-18.7	-20.1
<b>Underlying EBITDA</b>	<b>\$m -1.6</b>	<b>-3.6</b>	<b>-7.8</b>	<b>-1.7</b>	<b>-0.4</b>
EBITDA	\$m -2.2	-4.1	-8.0	-1.9	-0.6
Depreciation, amortisation and impairment	\$m -0.7	-0.7	-0.7	-0.7	-0.7
<b>EBIT</b>	<b>\$m -2.9</b>	<b>-4.9</b>	<b>-8.7</b>	<b>-2.7</b>	<b>-1.3</b>
Associates and JVs	\$m 0.0	0.0	0.9	0.9	0.9
Net interest	\$m -0.2	-4.3	-0.3	-0.3	-0.3
<b>PBT</b>	<b>\$m -3.1</b>	<b>-9.1</b>	<b>-8.1</b>	<b>-2.1</b>	<b>-0.7</b>
Income tax	\$m 1.0	0.0	0.6	0.0	0.0
<b>NPAT</b>	<b>\$m -2.2</b>	<b>-9.1</b>	<b>-7.5</b>	<b>-2.1</b>	<b>-0.7</b>

Source: Company reports and MST Access estimates

### PROFIT AND LOSS

	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Revenue</b>	<b>\$m 11.0</b>	<b>16.5</b>	<b>28.2</b>	<b>41.5</b>	<b>53.1</b>
Other income	\$m 0.8	1.9	1.3	1.3	1.3
Cash expenses	\$m -16.0	-23.6	-38.9	-42.4	-52.7
<b>Underlying EBITDA</b>	<b>\$m -4.1</b>	<b>-5.2</b>	<b>-9.5</b>	<b>0.3</b>	<b>1.6</b>
EBITDA	\$m -4.3	-6.3	-9.9	-0.1	1.2
Depreciation, amortisation and impairment	\$m -3.9	-1.5	-1.5	-1.5	-1.5
<b>EBIT</b>	<b>\$m -8.2</b>	<b>-7.8</b>	<b>-11.4</b>	<b>-1.6</b>	<b>-0.2</b>
Associates and JVs	\$m 0.0	0.0	1.8	1.8	1.8
Net interest	\$m -2.4	-4.5	-0.6	-0.6	-0.6
<b>PBT</b>	<b>\$m -10.6</b>	<b>-12.2</b>	<b>-10.1</b>	<b>-0.3</b>	<b>1.0</b>
Income tax	\$m 0.0	0.9	0.6	0.0	0.0
<b>NPAT</b>	<b>\$m -10.7</b>	<b>-11.3</b>	<b>-9.5</b>	<b>-0.3</b>	<b>1.0</b>

Weighted average diluted shares on issue	m	171.3	228.8	336.6	356.9	356.9
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### BALANCE SHEET

	FY20A	FY21A	FY22E	FY23E	FY24E
Cash & equivalents	\$m 2.6	8.8	18.3	16.9	16.7
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	1,355.3	2,290.4
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	27.9	17.2	10.9
Other	\$m 0.2	0.3	0.3	0.3	0.3
<b>Total Assets</b>	<b>\$m 32.8</b>	<b>63.8</b>	<b>144.5</b>	<b>1,405.9</b>	<b>2,334.8</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	1,341.0	2,266.3
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 33.3</b>	<b>54.9</b>	<b>93.0</b>	<b>1,353.4</b>	<b>2,279.3</b>
Net assets	\$m -0.5	8.9	51.5	52.5	55.6

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	-41.4	-40.4	-37.3
<b>Shareholder's equity</b>	<b>\$m -0.5</b>	<b>8.9</b>	<b>51.5</b>	<b>52.5</b>	<b>55.6</b>

Basic shares on issue	m	185.2	244.2	325.5	325.5	325.5
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### CASH FLOW

	FY20A	FY21A	FY22E	FY23E	FY24E
Net Income (Cashflow)	\$m -11.0	-11.3	-9.5	-0.3	1.0
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	2.6	2.6	2.6
Other	\$m 0.0	1.9	0.0	0.0	0.0
<b>Operating cash flow</b>	<b>\$m -1.2</b>	<b>-5.4</b>	<b>-6.2</b>	<b>2.9</b>	<b>4.2</b>
Capital expenditure	\$m -1.3	-2.4	2.7	-0.3	-0.3
Acquisitions/divestment/other	\$m -0.2	-0.3	-27.3	-4.0	-4.0
<b>Investing cash flow</b>	<b>\$m -1.5</b>	<b>-2.6</b>	<b>-24.5</b>	<b>-4.2</b>	<b>-4.2</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 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 1.0</b>	<b>6.3</b>	<b>9.5</b>	<b>-1.4</b>	<b>-0.1</b>
Free cash flow	\$m 0.8	-8.7	-30.9	-1.4	-0.1

