# Novatti Group Limited

**NOV.AX**

A research platform of MST Financial

2 November 2023

# Sharpening its strategic focus

## Streamlining business with strategic review

- Three year gross margin target of 70%+
- Cost to income ratio falls impressively in 1Q24
- Strategic review may deliver further expense savings

**Margin the #1 focus in the business, with a new margin target:** Novatti has established a 3 year 70%+ group gross margin target. Having achieved 51% gross margins 4Q23, it was 48% in 1Q24. Its Payments AU/NZ business this quarter lifted gross margins from 40% to 45%, and continued revenue growth should deliver further improvement.

**Exemplary cost discipline:** Novatti's enhanced focus on costs have seen a reduction in costs (excluding IBOA) of $1.2m quarter on quarter. Moves to streamline its businesses, as part of its strategic review, could deliver further cost to income improvements, as well as release capital to support strategic growth in other areas.

**Operational leverage to be delivered via strong revenue growth:** Novatti is focused on improving profitability through obtaining greater operational leverage on its relatively fixed cost base, via strong revenue growth. It is already starting to show it in its quarterly gross margins for its Payments AU/NZ division, and should in time demonstrate it for net margins and profit margins.

## Investment Thesis

**Switch from product to customer focus should aid revenue growth:** The move away from a business unit structure to a functional structure is delivering positive feedback from customers and enabling far greater agility, connectivity and collaboration, which should support stronger revenue growth via cross-sell.

**Omni-channel appeal across acquiring, coupled with issuing and payments:** Novatti now supports an omni-channel acquiring offering across online, offline, mobile and embedded payments which is a key appeal to potential acquiring customers, as well as strengthen margins as customers are migrated onto the Novatti payments platform. It may also increase its appeal to potential acquirers of the company, seeking to gain a comprehensive foothold in the Australian and south-east Asian markets.

**Capitalised for growth:** The consolidated group has $14.7m of cash available at the end of the period. With over 4 quarters of cash at the current burn rate, expecting by the end of FY24 to deliver positive operating cashflows, and with a strategic review which may release capital, it should have sufficient cash to achieve this without needing to raise further capital (however IBOA will need to raise further capital in order to obtain its unrestricted banking licence).

## Valuation

**Valuation falls by 3c to 44c due to higher risk free rates**. Lifting our risk free rate to 4.5% (from 4%) lifts our DCF cost of equity to 10.5% (from 10.0%). We make no changes to our earnings forecasts.

## Risks

Being a payments company and owning a bank, Novatti has a range of risks applicable including macroeconomic conditions, liquidity and funding risks, credit risk, fraud, cybersecurity, asset-liability mismatch and compliance risks.

**Equities Research Australia**

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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.

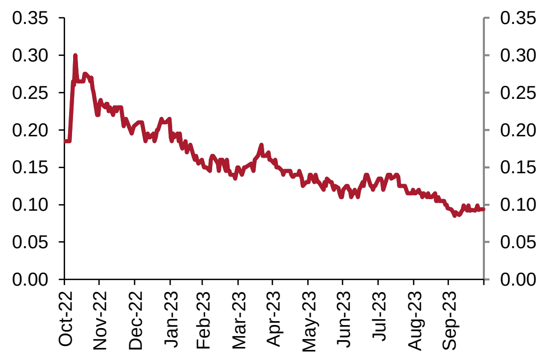
https://novatti.com/

| | |
|---|---|
| Valuation | **A$0.44** *(Prev A$0.47)* |
| Current price | **A$0.094** |
| Market cap | **A$31.8m** |
| Cash on hand | **A$14.7m** |

### Upcoming Catalysts / Next News

| Period | |
|---|---|
| Late January 2024 | 2Q24 activities update and Appendix 4C |
| Late February 2024 | 1H24 result |
| Pending Regulation | EMI License |

### Share Price ($A)



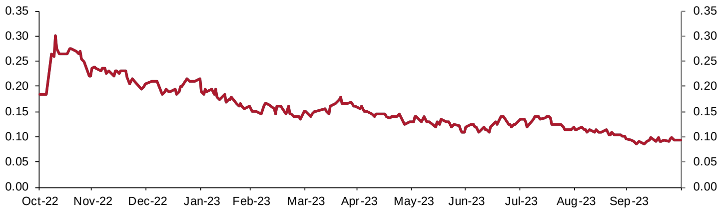

*Source: FactSet, MST Access*

# NOVATTI GROUP LIMITED — NOV-AU

**Year end 30 June, AUD unless otherwise noted**

| MARKET DATA | | |
|---|---|---|
| **Price** | **$** | 0.094 |
| **Valuation** | **$** | 0.44 |
| 52 week high / low | $ | 0.08 - 0.36 |
| **Market capitalisation** | **$m** | 31.8 |
| Shares on issue (basic) | m | 338.7 |
| Options / rights / ESP / LTIP | m | 0.0 |
| Other equity | m | 0.0 |
| Shares on issue (fully diluted) | m | 338.7 |

