

NOVATTI GROUP (ASX: NOV)

FINANCIAL SERVICES & DIGITAL PAYMENTS



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Key Highlights

- H1 FY22 Sales Revenue \$11.1m, +51% (H1 FY21: \$7.3m);
- New merchant acquiring division being accelerated by recruitment drive through H1;
- Acquiring licences to increase scale of division, improve margins, target larger clients;
- Reckon synergies confirmed, digital payments portal to be launched in FY22;
- Reckon has more than 114,000 business customers with potential synergies to be explored with Novatti's digital payment and banking services;
- Alternative payment capabilities growing following launch of CryptoSpend and RippleNet expansion;
- APRA resumed bank licence issuing in July 2021, Novatti now in pole position;
- \$13m in Series A funding secured for the launch of banking business;
- Novatti is winning the tech sector 'War on Talent' with headcount doubled over the past 12 months despite hugely competitive environment;
- Australian eCommerce industry valued at \$60 billion but forecast to reach \$91.5 billion by 2025;
- Banking licence application gearing Novatti as a potential takeover target.

Investment Case - Buy

Emerald Financial maintains its Buy rating on Novatti which is well positioned to secure its banking licence while identifying their launch of their merchant acquiring division and its acceleration as the primary revenue driver which will be accelerated by the digital payments gateway being recommended by Reckon to their 114,000 customers.

This division was accelerated in November 2021 when Novatti was granted acquiring licences from Visa and Mastercard, enabling them to become just one of 20 financial institutions in Australia that enable business customers to accept payment from those card issuers. By securing the licences, Novatti has created a significant and scalable gateway to their digital payments infrastructure, with their technology providing them with a competitive advantage over other merchant providers.

Outlook:

Date:

BUY

13 April 2022

Price (12 Apr):

\$0.230

Ticker:

ASX: NOV

52-Week range:

\$0.185-\$0.785

Market cap (AUD):

\$77.1m

Shares on issue

335.3m

	FY21	FY20	FY19
Revenue (\$m)	18.4	11.9	8.90
EBITDA (\$m)	-4.28	-5.63	-4.47
NPAT (\$m)	-11.8	-10.9	-4.95

NOV 12-mth Share Price Movement



Novatti



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The merchant acquiring division has undergone a major upgrade in recent months with additional headcount and growth in its salesforce. Emerald Financial views the division as potentially the largest revenue generator for Novatti over the long-term future based on the addressable market, growth in the eCommerce industry and its position as a vital gateway into Novatti's banking business.

Further upside is within sight in the form of their banking licence application which is nearing approval. Upon which, unlocking \$13m in Series A funding, notably reducing Novatti's cash outflows in the upcoming quarters (H1 cash outflow - \$6.5m). This secured funding would essentially be added to the \$12.9m cash on hand as of 31 December 2021.

One of the biggest pressures impacting Novatti is perceived market confidence. Emerald Financial views the recent share price decline as being overstated and misinterpreted. Novatti has continued to meet its stated objective to grow the digital payments infrastructure which resulted in 51% year-on-year growth in H1 sales revenue to \$11.1m, a new record for the Company.

Rather, the share price pressure has been reflective of a wider market downturn where Novatti has been primarily dragged down by a sector downturn, and in particular, the implosion of buy-now-pay-later operators.

This has been evidenced by the downturn of peer valuations within the payments sector, down from all time highs when Afterpay was acquired by Block (ASX: SQ2) for \$39 billion at a 41.8x revenue multiple. At the time, fintechs were trading around 8 to 10x revenue with, Novatti at 8.7x.



Since then, Novatti has fallen to a 4.3x multiple but has not endured as large a decline as the BNPL operators, headlined by Zip Co (ASX: Z1P) - 9.7x to 2.4x.

If the wider fintech industry is regressing back to 3-4x revenue multiples being a standardised valuation metric, Novatti is in a unique situation when compared to its peers based on balance sheet. With their 19.9% strategic stake in Reckon valued at \$22m, we can subtract this from Novatti's market cap which would then bring them to a revenue multiple of 3.1x.

Given the higher quality of business and scalability potential in Novatti's path, Emerald Financial views Novatti as undervalued compared to its peers with substantial revenue to be generated from the merchant acquiring division being accelerated, while the granting of its banking licence is likely to attract potential M&A attention in the medium-term future.