## Earnings estimate changes

Following Novatti's December 2021 quarter activities report and cashflows, we make the following changes to our earnings estimates for NOV:

Figure 1 –Earnings estimates for Novatti

		FY22E			FY23E			FY24E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	A\$m	28.0	28.2	0.7%	39.7	41.5	4.5%	50.8	53.1	4.4%
Underlying EBITDA	A\$m	-8.5	-9.5	-11.2%	0.3	0.3	-4.8%	2.6	1.6	-37.2%
EBIT	A\$m	-10.4	-11.4	-9.1%	-1.5	-1.6	-1.1%	0.7	-0.2	-133.2%
Profit before tax	A\$m	-9.2	-10.1	-10.3%	-0.3	-0.3	-5.0%	1.9	1.0	-50.0%
NPAT (reported)	A\$m	-8.6	-9.5	-11.1%	-0.3	-0.3	-5.0%	0.9	1.0	3.0%
EPS (underlying)	cps	-2.6	-2.8	-11.1%	-0.1	-0.1	-5.0%	0.3	0.3	3.0%
EPS (reported)	cps	-2.6	-2.8	-11.1%	-0.1	-0.1	-5.0%	0.3	0.3	3.0%
DPS	cps	0.0	0.0	n.a.	0.0	0.0	n.a.	0.0	0.0	n.a.

Source: Company reports, MST Access estimates

These changes reflect:

- Slightly lower revenues for the half than previously forecast.

Our revised forecasts are presented above. Novatti recently completed the acquisition of ATX. The revenue from this acquisition was previously incorporated into our forecasts in our earlier 1Q22 note.

## Valuation

We value NOV at A\$1.00 per share (down from \$1.15 ps) 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 7% (was 6.5%) and a terminal growth rate of 3%.

Figure 2 –MST Access valuation of Novatti

Current date		2-Feb-22													
Next balance date		31-Dec-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
<b>Free cash flow to equity</b>	<b>A\$m</b>	<b>-30.4</b>	<b>-0.5</b>	<b>-3.3</b>	<b>1.9</b>	<b>-2.9</b>	<b>2.7</b>	<b>2.2</b>	<b>3.7</b>	<b>4.4</b>	<b>5.4</b>	<b>6.5</b>	<b>7.9</b>	<b>9.6</b>	<b>11.9</b>
<b>Discounted cash flow</b>	<b>A\$m</b>	<b>-30.6</b>	<b>-0.5</b>	<b>-3.1</b>	<b>1.7</b>	<b>-2.5</b>	<b>2.3</b>	<b>1.8</b>	<b>3.0</b>	<b>3.4</b>	<b>4.0</b>	<b>4.7</b>	<b>5.5</b>	<b>6.5</b>	<b>7.8</b>
Sum of discount streams	A\$m	3.9		<b>CAPM</b>											
Future value into perpetuity	A\$m	545.8		Risk free rate		2.00%									
NPV of terminal value	A\$m	354.9		Equity beta		1.5									
add adjusted net cash	A\$m	12.8		Equity risk premium		3.30%									
<b>Value of total equity</b>	<b>A\$m</b>	<b>371.6</b>		Cost of equity		7.0%									
Diluted shares on issue	m	370.3													
<b>Value per share</b>	<b>A\$</b>	<b>1.00</b>		Terminal growth		3.0%									

Source: Company reports, MST Access estimates

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 the more appropriate industry classifications are:

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

We believe these industry classifications deliver a more appropriate peer group with which to compare Novatti.

Refining these screens deliver the peers and respective multiples in the following figure.

