

Racing towards cash breakeven

Novatti has recorded another record quarter of revenues, with its Payments division again accounting for the bulk of its revenue. Active cash flow management has seen its cash burn contract.

Cash position stronger than reported

Novatti is due to receive an \$8m+ special dividend from its strategic Recon shareholding, potentially towards the end of 1Q23 or early 2Q23. When we add this onto its cash balance, its cash runway increases from 2.7 to 6.2 quarters. This could be further extended through further reduction in cash burn, and from additional finance. So, we remain comfortable that the company does not need to raise additional equity to fund its operations, a key risk for any non-cash generating company.

Earnings and valuation changes

Allowing \$8m for a special dividend from Reckon in 1H23 and a minor adjustment to the shares on issue we change our EPS estimates: FY22E: -11%, FY23E: 152%, FY24E: large. We value NOV at A\$1.00 (down from A\$1.05), using a DCF on free cash flows to equity with a cost of equity of 9.0% (up from 8.0%), referencing peer multiples to validate reasonableness. Details inside including key risks on page 8.

Growing to scale new strategic focus

Consistent with recent commentary from major card schemes, Novatti is not seeing a slowdown in global demand for its services. Macro-level demand continues to suggest the shift to digital payments is just starting, further supporting Novatti's growth in the quarters ahead.

Stablecoin launch adds crypto appeal

AUDD provides a digital representation of the Australian Dollar and is secured with a 1:1 backing of AUD fiat value. AUDD will be available on multiple, leading blockchain networks (project partners include Ripple and Stellar), with the hopes of creating a secure and permanent digital record of all transactions and account balances, maintaining the integrity of each transaction and providing a strong framework to maintain Novatti's focus on compliance. AUDD will be integrated into Novatti's existing suite of payment solutions, providing clients with a new and innovative way to pay and be paid through potentially faster and lower cost domestic, cross-border and billing payments, as well as stablecoin-linked payment cards, while also creating new additional revenue streams, subject to product demand.

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.

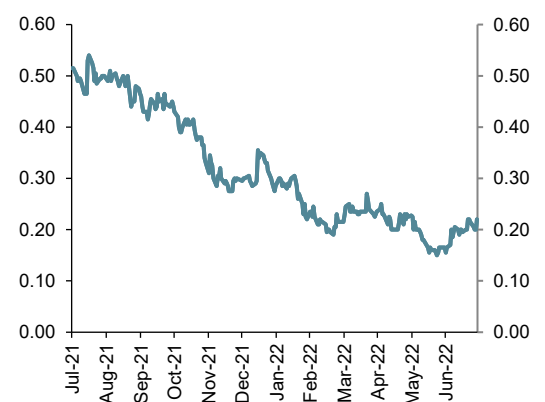
Its services capture the entire payments value chain. This includes issuing, such as prepaid Visa cards, acquiring, enabling merchants to accept payment from financial institutions, and processing, including cross-border transfers and automated invoicing.

Stock	NOV.ASX
Market cap	A\$75.4m
Price	A\$0.205
Valuation	A\$1.00 (was A\$1.05)

Company data	
Cash at 4Q22:	~A\$6.1m
Shares on issue:	335.3m

Next steps	
FY22 final result	Late August 2022
ADI licence; EMI licence	Pending regulators
1Q23 Appendix 4C	Late October 2022

NOV Share Price (A\$)



Glen Wellham, Senior Analyst

Financials

NOVATTI GROUP LIMITED

NOV-AU

Year end 30 June, AUD unless otherwise noted

MARKET DATA

Price	\$	0.205
Valuation	\$	1.00
52 week high / low	\$	0.15 - 0.56
Market capitalisation	\$m	68.7
Shares on issue (basic)	m	335.3
Options / rights / ESP / LTIP	m	15.9
Other equity	m	0.0
Shares on issue (fully diluted)	m	351.2
Out of the money options	m	24

