

Cost control & new products

In addition to an increased focus on cost control, which has seen operating costs fall quarter on quarter, Novatti continues to invest in innovative products, which should accelerate revenue growth in future quarters.

- Bank licence
- Launch of AUD backed stablecoin
- Strong Acquiring product roadmap and channel growth including Reckon partnership

Bank licence a game changer

Novatti’s 91% subsidiary International Bank of Australia has been awarded a restricted ADI. Novatti is the only listed company with such a licence. With a unique business plan centred on “payments banking” and an expedited path to banking revenues we see this as a major long-term asset. Attaining such a licence is testament to Novatti’s management and compliance capabilities.

Stablecoin launch adds crypto appeal

Novatti’s AUD stablecoin launched on 1 November 2022 on the Stellar blockchain, and shortly on the Ripple and Ethereum blockchains, facilitating remittance payments and FX. Novatti’s stablecoin AUDD is fully backed one-on-one by Australian currency in Australian banks, bank bills and treasury notes.

A seasonally soft 1Q23 for ATX

Group revenue fell 4% 1Q23 on 4Q22, while almost doubling on pcp, due to ATX having a seasonally soft quarter. With ATX having lower margins than many of Novatti’s other offerings, it is possible that group gross margins still grew over the quarter.

Cash position improved post quarter

Novatti has injected \$5m of its cash into its bank, and received a \$12.8m special dividend from Reckon on 22 November 2022. Allowing for this and excluding its R&D tax credit received during 1Q23 and bank expenses, plus adjusting for the ordinary Reckon dividend paid in September, we think that it has 8.3 quarters of expected funding, rather than the 7.1 quarters reported in its ASX disclosures. It is targeting generating operating cashflows by 4Q23, so this cash runway could be conservative.

Earnings and valuation changes

Allowing for the actual dividend from Reckon, estimated impairment of Reckon valuation and expectation of being operating cashflow positive by 4Q23, we alter our reported EPS estimates: FY23E: -356%, FY24E: 62%, FY25E: 44%. We value NOV at A\$0.67 (down from 76c), using a DCF with a cost of equity of 10.0% (up from 9%). Full details are inside, including a discussion of risks on page 10.

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.

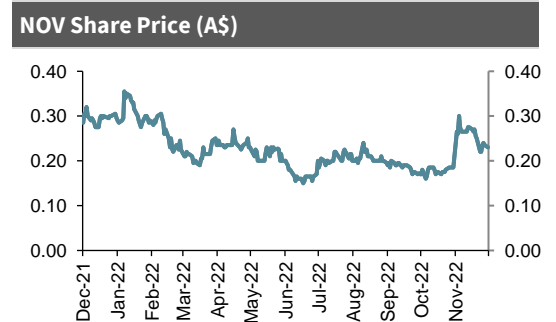
Its services capture the entire payments value chain. This includes issuing, such as prepaid Visa cards, acquiring, enabling merchants to accept payment from financial institutions, and processing, including cross-border transfers and automated invoicing.

Stock	NOV.ASX
Market cap	A\$79.3m
Price	A\$0.235
Valuation	A\$0.67 (previously A\$0.76)

Company data	
Adjusted net cash:	A\$22.3m
Shares on issue:	336.5m

Recent events	
AGM	23 November 2022
\$12.8m Reckon Dividend	22 November 2022
IBOA Launch	7 November 2022

Next Steps	
4Q23 Appendix 4C	Late January 2023
EMI licence	Pending regulators



Glen Wellham, Senior Analyst

Financials

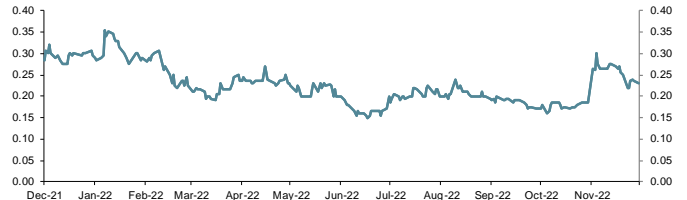
NOVATTI GROUP LIMITED

NOV-AU

Year end 30 June, AUD unless otherwise noted

MARKET DATA

Price	\$	0.235
Valuation	\$	0.67
52 week high / low	\$	0.15 - 0.38
Market capitalisation	\$m	79.3
Shares on issue (basic)	m	337.6
Options / rights / ESP / LTIP	m (currently anti-dilutive)	0.0
Other equity	m	0.0
Shares on issue (fully diluted)	m	337.6