**12-MONTH SHARE PRICE PERFORMANCE**




| INVESTMENT FUNDAMENTALS | | FY22A | FY23A | FY24E | FY25E | FY26E |
|---|---|---|---|---|---|---|
| Reported NPAT | $m | (16.6) | (26.5) | (6.9) | 0.1 | 2.4 |
| **Underlying NPAT** | **$m** | **(16.6)** | **(26.5)** | **(6.9)** | **0.1** | **2.4** |
| | | | | | | |
| Reported EPS (diluted) | ¢ | (5.1) | (7.9) | (2.0) | 0.0 | 0.7 |
| **Underlying EPS (diluted)** | **¢** | **(5.1)** | **(7.9)** | **(2.0)** | **0.0** | **0.7** |
| ….Growth | % | (1%) | 54% | (74%) | (102%) | 1908% |
| **PER underlying** | **x** | **(1.8)** | **(1.2)** | **(4.6)** | **267.6** | **13.3** |
| | | | | | | |
| Operating cash flow per share | ¢ | (4.0) | 0.4 | (1.7) | 0.3 | 0.9 |
| Free cash flow per share | ¢ | (12.0) | 2.7 | (3.0) | 0.1 | 0.8 |
| **Price to free cash flow per share** | **x** | **n.m.** | **0.0** | **n.m.** | **0.6** | **0.1** |
| FCF yield | % | (128.1%) | 29.2% | (32.4%) | 1.6% | 8.3% |
| | | | | | | |
| **Dividend** | **¢** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| Payout | % | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Yield** | **%** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| Franking | % | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | | | |
| **Enterprise value** | **$m** | **25.8** | **13.6** | **23.9** | **23.4** | **20.8** |
| EV/Revenue | x | 0.8 | 0.3 | 0.4 | 0.3 | 0.2 |
| EV/Underlying EBITDA | x | -1.9 | -0.9 | -6.2 | 7.5 | 2.8 |
| | | | | | | |
| Book value per share | ¢ | 10.9 | 4.6 | 2.5 | 2.6 | 3.3 |
| Price to book (NAV) | x | 0.9 | 2.1 | 3.7 | 3.6 | 2.9 |
| | | | | | | |
| Net tangible assets per share | ¢ | 8.1 | 2.2 | 0.2 | 0.2 | 0.9 |
| Price to NTA | x | 1.2 | 4.2 | 45.2 | 38.7 | 9.9 |

| KEY RATIOS | | FY22A | FY23A | FY24E | FY25E | FY26E |
|---|---|---|---|---|---|---|
| Net debt /(cash) | $m | (6.0) | (18.2) | (7.9) | (8.4) | (11.0) |
| Interest cover (Operating NPAT / net inter | x | (22.9) | (37.1) | (16.2) | 1.3 | 12.0 |
| Gearing (net debt / underlying EBITDA) | x | 0.4 | 1.3 | 2.1 | nm | nm |
| Leverage (net debt / (net debt + equity) | x | nm | 6.6 | nm | nm | nm |

| DUPONT RATIOS | | FY22A | FY23A | FY24E | FY25E | FY26E |
|---|---|---|---|---|---|---|
| Return on Assets | % | nm | nm | nm | 0.07 | 1.13 |
| Financial Leverage | x | 3.0 | 9.4 | 17.6 | 18.3 | 19.1 |
| **Return on Equity** | **%** | nm | nm | nm | 1.36 | 21.49 |

| GROWTH PROFILE | | FY22A | FY23A | FY24E | FY25E | FY26E |
|---|---|---|---|---|---|---|
| Revenue | % | 97.5 | 19.7 | 46.4 | 23.2 | 21.2 |
| Underlying EBITDA | % | (217.4) | (6.6) | 73.4 | 181.6 | 136.0 |
| NPAT | % | (40.3) | (59.7) | 74.1 | 102 | 1,908 |
| Underlying Profit | % | (92.3) | (194.1) | 249.7 | 345 | 6,462 |
| Underlying EPS | % | 1.2 | (54.1) | 74.3 | 102 | 1,908 |
| DPS | % | n/a | n/a | n/a | n/a | n/a |

