

Beating revenue guidance

Novatti delivered a strong 4Q cashflows and quarterly activities update, beating its quarterly revenue guidance released at the end of last month, and in turn also beating its annual revenue guidance.

Adjusted cashflow runway longer

While Novatti disclosed a comfortable 8 quarters of cash based on its 30 June cash balance and its burn rate during the June quarter, this excludes its \$40m capital raising in early July, some of which has already been spent on acquiring 19.9% of Reckon. Adjusting to back out the government grants and rebates, and allowing for the additional net cash from its raising, we calculate that it has an even more impressive 12 quarters of cash. It should achieve breakeven within this time, so we remain comfortable that it is unlikely to return to market to raise equity except for potential additional acquisitions.

Lots of upcoming catalysts for the stock

Novatti in its outlook (reproduced inside) highlighted that it is targeting achieving obtaining:

- acquiring licences from Visa and Mastercard by the end of September 2021, and
- its banking licence from APRA by the end of November 2021.

To these, we can also add its

- FY21 result in August,
- AGM in November

and as we called out in our initiation report, traction with Reckon to integrate payments into its product and hence provide Novatti access to its customer base.

Earnings and valuation changes

We make very modest changes to our reported EPS estimates: FY21E: 4%, FY22E: -1%, FY23E: -1%. We value NOV at A\$0.80, using a DCF on free cash flows to equity forecasting out 7 years before applying a terminal value using a terminal growth rate of 3.0% and a cost of equity of 6.5%, referencing peer multiples to validate reasonableness.

At the current share price, NOV is trading on 5.7x FY22 EV/revenue and 2.6x 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 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\$0.515
Market cap	A\$155m
Valuation	A\$0.80

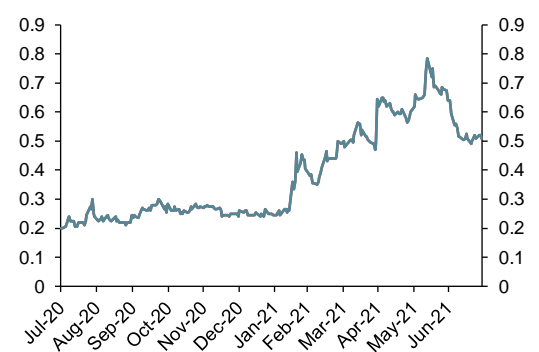
Company data

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\$)



Glen Wellham
Senior Research Analyst

Financials

NOVATTI GROUP LIMITED

NOV-AU

Year end 30 June, AUD unless otherwise noted

MARKET DATA

Price	\$	0.515
Valuation	\$	0.80
52 week high / low	\$	0.19 - 0.79
Market capitalisation	\$m	154.6
Shares on issue (basic)	m	300.2
Options / rights / ESP / LTIP	m	35.4
Other equity	m	0.4
Shares on issue (fully diluted)	m	336.1
Out of the money options	m	0.6

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS

	FY19A	FY20A	FY21E	FY22E	FY23E
Reported NPAT	\$m (4.0)	(11.5)	(11.0)	(9.9)	(2.4)
Underlying NPAT	\$m (4.0)	(11.5)	(11.0)	(9.9)	(2.4)
Reported EPS (diluted)	¢ (2.5)	(6.7)	(4.5)	(2.9)	(0.7)
Underlying EPS (diluted)	¢ (2.5)	(6.7)	(4.5)	(2.9)	(0.7)
...Growth	% n/a	167%	(33%)	(36%)	(77%)
PER underlying	x (20.5)	(7.7)	(11.5)	(17.8)	(76.9)
Operating cash flow per share	¢ (1.3)	(0.7)	(2.2)	(2.0)	0.2
Free cash flow per share	¢ (2.7)	0.5	(3.5)	(9.1)	(1.0)
Price to free cash flow per share	x nm	1.0	nm	nm	nm
FCF yield	% (5.2%)	1.0%	(6.8%)	(17.7%)	(1.9%)