12-MONTH SHARE PRICE PERFORMANCE

INVESTMENT FUNDAMENTALS

	FY21A	FY22A	FY23E	FY24E	FY25E
Reported NPAT	\$m (11.9)	(16.6)	(6.2)	(0.5)	2.1
Underlying NPAT	\$m (11.9)	(16.6)	(6.2)	(0.5)	2.1
Reported EPS (diluted)	¢ (5.2)	(5.1)	(1.9)	(0.2)	0.6
Underlying EPS (diluted)	¢ (5.2)	(5.1)	(1.9)	(0.2)	0.6
...Growth	% (17%)	(1%)	(64%)	(92%)	(510%)
PER underlying	x (4.5)	(4.6)	(12.7)	(155.8)	38.0
Operating cash flow per share	¢ (2.4)	(4.0)	1.1	0.0	0.8
Free cash flow per share	¢ (3.8)	(12.0)	2.9	(1.3)	0.6
Price to free cash flow per share	x nm	nm	0.1	nm	0.4
FCF yield	% (16.3%)	(51.2%)	12.3%	(5.6%)	2.6%

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	75.4	73.3	73.6	78.0	76.0
EV/Revenue	x	4.6	2.3	1.4	1.1	0.9
EV/Underlying EBITDA	x	-14.5	-4.3	13.8	43.5	11.9
Book value per share	¢	3.6	10.9	9.1	8.9	9.5
Price to book (NAV)	x	8.9	2.2	2.6	2.7	2.5
Net tangible assets per share	¢	1.6	8.1	6.3	6.1	6.8
Price to NTA	x	20.3	2.9	3.8	3.8	3.5

KEY RATIOS

	FY21A	FY22A	FY23E	FY24E	FY25E
Net debt / (cash)	\$m (3.9)	(6.0)	(5.7)	(1.3)	(3.4)
Interest cover (Operating NPAT / net interest)	x (1.6)	41.8	(14.5)	(0.3)	11.2
Gearing (net debt / underlying EBITDA)	x 0.7	0.4	nm	nm	nm
Leverage (net debt / (net debt + equity))	x nm	nm	nm	nm	nm

DUPONT RATIOS

	FY21A	FY22A	FY23E	FY24E	FY25E
Return on Assets	% nm	nm	nm	nm	0.99
Financial Leverage	x 7.2	3.0	6.0	6.7	6.6
Return on Equity	% nm	nm	nm	nm	6.48

GROWTH PROFILE

	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	% 49.8	97.5	56.1	38.6	23.3
Underlying EBITDA	% (26.5)	(229.4)	131.0	(66.3)	255.3
NPAT	% (11.3)	(40.0)	62.7	91.8	510.0
Underlying Profit	% (19.4)	(91.5)	203.7	308.0	1,710.0
Underlying EPS	% 16.7	1.4	63.8	91.8	510.0
DPS	% n/a	n/a	n/a	n/a	n/a

HALF YEARLY DATA

	1H22A	2H22A	1H23E	2H23E	1H24E	
Revenue	\$m	11.1	15.6	20.7	30.1	30.2
Other income	\$m	1.2	0.6	14.0	1.0	1.2
Cash expenses	\$m	-18.2	-33.0	-25.2	-35.3	-31.4
Underlying EBITDA	\$m	-5.9	-16.8	9.5	-4.1	0.0
EBITDA	\$m	-10.2	-10.5	9.3	-4.3	-0.2
Depreciation, amortisation and impairment	\$m	-0.2	-0.8	-10.0	-0.8	-0.8
EBIT	\$m	-10.4	-11.2	-0.7	-5.1	-1.0
Associates and JVs	\$m	-1.6	0.0	0.0	0.0	0.0
Net interest	\$m	0.5	-0.1	-0.2	-0.2	-0.2
PBT	\$m	-11.4	-11.3	-0.9	-5.3	-1.2
Income tax	\$m	-0.1	0.0	0.0	0.0	0.0
NPAT	\$m	-11.5	-11.2	-0.9	-5.3	-1.2