12-MONTH SHARE PRICE PERFORMANCE

INVESTMENT FUNDAMENTALS

	FY20A	FY21A	FY22E	FY23E	FY24E
Reported NPAT	\$m (10.7)	(12.2)	(14.6)	2.7	4.7
Underlying NPAT	\$m (10.7)	(12.2)	(14.6)	2.7	4.7
Reported EPS (diluted)	¢ (6.2)	(5.4)	(4.5)	0.8	1.3
Underlying EPS (diluted)	¢ (6.2)	(5.4)	(4.5)	0.8	1.3
...Growth	% 148%	(14%)	(17%)	(117%)	71%
PER underlying	x (3.3)	(3.8)	(4.6)	26.4	15.4
Operating cash flow per share	¢ (0.7)	(2.4)	(4.5)	1.2	1.7
Free cash flow per share	¢ 0.5	(3.8)	(13.5)	(0.1)	0.4
Price to free cash flow per share	x 0.4	nm	nm	nm	0.5
FCF yield	% 2.4%	(18.6%)	(65.7%)	(0.5%)	2.1%

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	71.8	64.8	64.5	64.8	63.3
EV/Revenue	x	6.5	3.9	2.0	1.5	1.1
EV/Underlying EBITDA	x	-17.4	-12.4	-5.8	12.9	9.1
Book value per share	¢	-0.3	3.6	12.2	13.6	15.6
Price to book (NAV)	x	-141.6	7.7	1.6	1.4	1.2
Net tangible assets per share	¢	-3.3	1.6	10.9	12.3	14.3
Price to NTA	x	-11.1	17.6	1.7	1.5	1.3

KEY RATIOS

	FY20A	FY21A	FY22E	FY23E	FY24E
Net debt / (cash)	\$m 3.0	(3.9)	(4.3)	(3.9)	(5.4)
Interest cover (Operating NPAT / net interest)	x (3.4)	(1.7)	50.9	7.8	12.7
Gearing (net debt / underlying EBITDA)	x nm	0.7	0.4	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	0.48	0.51
Financial Leverage	x -67.6	7.2	2.9	12.4	17.6
Return on Equity	% nm	nm	nm	5.98	8.91

GROWTH PROFILE

	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	% 30.7	49.8	97.6	36.5	34.0
Underlying EBITDA	% (86.9)	(26.5)	(113.4)	145.2	38.4
NPAT	% (165.4)	(14.8)	(19.5)	118.7	70.6
Underlying Profit	% (264.5)	(25.3)	(44.6)	390.0	248.1
Underlying EPS	% (147.8)	14.1	16.8	117.5	70.6
DPS	% n/a	n/a	n/a	n/a	n/a

HALF YEARLY DATA

	1H21A	2H21A	1H22A	2H22E	1H23E
Revenue	\$m 7.4	9.1	11.1	21.5	17.7
Other income	\$m 1.0	0.9	1.2	0.2	9.2
Cash expenses	\$m -10.0	-13.6	-18.2	-26.8	-20.3
Underlying EBITDA	\$m -1.7	-3.6	-5.9	-5.2	6.5
EBITDA	\$m -2.2	-4.1	-8.6	-5.4	6.3
Depreciation, amortisation and impairment	\$m -0.7	-0.7	-0.2	-0.8	-0.8
EBIT	\$m -3.0	-4.8	-8.8	-6.1	5.6
Associates and JVs	\$m 0.0	0.0	-1.6	0.0	0.0
Net interest	\$m -0.1	-4.3	0.5	-0.2	-0.2
PBT	\$m -3.1	-9.1	-9.9	-6.3	5.4
Income tax	\$m 0.0	0.0	-0.1	0.0	0.0
NPAT	\$m -3.1	-9.1	-9.9	-6.3	5.4

