

## Strong start to FY22

Novatti delivered 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.

## November 2021 catalysts piling up

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

- its banking licence from APRA
- acquiring licences from Visa and Mastercard
- completion of its ATX acquisition
- expanding its relationship with Ripple in SE Asia

The first three of these, plus its AGM, are scheduled to complete in November.

Discussions with Reckon to integrate payments into its product and hence provide Novatti access to its customer base are reportedly going well, and may present further upside when completed.

## Cash runway likely longer than stated

While Novatti disclosed a comfortable 5 quarters of cash based on its 30 September cash balance and its burn rate during the September quarter, as detailed inside we think its cash position is stronger than this calculation suggests.

## Earnings and valuation changes

We change our EPS estimates: FY22E: -13%, FY23E: +67%, FY24E: -26%. We value NOV at A\$1.15 ps (up from 80cps), 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 4.3x FY22 EV/revenue and 2.7x 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\$0.39
Market cap	A\$140m
Valuation	A\$1.15

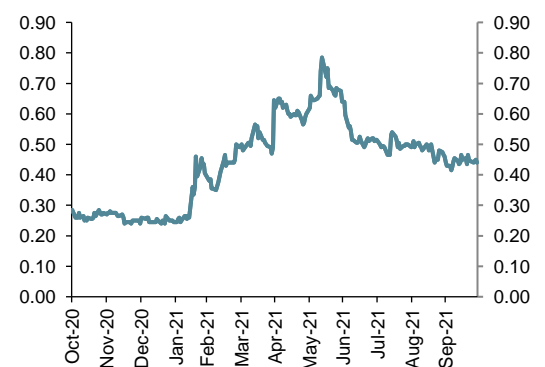
### Company data

Net cash at 30 Sept:	~A\$19.9m
Basic shares on issue:	325.5m

### Next steps

Visa and MC acquiring licences	November 2021
RADI licence approval	November 2021
ATX acquisition completion	November 2021
AGM	24 November 2021

### NOV Share Price (A\$)



Glen Wellham  
Senior Research Analyst



## Earnings estimate changes

Following Friday's 1Q22 cashflows announcement, 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	21.1	28.0	32.4%	28.4	39.7	39.9%	36.1	50.8	40.8%
Underlying EBITDA	A\$m	-7.4	-8.5	-15.9%	-0.1	0.3	711.9%	2.2	2.6	17.1%
EBIT	A\$m	-9.2	-10.4	-12.6%	-1.9	-1.5	20.4%	0.3	0.7	109.7%
Profit before tax	A\$m	-8.3	-9.2	-10.8%	-1.0	-0.3	67.0%	1.3	1.9	50.6%
NPAT (reported)	A\$m	-7.7	-8.6	-11.6%	-1.0	-0.3	67.0%	1.3	0.9	-26.9%
EPS (underlying)	cps	-2.2	-2.5	-12.5%	-0.3	-0.1	66.7%	0.4	0.3	-26.3%
EPS (reported)	cps	-2.2	-2.5	-12.5%	-0.3	-0.1	66.7%	0.4	0.3	-26.3%
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 stronger than anticipated revenue growth being achieved in its payments business, which is the primary source of our upgrades
- Initial revenues for the acquiring business in 2Q22, with ongoing revenues thereafter.
- The acquisition of ATX, which provides a positive contribution from day 1
- The launch of Verv in Europe and partnership with Ripple in Thailand
- Adjusting shares on issue for the actual amount of shares issued in its Share Purchase Plan and script component of the ATX acquisition.

## Valuation

We value NOV at A\$1.15 per share (up from 80cps) 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-Oct-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	
<b>Free cash flow to equity</b>	<b>A\$m</b>	-6.0	-29.5	-0.4	-3.3	1.9	-2.4	2.2	2.7	4.2	5.0	5.8	7.2	8.2	9.1	11.9	
<b>Discounted cash flow</b>	<b>A\$m</b>	0.0	-29.2	-0.4	-3.1	1.7	-2.1	1.9	2.2	3.3	3.9	4.4	5.2	5.7	6.2	7.8	
Sum of discount streams	A\$m	7.5		<b>CAPM</b>													
Future value into perpetuity	A\$m	600.0		Risk free rate			2.00%										
NPV of terminal value	A\$m	394.3		Equity beta			1.5										
add adjusted net cash	A\$m	16.6		Equity risk premium			3.00%										
<b>Value of total equity</b>	<b>A\$m</b>	<b>418.4</b>		Cost of equity			6.5%										
Diluted shares on issue	m	364.5															
<b>Value per share</b>	<b>A\$</b>	<b>1.15</b>		Terminal growth			3.0%										