PROFIT AND LOSS

	FY21A	FY22A	FY23E	FY24E	FY25E	
Revenue	\$m	16.5	32.6	50.8	70.4	86.8
Other income	\$m	1.9	1.8	15.0	2.2	2.2
Cash expenses	\$m	-23.6	-51.5	-60.5	-70.8	-82.6
Underlying EBITDA	\$m	-5.2	-17.2	5.3	1.8	6.4
EBITDA	\$m	-5.9	-15.2	4.9	1.4	6.0
Depreciation, amortisation and impairment	\$m	-1.5	-1.9	-10.7	-1.5	-1.5
EBIT	\$m	-7.4	-17.0	-5.8	-0.1	4.5
Associates, JVs and fair value adjustments	\$m	0.0	0.0	0.0	0.0	0.0
Net interest	\$m	-4.5	0.4	-0.4	-0.4	-0.4
PBT	\$m	-11.9	-16.6	-6.2	-0.5	4.1
Income tax	\$m	0.0	0.0	0.0	0.0	-2.0
NPAT	\$m	-11.9	-16.6	-6.2	-0.5	2.1

Weighted average diluted shares on issue	m	228.8	325.0	335.3	335.3	335.3
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BALANCE SHEET

	FY21A	FY22A	FY23E	FY24E	FY25E	
Cash & equivalents	\$m	8.8	6.1	15.8	11.4	13.4
Trade & other receivables	\$m	4.1	8.4	8.9	9.5	10.1
Financial assets - funds in trust	\$m	39.0	52.4	120.6	135.5	143.8
Investments accounted for using the equity method	\$m	0.8	0.1	0.1	0.1	0.1
Other investments	\$m	1.0	27.7	27.7	27.7	27.7
Net Property Plant And Equipment	\$m	0.5	0.5	0.5	0.5	0.5
Right of use assets	\$m	1.9	1.8	1.8	1.8	1.8
Intangibles	\$m	5.0	9.3	9.3	9.3	9.3
Deposits	\$m	2.2	3.7	-2.1	2.3	2.9
Other	\$m	0.3	0.9	0.9	0.9	0.9
Total Assets	\$m	63.8	111.0	183.6	199.0	210.5

Trade and other payables	\$m	6.8	16.2	17.2	18.3	19.4
Settlement and remittance funds payable	\$m	38.6	52.1	119.7	134.5	142.7
Lease liabilities	\$m	2.2	2.1	2.1	2.1	2.1
Unearned revenue	\$m	0.2	0.3	0.3	0.3	0.3
Borrowings, including convertible notes	\$m	4.9	0.0	10.0	10.0	10.0
Employee benefits	\$m	1.5	2.9	3.0	3.1	3.3
Other	\$m	0.6	0.8	0.8	0.8	0.8
Total liabilities	\$m	54.9	74.4	153.1	169.1	178.5
Net assets	\$m	8.9	36.6	30.4	29.9	32.0

Contributed equity	\$m	44.1	89.3	89.3	89.3	89.3
Reserves	\$m	3.8	5.0	5.0	5.0	5.0
Retained earnings	\$m	-41.0	-57.7	-63.9	-64.4	-62.3
Shareholder's equity	\$m	8.9	36.6	30.4	29.9	32.0

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

	FY21A	FY22A	FY23E	FY24E	FY25E	
Net Income (Cashflow)	\$m	-12.3	-16.6	-6.2	-0.5	2.1
Depreciation & Amortization	\$m	1.5	1.9	1.5	1.5	1.5
Change in Net Operating Assets	\$m	-2.8	4.0	-1.6	-1.7	-1.8
Other Non-Cash Items, Total	\$m	5.2	-2.4	10.0	0.8	0.8
Other	\$m	2.9	0.0	0.0	0.0	0.0
Operating cash flow	\$m	-5.4	-13.0	3.7	0.1	2.6
Capital expenditure	\$m	-2.4	-2.1	-0.3	-0.3	-0.3
Acquisitions/divestment/other	\$m	-0.3	-24.6	-4.0	-4.0	0.0
Investing cash flow	\$m	-2.6	-26.7	-4.2	-4.2	-0.3
Equity	\$m	15.1	36.0	0.0	0.0	0.0
Debt (including convertible)	\$m	-0.4	-0.8	10.5	0.0	0.0
Leases	\$m	-0.3	-0.2	-0.3	-0.3	-0.3
Financing cash flow	\$m	14.4	36.6	10.2	-0.3	-0.3
Net cash flow	\$m	6.3	-3.1	9.7	-4.4	2.0
Free cash flow	\$m	-8.74	-39.141	9.7268	-4.4026	2.03258