Source: Company reports and MST Access estimates

PROFIT AND LOSS

	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	\$m 11.0	16.5	32.6	44.5	59.6
Other income	\$m 0.8	1.9	1.4	10.4	2.4
Cash expenses	\$m -16.0	-23.6	-45.1	-49.8	-55.0
Underlying EBITDA	\$m -4.1	-5.2	-11.1	5.0	7.0
EBITDA	\$m -4.3	-6.3	-12.4	4.6	6.6
Depreciation, amortisation and impairment	\$m -3.9	-1.5	-0.9	-1.5	-1.5
EBIT	\$m -8.2	-7.8	-13.3	3.1	5.1
Associates, JVs and fair value adjustments	\$m 0.0	0.0	-1.6	0.0	0.0
Net interest	\$m -2.4	-4.5	0.3	-0.4	-0.4
PBT	\$m -10.6	-12.2	-14.6	2.7	4.7
Income tax	\$m 0.0	0.0	-0.1	0.0	0.0
NPAT	\$m -10.7	-12.2	-14.6	2.7	4.7

Weighted average diluted shares on issue	m	171.3	228.8	328.6	351.2	351.2
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BALANCE SHEET

	FY20A	FY21A	FY22E	FY23E	FY24E
Cash & equivalents	\$m 2.6	8.8	4.5	4.1	5.6
Trade & other receivables	\$m 2.8	4.1	5.1	5.4	5.8
Financial assets - funds in trust	\$m 17.5	39.0	60.5	508.2	858.8
Investments accounted for using the equity method	\$m 0.0	0.8	0.8	0.8	0.8
Other investments	\$m 0.9	1.0	22.0	22.0	22.0
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	1.8	1.8	1.8
Intangibles	\$m 5.7	5.0	4.5	4.5	4.5
Deposits	\$m 0.2	2.2	13.6	14.9	17.2
Other	\$m 0.4	0.3	3.8	3.8	3.8
Total Assets	\$m 32.8	63.8	117.0	565.9	920.7

Trade and other payables	\$m 5.9	6.8	8.4	8.9	9.4
Settlement and remittance funds payable	\$m 17.5	38.6	60.0	503.6	851.1
Lease liabilities	\$m 2.5	2.2	2.1	2.1	2.1
Unearned revenue	\$m 0.2	0.2	0.2	0.2	0.2
Borrowings, including convertible notes	\$m 5.6	4.9	0.2	0.2	0.2
Employee benefits	\$m 1.0	1.5	1.7	1.8	1.9
Other	\$m 0.6	0.6	0.3	0.3	0.3
Total liabilities	\$m 33.3	54.9	72.8	517.1	865.2
Net assets	\$m -0.5	8.9	44.2	48.9	55.5

Contributed equity	\$m 26.7	44.1	90.1	90.1	90.1
Reserves	\$m 2.4	3.8	4.6	4.6	4.6
Retained earnings	\$m -29.5	-41.0	-53.6	-49.0	-42.3
Shareholder's equity	\$m -0.5	8.9	41.0	45.7	52.3

Basic shares on issue	m	185.2	244.2	335.3	335.3	335.3
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CASH FLOW

	FY20A	FY21A	FY22E	FY23E	FY24E
Net Income (Cashflow)	\$m -11.0	-12.3	-16.3	2.7	4.7
Depreciation & Amortization	\$m 0.9	1.5	1.5	1.5	1.5
Change in Net Operating Assets	\$m 2.5	-2.8	-2.4	-0.9	-1.0
Other Non-Cash Items, Total	\$m 6.3	5.2	-1.2	0.8	0.8
Other	\$m 0.0	2.9	3.5	0.0	0.0
Operating cash flow	\$m -1.2	-5.4	-14.9	4.1	6.0
Capital expenditure	\$m -1.3	-2.4	-0.8	-0.3	-0.3
Acquisitions/divestment/other	\$m -0.2	-0.3	-25.7	-4.0	-4.0
Investing cash flow	\$m -1.5	-2.6	-28.4	-4.2	-4.2

Equity	\$m 0.1	15.1	39.6	0.0	0.0
Debt (including convertible)	\$m 3.8	-0.4	-0.6	0.0	0.0
Leases	\$m -0.2	-0.3	-0.3	-0.3	-0.3
Financing cash flow	\$m 3.7	14.4	38.8	-0.3	-0.3

Net cash flow	\$m 1.0	6.3	-4.6	-0.4	1.5
Free cash flow	\$m 0.8	-8.7	-44.2	-0.4	1.5

Source: Company reports and MST Access estimates

Quarterly Activities Report and Appendix 4C Cashflow Analysis

Outlook highlights the shift toward achieving positive cash flow.