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 153.2	157.7	146.2	136.6	140.2
EV/Revenue	x 18.2	14.3	8.9	5.7	4.2
EV/Underlying EBITDA	x -69.5	-31.8	-21.9	-14.3	-94.2

Book value per share	¢ 3.7	-0.3	7.6	18.0	18.1
Price to book (NAV)	x 25.3	-318.4	8.3	2.6	2.6
Net tangible assets per share	¢ 0.9	-3.3	5.4	16.4	16.4
Price to NTA	x 104.6	-25.0	11.7	2.9	2.9

KEY RATIOS	FY19A	FY20A	FY21E	FY22E	FY23E
Net debt / (cash)	\$m (1.4)	3.0	(8.4)	(18.0)	(14.5)
Interest cover (Operating NPAT / net interest)	x nm	nm	(208.9)	(252.4)	(294.5)
Gearing (net debt / underlying EBITDA)	x 0.6	nm	1.3	1.9	9.7
Leverage (net debt / (net debt + equity))	x nm	1.2	nm	nm	nm

DUPONT RATIOS	FY19A	FY20A	FY21E	FY22E	FY23E
Return on Assets	% nm	nm	nm	nm	nm
Financial Leverage	x 2.7	-67.6	2.9	2.0	2.8
Return on Equity	% nm	nm	nm	nm	nm

GROWTH PROFILE	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	% n/a	30.7	49.7	44.9	39.9
Underlying EBITDA	% n/a	125.2	34.2	43.4	(84.4)
NPAT	% n/a	186.5	(4.8)	(9.6)	(75.4)
Underlying Profit	% n/a	186.5	(4.8)	(9.6)	(75.4)
Underlying EPS	% n/a	167.4	(33.4)	(35.5)	(76.8)
DPS	% n/a	n/a	n/a	n/a	n/a

HALF YEARLY DATA	2H20A	1H21A	2H21E	1H22E	2H22E
Revenue	\$m 6.1	7.4	9.1	10.6	13.2
Other income	\$m 0.0	0.0	0.0	0.0	0.0
Cash expenses	\$m -8.2	-9.9	-13.2	-17.6	-15.9
Underlying EBITDA	\$m -2.1	-2.6	-4.1	-6.9	-2.6
EBITDA	\$m -2.4	-3.1	-6.5	-7.1	-2.8
Depreciation, amortisation and impairment	\$m -0.5	-0.7	-0.7	-0.7	-0.7
EBIT	\$m -2.9	-3.9	-7.2	-7.9	-3.6
Associates and JVs	\$m 0.0	0.0	0.0	1.5	0.0
Net interest	\$m -1.8	-0.2	-1.6	-0.3	-0.3
PBT	\$m -4.7	-4.1	-8.8	-6.7	-3.9
Income tax	\$m 0.0	1.0	1.0	0.6	0.0
NPAT	\$m -4.8	-3.1	-7.8	-6.1	-3.9

Source: Company reports and MST Access estimates

PROFIT AND LOSS

	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	\$m 8.4	11.0	16.5	23.9	33.4
Other income	\$m 0.0	0.0	0.0	0.0	0.0
Cash expenses	\$m -10.6	-16.0	-23.1	-33.4	-34.9
Underlying EBITDA	\$m -2.2	-5.0	-6.7	-9.6	-1.5
EBITDA	\$m -3.0	-5.2	-9.6	-10.0	-1.9
Depreciation, amortisation and impairment	\$m -0.4	-3.9	-1.5	-1.5	-1.5
EBIT	\$m -3.3	-9.1	-11.1	-11.4	-3.4
Associates and JVs	\$m 0.0	0.0	0.0	1.5	1.5
Net interest	\$m -0.7	-2.4	-1.8	-0.6	-0.6
PBT	\$m -4.0	-11.5	-12.9	-10.5	-2.4
Income tax	\$m 0.0	0.0	1.9	0.6	0.0
NPAT	\$m -4.0	-11.5	-11.0	-9.9	-2.4

Weighted average diluted shares on issue	m	159.9	171.3	244.6	343.0	364.0
--	---	-------	-------	-------	-------	-------