Source: Company reports and MST Access estimates

AGM brings forward our expected cashflow breakeven to 4Q23

Top line revenue growth to deliver operating cash flow generation

Novatti has transitioned to now having a clear focus on generating operating cashflows. While it is not there yet, it significantly reduced its cash burn again during the 1Q23, although this was in part due to its R&D tax refund. Combined with the increase in its cash balance from its recent bond issue, this has seen its expected cash runway increase, which has further increased since receiving its special dividend from Reckon. We anticipate that this should result in Novatti having sufficient cash on hand to see it through to becoming cashflow generative.

Notably, the drive to become cashflow positive hasn't seen Novatti indiscriminately slash its spending. There are clear signs of continued investment by the company with particular focus on monetising existing infrastructure, including the launch of an offering enabling Android phones to be merchant terminals during October 2022, and the launch on 1 November 2022 of its AUDD stablecoin, both of which should drive further revenue growth.

Novatti was granted on 2 November 2022 a restricted banking licence, and continues to pursue an EMoney Issuing licence in Europe.

Figure 1 –Novatti Outlook presented at its recent AGM

What to expect going forward

Novatti

Novatti's business has shifted from an investment and development phase to driving increased margin. Focus on scaling for growth in FY23:



Shift to positive cashflow

- Focus already shifted to delivering positive cashflow
- 47% decrease in September quarter cash use YoY
- Objective is positive cashflow in Q4 FY23



Drive returns from existing investment

- Drive sales traction from ecosystem globally
- Leverage scalable solutions for growth – particularly Acquiring



This presentation has been approved for release to the ASX by Peter Cook, Managing Director
www.novatti.com

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Source: Company reports, MST Access estimates

Quarterly Activities Report and Appendix 4C Cashflow Analysis

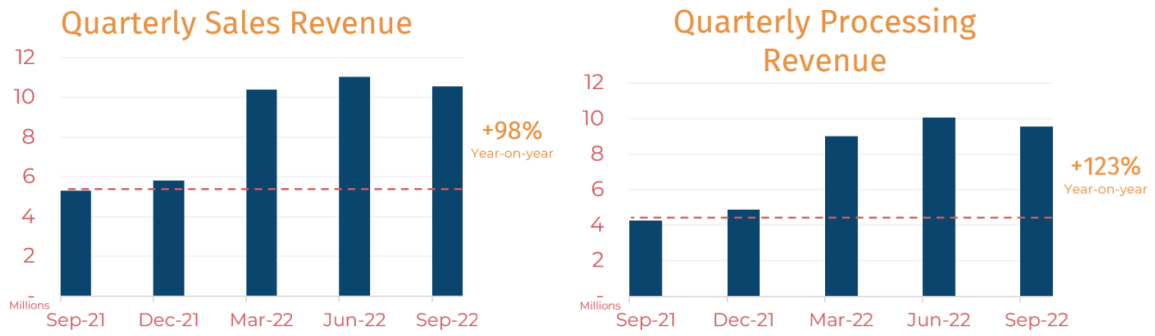
1Q23 revenue almost double pcp, but seasonality drives it down 4% qoq

Novatti's sales revenue continued to grow strongly on pcp, up 98% year on year, with this growth primarily driven by the increase in its quarterly processing revenue, which increased by 123% year on year, and now represents around 90% of Novatti's sales revenues, highlighting the high proportion of reoccurring revenues that that Novatti has.

The recent launch by Novatti in conjunction with MYPINPAD of a 'tap and pay' solution enabling Android mobile phones to act as payment terminals without additional hardware should deliver a further boost to sales and processing revenues. Depending on marketing (particularly if it goes viral), this could be rapidly adopted across the various markets that Novatti operates in.

In Australia approximately 53.3% of the smartphone market (according to media reports earlier in 2022 citing Kantar Analytics statistics) is Android phones. Due to iPhone users holding onto their handsets longer, Android has a larger percentage of sales, with Telsyte suggesting that Android phones accounted for 56% of smartphones sales in Australia in 1H calendar 2022. As iPhones are typically more expensive handsets, the proportion of Android devices in many of the countries and regions in which Novatti operates which have a lower average income per capita than Australia, such as the US, Europe, Malaysia, and the Philippines, is either similar or even higher.