Novatti reiterated its shift in focus towards generating positive operating cashflows and the June quarter results highlight the significant progress already achieved. As such, its cash burn rate is expected to continue to fall in the quarters ahead.

Novatti's strategic investment in Reckon is also set to support its cash position. To date, has received more than \$1.1m in dividends from its strategic investment in Reckon Limited. Novatti now expects to receive an additional \$8m+ special dividend following the sale of Reckon's Accounts Practice Management Group to Access Group for \$100m.

Figure 1 –Novatti Outlook

What to expect going forward

Novatti

Novatti continues to be in a strong position to capture growth in the global demand for digital payments. After several years of investment, focused on delivering returns:



Shift to positive cashflow

- Focus already shifted to delivering positive cashflow
- Substantial progress already made in June quarter
- Expect cash usage rate to continue to fall in coming quarters



Leveraging existing investment

- Promote and leverage ecosystem globally
- Grow acquiring business
- Secure restricted banking and other existing licence applications



Macro-level growth

- Still seeing strong macro-level growth in shift to digital
- Will continue to position Novatti to capture this growth without need for substantial capital

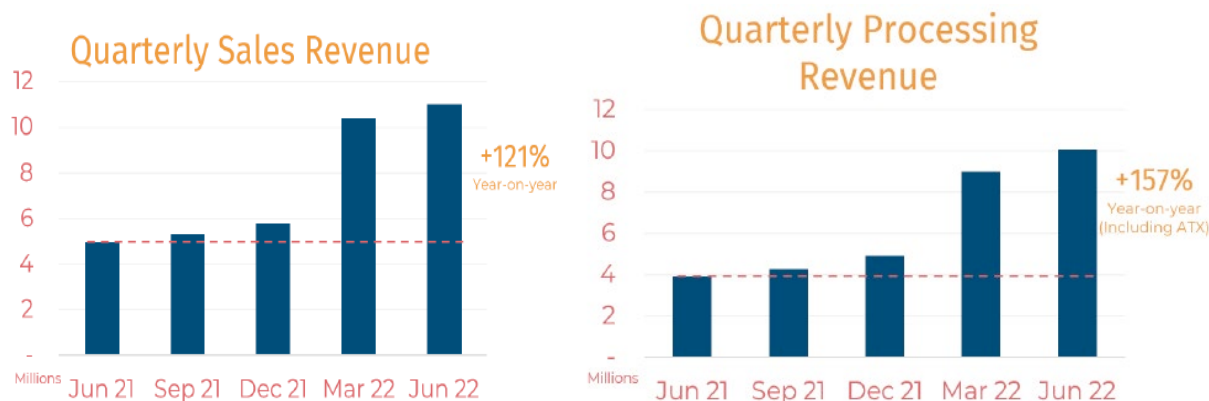
Source: Company reports, MST Access estimates

Record 4Q22 revenue

Novatti achieved yet another record result in 4Q22, with revenues exceeding \$11m for the first time. This represents a +121% increase YoY. This marked 10 consecutive quarters of revenue growth, and four consecutive quarters of record revenues across FY22, resulting in annual sales revenue of \$32.5m, an increase of 97% on the previous financial year. Novatti has managed to grow its annual sales revenue by a CAGR of 76% across the past five years, however we would note that acquisitions are included in this growth rate.

The completed acquisition of ATX supported strong growth in Novatti's processing business, which continues to account for the lion's share of group revenues, with June quarter sales revenue of more than \$10m, setting another record and an increase of more than 157% YoY. This acquisition has immediately created an established base for Novatti to operate within South East Asia, further leveraging existing partnerships in that region. With Novatti's global B2B payment ecosystem now well-established, management are focused on delivering increasing returns from this investment.