1. Digital Payments Sector - 11 April 2022

Company	ASX Ticker	FY21 Revenue (\$m)	Market Cap (\$m)	Revenue Multiple
Zip Co	Z1P	403.19	973	2.4
Sezzle	SZL	158.2	269	1.7
EML Payments	EML	192.22	1,041	5.4
Tyro Payments	TYR	238.52	804	3.4
Wizr	WZR	27.23	210	7.7
EarlyPay	EPY	0.18	134	744.4
Dough	DOU	0.034	26	753.8
Novatti	NOV	18.4	79	4.3

2. Digital Payments Sector - 16 Sep 2021

Company	ASX Ticker	FY21 Revenue (\$m)	Market Cap (\$m)	Revenue Multiple
Afterpay	APT	924.7	38,630	41.8
Zip Co	Z1P	403.19	3,929	9.7
EML Payments	EML	192.22	1,534	8.0
Tyro Payments	TYR	238.52	2,080	8.7
Wizr	WZR	27.23	362	13.3
Dough	DOU	0.034	60	1,764.7
Novatti	NOV	18.4	160	8.7

ASX Digital Payments & BNPL Companies - Price Comparison



Company Summary

Novatti Group Limited (ASX: NOV) is an Australian fintech company which specialises in digital payments, underpinned by their strong history of regulatory compliance that have made the Company a partner of choice for payment solutions.

The Company operates a range of different payments businesses that include international payment processing, business automation and billing software, card issuing, payments tech app development, and growth-oriented eCommerce project incubation.

Novatti's revenue is generated across a variety of streams including a percentage of payments processed, enterprise contracts for their payments tech and regulatory services, recurring SaaS fees and capital returns from incubator projects.

Within their suite of financial licences, Novatti is one of just 20 financial institutions in Australia that can offer merchant acquiring services that enable businesses to

accept payment via Visa and Mastercard.

Expanding on its global fintech infrastructure which processes more than \$2.5 billion in total transaction volumes, Novatti submitted an application to APRA for a banking licence. This follows banking sector regulatory changes in 2017 enabling consumers to gain access to a greater range of competitive banking products and the introduction of digital banks in Australia.

Once issued with their restricted banking licence, it is expected to lead to the launch of a digital banking business in conjunction with their application for a full banking licence.

Novatti has established business partnerships through existing B2B payment service networks which will enable the rapid expansion of their digital banking services to differentiate from competitors by primarily targeting migrant demographics.

Novatti Group - Historical Statistics

INCOME SUMMARY	2016/06	2017/06	2018/06	2019/06	2020/06	2021/06
Revenues (m)	3.90	2.19	5.43	8.42	11.00	16.48
EBITDA (m)	-4.65	-4.68	-1.77	-4.47	-5.63	-8.84
Depreciation (m)	0.00	-0.03	-0.02	-0.05	-0.38	-0.46
Amortisation	0.00	-0.03	-0.27	-0.34	-0.52	-1.02
EBIT (m)	-4.67	-4.73	-2.07	-4.86	-6.53	-10.32
Earning Before Tax & Abnormals (m)	-	-4.72	-2.07	-4.92	-7.90	-11.83
Income Tax Rate (%)	-2.00	0.00	0.00	-0.60	-0.40	0.10
Net Profit After Abnormals (m)	-5.00	-4.72	-2.07	-4.95	-10.96	-11.81

With a network of Tier 1 corporate partnerships including Google, Samsung, Apple, Afterpay, Ripple, UnionPay, WeChat Pay, Alipay, Bank of Shanghai, IBM World Wire, VISA Inc, Marqeta, and Decta already secured, Novatti's digital banking capabilities are positioned to significantly disrupt existing mediums of migrant banking services in Australia, with a seamless experience to manage their payments and savings both domestically and abroad.

A Digital Payments Gateway with Reckon

In July 2021, Novatti acquired a 19.9% strategic stake in accounting software company Reckon Limited (ASX: RKN). At the time of announcement, minimal details were provided to the market and no formal partnership agreement had been entered into between the two fintech companies.