Figure 2 – Novatti quarterly revenue trends



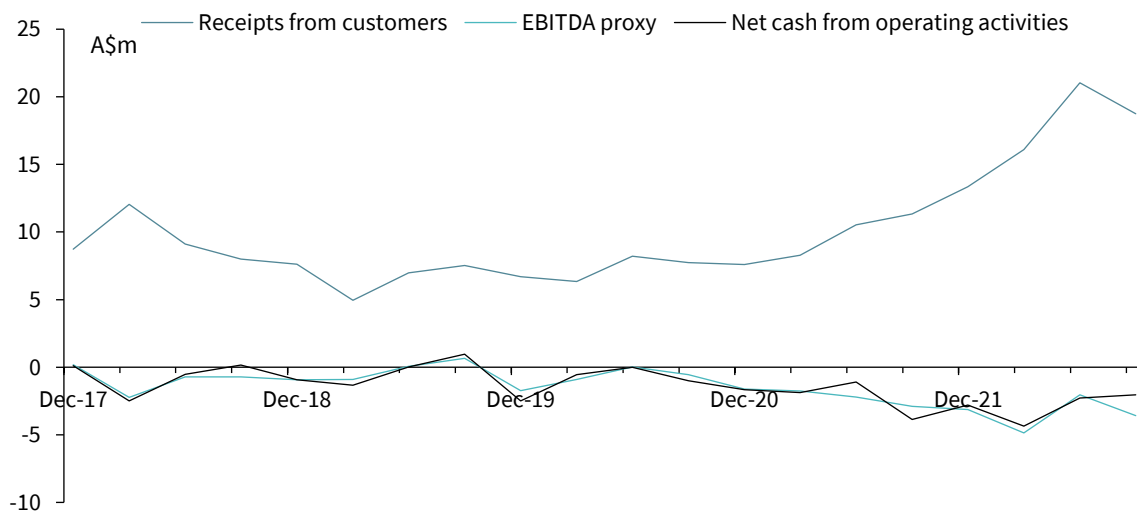
Source: Company reports

Cash receipts continue to rise, second highest quarter on record

While cash receipts were down slightly quarter on quarter due to seasonality at ATX, they were the second highest on record, again displaying the continuing growth the company has been achieving. We suspect too that gross margins continued to grow over the quarter, given that ATX revenues are relatively low margin.

The quarter also saw Novatti receive over \$1m in government R&D grants, which the reason why our EBITDA proxy diverges from the net cash from operating activities.

Figure 3 – Quarterly cash receipts and operating cashflow

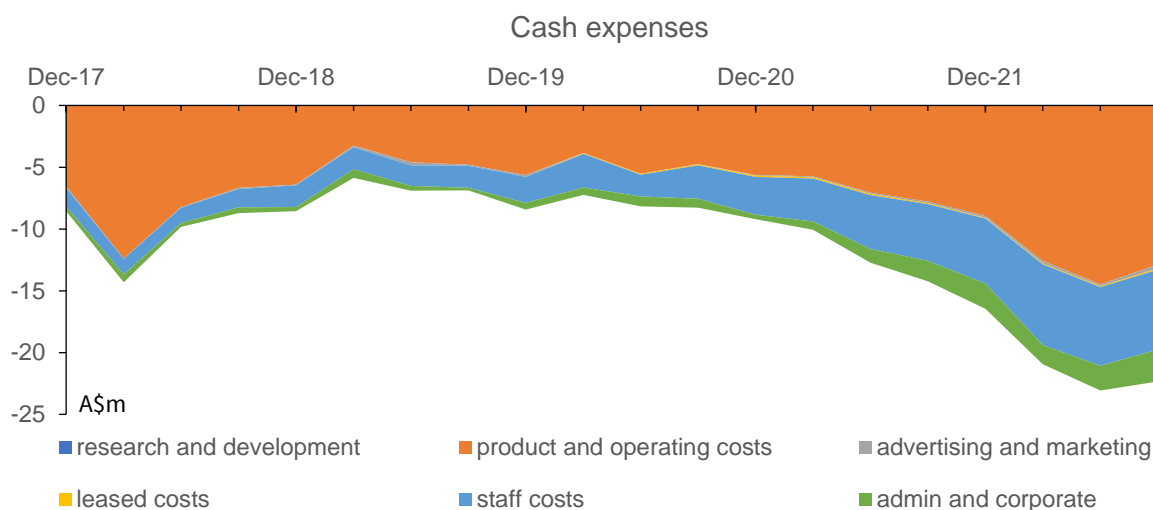


Source: Company reports, MST Access estimates

Operating expenses decrease

The increased focus on cost control was evident in the quarter, revealing a clear inflection point in 4Q22 when charted in Figure 4, with a reduction in product and operating costs offset slightly by a very modest increase in staff, admin and corporate, and advertising and marketing costs.