Figure 2 – Novatti quarterly revenue trends

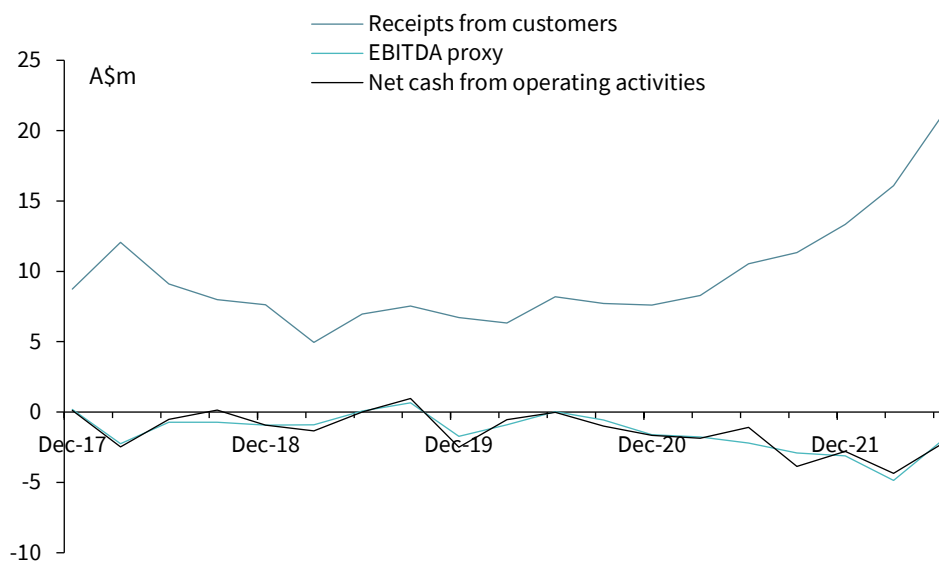


Source: Company reports

Cash receipts continue to rise

Novatti’s cash receipts increased 31% over the previous quarter to \$21m. When combined with Novatti’s cash consumption in operations falling 48% on the prior quarter, to \$2.3m, the shift in focus to delivering positive cashflow is already well underway. We expect Novatti’s cash burn rate to continue to fall in the quarters ahead.

Figure 3 – Quarterly cash receipts and operating cashflow



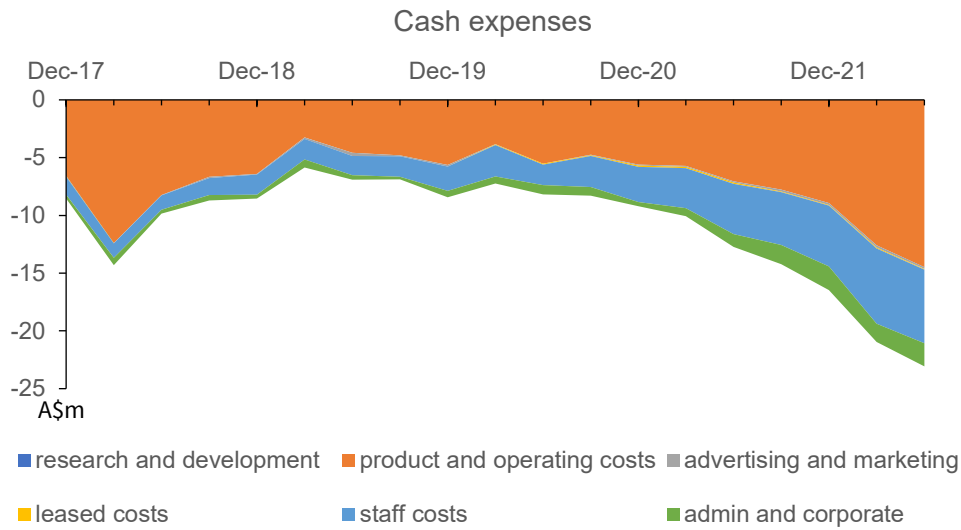
Source: Company reports, MST Access estimates

Operating expenses increasing too

Reflecting the additional costs added by ATX, and consistent with Novatti’s articulated strategy of increasing its investments to grow the company, its product and operating costs increased in 4Q22, although showing that it does carefully manage costs, staff and advertising and marketing costs contracted.

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. The track towards break-even suggests we may now be past the inflection point of this J-curve.