However, the deal was brokered by a third party which enabled Novatti to acquire the strategic stake via an off-market block trade for \$1 per RKN share, which created an opportunity for Novatti and Reckon to commence discussions around digital payment services.

Novatti's investment needs to be viewed from a lens that highlights the business assets that Reckon has, beyond their accounting software that is a low-cost

alternative for small businesses, compared to Xero and MYOB. In particular, they have a valuable market share of SMB customers that will at some point require digital payment and/or banking services.

Discussions between Reckon and Novatti have now been confirmed with Reckon announcing in April 2022 the launch of a digital payments gateway that has been integrated into their cloud-based software. This gives users of Reckon's accounting software an option to accept digital payment by Visa or Mastercard directly through Reckon's invoicing app.

In our view, Novatti are following an approach that a number of private equity firms have achieved in the US, whereby they are "buying" an addressable market for their acquiring services (in this case, the 114,000 business users of Reckon's accounting software).

This is a large customer base that Novatti can bring payments and banking services to, where there is mutual benefit for Reckon to utilise Novatti's service as Reckon's major shareholder.

As digital payment providers, all businesses require a payments company to settle their digital payment transactions. These businesses will subsequently pay 'merchant fees' to the payments company, normally around 1-2% of the transaction value.

How will customers benefit?



Case study: Dan the electrician

Dan can leverage digital payment tools within his Reckon products

- ✓ Simplifies invoicing, with multiple payment options
- ✓ Get paid faster
- ✓ Improve cashflow
- ✓ Stop chasing payment with automatic reminders
- ✓ Less hassle with automatic reconciling

Turn 10 steps into 3

1. Create invoice
2. Send invoice
3. Send payment reminder
4. Track payment received
5. Verify payment
6. Receive/apply payment
7. Reconcile payment
8. Mark as paid
9. Send receipt
10. Any 3rd party steps

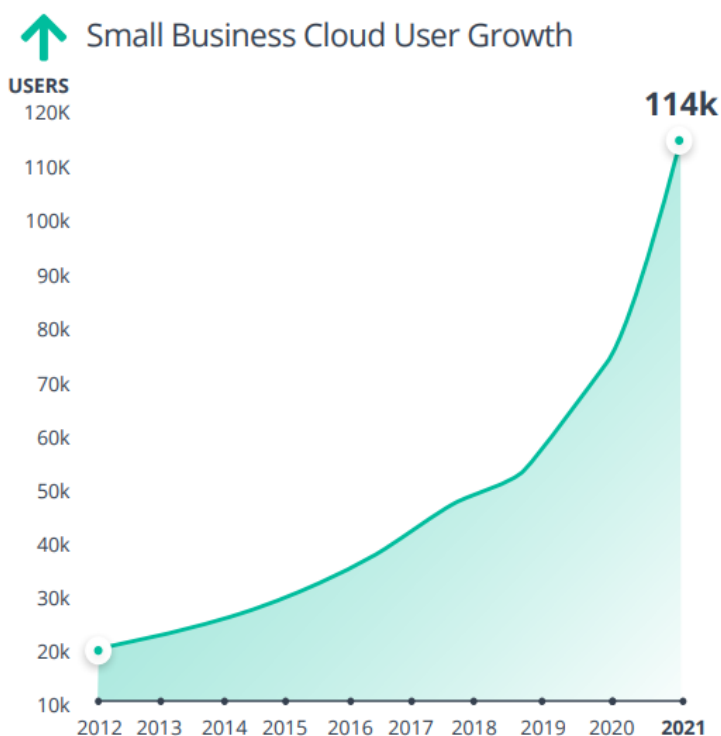


1. Create invoice
2. Save for future use
3. Send via SMS or email

Automate all other steps

- ✓ Payment reminders
- ✓ Real-time notification
- ✓ Payment receipts
- ✓ Mark as paid
- ✓ Reconcile payments





12% annualised user growth

8% cloud revenue growth over FY 2020

58% of available SME Group revenue cloud based for FY 2021

At present, Reckon does not offer merchant payment services directly which means those 114,000 small business customers must pay their digital payment merchant fees to a third party, likely one of the major banks that they do their banking with, or a non-bank payments company. For the small business operator, these fees are only a small fraction of their revenue where many will even on-charge the fees to their customers.