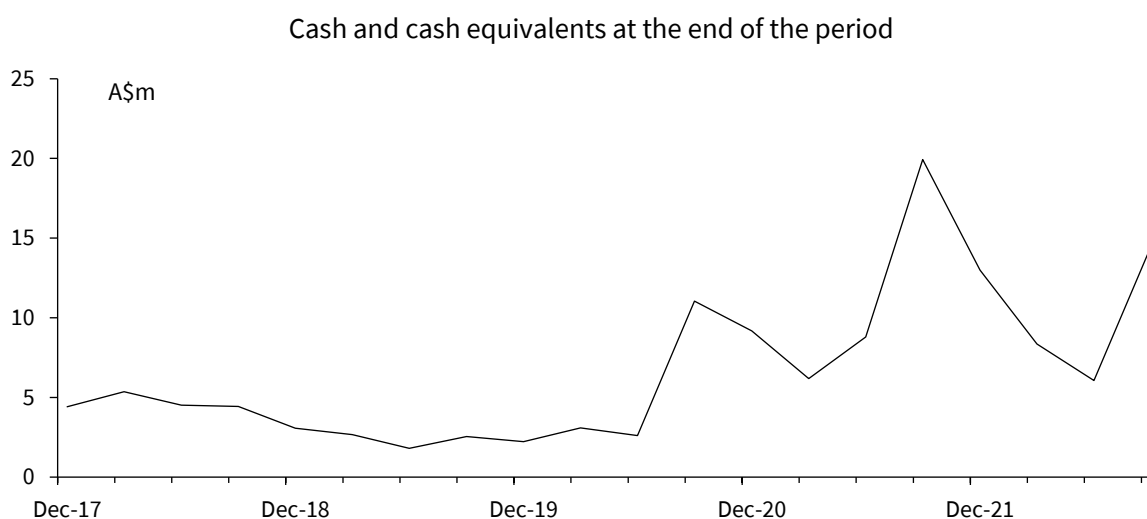
Figure 4 – Cash operating expenses



Source: Company reports, MST Access estimates

A\$12.8m in special dividends from Reckon extends cash runway

Figure 5 – Novatti quarterly cash balance



Source: Company reports, MST Access estimates

Novatti's cash balance increased significantly during the quarter, attributable to its bond issue of \$10.5m received in July. Its cash balance has since been further bolstered by the special dividend of \$12.8m paid by Reckon, partially offset by the \$5m it is injected into its bank, the International Bank of Australia, increasing its ownership of the bank to ~91%.

With a 91% ownership of the bank, Novatti will likely consolidate it for accounting purposes. However, it has been established as an independent entity, with an independent holding company and board of directors, so it's possible that Novatti might not have control, and hence not consolidate it.

For the past couple of years, Novatti has funded the ongoing expenses associated with the bank, which Novatti suggest have been in the magnitude of \$250,000 per month, or \$0.75m per quarter. Given that we have reduced Novatti's cash balance for the cash injected into the bank, we will be consistent and reduce its quarterly expenses and cash consumption for the expenses attributable to the bank, although it could all end up being consolidated, while the cash injected into the bank becomes restricted cash.

Also adjusting for the R&D tax credit, which isn't reoccurring on a quarterly basis, and allowing for half the ordinary Reckon dividend paid in September (given Reckon pays level half yearly dividends) with the above changes to cash balances, we estimate that the company has around 8.3 quarters of funding available from its current pro-forma cash balance, a little higher than the 7.1 quarters suggested in its ASX disclosures. Given the company's focus on becoming operating cashflow positive, which it clarified in its AGM presentation that this is targeted to be achieved by 4Q23, and its continued strong revenue growth which should fall through to improved cashflow, we believe that it has sufficient cash runway to achieve generating operating cashflows without needing to return to equity investors.