Figure 3 – Selected comparable companies multiples

Identifier (RIC)	Company Name	Market Cap US\$m	P/B	P/NTA	Price/Sales	Forward Price / Sales (FY1)
NOV.AX	Novatti Group Ltd	51	10.57	37.80	4.17	
EML.AX	EML Payments Ltd	751	2.59	16.59	5.56	
SMP.AX	SmartPay Holdings Ltd	121	5.46	67.48	4.28	
TYR.AX	Tyro Payments Ltd	801	6.34	28.80	4.87	
SQ	Block Inc	50,916	17.19	23.43	3.45	7.01
MQ.O	Marqeta Inc	5,688	3.61	3.61	12.51	
V	Visa Inc	478,074	14.41	-45.02	23.39	17.63
MA	Mastercard Inc	375,838	51.27	-93.23	20.09	16.70
PYPL.O	PayPal Holdings Inc	192,125	8.69	16.36	7.91	11.70
AMA.MC	Amadeus IT Group SA	29,647	7.22	-6.87	11.40	9.14
NETW.L	Network International Holdings PLC	1,908	3.67	27.59	6.05	7.76
FIS	Fidelity National Information Services Inc	71,489	1.52	-3.43	5.41	5.94
PAY.TO	Payfare Inc	215	5.89	5.99	8.94	
FISV.O	Fiserv Inc	69,252	2.19	-3.65	4.49	4.87
WEX	WEX Inc	6,993	3.79	-2.54	3.98	
PSFE.K	Paysafe Ltd	2,475	1.00	-1.11	0.98	
PAYP.L	PayPoint plc	606	5.61	-25.03	3.30	
WLN.PA	Worldline SA	13,187	1.22	-2.57	3.02	4.73
WU	Western Union Co	7,574	20.63	-3.61	1.53	

Source: IBES, Refinitiv

With Novatti being the Australian partner for Marqeta, we see that as its main peer, trading on 12.5x last year's sales. In comparison, on our forecasts Novatti is trading on 4.2x.

## Quarterly Activities Report and Appendix 4C Cashflow Analysis

### Outlook commentary highlights key upcoming catalysts for the stock

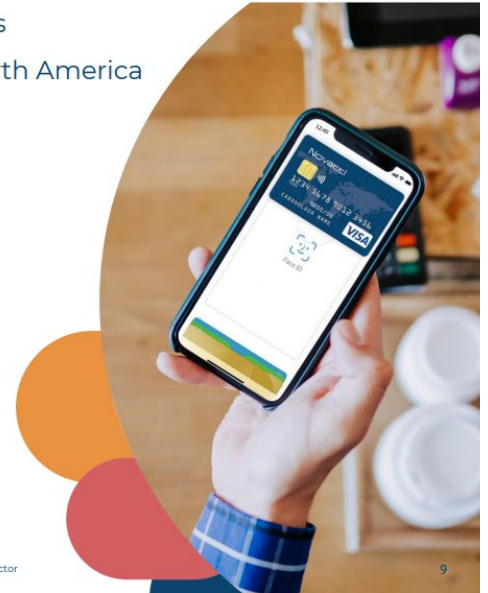
Novatti offered the following outlook commentary as part of a presentation alongside its quarterly activities report, suggesting some key upcoming catalysts for the stock over during the remainder of its financial year.

Figure 4 –Novatti Outlook

## Outlook

- Many years of investment and development seeing results
- Leverage global operations – Australasia, Asia, Europe, North America
- Grow topline revenue by delivering on growth strategy:
  1. New and expanded markets
    - Continue to promote and leverage ecosystem globally
    - Accelerate customer development for acquiring business
    - Finalise restricted banking licence approvals
  2. Acquisitions
    - Assessing other opportunities in pipeline
  3. Strategic investment in Reckon
    - Continue discussions on servicing the needs of Reckon’s customers