However, when those small 1-2% fees are multiplied by the 114,000 business customers that already use Reckon accounting software, it equates to millions of dollars worth of merchant fees that are not currently in Reckon or Novatti's ecosystem, but could be in the near future after the inked their collaboration in April 2022

So why doesn't Reckon offer digital payment and banking services themselves?

They can't without a massive investment of capital to secure the relevant merchant acquiring and financial

EXAMPLE:

JimBob's Removalist Co operates in the Western Suburbs where customers book his moving services, at a rate of \$200 per hour for two removalists and the truck. When collecting payment at the end of a job, JimBob no longer has to call the office and read the numbers out to be input into the POS terminal. Because Removalist Co uses Reckon as their accounting software provider, JimBob can just enter the credit card numbers into the Reckon payments gateway on his phone and collect the payment instantly.

From Monday to Sunday, JimBob's Removalist Co works 50 billable hours for the week, totalling \$10,000 in takings that he can collect payment for immediately upon job completion.

\$10,000 x 50 weeks = \$500,000 of sales revenue.

With a 1.5% merchant fee, JimBob's Removalist Co pays \$7,500 per annum in merchant fees to secure that \$500,000 in sales revenue.

services licences to accept payments. On top of this, the regulatory requirements are enormous, which is what prevents new entrants from coming into the payments market where Novatti is already a major player that has a good track record with Australian regulators.

Beyond merchant acquiring, there are further synergies that can be realised between the two companies as Novatti's neobank rolls out new banking products, specifically ones that could be designed for small-to-medium enterprises (SMEs).

At present, Judo Bank is Australia's most successful neobank with its primary operation being business loans to SMEs. Without the retail shopfronts of the Big Four, Judo's interest rates and loan approvals are particularly attractive to business owners. It's how they built a \$3 billion loan book and have a \$1.8 billion valuation, after listing on the ASX in November 2021.

Where a partnership for lending services between Novatti and Reckon makes the most sense is the existing business data already recorded within

Reckon's cloud-based platform.

Fintech service providers have been trending towards low-touch services that can be processed via automation which eliminates any need for an in-person meeting with a banker.

This form of neo-lending has become particularly popular for business lending and is increasing its presence in personal lending and mortgages as well. Approval times are subsequently becoming the biggest drawcard for customers that don't have time to wait weeks for a response from the big banks which is where accelerated approval times have been a key motivator for neolenders like Judo, Wisr and more.

With just basic data sharing between Reckon and Novatti, the application process for business loans could take just a matter of seconds given all the relevant accounting data is already recorded by Reckon. Once combined with Novatti's banking business that then automatically logs the relevant data - an instantaneous loan approvals process would be possible.

For the Full Year ended 31 December 2021, Reckon increased its revenue by 1.6% to \$71.3 million. This resulted in a full year NPAT of \$9.2m. Shareholders were rewarded with a fully franked dividend of \$0.02 per share, taking the full year payout to \$0.05 per share.

With their 22,518,138 RKN shares, this delivered Novatti a fully franked full year dividend of \$1,125,906.



Reckon - Historical Statistics

INCOME SUMMARY	2018/06	2019/06	2020/06	2021/06
Revenues (m)	74.50	74.50	75.20	71.10
EBITDA (m)	29.60	29.80	32.30	28.90
Depreciation (m)	-0.74	-2.17	-2.16	-2.01
Amortisation	-17.30	-16.80	-16.90	-16.80
EBIT (m)	11.62	10.83	13.17	10.13
Earning Before Tax & Abnormals (m)	11.01	10.08	12.37	9.60
Income Tax Rate (%)	19.70	19.40	21.30	5.20
Net Profit After Abnormals (m)	7.71	8.12	9.74	9.82

Banking business becomes clearer

One of the biggest upsides to Novatti is the substantial investment they have made in progressing their banking business which led to a licence application in November 2019 for a restricted authorised deposit-taking institutions (RADl) licence.

Granting of the licence application would enable Novatti to launch their neobank, and provide a financial services vehicle that would encapsulate all of their existing digital payment services under one banner.