BALANCE SHEET

	FY19A	FY20A	FY21E	FY22E	FY23E
Cash & equivalents	\$m 1.8	2.6	8.9	18.0	14.5
Trade & other receivables	\$m 4.3	2.8	3.5	3.7	3.9
Financial assets - funds in trust	\$m 3.8	17.5	24.0	50.5	98.9
Investments accounted for using the equity method	\$m 0.0	0.0	0.8	3.1	3.1
Other investments	\$m 0.8	0.9	0.8	0.8	0.8
Net Property Plant And Equipment	\$m 0.6	0.6	0.5	0.5	0.5
Right of use assets	\$m 0.0	2.2	2.1	2.1	2.1
Intangibles	\$m 4.6	5.7	5.5	5.5	5.5
Deposits	\$m 0.1	0.2	6.8	35.5	39.0
Other	\$m 0.5	0.4	0.4	0.4	0.4
Total Assets	\$m 16.5	32.8	53.2	119.9	168.6
Trade and other payables	\$m 4.6	5.9	5.8	6.2	6.6
Settlement and remittance funds payable	\$m 3.8	17.5	23.8	50.0	98.1
Lease liabilities	\$m 0.1	2.5	2.3	2.3	2.3
Unearned revenue	\$m 0.0	0.2	0.3	0.3	0.3
Convertible note facilities	\$m 0.4	5.6	0.4	0.0	0.0
Employee benefits	\$m 0.6	1.0	1.2	1.2	1.3
Other	\$m 0.9	0.6	0.7	0.7	0.7
Total liabilities	\$m 10.4	33.3	34.5	60.7	109.2
Net assets	\$m 6.1	-0.5	18.7	59.2	59.3

Contributed equity	\$m 24.1	26.7	51.2	94.2	94.2
Reserves	\$m 2.2	2.4	3.6	3.6	3.6
Retained earnings	\$m -20.1	-29.5	-36.2	-38.6	-38.4
Shareholder's equity	\$m 6.1	-0.5	18.7	59.2	59.3

Basic shares on issue	m	166.9	185.2	244.2	328.2	328.2
-----------------------	---	-------	-------	-------	-------	-------

CASH FLOW

	FY19A	FY20A	FY21E	FY22E	FY23E
Net Income (Cashflow)	\$m -5.0	-11.0	-11.0	-9.9	-2.4
Depreciation & Amortization	\$m 0.4	0.9	1.5	1.5	1.5
Change in Net Operating Assets	\$m 1.8	2.5	-0.7	-0.6	-0.7
Other Non-Cash Items, Total	\$m 0.6	6.3	4.9	2.3	2.3
Other	\$m 0.0	0.0	0.0	0.0	0.0
Operating cash flow	\$m -2.1	-1.2	-5.3	-6.7	0.7
Capital expenditure	\$m -0.5	-1.3	-0.8	2.7	-0.3
Acquisitions/divestment/other	\$m -2.1	-0.2	0.1	-23.3	0.0
Investing cash flow	\$m 2.2	3.7	12.4	36.4	-3.9
Equity	\$m 1.8	0.1	15.1	40.4	0.0
Debt (including convertible)	\$m 0.4	3.8	-0.4	0.0	0.0
Leases	\$m 0.0	-0.2	-2.2	-3.9	-3.9
Financing cash flow	\$m 2.2	3.7	12.4	36.4	-3.9
Net cash flow	\$m -2.5	1.0	6.5	9.1	-3.5
Free cash flow	\$m -4.3	0.8	-8.6	-31.2	-3.5

Earnings estimate changes

Following today's announcement, we make the following changes to our earnings estimates for NOV:

Figure 1 –Earnings estimates for Novatti

		FY21E			FY22E			FY23E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	A\$m	16.5	16.5	0.0%	23.9	23.9	0.0%	23.9	23.9	0.0%
Underlying EBITDA	A\$m	-6.7	-6.7	0.0%	-9.6	-9.6	0.0%	-1.5	-1.5	0.0%
EBIT	A\$m	-11.1	-11.1	0.0%	-11.4	-11.4	0.0%	-3.4	-3.4	0.0%
Profit before tax	A\$m	-12.9	-12.9	0.0%	-10.5	-10.5	0.0%	-2.4	-2.4	0.0%
NPAT (reported)	A\$m	-11.4	-11.0	3.9%	-9.9	-9.9	0.0%	-2.4	-2.4	0.0%
EPS (underlying)	cps	-4.7	-4.5	3.9%	-2.9	-2.9	-1.0%	-0.7	-0.7	-1.2%
EPS (reported)	cps	-4.7	-4.5	3.9%	-2.9	-2.9	-1.0%	-0.7	-0.7	-1.2%
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:

- The disclosure of the company's full year revenues as part of its June 2021 quarterly activities report, which sees us adjust our tax line which includes R&D refunds and JobKeeper.
- Adjusting the company's cash balance at 30 June 2021 to the \$8.8m reported in its Appendix 4C release.
- Adjusting shares on issue down, recognising the balance of probabilities that it may not reach a full subscription of its Share Purchase Plan, given the company's share price is currently below the level at which shareholders can subscribe to new shares under this plan.

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 2 –MST Access valuation of Novatti

Current date	30-Jul-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	-6.9	-26.2	-5.0	-1.1	-2.4	0.3	-1.2	1.5	0.0	2.8	1.8	4.5	4.0	6.8	7.1
Discounted cash flow	A\$m	0.0	-25.5	-4.7	-1.0	-2.1	0.2	-1.0	1.2	0.0	2.1	1.3	3.2	2.8	4.5	4.6
Sum of discount streams	A\$m	-14.5	CAPM													
Future value into perpetuity	A\$m	396.6	Risk free rate		2.00%											
NPV of terminal value	A\$m	256.5	Equity beta		1.5											
add adjusted net cash	A\$m	26.3	Equity risk premium		3.00%											
Value of total equity	A\$m	268.3	Cost of equity		6.5%											
Diluted shares on issue	m	336.1														
Value per share	A\$	0.80	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 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 within specialised finance.

Using these industry classifications we believe deliver a more appropriate peer group to which to compare Novatti. Refining these screens deliver the peers and respective multiples in Figure 3.

Figure 3 – Selected Peer Valuation Multiples sorted by EV/1 year forward revenue

Company Name	EV/Forward Revenue	EV/Forward EBITDA	Forward P/E
Tyro Payments Limited (ASX:TYR)	5.8x	120.1x	NM
EML Payments Limited (ASX:EML)	5.7x	19.6x	34.8x
Smartpay Holdings Limited (NZSE:SPY)	4.3x	20.0x	NM
Australian Peer Average	5.3x	53.2x	34.8x
Marqeta, Inc. (NasdaqGS:MQ)	32.3x	NM	NM
Visa Inc. (NYSE:V)	19.2x	27.0x	36.0x
Mastercard Incorporated (NYSE:MA)	19.1x	31.8x	42.2x
PayPal Holdings, Inc. (NasdaqGS:PYPL)	12.4x	42.9x	59.3x
Payfare Inc. (TSX:PAY)	10.1x	NM	NM
Paymentus Holdings, Inc. (NYSE:PAY)	8.6x	149.1x	NM
Amadeus IT Group, S.A. (BME:AMS)	8.4x	28.0x	97.0x
Fidelity National Information Services, Inc. (NYSE:FIS)	7.9x	17.4x	21.8x
Network International Holdings plc (LSE:NETW)	7.8x	18.7x	41.2x
Paysafe Limited (NYSE:PSFE)	6.2x	18.6x	81.8x
WEX Inc. (NYSE:WEX)	5.9x	15.2x	21.0x
Fiserv, Inc. (NasdaqGS:FISV)	5.8x	14.2x	19.0x
Square, Inc. (NYSE:SQ)	5.7x	125.8x	162.7x
Worldline SA (ENXTPA:WLN)	4.9x	18.6x	29.2x
PayPoint plc (LSE:PAY)	3.9x	8.0x	11.5x
The Western Union Company (NYSE:WU)	2.2x	8.2x	10.9x
International Peer Average	10.0x	37.4x	48.7x
Novatti Group Limited (ASX:NOV) (MST FY22E)	5.7x	NM	NM

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 32.3x 1 year forward revenue. In comparison, on our forecasts Novatti is trading on 5.7x EV/FY22 revenue.