| HALF YEARLY DATA | | 1H23A | 2H23A | 1H24E | 2H24E | 1H25E |
|---|---|---|---|---|---|---|
| **Revenue** | **$m** | 19.9 | 19.1 | 27.8 | 29.2 | 34.6 |
| Other income | $m | 1.3 | 0.9 | 1.6 | 1.0 | 1.6 |
| Cash expenses | $m | -28.2 | -27.4 | -33.4 | -30.1 | -34.7 |
| **Underlying EBITDA** | **$m** | **-7.0** | **-7.4** | **-4.0** | **0.1** | **1.4** |
| EBITDA | $m | -10.0 | -10.2 | -4.2 | -0.1 | 1.2 |
| Depreciation, amortisation and impairmen | $m | -1.1 | -1.1 | -1.1 | -1.1 | -1.1 |
| **EBIT** | **$m** | **-11.1** | **-11.3** | **-5.3** | **-1.2** | **0.1** |
| Associates and JVs | $m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net interest | $m | -1.0 | 0.3 | -0.2 | -0.2 | -0.2 |
| **PBT** | **$m** | **-12.1** | **-10.9** | **-5.5** | **-1.4** | **-0.1** |
| Income tax | $m | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| **NPAT** | **$m** | **-12.3** | **-10.9** | **-5.5** | **-1.4** | **-0.1** |

| PROFIT AND LOSS | | FY22A | FY23A | FY24E | FY25E | FY26E |
|---|---|---|---|---|---|---|
| **Revenue** | **$m** | **32.6** | **39.0** | **57.1** | **70.3** | **85.2** |
| Other income | $m | 1.8 | 2.1 | 2.6 | 2.6 | 2.5 |
| Cash expenses | $m | -48.0 | -55.6 | -63.5 | -69.7 | -80.3 |
| **Underlying EBITDA** | **$m** | **-13.6** | **-14.5** | **-3.8** | **3.1** | **7.4** |
| EBITDA | $m | -14.0 | -23.5 | -4.2 | 2.7 | 7.0 |
| Depreciation, amortisation and impairment | $m | -1.9 | -2.2 | -2.2 | -2.2 | -2.2 |
| **EBIT** | **$m** | **-15.9** | **-25.7** | **-6.5** | **0.5** | **4.8** |
| Associates, JVs and fair value adjustments | $m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net interest | $m | -0.7 | -0.7 | -0.4 | -0.4 | -0.4 |
| **PBT** | **$m** | **-16.5** | **-26.4** | **-6.9** | **0.1** | **4.4** |
| Income tax | $m | -0.1 | -0.1 | 0.0 | 0.0 | -2.0 |
| **NPAT** | **$m** | **-16.6** | **-26.5** | **-6.9** | **0.1** | **2.4** |
| | | | | | | |
| Weighted average diluted shares on issue | m | 325.0 | 336.8 | 338.7 | 338.7 | 338.7 |

| BALANCE SHEET | | FY22A | FY23A | FY24E | FY25E | FY26E |
|---|---|---|---|---|---|---|
| Cash & equivalents | $m | 6.1 | 18.2 | 7.9 | 8.4 | 11.0 |
| Trade & other receivables | $m | 8.4 | 7.7 | 8.2 | 8.7 | 9.3 |
| Financial assets - funds in trust | $m | 52.4 | 92.4 | 103.9 | 110.2 | 158.7 |
| Investments accounted for using the equity metho | $m | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other investments | $m | 27.7 | 11.8 | 11.8 | 11.8 | 11.8 |
| Net Property Plant And Equipment | $m | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 |
| Right of use assets | $m | 1.8 | 1.5 | 1.5 | 1.5 | 1.5 |
| Intangibles | $m | 9.3 | 7.9 | 7.9 | 7.9 | 7.9 |
| Deposits | $m | 3.7 | 4.4 | 8.9 | 9.6 | 10.2 |
| Other | $m | 0.9 | 1.1 | 1.1 | 1.1 | 1.1 |
| **Total Assets** | **$m** | **111.0** | **145.6** | **151.7** | **159.7** | **211.9** |
| | | | | | | |
| Trade and other payables | $m | 16.2 | 22.4 | 23.8 | 25.2 | 26.8 |
| Settlement and remittance funds payable | $m | 52.1 | 91.6 | 102.9 | 109.2 | 157.3 |
| Lease liabilities | $m | 2.1 | 1.8 | 1.8 | 1.8 | 1.8 |
| Unearned revenue | $m | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Borrowings, including convertible notes | $m | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Employee benefits | $m | 2.9 | 3.5 | 3.7 | 3.9 | 4.2 |
| Other | $m | 0.8 | 10.5 | 10.5 | 10.5 | 10.5 |
| **Total liabilities** | **$m** | **74.4** | **130.2** | **143.1** | **151.0** | **200.8** |
| Net assets | $m | 36.6 | 15.5 | 8.6 | 8.7 | 11.1 |
| | | | | | | |
| Contributed equity | $m | 89.3 | 90.7 | 90.7 | 90.7 | 90.7 |
| Reserves | $m | 5.0 | 5.4 | 5.4 | 5.4 | 5.4 |
| Retained earnings | $m | -57.7 | -83.5 | -90.3 | -90.2 | -87.8 |
| **Shareholder's equity** | **$m** | **36.6** | **15.5** | **8.6** | **8.7** | **11.1** |
| | | | | | | |
| Basic shares on issue | m | 335.3 | 338.7 | 338.7 | 338.7 | 338.7 |