This has been what Novatti has been working towards for the past 3 years to the point where Novatti had secured the full funding required to launch the neobank. Unfortunately for Novatti, the application was under review just as the coronavirus pandemic started.

The pandemic halted the review process at APRA which announced in April 2020 that no new applications would be approved for six months due to disruption of their general activities. This delay was extended until March 2021, which means Novatti's application review has now resumed. APRA issued their first new licence since the hiatus in July 2021, to Alex Bank.

The reissuing of banking licences was then again in the spotlight when B2B neolender Avenue Bank was granted a restricted licence in September 2021. No further licences have been granted since with key personnel at APRA having taken annual leave over the Christmas period. This had no impact on Novatti other

than pushing their review process further back but in discussions with Novatti CEO Peter Cook, Novatti had been in regular contact with APRA before and after the holiday season when the review of their application resumed in 2022.

Delays in the approval of Novatti's application can also be explained by changes to the approval process which is now vastly different to what it looked like when Novatti submitted their application in 2019.

Neobank Xinja made headlines for the wrong reasons when its business collapsed in December 2020, resulting in the neobank returning all deposits. It is worth noting however, that Xinja was in a vastly different position to Novatti and other neobanks.

As a new business at the time, Xinja started from scratch and invested substantially in Australian customer acquisition through unsustainable interest on savings deposited. Conversely, Novatti already has a strong payments network and global customer base for which it has been producing supplementary information to confirm their capacity to have revenue-generating financial products on launch of the banking business.

It is worth noting that Novatti commenced a public hiring spree from September 2021 onwards via LinkedIn and other recruitment channels with an emphasis on applicants with experience in the banking sector. This recruitment has been subsequently reflected in Novatti's half year results with increased operating expenses but the timing of recruitment is in line with the banking business launch being imminent.



Funding requirements for the launch of Novatti's banking business may be misunderstood within the investor community with \$13m in Series A funding secured for the business that does not currently sit on the balance sheet, but will be accessible upon granting of the licence. Upon release, this will significantly reduce the cash outflow of Novatti.

While all eyes are on Novatti's Australian banking business, Novatti already has banking infrastructure established in Europe where they launched Verv in September 2021.

Once signed up to Verv, Europeans can open a digital bank account with its own unique IBAN – International Bank Account Number – for standardised banking services worldwide.

This is the international equivalent of Australia's BSB system, but on a global scale. Upon account verification, European-based customers can send and receive money, make payment requests, schedule recurring payments and withdraw funds from ATMs. This is just a very limited number of financial services Novatti is offering in Europe where they have an e-Money licence application pending also.

With this international infrastructure established between Australia, Europe and SouthEast Asia, Novatti's network shapes as a major attraction for migrants in Australia and abroad as the bank of choice that can seamlessly move money around the world with Novatti taking a clip on payments processed along the way.