Figure 4 – Cash operating expenses

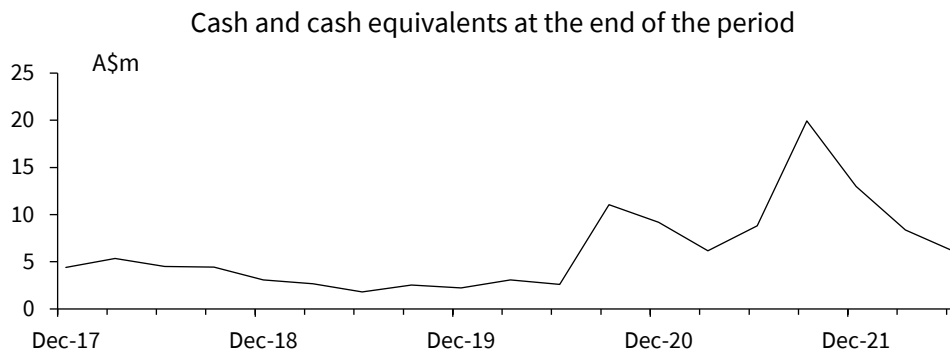


Source: Company reports, MST Access estimates

Reckon special dividends likely to extend cash runway

Novatti's cash at the end of June 2022 was \$6.1m, having decreased from \$8.36m in the March 2022.

Figure 5 – Novatti quarterly cash balance



Source: Company reports, MST Access estimates

Figure 6 – Novatti adjusted cash runway

	2022 Q4 A\$m	Adjustments A\$m	Adjusted A\$m	Comments
Net cash from / (used in) operating activities	-2,278		-2,278	
Cash and cash equivalents at quarter end	6,059	8,000	14,059	Expected \$8m+ special dividend from Reckon
Unused finance facilities available at quarter end	0		0	
Total available funding available	6,059		14,059	
Estimated periods of funding available	2.7		6.2	

Source: Company reports, MST Access estimates

At 30 June Novatti had 2.7 quarters of future cash available at the pace of operating cash burn during the June quarter. However, we believe that investors should also add in the expected dividend from Reckon to more accurately assess Novatti's cash runway. Doing this increases the number of quarters of funding available to over 6.

Additionally, once it receives its ADI licence, costs it continues to incur with its banking team will be deconsolidated, which should help reduce its cash burn, further extending its cash runway.

Should this be an insufficient runway to break even, Novatti have a wide range of assets that it has previously indicated it could use as collateral to raise additional finance. Furthermore, now that it has achieved a partnership with Reckon, it could look to reduce its holding in Reckon, although given the likely partnership synergies which should lift the value of its Reckon stock in time, this would likely be an option of last resort. As such Novatti's management remain adamant that there is no equity raise coming to increase its cash position.

Earnings estimate changes

Following today's quarterly update, presentation and Appendix 4C, we make the following changes to our earnings estimates for NOV:

Figure 7 – Earnings estimates for Novatti

		FY22E			FY23E			FY24E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	A\$m	29.1	32.6	12.0%	41.6	44.5	6.9%	53.5	59.6	11.4%
Underlying EBITDA	A\$m	-9.5	-11.1	-16.7%	-3.0	5.0	269.1%	2.5	7.0	183.5%
EBIT	A\$m	-11.7	-13.3	-13.6%	-4.9	3.1	164.2%	0.6	5.1	811.4%
Profit before tax	A\$m	-13.0	-14.6	-12.2%	-5.3	2.7	151.8%	0.2	4.7	2901.3%
NPAT (reported)	A\$m	-13.0	-14.6	-12.2%	-5.3	2.7	151.8%	0.2	4.7	2901.3%
EPS (underlying)	cps	-4.0	-4.5	-11.3%	-1.5	0.8	151.8%	0.0	1.3	large
EPS (reported)	cps	-4.0	-4.5	-11.3%	-1.5	0.8	151.8%	0.0	1.3	large
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:

- A minor adjustment for the shares on issue
- Allowing \$8m for a special dividend from Reckon in 1H23.

Full details of our revised financial estimates for Novatti are contained on page 2.