Quarterly Activities Report and Appendix 4C Cashflow Analysis

Outlook commentary highlights several upcoming catalysts for the stock

Novatti offered the following outlook commentary as part of a presentation alongside its quarterly activities report, suggesting several upcoming catalysts for the stock over the next few months, in addition to its FY21 result and AGM.

Figure 4 –Novatti Outlook

Outlook

- Recent 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
- Opportunity 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

Novatti



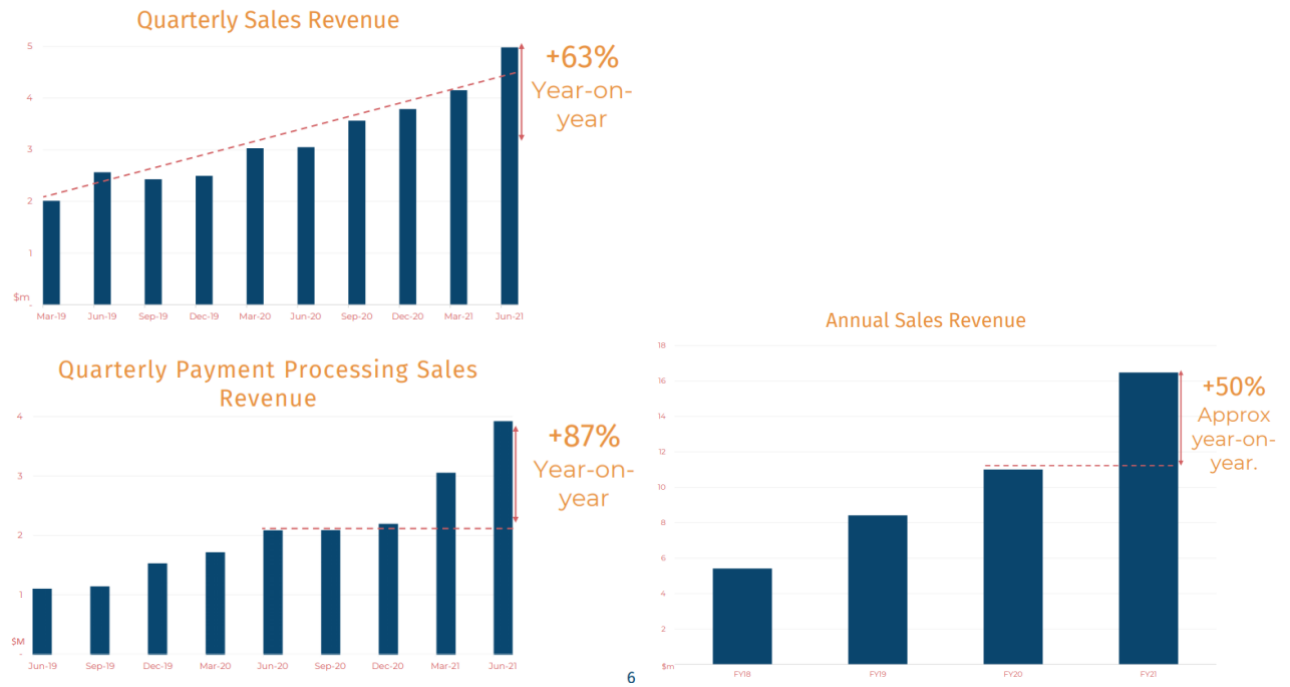
Source: Company reports, MST Access estimates

4Q21 revenue beats company guidance

Novatti's achieved record quarterly revenues in 4Q21, with sales revenues lifting to of \$4.9m, well in excess of its forecast \$4.15m (the level it achieved in 3Q21), when it conducted a capital raise at the start of this month. The major component of its sales revenues are payment processing revenues which were \$3.9m in the quarter and continue to grow at a faster rate than Novatti's total sales revenue, a trend which if it continues will see payment processing continue to become a larger proportion of its revenue in the future.