Source: Company reports, MST Access estimates

## Comparative Multiples

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

While Novatti currently has its primary industry classification as application service provider under software, we believe a more appropriate industry 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
Marqeta, Inc. (NasdaqGS:MQ)	28.8x	NM	NM
Visa Inc. (NYSE:V)	16.0x	22.7x	29.6x
Mastercard Incorporated (NYSE:MA)	15.4x	25.5x	33.7x
PayPal Holdings, Inc. (NasdaqGS:PYPL)	9.8x	33.4x	46.7x
Amadeus IT Group, S.A. (BME:AMS)	7.8x	24.2x	66.3x
Network International Holdings plc (LSE:NETW)	6.9x	16.7x	34.8x
Paymentus Holdings, Inc. (NYSE:PAY)	6.5x	100.6x	NM
Square, Inc. (NYSE:SQ)	6.3x	106.8x	136.3x
Fidelity National Information Services, Inc. (NYSE:FIS)	6.0x	13.4x	15.7x
Payfare Inc. (TSX:PAY)	5.9x	NM	NM
Fiserv, Inc. (NasdaqGS:FISV)	5.1x	12.5x	15.7x
WEX Inc. (NYSE:WEX)	4.9x	12.9x	15.5x
Paysafe Limited (NYSE:PSFE)	4.6x	14.1x	96.2x
PayPoint plc (LSE:PAY)	4.6x	9.3x	13.6x
Worldline SA (ENXTPA:WLN)	3.9x	14.6x	19.9x
The Western Union Company (NYSE:WU)	1.8x	6.9x	8.4x
<b>International peer average</b>	<b>8.4x</b>	<b>29.6x</b>	<b>41.0x</b>
EML Payments Limited (ASX:EML)	4.2x	16.2x	35.6x
Smartpay Holdings Limited (NZSE:SPY)	4.6x	22.2x	-
Tyro Payments Limited (ASX:TYR)	6.1x	77.5x	NM
<b>Australian peer average</b>	<b>5.0x</b>	<b>38.6x</b>	<b>35.6x</b>
<b>Novatti Group Limited (ASX:NOV)</b>	<b>4.3x</b>	<b>NM</b>	<b>NM</b>

Source: IBES, Capital IQ, MST Access estimates

With Novatti being the Australian partner for Marqeta, we see that as its main peer, despite it being the most expensive of our peer group, trading on 28.8x 1 year forward revenue. In comparison, on our forecasts Novatti is trading on 4.3x EV/FY22 revenue.

Once the acquisition of Afterpay by Square is completed, and has a local listing on the ASX, we will shift Square from our international peer average into our Australian peer average.

## 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 AGM on 24 November 2021, where it will likely revisit its transformational progress over the past year.

Figure 4 –Novatti Outlook

### Outlook

- Main ambition – continue to grow top line revenue
- Deliver on expanded growth strategy, underpinned by strong balance sheet with cash balance of \$19.9m\*:
  1. New and expanded markets
    - Finalise restricted banking licence approval
    - Strengthen acquiring business with Visa and Mastercard licences
    - Discussions with Ripple on new markets in South East Asia
  2. Acquisitions
    - ATX – complete acquisition and integrate
    - Assess other opportunities in pipeline
  3. Strategic investment in Reckon
    - Discussions begun on servicing the needs of Reckon’s customers

Novatti



\*Cash balance at end of September quarter.

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

### 1Q22 revenue plus ATX acquisition leads to upgrades

Novatti’s achieved record 1Q revenues again in 1Q22, with sales revenues comfortably exceeding \$5m, compounding upon last quarter’s record sales revenues. Payment processing revenues also had another record quarter, exceeding \$4m and more than doubling on pcp, with payment processing continuing to become a larger proportion of Novatti’s overall revenue given its faster growth.