Novatti



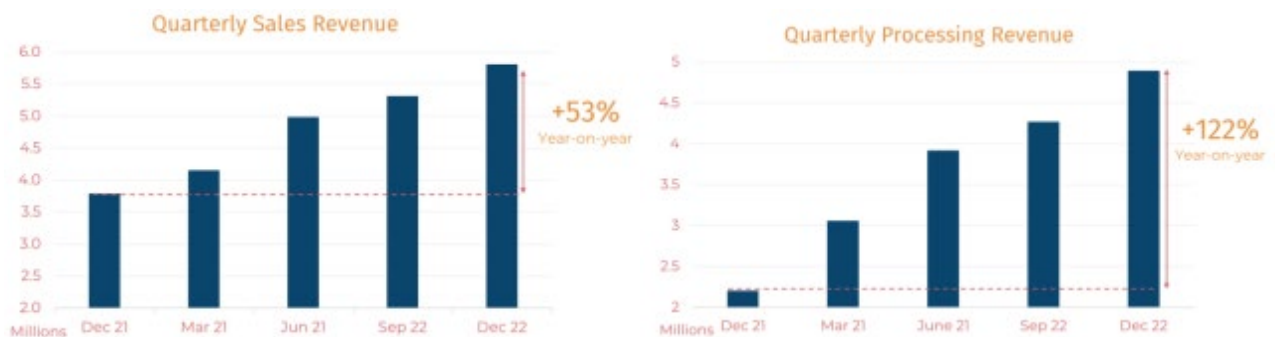
This presentation has been approved for release to the ASX by Peter Cook, Managing Director  
[www.novatti.com](http://www.novatti.com)

Source: Company reports, MST Access estimates

## Record 2Q22 revenue

Novatti achieved record revenues again in 2Q22, with sales revenues hitting \$5.8m, with the compound growth quarter on quarter becoming increasingly clear. Payment processing revenues now account for ~85% of quarterly revenues, with \$4.9m achieved in the quarter, more than doubling on pcp. If this trend continues, Novatti will likely be reclassified as a payments processor; however other investments, such as a potential partnership with Reckon and its banking associate gaining its banking licence, may gain traction in the interim, preventing this from occurring. The completion of the acquisition of ATX in mid-January will deliver further growth in coming quarters, plus should Novatti’s discussions with Reckon prove fruitful, they will deliver further processing revenue growth, suggesting that this rapid pace of growth may actually accelerate in coming quarters.

Figure 5 –Novatti quarterly revenue trends



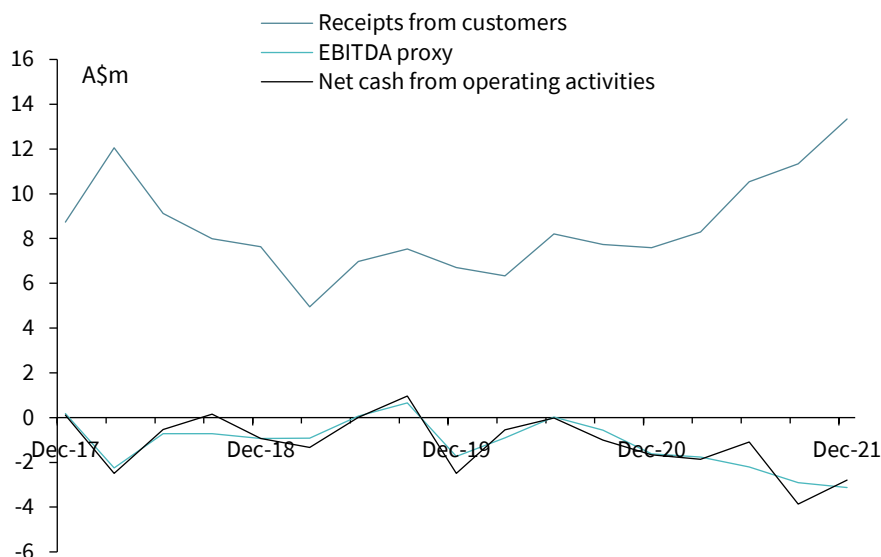
Source: Company reports

## Cash receipts continue to rise

While continuing to operate at a manageable operating cashflow deficit, smaller than last quarter’s, the company’s receipts from customers continued to climb over the past quarter. While the accounting treatment for prepaid cards disrupts the direct relationship between revenues and receipts from customers (and also explains why it is more than

twice revenues with likely seasonality associated with Christmas), it is positive to see. The closure of the gap in 2Q22 between our EBITDA proxy and Novatti’s net cash from operating activities further suggests potential timing issues, likely around temporary movements in its cash float.