| CASH FLOW | | FY22A | FY23A | FY24E | FY25E | FY26E |
|---|---|---|---|---|---|---|
| Net Income (Cashflow) | $m | -16.6 | -23.2 | -6.9 | 0.1 | 2.4 |
| Depreciation & Amortization | $m | 1.9 | 2.2 | 2.2 | 2.2 | 2.2 |
| Change in Net Operating Assets | $m | 4.0 | -5.6 | -2.0 | -2.2 | -2.3 |
| Other Non-Cash Items, Total | $m | -2.4 | 4.6 | 0.8 | 0.8 | 0.8 |
| Other | $m | 0.0 | 23.4 | 0.0 | 0.0 | 0.0 |
| **Operating cash flow** | **$m** | **-13.0** | **1.4** | **-5.9** | **1.0** | **3.1** |
| | | | | | | |
| Capital expenditure | $m | -2.1 | -2.0 | -0.3 | -0.3 | -0.3 |
| Acquisitions/divestment/other | $m | -24.6 | 0.0 | -4.0 | 0.0 | 0.0 |
| **Investing cash flow** | **$m** | **-26.7** | **-2.0** | **-4.2** | **-0.2** | **-0.2** |
| | | | | | | |
| Equity | $m | 36.0 | 3.1 | 0.0 | 0.0 | 0.0 |
| Debt (including convertible) | $m | -0.8 | 10.1 | 0.0 | 0.0 | 0.0 |
| Leases | $m | -0.2 | -0.3 | -0.2 | -0.2 | -0.2 |
| **Financing cash flow** | **$m** | **36.6** | **12.9** | **-0.2** | **-0.2** | **-0.2** |
| | | | | | | |
| **Net cash flow** | **$m** | **-3.1** | **12.3** | **-10.3** | **0.5** | **2.6** |
| Free cash flow | $m | -39.1 | 9.2 | -10.3 | 0.5 | 2.6 |

*Source: Company reports and MST Acccess estimates*

# Outlook statement

Comparing its outlook side last quarter to this quarter's, the main change is under its "Simplify the business" heading. Having completed its structed business portfolio review, it is now undertaking a strategic review.

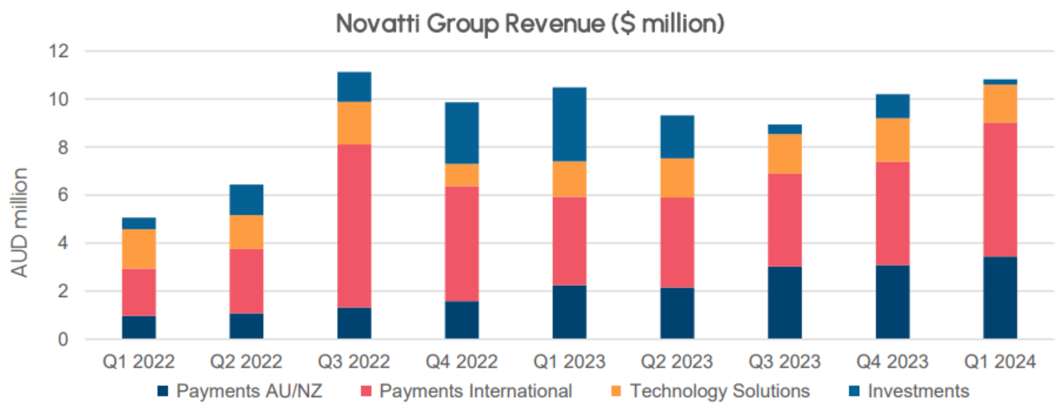
We expect that one of the conclusions from its strategic review will be the sell-down of its holding in IBOA, in part driven by the needs of IBOA to raise additional capital ahead of it securing its unrestricted ADI (banking) licence.

**Figure 1: Novatti's 4Q23 outlook statement**


*Source: Company reports*

Novatti continues to simplify its business, which should lead to further margin improvements. At the same time the company continues to grow aggressively. We anticipate that Novatti's continued revenue growth, combined with margin improvement will be how the company achieves its positive operating cashflow target within the next year. Its businesses are clearly benefiting from the resumption of global travel, with strong revenue growth in both Payments divisions in 1Q24. Payments AU/NZ division delivered strong margin improvement progress in the quarter, improving gross margins from 40% to 45%. This is still a little below Novatti's overall group gross margin of 48% in the quarter. As Payments AU/NZ gains further scale, and its gross margins further improve, this will help lift overall group gross margins towards Novatti's new 3 year target of 70%.