Figure 6 – Novatti adjusted cash runway

	2023 Q1 A\$K	Adjustments A\$K	Adjusted A\$m	Comments
Net cash from / (used in) operating activities	-2,037	-639	-2,676	Add back the R&D tax benefit plus deducting half of the Reckon ordinary dividend to get the true picture of underlying quarterly cash consumption, and remove the expenses associated with the bank
Cash and cash equivalents at quarter end	14,488	7,800	22,288	Add on the expected Reckon dividend to be received mid-November, less A\$5m cash injected into the bank
Unused finance facilities available at quarter end	0		0	
Total available funding available	14,488		22,288	
Estimated periods of funding available	7.1		8.3	

Source: Company reports, MST Access estimates

Restricted authorised deposit-taking institution licence for International Bank of Australia (IBoA)

Novatti's application for a banking licence has finally come through, with a restricted authorised deposit-taking institution (banking) licence granted to International Bank of Australia. The stock's initial reaction, coming out of trading halt following this announcement, has been very positive.

Having received its restricted banking licence in early November, IBoA expect to spend the next six months developing products to launch, and are aiming to receive their full banking licence in a year's time. This suggests that there will be negligible revenues in FY23 attributable to the bank, with the real revenue growth attributable to the bank coming from 2H24 onward as growth picks up once it receives a full ADI licence.

As such, we remain comfortable with our prior forecasts for the bank of limited revenue in 1H23, then in 2H23 and 1H24 revenue of \$1.5m in each period while it remains a restricted ADI (~\$250,000 of revenue a month), acknowledging that there might be some downside risk to these estimates, before growing thereafter. Novatti's 2Q23 cashflows and/or 1H23 result may provide some further clarity around the trajectory of these potential revenues.

Earnings estimate changes

Following Novatti's quarterly update, presentation and Appendix 4C, and issue of restricted banking licence to International Bank of Australia, we make the following changes to our earnings estimates for NOV:

Figure 7 –Earnings estimates for Novatti

		FY23E			FY24E			FY25E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	A\$m	50.8	50.8	0.0%	69.4	70.4	1.5%	85.6	86.8	1.4%
Underlying EBITDA	A\$m	4.7	5.3	12.7%	1.0	1.8	87.0%	5.7	6.4	11.0%
EBIT	A\$m	2.8	-5.8	-305.5%	-0.9	-0.1	88.7%	3.8	4.5	16.4%
Profit before tax	A\$m	2.4	-6.2	-355.9%	-1.3	-0.5	62.3%	3.4	4.1	18.3%
NPAT (reported)	A\$m	2.4	-6.2	-355.9%	-1.3	-0.5	62.3%	1.4	2.1	43.7%
EPS (underlying)	cps	0.7	-1.9	-355.9%	-0.4	-0.2	62.3%	0.4	0.6	43.7%
EPS (reported)	cps	0.7	-1.9	-355.9%	-0.4	-0.2	62.3%	0.4	0.6	43.7%
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:

- Adjusting the Reckon dividend from a previously estimated \$12.2m to the realised \$12.8m.
- Allowing for the impairment of the valuation Reckon is held on Novatti's balance sheet, reducing the value from \$1 per share to \$0.59 per share.
- The \$5m investment made into International Bank of Australia.
- The announcement at its AGM that Novatti is targeting being operating cashflow positive by 4Q23.

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

Valuation

Figure 8 –MST Access valuation of Novatti

		MST Access valuation of Novatti													
		Current date		6-Dec-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	9.8	-5.1	-5.2	0.8	0.6	1.4	2.3	3.7	4.6	7.5	8.2	11.8	10.6	14.5
Discounted cash flow	A\$m	9.3	-4.6	-4.5	0.6	0.5	1.1	1.7	2.5	3.0	4.6	4.8	6.6	5.7	7.4
Sum of discount streams	A\$m	38.7		CAPM											
Future value into perpetuity	A\$m	358.5		Risk free rate			4.00%								
NPV of terminal value	A\$m	182.7		Equity beta			1								
add net cash at FY22	A\$m	6.1		Equity risk premium			6.00%								
Value of total equity	A\$m	227.5		Cost of equity			10.0%								
Diluted shares on issue	m	337.6													
Value per share	A\$	0.67		Terminal growth			3.0%								

Source: Company reports, MST Access estimates

We continue to use a DCF of free cash flow to equity forecasting out 7 years before applying a terminal value.