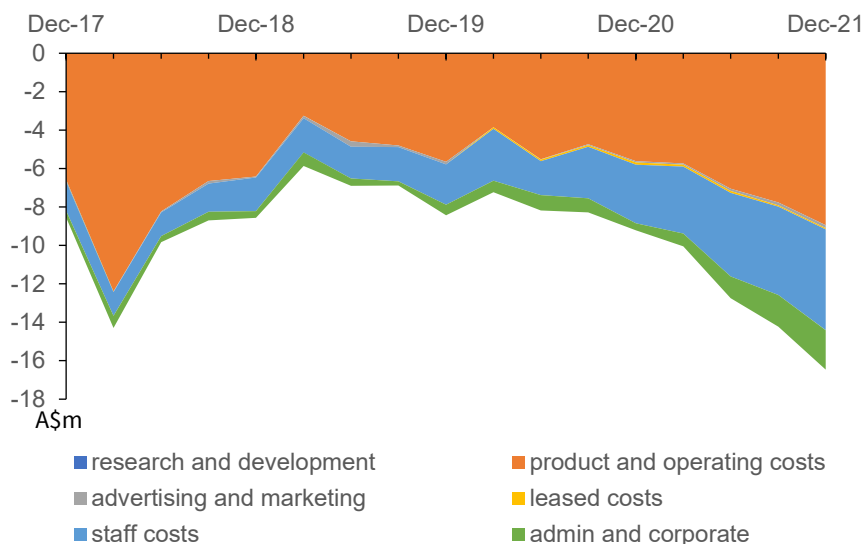
Figure 6 – Quarterly cash receipts and operating cashflow



Source: Company reports, MST Access estimates

## Operating expenses increasing too

Figure 7 – Cash operating expenses



Source: Company reports, MST Access estimates

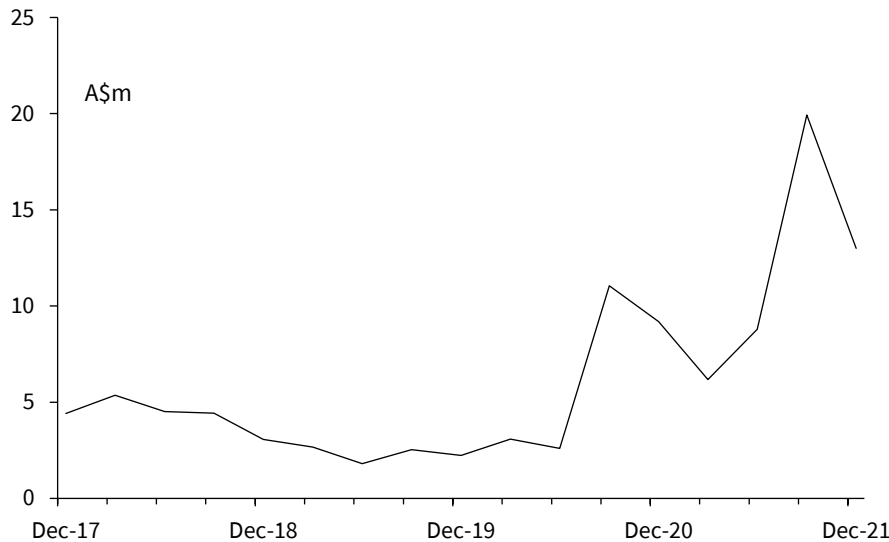
Consistent with Novatti’s articulated strategy of increasing its investments to grow the company, its product and operating costs, staff costs and admin and corporate costs all increased in 2Q22. We continue to believe that the relationship between these costs and revenues is a J curve, where Novatti needs to invest ahead of revenues, in areas such as compliance and technology, but after a few years revenues begin to exceed these costs and its investments will become profitable.



## Cash runway extends when adjusted for post quarter activities, one-offs

Novatti's cash at the end of December 2021 was \$13m, having decreased due to the initial cash payment for its ATX acquisition, as well as its operating cash burn and investments during the quarter.

Figure 8 – Novatti quarterly cash balance



Source: Company reports, MST Access estimates

Figure 9 – Novatti adjusted cash runway

	2022 Q2 A\$k	Adjustments A\$k	Adjusted A\$m
Net cash from / (used in) operating activities	-2,798	665	-2,133
Cash and cash equivalents at quarter end	12,994		12,994
Unused finance facilities available at quarter end	0		0
Total available funding available	12,994		12,994
Estimated periods of funding available	4.6		6.1

Source: Company reports, MST Access estimates

As its Appendix 4C states, Novatti at 31 December had 4.6 quarters of future cash available at the pace of operating cash burn during the December quarter. However, we believe this doesn't reflect the company's current position, and that the following adjustments are required:

- To cash from operating activities:
  - Allow for the EBITDA contribution of ATX at around A\$125k a quarter (and growing)
  - Allow for banking costs set to be deconsolidated upon receiving its banking licence, which last quarter totalled around \$540k.