Figure 5 –Novatti quarterly revenue trends



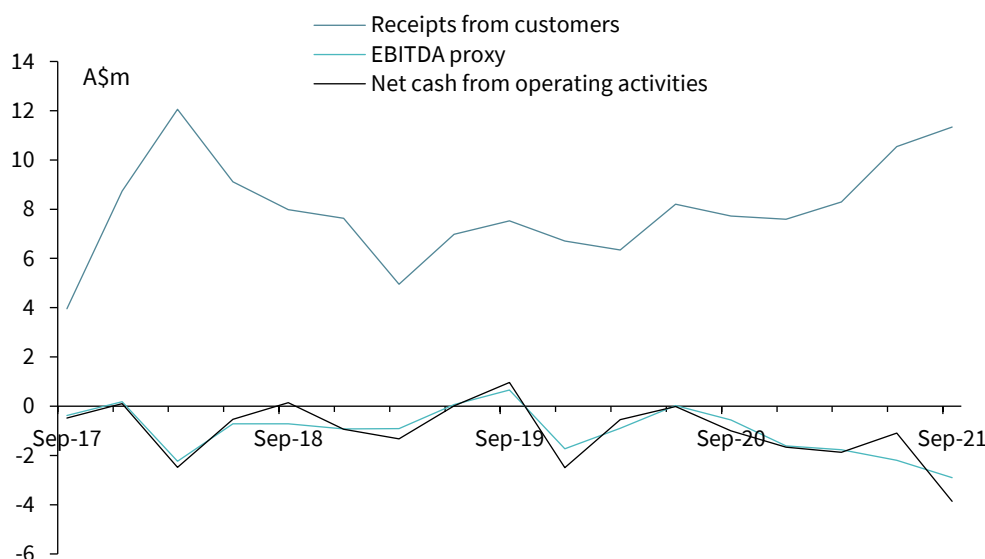
Source: Company reports

The acquisition of ATX 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.

## Cash receipts continue to rise

While continuing to operate at a manageable operating cashflow deficit, 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 roughly twice revenues), it is positive to see. The reversal of the gap in 1Q22 from 4Q21 between our EBITDA proxy and Novatti’s net cash from operating activities suggests potential timing issues, likely around temporary movements in its cash float.

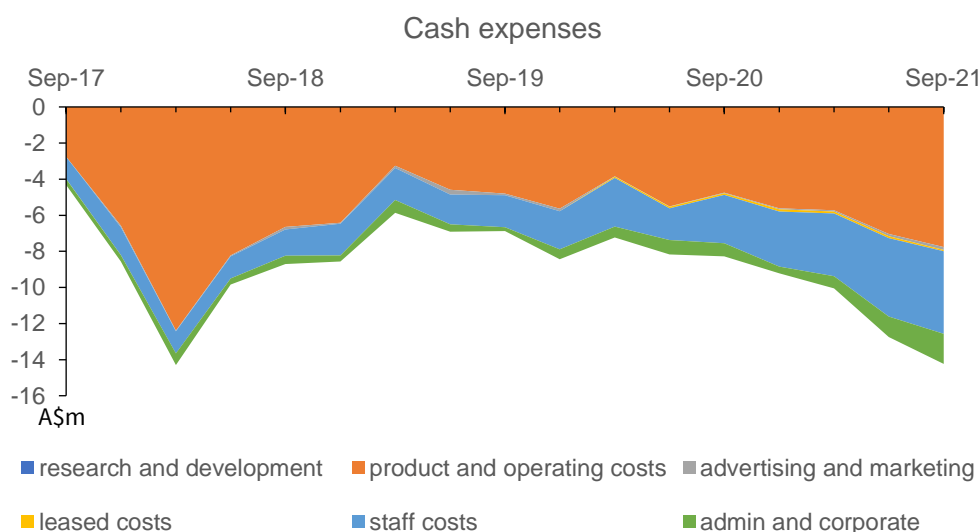
Figure 6 – Quarterly cash receipts and operating cashflow