With the modest changes in earnings above, and change in net cash position of the company, if we maintained our cost of equity at 9.0% our valuation of NOV would increase slightly from 76c to 81c.

However, given the continued rise in long term government bonds, we have again lifted our cost of equity from 9.0% to 10.0% (lifting our risk-free rate from 3% to 4%, and keeping our equity risk premium at 6% and our beta at 1) and continue to assume a terminal growth rate of 3%. This reduces our valuation to 67c.

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.

With Novatti being the Australian partner for Marqeta, we see that as its main peer, trading on 2.1x forward EV/Revenue. In comparison, on our forecasts Novatti is trading on 1.5x.

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.

Figure 9 –Selected peer comparable companies' valuation multiples

Identifier (RIC)	Company Name	EV / Revenue	EV / EBITDA	Price / EPS	Price / Cash Flow	Price / Book	Dividend Yield %
NOV.AX	Novatti Group Ltd	1.5	13.8	-12.7	8.1	2.6	0.0%
CCA.AX	Change Financial Ltd	1.2	-15.7	-17.8	-13.4	4.2	0.0%
A2B.AX	A2B Australia Ltd	0.8	5.9	7.4	6.4	1.4	9.3%
EML.AX	EML Payments Ltd	n.a.	n.a.	26.3	4.8	0.6	0.0%
SMP.AX	SmartPay Holdings Ltd	2.8	11.9	25.8	n.a.	5.6	0.0%
TYR.AX	Tyro Payments Ltd	2.1	24.0	258.1	31.2	5.8	0.0%
	Australian average	1.9	13.9	79.4	14.1	3.4	2.3%
	Australian median	2.1	11.9	26.1	6.4	3.5	0.0%
MQ.O	Marqeta Inc	2.1	n.a.	n.a.	n.a.	2.6	0.0%
V	Visa Inc	12.6	17.8	25.1	22.2	10.6	0.8%
MA	Mastercard Inc	13.9	22.8	29.2	27.7	34.1	0.6%
PYPL.O	PayPal Holdings Inc	3.0	11.8	16.5	11.7	3.7	0.0%
AMA.MC	Amadeus IT Group SA	4.8	12.2	20.9	13.0	4.4	2.0%
NETW.L	Network International Holdings PLC	4.7	11.1	20.3	12.1	3.0	0.8%
FIS	Fidelity National Information Services Inc	4.0	9.1	10.7	9.0	0.9	2.8%
PAY.TO	Payfare Inc	0.9	6.9	13.8	n.a.	n.a.	n.a.
FISV.O	Fiserv Inc	4.8	10.9	14.3	11.0	1.9	0.0%
WEX	WEX Inc	3.9	8.8	12.1	11.3	3.6	n.a.
PSFE.K	Paysafe Ltd	0.8	2.7	46.6	0.5	1.3	n.a.
PAYP.L	PayPoint plc	2.6	5.6	9.4	n.a.	n.a.	7.4%
WLN.PA	Worldline SA	3.8	14.7	18.6	13.5	1.2	0.0%
WU	Western Union Co	1.7	7.2	9.2	6.3	9.1	6.5%
SQ	Block Inc	2.0	31.3	39.3	20.4	2.3	0.0%
	International average	4.4	12.3	20.4	13.2	6.1	1.7%
	International median	3.8	11.0	17.5	11.9	3.0	0.7%

Source: IBES, Refinitiv, MST Access estimates for Novatti, A2B Australia and Change Financial

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.

The diversification that Novatti has in its business model across a variety of technology, licenses and partnerships is demonstrating resilience to disruptive developments, such as its recent launch of merchant acceptance on Android smartphones, providing it with a first mover advantage over Westpac which has also flagged a similar launch on Android, and the likely forthcoming launch by Apple of 'tap to pay on iPhone' in Australia; 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 few specific risks we see Novatti facing due to this regulatory framework:

- The recent October 2022 Federal Budget clarified the taxation treatment of cryptocurrency as assets, rather than as currency. This might impact the uptake and adoption of Novatti's AUDD stablecoin.
- 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 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, should it launch bridges between blockchains for its AUDD stablecoin, a cyberattack on these bridges 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.

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. It is also in the process of applying for an EMoney Issuing (EMI) licence in Europe.

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Level 13, 14 Martin Place, Sydney, NSW 2000
Main +61 2 8999 9988
www.mstfinancial.com.au