**Figure 2: Novatti's new divisions by revenue**

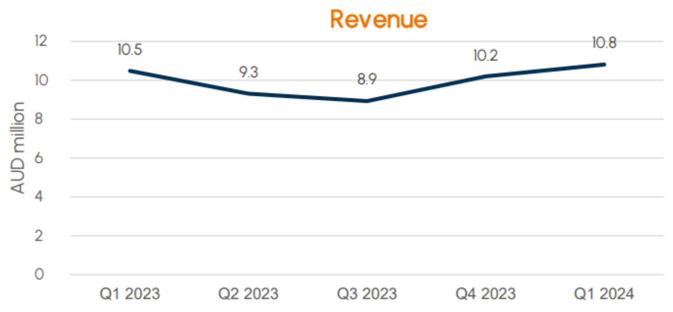



*Source: Company reports*

While Payments International has historically been Novatti's largest division under this new structure Payments AU/NZ has been growing strongly, with Payments AU/NZ seemingly the focus of the main growth driver of the business. Its Technology Solutions and Investments had a relatively small contribution in the quarter, despite the receipt of a $0.6m dividend from Reckon.

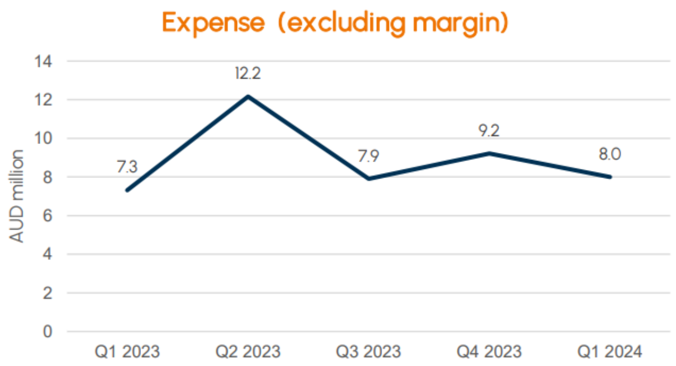
# 4Q23 Quarterly Activities Report and Appendix 4C Cashflow Analysis

**Figure 3: Novatti quarterly revenue**




*Source: Company reports*

**Figure 4: Novatti quarterly expenses**

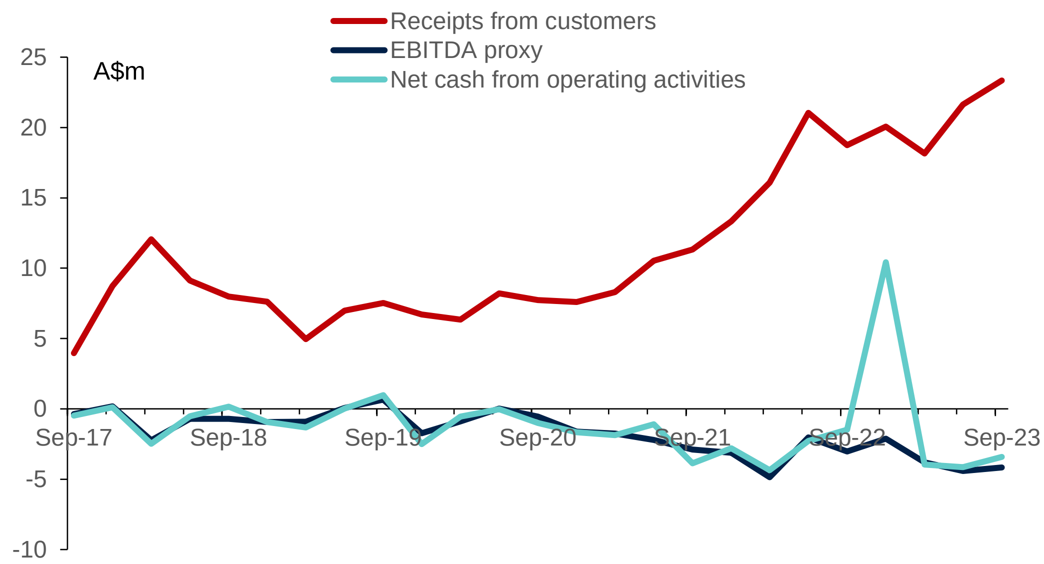



*Source: Company reports*

There was a welcome continued increase in Novatti's revenue 1Q24, with revenues now having recovered to be above where they were a year earlier, although its gross margin slipped a little from 51% at 4Q23 to 48% in 1Q24 – which could be reflective of some seasonal variation in payments products, with changes in its volume-margin mix impacting gross margins in aggregate.