Source: Company reports, MST Access estimates

## Operating expenses increasing too

Figure 7 – Cash operating expenses



Source: Company reports, MST Access estimates

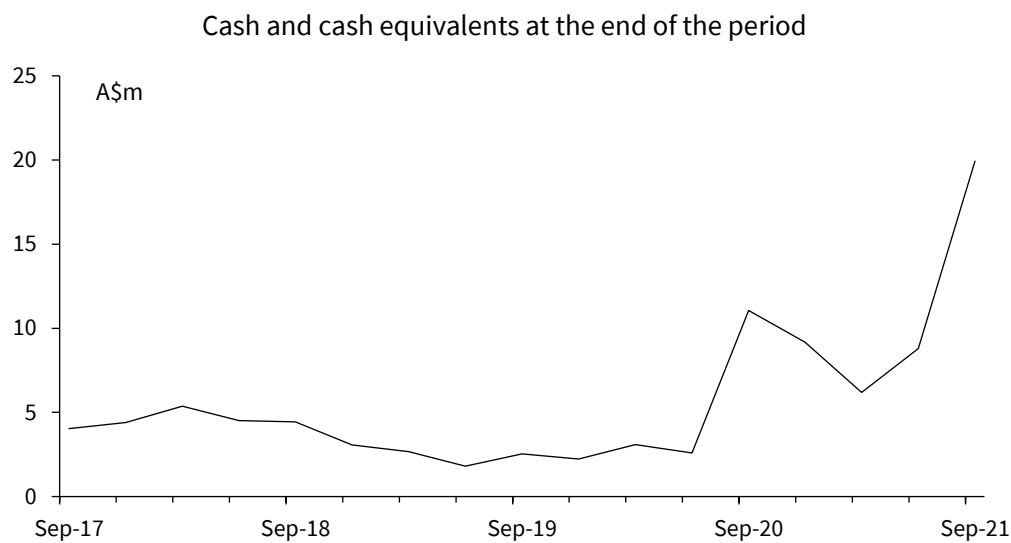
Consistent with Novatti’s articulated strategy of increasing its investments to grow the company, its product and operating costs, staff costs and admin and corporate costs all increased in 1Q22. We continue to believe that the relationship between these costs and revenues is a J curve, where Novatti 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 September 2021 was \$19.9m, up substantially from June following its capital raising at the start of July (which was announced at the end of June) and Share Purchase Plan, offset by cash invested in its strategic stake Reckon. It will have further decreased during October from the initial cash payment for its ATX acquisition.

Figure 8 – Novatti quarterly cash balance



Source: Company reports, MST Access estimates

Figure 9 – Novatti adjusted cash runway

	2022 Q1 A\$ <b>k</b>	Adjustments A\$ <b>k</b>	Adjusted A\$ <b>m</b>	Comments
Net cash from / (used in) operating activities	-3,863	1,125	-2,738	Add EBITDA from ATX acquisition, add back impact of one-off costs in quarter, plus bank costs which will be deconsolidated once licence is received
Cash and cash equivalents at quarter end	19,932	-3,285	16,647	Initial cash payment for ATX, plus Reckon dividend
Unused finance facilities available at quarter end	0		0	
Total available funding available	19,932		16,647	
Estimated periods of funding available	5.2		6.1	

Source: Company reports, MST Access estimates

As its Appendix 4C states, Novatti at 30 September had 5.2 quarters of future cash available at the pace of operating cash burn during the September quarter. However, we believe this doesn't reflect the company's current position, and that the following adjustments are required:

- To cash balances:
  - Deduct the initial cash of \$3.94m associated with its acquisition of ATX
  - Add the dividend it has received from Reckon of \$675k

- To cash from operating activities:
  - Allow for the EBITDA contribution of ATX at around A\$125k a quarter (and growing)
  - Allow for one off operating items and banking costs set to be deconsolidated upon receiving its banking licence, together which total around \$1m of the \$3.9m in operating cash consumption.

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

## Updated Investment thesis

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

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

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

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

## Key Risks and Sensitivities

### Macroeconomic impacts

Key influences on our valuation include:

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

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

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

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

### Regulatory Requirements

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

- Anti-money laundering and counter terrorist financing requirements administered by Austrac;
- Authorised Deposit Institution regulation administered by the Australian Prudential Regulatory Authority;
- Foreign Investment restrictions administered by the Foreign Investment Review Board;
- Privacy requirements administered by the Privacy Commissioner;
- Financial Service licencing and Credit licencing requirements administered by the Australian Securities and Investments Commission (ASIC);
- Australian Consumer Law and unfair contract terms contained in the Corporations Act administered by the Australian Competition and Consumer Commission (ACCC);



- Restrictions on merchant pricing, or interchange fees, administered by the Reserve Bank of Australia (RBA) leading to fee compression;
- Taxation legislation administered by the Australian Taxation Office (ATO);
- Accounting standards required under the Corporations Act administered by the Australian Accounting Standards Board (AASB) and ASIC;
- Design and distribution obligations, several of which will be governed by contract law.

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

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

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

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

### Growing pains

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

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

### Reputational risks

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

### Technology Changes

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

### Market & Shareholder Support

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

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

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

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## Company Description

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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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