Annual sales revenue was approximately \$16.5m, and total annual revenues were \$18.4m, with the company suggesting that the difference between these two figures was attributable to government R&D grants and JobKeeper (given these differences are tax related, we put them through our tax line). Again, due to exceeding its 4Q21 forecast, Novatti also beat its annual forecast sales revenue. Novatti has now averaged a 45% sales revenue CAGR over the past 3 years, and given its latest initiatives are still gaining traction, with further growth initiatives in the pipeline, highlighted but its recent capital raising and acquisition of 19.9% of Reckon, it is strongly positioned, and funded, to continue this rapid growth for the foreseeable future.

Figure 5 – Novatti quarterly and annual revenue trends

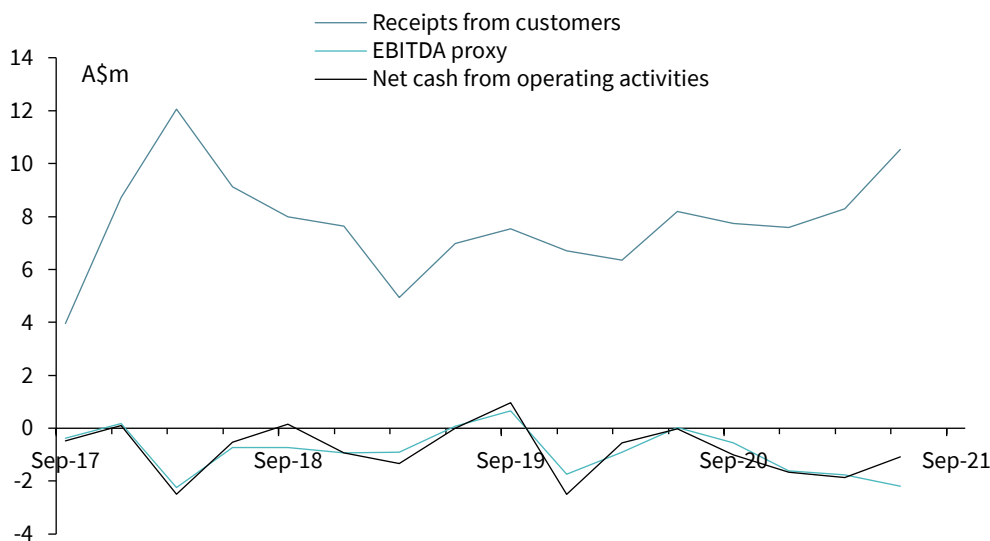


Source: Company reports

Cash receipts picking up

While continuing to operate at a manageable operating cashflow deficit, the company’s accelerating receipts from customers begun to accelerate again 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 roughly twice revenues), it is positive to see. The increased gap in 4Q21 between our EBITDA proxy and Novatti’s net cash from operating activities is almost all attributable to government grants and taxes.