The combination of growing revenues, lifting gross margins, and impressive cost control improving its cost to income ratio provides a compound benefit to gross profit, which should conceivably allow Novatti to reach a positive operating cashflow runrate within the next year.

**Figure 5: Novatti cash receipts, EBITDA proxy and operating cash flow (A$m)**

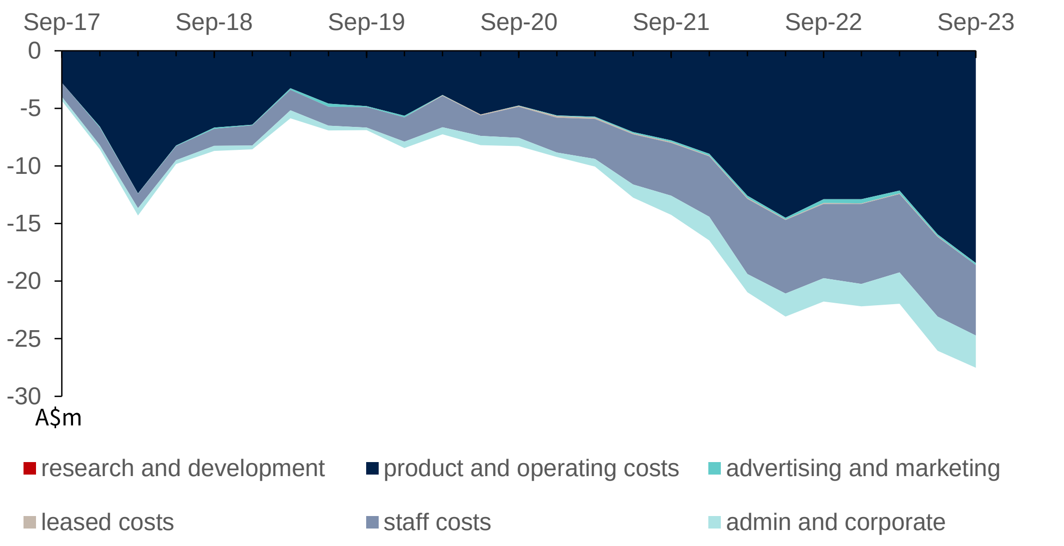



*Source: Company reports*

Recent weakness in receipts from customers following the new commercial arrangements with one international client appears to have now passed, with Novatti again achieving record receipts from customers in the quarter.

Its strong cost control, where costs fell excluding IBOA, delivered a decrease in its cash burn, coming in at under A$4m – even when the dividend from Reckon is excluded – which is a notably improvement quarter on quarter.

**Figure 6: Novatti Quarterly Cash Operating Expenses (A$m)**



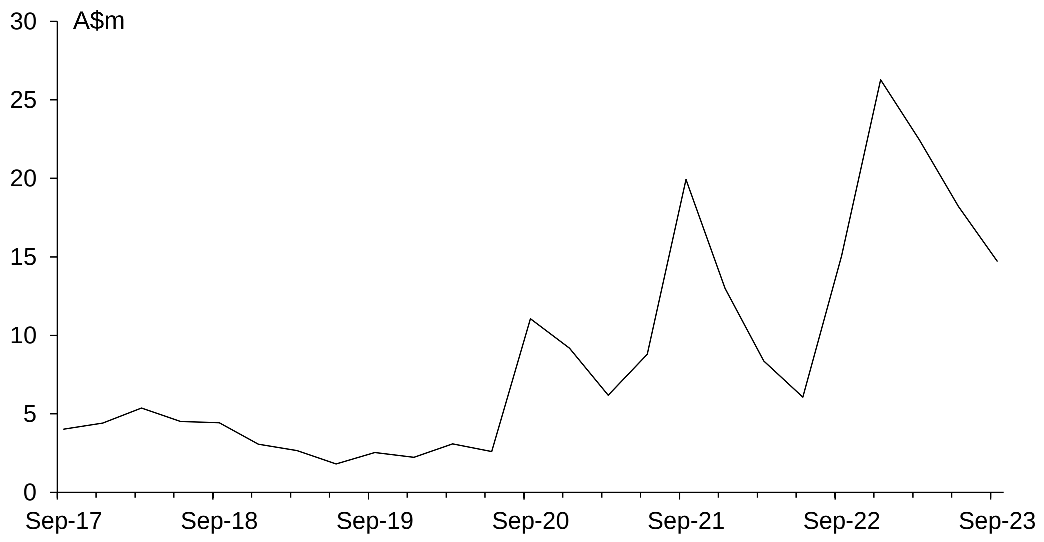

*Source: Company reports*

The rise in product and operating costs likely reflects some of the transition costs in migrating products to Novatti's platform, as well as potentially some non-recurring staff costs.