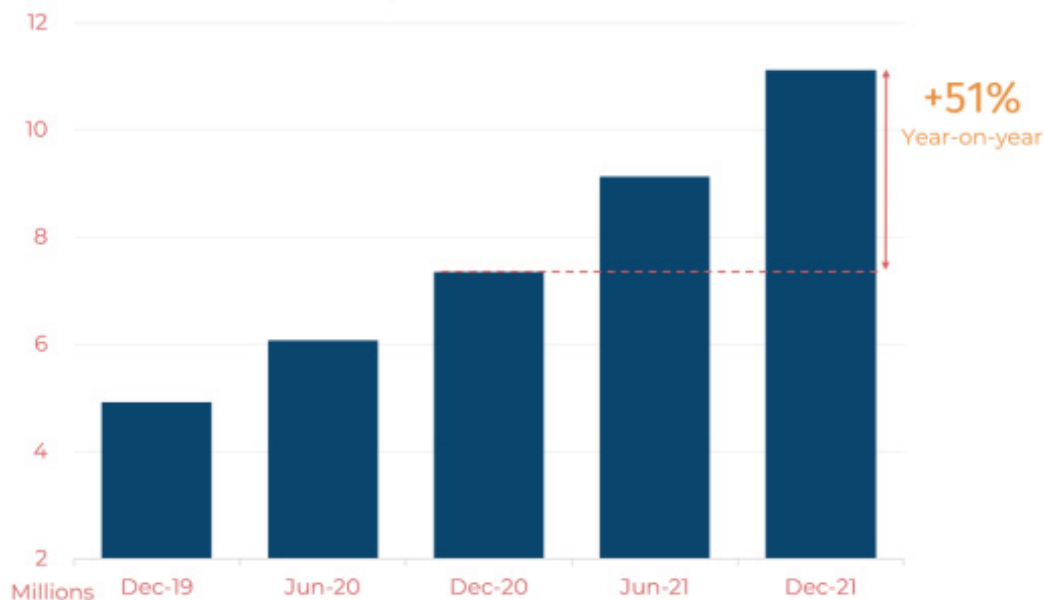


Financial Performance - H1 FY22

As per their stated strategy seeking to grow the business by leveraging their digital payments infrastructure, Novatti has continued to emerge from the pandemic in good shape having been well positioned for surges in demand for digital payments.

Restrictions around lockdowns and foot traffic played a key role to increasing payment processing for Novatti as cash economies continued their downturn while eCommerce witnessed 10 years of growth within the space of months when online shopping became the sole medium for retail.

Half Yearly Sales Revenue



Despite the lifting of most restrictions which has slowed down the momentum of eCommerce, Novatti continued to grow its revenue to report \$11.1m in revenue for the half year ended 31 December 2021. This was a 51% increase on their previous year and already more than the full year result reported in FY20, just 18 months ago.

While the large jump in revenue was notable, it only included one month's contribution

from ATX which settled in December 2021. On an annualised basis, ATX was generating \$3m in annualised revenue and \$0.6m EBITDA.

The revenue also included minimal contribution from Novatti's recently launched merchant acquiring division, which was ramping up its sales team throughout the quarter having only been granted the required licence by Visa and Mastercard in November 2021.

Given the addressable market, limited suppliers with relevant licences and Novatti's digital-only service - Emerald Financial sees considerable upside from this division which could be Novatti's largest revenue generator within the medium-term future.

Revenue continues to be the primary indicator of Novatti's business while the Company continues to scale its infrastructure. To do so, there have been additional expenses incurred which contributed to the underlying EBITDA loss of \$5.9m for the half year.

The jump from the \$0.78m loss for the previous

corresponding period was attributed to a large increase in headcount for Novatti. This has included increases in hiring for the banking business which were required as part of their banking licence application which Novatti is funding until the licence is granted.

On top of that, Novatti has been adversely affected by the pandemic where substantial changes in the tech industry and its limited talent sourcing due to international border restrictions have increased operating expenses globally for the sector.

Undergoing its aggressive growth strategy to launch its merchant acquiring and banking businesses, these expenses were classified as necessary and to secure such talent ahead of larger tech companies can be viewed as a win for the Company which should see those expenses recouped in the immediate future.

Following on from the 11.8m EBITDA loss reported in FY21, Novatti's cash flow situation has been taken into consideration where the Company is still several years away from becoming EBITDA positive, but this is no

Novatti Group Ltd Statement of profit or loss and other comprehensive income 31 Dec 2021		
	31 Dec 2021 \$'000	31 Dec 2021 \$'000
Revenue	11,121	7,350
Other Income	1,216	991
Expenses		
Administrative and corporate costs	(1,350)	(1,055)
Client hosting fees and other direct services	(4,910)	(1,938)
Employee benefits	(12,511)	(6,830)
Foreign currency gains/(losses)	257	(218)
Marketing and selling expenses	(153)	(11)
Data management expenses	(394)	(173)
Loss on investments at fair value through profit or loss	(1,575)	-
Share-based payments	(1036)	(574)
Share of net profit of joint ventures accounted for using the equity method	7	5
Gain on embedded derivative - convertible note facility into Novatti Group Ltd the parent entity	729	791
Depreciation and amortisation expense	(750)	(740)
Finance costs	(513)	(710)
Loss before income tax expense	(9,862)	(3,112)
Income tax expense	(61)	(7)
Loss after income tax expense for the half year attributable to the owners of Novatti Group Limited	(9,923)	(3,119)

different to other tech companies within their sector. Of note, this is particularly common within the fintech industry where the bottom line takes a back seat to potential earnings, customer numbers and scalability.