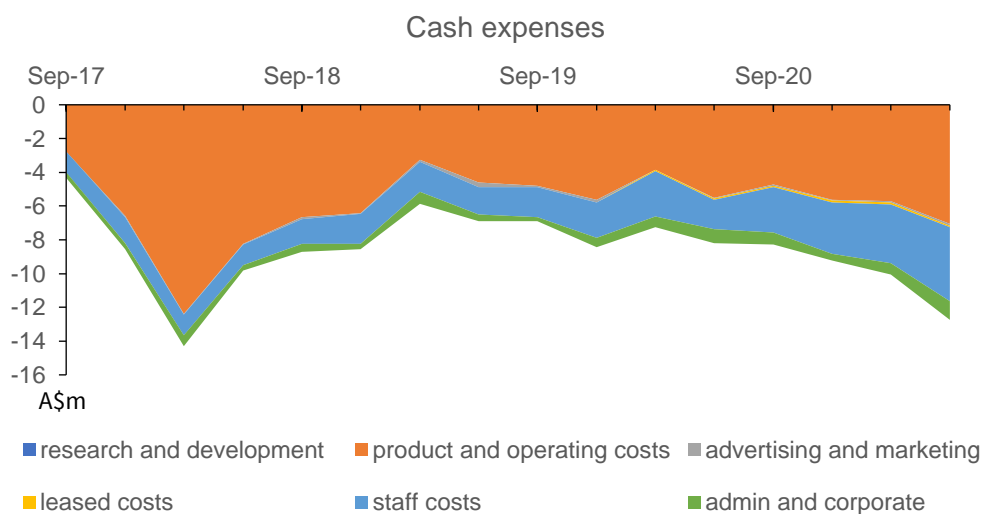
Figure 6 – Quarterly cash receipts and operating cashflow



Source: Company reports, MST Access estimates

Operating expenses increasing too

Figure 7 – Cash operating expenses



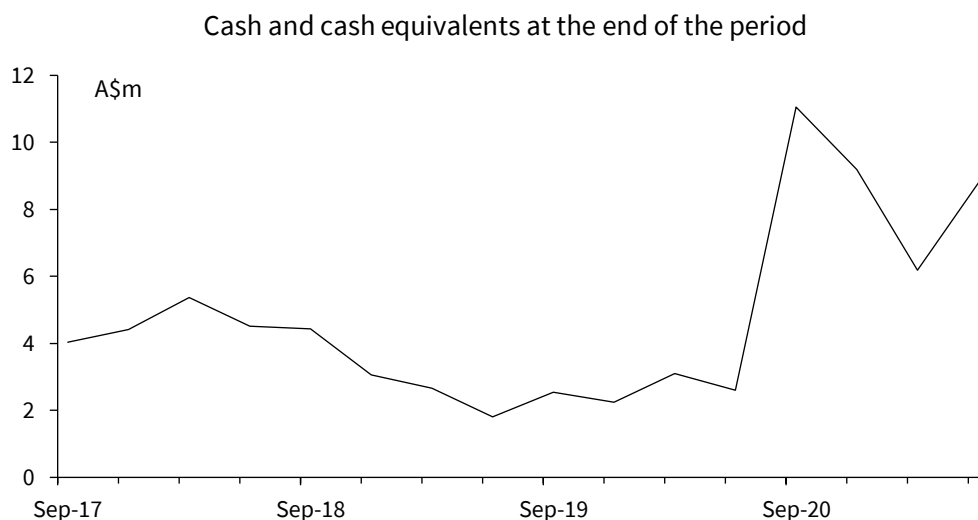
Source: Company reports, MST Access estimates

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 4Q21. 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 extended, with a further extension to come from July raising

Novatti’s cash at the end of June 2021 was approximately \$8.8m, aided from its placement associated with selling down its stake in its (yet to be licenced) banking entity. Its cash position has since increased following its capital raising at the start of July (which was announced at the end of June), and is set to further increase once its currently open Share Purchase Plan closes, although perhaps not to the full amount of the Share Purchase Plan due to the company’s weak share price.

Figure 8 – Novatti quarterly cash balance



Source: Company reports, MST Access estimates

As its Appendix 4C states, Novatti at 30 June had 8.04 quarters of future cash available at the pace of operating cash burn during the June quarter. However, we believe this doesn't reflect the company's current position; because of:

- its early July capital raise (net of the amount paid for its 19.9% stake in Reckon) and
- the reduction in operating cash burn from government grants and tax incentives.

Adjusting for both these considerations produces a cash runway estimate of 11.6 quarters.

Figure 9 – Novatti adjusted cash runway

	2021 Q4	Adjustments	Adjusted
	A\$ k	A\$ k	A\$ m
Net cash from / (used in) operating activities	-1,094	-1,170	-2,264
Cash and cash equivalents at quarter end	8,798	17,500	26,298
Unused finance facilities available at quarter end	0		0
Total available funding available	8,798		26,298
Estimated periods of funding available	8.0		11.6

Source: Company reports, MST Access estimates

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.