The current strategic review is likely to lead to further cost reductions, as Novatti seeks to streamline its offerings. We continue to believe that costs will likely take a step down once its bank, IBOA, is deconsolidated, ahead of it receiving its full banking licence, removing IBOA's costs from Novatti's accounts. Once IBOA receives its full banking licence, Novatti can also transfer business conducted with other banks across to it, which should lead to a further step-down in Novatti's costs.

Novatti's stablecoin AUDD, might also be opened up to wider ownership following Novatti's strategic review, while Novattil might also look to divest its strategic shareholding in Reckon.

**Figure 7: Novatti Quarterly Cash Balance (A$m)**




*Source: Company reports*

Due to the 4C reporting requirements for consolidated entities, its cash position of $14.7m represents both Novatti's core payments business and IBOA.

**Figure 8: Cash runway**

| | 2024 Q1 A$k | Adjustments A$k | Adjusted A$m | Comments |
|---|---|---|---|---|
| Net cash from / (used in) operating activities | -3,423 | 563 | -3,986 | Exclude Reckon dividend |
| Cash and cash equivalents at quarter end | 14,724 | | 14,724 | |
| Unused finance facilities available at quarter end | 0 | | 0 | |
| Total available funding available | 14,724 | | 14,724 | |
| Estimated periods of funding available | 4.3 | | 3.7 | |

*Source: Company reports, MST Access estimates*

Novatti's cash runway is now 4.3 quarters. Given that it is targeting generating positive operating cashflows by end FY24, this may be sufficient for Novatti to become self-funding without needing a further capital raising. However, if we were to exclude the Reckon dividend, then its position becomes a little tighter at 3.7 quarters.

Novatti has again not called out the appropriate adjustments to back out IBOA from its cashflows. When we have previously adjusted for IBOA, this has meaningfully increased Novatti's cash runway, and hence makes the 4.3 quarters indicated by its cash runway calculation in the current quarter potentially conservative.

# No Earnings Revisions

Following Novatti's 1Q24 quarterly activities update and cashflow release, we do not make any changes to our earnings estimates.

Full details of our earnings estimates appear in the financial summary on page 2.

# Valuation

We use a blend of valuation approaches to estimate Novatti's valuation, considering:

- intrinsic valuation scenarios of its potential future growth profiles
- peer multiples and growth rates,

Other equity market considerations such as short sales; any likely forthcoming changes in index inclusion; depth of stock research coverage; composition of and change in the mix of investors (such as founders, board and staff, domestic institutions, foreign institutions, and retail investors) are not incorporated in our valuation; however investors should consider such factors if they seek to develop a price target for the company.

## Discounted cash flow

**Figure 9: MST Access valuation of Novatti**

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Current date | | 30-Oct-23 | | | | | | | | | | | |
| Next balance date | | 31-Dec-23 | | | | | | | | | | | |
| | | Dec-23 | Jun-24 | Dec-24 | Jun-25 | Dec-25 | Jun-26 | Dec-26 | Jun-27 | Dec-27 | Jun-28 | Dec-28 | Jun-29 |
| **Free cash flow to equity** | **A$m** | **-9.3** | **-1.1** | **0.0** | **0.5** | **0.9** | **1.7** | **3.5** | **3.8** | **5.4** | **7.1** | **8.3** | **8.4** |
| **Discounted cash flow** | **A$m** | **-9.1** | **-1.0** | **0.0** | **0.4** | **0.7** | **1.3** | **2.5** | **2.7** | **3.6** | **4.4** | **5.0** | **4.8** |

| | | | | |
|---|---|---|---|---|
| Sum of discount streams | A$m | 15.3 | **CAPM** | |
| Future value into perpetuity | A$m | 222.9 | Risk free rate | 4.50% |
| NPV of terminal value | A$m | 126.6 | Equity beta | 1.2 |
| add net cash at FY23 | A$m | 7.7 | Equity risk premium | 5.00% |
| **Value of total equity** | **A$m** | **149.6** | Cost of equity | 10.5% |
| Diluted shares on issue | m | 338.7 | | |
| **Value per share** | **A$** | **0.44** | Terminal growth | 3.0% |
| | | | | |
| Upside/downside | % | 370% | | |

*Source: Company reports, MST Access estimates*

We continue to use a DCF of free cash flow to equity forecasting out to FY29 before applying a terminal value. In response to rising long-bond rates, we have lifted our cost of equity to 10.5% from 10.0%, composing of a 4.5% risk free rate (up from 4.0%), retaining a 5% equity risk premium and beta of 1.2, and we continue to assume a 3.0% terminal growth rate.