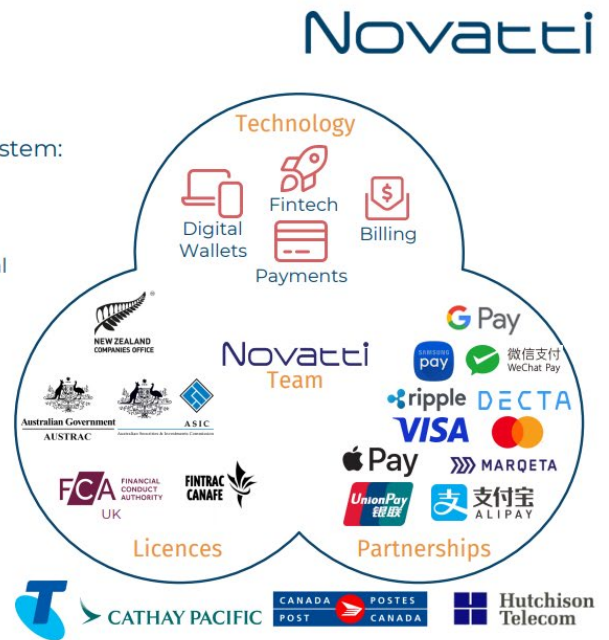
Adjusting for both these considerations produces a cash runway estimate of 6.1 quarters.

## Updated Investment Thesis

Figure 10 – Novatti strategy

### Strategy

- We have established a global B2B payments ecosystem:
  - **Technology** – digital and mobile platforms
  - **Licences** – opening jurisdictions and highlighting trust
  - **Partnerships** – providing scale without substantial capital
  - **Team** – leading in-house expertise
- Ecosystem now being monetised as fintechs and businesses utilise Novatti's capabilities
- Focused on accelerating expansion



5

Source: Company reports, MST Access estimates

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.

However, as we have highlighted for some time in our key risks and sensitivities, disruptive technology changes are a key threat, which could erode the moat Novatti has been building and threaten its payments revenues. The past week has seen:

- Visa in its 1Q22 earnings call on 27 January 2022 (US time, 28 January 2022 in Australia) introduced a forthcoming new offering, the "Visa Acceptance Cloud".
  - This was described by Visa's Chairman and CEO as "Visa Acceptance Cloud enables clients to move embedded payment processing software from individual devices to the cloud, eliminating the need for expensive terminals as well as the cost and time to certify the processing software. In addition, clients can access value-added services from fraud management to BNPL."
  - Perhaps more worrying for investors in Novatti was the response to a question about card acceptance and monetisation: "Our approach on this is to not charge for it because we think it's extremely valuable for the ecosystem to expand acceptance. And that's really the driving strategic force for us here, is to drive acceptance. And certainly, my expectation is that once we can get the transaction on our network, we'll have more opportunity to sell things like value-added services over time. But despite the fact that our network has the 100 million merchant locations, there is still a long



tail of merchants around the world that are not accepting. And it's important that we do everything we can to bolster the acceptance footprint that we have around the world.”

- Also on 27 January 2022 Bloomberg reported (a report that was widely syndicated including in the AFR the same day) that Apple plans to use its August 2020 acquisition of Mobeewave to bring the capability to accept tap-and-go payments to its smartphones heavily restricted NFC chips.

Inferring between these two pieces of news suggest that one of the major global card networks is about to enable a large proportion of smartphones globally to accept credit card payments fee free This may challenge the business model of not just merchant acceptance providers such as Novatti, but also payment terminal providers such as A2B, SQ2, TYR and SMP – particularly as all of these organisations are predominantly focused on serving small businesses. Visa is clear in its motivation of expanding businesses accepting cards down into micro businesses; however it is hard not to assume there will be some adverse impacts on providers serving small businesses.

We think that the diversification that Novatti has in its business model across a variety of technology, licenses and partnerships should provide it with some resilience to these disruptive developments which appear set to be launched later this calendar year; however, it does again highlight that there meaningful potential downside risks for Novatti and its stock.

Given the recent sell off in the stock and its peers, it is trading well below our assessed intrinsic valuation for the company, although perhaps doesn't look quite as attractive on some multiples relative to peers.

## 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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## 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.

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