This is why fintech growth companies quickly enter the M&A space by their larger counterparts upon nearing an inflection point in earnings.

In Novatti's case, the additional operating expenses are attributable to new business divisions with revenues expected to increase from their merchant acquiring division over the next 12 months, and their banking division over the next 24 months.

With \$12.9m cash in the bank, we assess Novatti to have a cash runway of more than 12 months given the Company has \$10.9m in funding secured for the launch of their banking business upon granting of that licence, a portion of which will become revenue to Novatti for digital payment services.

Additional earnings will also be generated by ATX which has annualised EBITDA of \$0.6m but Novatti has signalled its intent to integrate existing Novatti services to SouthEast Asia via ATX which will be a scalability driver.

Lastly, Novatti is earning around \$1.3m in dividends from their 19.9% strategic stake in Reckon which does not yet include any synergies between the two companies which are expected to accelerate revenue for Novatti's merchant acquiring division.

Multi- Cryptocurrency Payments Gateway

One of the underlying principles behind all of Novatti's individual businesses is that they are all geared around a societal shift away from traditional cash economies. This is how they have monetised a range of digital payment and cash voucher products which are particularly popular amongst users that have a specific demand not to use cash.

Anonymity is one reason for general avoidance of cash which is a trend that Novatti has been at the forefront of, first with their cash voucher business Flexipin, and now in the cryptocurrency space.

Novatti has long had exposure to the rise of cryptocurrency with their first foray into its use as an alternate payment asset back in 2016 when partnering with Stellar. Since then, Novatti has continued to pay close attention to its rise while working in the background on a cryptocurrency payments gateway.

This emerged onto the public sphere in February 2021 when Novatti lodged their provisional patent application for a cryptocurrency payments gateway. The application was lodged with the Australian Patent Office on 16 February 2021.

CEO Peter Cook referenced it in an Shareholder update describing it as a "first-of-a-kind gateway will be accessible to all participating crypto exchanges and wallets. It will provide consumers with digital asset wallets with participating exchanges with a secure and



compliant option to pay in their chosen, participating cryptocurrency, while ensuring merchants receive the applicable fiat or cryptocurrency in return.”

Since then, Novatti has invited cryptocurrency exchanges to trial a new product but the exact details of that product have not been disclosed to the public. Based on the name of their patent application and commentary from Cook, Emerald Financial expects that technology between Novatti and crypto exchanges would link the crypto exchange to a Novatti product. One scenario of this might be a Visa card where the user makes a purchase where the merchant receives the funds in fiat, but the funds are taken from the user's cryptocurrency wallet (held at the exchange) where Novatti can instantly process the fiat amount based on the exchange's spot price.

This would solve a customer problem by enabling them to use crypto for day-to-day purchases while the corresponding merchant still receives full payment in fiat. Novatti would potentially take a clip on the exchange rate, or offer the card with a monthly fee. By engaging directly with crypto exchanges, the multi-currency element becomes more appealing if the user can designate their preferred transaction currency which has no impact on the merchant.

Such a mechanism would be the next iteration of Novatti's crypto payments products having partnered with Sydney-based startup CryptoSpend in June 2021 for a Visa card that allows users to pay for goods in a store using their cryptocurrency with the cards to be issued by Novatti. These cards were formally launched in January 2022 and represented the first time cryptocurrencies can be spent on a card issued in Australia.

The launch also highlighted global moves by Visa to make it easier to spend Bitcoin and other digital currencies to pay for everyday items. By selecting Novatti as the cards' issuer, CryptoSpend secured the benefit of Novatti's digital payments infrastructure which enabled the cards to be mobile payment functioning, which enables users to tap their phone to instantly exchange Bitcoin to AUD while merchants are paid instantly in AUD.

This is something that will be particularly appealing to investors who have ridden the crypto market to Bitcoin's all time highs and now want to cash out

their gains without having to offboard to fiat via an exchange.

Foreseeing the value of cryptocurrency and digital payment rails they have created, Novatti further strengthened its digital payments infrastructure in December 2020 when partnering with Ripple for use of RippleNet to accelerate its growth in SouthEast Asia.