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.

Disclaimers

MST Access is a registered business name of MST Financial Services Pty Ltd (ACN 617 475 180 "MST Financial") which is a limited liability company incorporated in Australia on 10 April 2017 and holds an Australian Financial Services Licence (Number: 500 557). This research is issued in Australia through MST Access which is the research division of MST Financial. The research and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by MST Access is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

This report has been commissioned by Novatti Group Limited and prepared and issued by Glen Wellham of MST Access in consideration of a fee payable by Novatti Group Limited. MST Access receives fees from the company referred to in this document, for research services and other financial services or advice we may provide to that company. The analyst has received assistance from the company in preparing this document. The company has provided the analyst with communication with senior management and information on the company and industry. As part of due diligence, the analyst has independently and critically reviewed the assistance and information provided by the company to form the opinions expressed in the report. Diligent care has been taken by the analyst to maintain an honest and fair objectivity in writing this report and making the recommendation. Where MST Access has been commissioned to prepare Content and receives fees for its preparation, please note that NO part of the fee, compensation or employee remuneration paid will either directly or indirectly impact the Content provided.

Accuracy of content: All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of MST Access at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results and estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

Exclusion of liability: To the fullest extent allowed by law, MST Access shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out of or in connection with the access to, use of or reliance on any information contained in this report. No guarantees or warranties regarding accuracy, completeness or fitness for purpose are provided by MST Access, and under no circumstances will any of MST Financial's officers, representatives, associates or agents be liable for any loss or damage, whether direct, incidental or consequential, caused by reliance on or use of the content.

General Advice Warning

MST Access Research may not be construed as personal advice or recommendation. MST encourages investors to seek independent financial advice regarding the suitability of investments for their individual circumstances and recommends that investments be independently evaluated. Investments involve risks and the value of any investment or income may go down as well as up. Investors may not get back the full amount invested. Past performance is not indicative of future performance. Estimates of future performance are based on assumptions that may not be realised. If provided, and unless otherwise stated, the closing price provided is that of the primary exchange for the issuer's securities or investments. The information contained within MST Access Research is published solely for information purposes and is not a solicitation or offer to buy or sell any financial instrument or participate in any trading or investment strategy. Analysis contained within MST Access Research publications is based upon publicly available information and may include numerous assumptions. Investors should be aware that different assumptions can and do result in materially different results.

MST Access Research is distributed only as may be permitted by law. It is not intended for distribution or use by any person or entity located in a jurisdiction where distribution, publication, availability or use would be prohibited. MST makes no claim that MST Access Research content may be lawfully viewed or accessed outside of Australia. Access to MST Access Research content may not be legal for certain persons and in certain jurisdictions. If you access this service or content from outside of Australia, you are responsible for compliance with the laws of your jurisdiction and/or the jurisdiction of the third party receiving such content. MST Access Research is provided to our clients through our proprietary research portal and distributed electronically by MST to its MST Access clients. Some MST Access Research products may also be made available to its clients via third party vendors or distributed through alternative electronic means as a convenience. Such alternative distribution methods are at MST's discretion.

Access and Use

Any access to or use of MST Access Research is subject to the Terms and Conditions of MST Access Research. By accessing or using MST Access Research you hereby agree to be bound by our Terms and Conditions and hereby consent to MST collecting and using your personal data (including cookies) in accordance with our Privacy Policy (<https://mstfinancial.com.au/privacy-policy/>), including for the purpose of a) setting your preferences and b) collecting readership data so we may deliver an improved and personalised service to you. If you do not agree to our Terms and Conditions and/or if you do not wish to consent to MST's use of your personal data, please do not access this service.

Copyright of the information contained within MST Access Research (including trademarks and service marks) are the property of their respective owners. MST Access Research, or any portion thereof, may not be reprinted, sold or redistributed without the prior and written consent of MST.