The higher risk free rate lowers our valuation to 44c from 47c.

## Peer comparative multiple valuation currently inappropriate

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.

As part of March 2023 changes to the Global Industry Classification Standard, Novatti now falls under the new Transaction and Payment Processing Services sub-industry within the Financial Services industry, in the Financials sector, which should deliver a more appropriate peer group for Novatti.

With Novatti being the Australian partner for Marqeta, we see that as its key peer, trading on 2.5x forward EV/Revenue. In comparison, on our forecasts Novatti is trading on 0.4x.

**Figure 10: Selected peer comparable companies' valuation multiples**

| Identifier (RIC) | Company Name | EV / Revenue | EV / EBITDA | P/E | P/CF | P/B | Dividend Yield % |
|---|---|---|---|---|---|---|---|
| NOV.AX | Novatti Group Ltd | 0.4 | -6.2 | -4.6 | n.m. | 3.7 | 0.0% |
| CCA.AX | Change Financial Ltd | 1.9 | 17.5 | 31.8 | 39.1 | 3.5 | 0.0% |
| EML.AX | EML Payments Ltd | | | 16.6 | 10.6 | 2.1 | |
| SMP.AX | SmartPay Holdings Ltd | 2.7 | 10.8 | 22.1 | 9.5 | 5.5 | 0.0% |
| TYR.AX | Tyro Payments Ltd | 0.9 | 7.5 | 35.7 | 11.9 | 2.3 | 0.0% |
| MQ.O | Marqeta Inc | 2.5 | | | | 2.1 | 0.0% |
| V | Visa Inc | 12.8 | 18.1 | 22.8 | 18.8 | 10.3 | 0.9% |
| MA | Mastercard Inc | 12.7 | 20.5 | 26.1 | 24.2 | 38.7 | 0.7% |
| PYPL.O | PayPal Holdings Inc | 1.8 | 7.0 | 9.2 | 7.3 | 2.3 | 0.0% |
| AMA.MC | Amadeus IT Group SA | 4.2 | 10.8 | 18.3 | 13.4 | 4.1 | 2.5% |
| NETW.L | Network International Holdings PLC | 4.7 | 11.2 | 19.9 | 14.2 | | 1.0% |
| FIS | Fidelity National Information Services Inc | 3.0 | 7.1 | 7.3 | 6.3 | 1.4 | 4.6% |
| PAY.TO | Payfare Inc | 0.6 | 4.3 | 7.8 | | | |
| FI | Fiserv Inc | 4.6 | 10.3 | 13.4 | 10.7 | 1.2 | 0.0% |
| WEX | WEX Inc | 3.6 | 8.4 | 10.2 | 9.2 | 3.0 | 0.0% |
| PSFE.K | Paysafe Ltd | 0.9 | 3.1 | 11.8 | 2.3 | 0.6 | 0.0% |
| PAYP.L | PayPoint plc | 1.7 | 3.8 | 7.7 | | | 8.3% |
| WLN.PA | Worldline SA | 1.4 | 5.5 | 5.4 | 4.4 | 0.3 | 0.0% |
| WU | Western Union Co | 1.3 | 5.1 | 6.6 | 5.9 | 7.2 | 8.4% |
| SQ | Block Inc | 0.9 | 11.8 | 17.3 | 17.5 | 1.3 | 0.0% |

*Source: IBES, Refinitiv, MST Access estimates for Novatt and Change Financial*

# Investment thesis

The stock is trading well below our assessed intrinsic valuation for the company.

With a moat provided by a trifecta of technology, licences and partnerships difficult, time consuming and costly 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 and partnerships for digital payments.

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

- 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.
- Through investing in fintech start-ups and providing underlying payment technologies for these start-ups.

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.

The diversification that Novatti has in its business model across a variety of technology, licenses and partnerships is demonstrating resilience to disruptive developments, however, it does again highlight that there meaningful potential downside risks for Novatti and its stock.

# 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.

### Regulatory Requirements

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.

### 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.

### 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 last calendar year to Tyro Payments), leading to a loss of customer and/or investor confidence, this could in turn threaten its financial viability. Similarly, a cyberattack on bridges between blockchains for its AUDD stablecoin could lead to the realization of these reputation risks.

### 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.

# 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. This ecosystem is hard (expensive and time consuming) to replicate and creates a "moat" to new entrants, with other organisations having such an ecosystem typically much larger than Novatti.

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 is a 91% owner of International Bank of Australia Pty Ltd which has a Restricted ADI licence. It is also in the process of applying for an EMoney Issuing (EMI) licence in Europe.

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