Ripple, best known for their cryptocurrency XRP, builds financial solutions and services leveraging XRP – to move money at the same speed and standard that information moves today. RippleNet uses distributed ledger technology to deliver financial solutions – from bi-directional messaging, settlement, liquidity management and lines of credit – to a global network of partners that include major financial institutions such as American Express, Bank of America and Moneygram.



The Ripple partnership kicked off in the Philippines where Novatti reported its first revenues from its cross-border transactions on RippleNet in April 2021. Since then, management have confirmed plans to open international pathways with other countries in SouthEast Asia via RippleNet where Malaysia, Cambodia and Indonesia have been mentioned by Novatti representatives.

According to Ripple, its international transactions take just 3 seconds to send a payment via RippleNet which is active in 55 countries and pairs with more than 120 different currencies.

M&A Prospects - Low to Medium

Novatti does not appear an obvious takeover target at present. However, the success of their banking business could attract a range of suitors from the financial services and fintech industries.

Based on the amount of time it has taken Novatti to be granted the licence, the process of securing one appears to be substantially more difficult than it was two years ago. We have already seen activity in the space with neobank 86 400 acquired by NAB for \$220 million which has enabled NAB to accelerate its digital presence while getting a significant customer injection for its own digital banking business, U Bank.

Other banks have also voiced their desire to engage with younger audiences, acknowledging that the banking needs of Australians are now vastly different to generations of yesteryear. This has seen Bendigo and Adelaide Bank launch Up Bank, also via acquisition.

Elsewhere, Commonwealth Bank has been active in the fintech startup space for similar reasons through their x15 ventures incubator which invests in early stage fintechs, of which Novatti's banking business would qualify.

The current list of their ventures can be viewed here: <https://www.x15ventures.com.au/ventures>.

Other non-bank suitors could potentially emerge from the buy-now-pay-later industry which is undergoing a major restructure due to market saturation. This consolidation has been headlined by Afterpay's acquisition by Square, the Zip - Sezzle merger and Latitude Financial acquiring Humm's consumer lending division.

High operating expenses and delinquency rates are the underlying issue for the BNPL sector which could well see it consolidated or absorbed into just a handful of brands. Due to the capital requirement to acquire a company like Novatti, it is more likely that the acquisition would take place in the reverse where Novatti's banking business acquires a BNPL company for their large customer base.

These customers would then have their BNPL accounts transitioned into a Novatti bank account where repayments would be made like traditional credit cards given Novatti already has the licence to issue Visa cards.



Novatti Group Limited

Statement of profit or loss and other comprehensive income

For the year ended 30 June 2021

	Consolidated	
	2021 \$'000	2020 \$'000
Revenue	16,482	11,004
Other income	1,947	854
Expenses		
Administrative and corporate costs	(2,227)	(1,904)
Client hosting fees and other direct services	(4,979)	(3,137)
Employee benefits	(15,888)	(11,234)
Foreign currency translation (losses) / gains	(116)	(179)
Marketing and selling expenses	(57)	126
Data management expenses	(454)	(257)
Gain on investments at fair value through profit or loss	366	-
Share based payment on investor and broker options	(1,085)	(190)
Share of net profit of joint ventures accounted for using the equity method	33	17
Loss on embedded derivative - convertible note facility into Novatti Group Ltd the parent entity	(2,860)	(727)
Impairment of capitalised bank licensing costs	-	(3,013)
Depreciation and amortisation expense	(1,481)	(906)
Finance costs	(1,507)	(1,367)
Loss before income tax expense	(11,826)	(10,913)
Income tax expense	(17)	(47)
Loss after income tax expense for the year	(11,843)	(10,960)
Other comprehensive income		
<i>Items that may be reclassified subsequently to profit or loss</i>		
Foreign currency translation	(43)	90
Other comprehensive income for the year, net of tax	(43)	90
Total comprehensive income for the year	(11,886)	(10,870)
	Cents	Cents
Basic earnings per share	(5.162)	(6.398)
Diluted earnings per share	(5.162)	(6.398)



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Recommendation Rating Guide	Total Return Expectations on a 12-mth view
Speculative Buy	Greater than +30%
Buy	Greater than +10%
Hold	Greater than 0%
Sell	Less than -10%

*A Speculative Buy is speculative in nature for companies that do not have significant historical data



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