Valuation

Figure 8 – MST Access valuation of Novatti

Current date	2-Aug-22															
Next balance date	30-Jun-22															
		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	Dec-28	Jun-29
Free cash flow to equity	A\$m	-8.5	1.8	-2.1	-2.2	3.8	3.4	4.0	4.8	6.4	7.3	9.9	11.0	13.7	14.0	17.1
Discounted cash flow	A\$m	0.0	1.7	-2.0	-2.0	3.2	2.7	3.1	3.6	4.6	5.0	6.5	6.9	8.3	8.1	9.4
Sum of discount streams	A\$m	59.1	CAPM													
Future value into perpetuity	A\$m	519.3	Risk free rate			3.00%										
NPV of terminal value	A\$m	286.3	Equity beta			1										
add net cash	A\$m	6.1	Equity risk premium			6.00%										
Value of total equity	A\$m	351.4	Cost of equity			9.0%										
Diluted shares on issue	m	351.2														
Value per share	A\$	1.00	Terminal growth			3.0%										

Source: Company reports, MST Access estimates

Incorporating the earnings changes above and a higher cost of capital, we value NOV at A\$1.00 per share (down from A\$1.05) using a DCF of free cash flow to equity forecasting out 7 years before applying a terminal value. We have lifted

our cost of equity from 8.0% to 9.0% (lifting our risk free rate from 2% to 3%, and keeping our equity risk premium at 6% and our beta at 1) and continue to assume a terminal growth rate of 3%.

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 the following figure.

Figure 9 – Selected peer comparable companies' valuation multiples

Identifier (RIC)	Company Name	Enterprise Value US\$m	Trailing EV/Revenue	Forward EV/Revenue	P/NTA	P/B
NOV.AX	Novatti Group Ltd	14.1	7.1	n.a.	2.0	22.6
EML.AX	EML Payments Ltd	-1,114.8	-1.3	n.a.	-13.8	3.0
SMP.AX	SmartPay Holdings Ltd	110.9	3.6	2.7	33.2	4.7
TYR.AX	Tyro Payments Ltd	259.8	7.7	1.2	12.3	10.4
CCA.AX	Change Financial Ltd	15.0	4.8	n.a.	-15.6	4.7
A2B.AX	A2B Australia Ltd	101.7	1.4	n.a.	2.4	1.4
SQ	Block Inc	44,086.9	4.2	2.5	16.3	22.9
MQ.O	Marqeta Inc	3,576.9	14.6	5.0	3.4	5.9
V	Visa Inc	448,109.7	19.9	15.4	-38.5	13.6
MA	Mastercard Inc	350,107.2	19.0	15.7	-68.2	48.2
PYPL.O	PayPal Holdings Inc	101,461.2	8.7	3.6	12.5	10.1
AMA.MC	Amadeus IT Group SA	28,982.5	11.2	6.5	-6.8	7.2
NETW.L	Network International Holdings PLC	1,590.4	7.0	3.6	-10.9	3.6
FIS	Fidelity National Information Services Inc	80,253.4	6.1	5.4	-3.1	1.4
PAY.TO	Payfare Inc	139.6	7.3	1.4	4.8	8.1
FISV.O	Fiserv Inc	86,912.3	5.5	5.2	-3.6	2.2
WEX	WEX Inc	8,398.4	4.2	4.3	-2.9	3.4
PSFE.K	Paysafe Ltd	2,300.5	2.5	1.5	-0.6	1.1
PAYP.L	PayPoint plc	539.4	3.1	3.9	-39.8	4.8
WLN.PA	Worldline SA	17,200.4	5.5	3.8	-4.7	1.5
WU	Western Union Co	7,809.0	1.8	1.7	-3.2	19.8

Source: IBES, Refinitiv

With Novatti being the Australian partner for Marqeta, we see that as its main peer, trading on 5.1x forward EV/Revenue. In comparison, on our forecasts Novatti is trading on 2.4x.

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.

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.

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 by Visa and Apple; 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-licensed 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. It is also in the process of applying for an EMoney Issuing (EMI) licence in Europe.

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