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Key Highlights

- Novatti added to S&P/ASX All Technology Index in September 2021
- FY21 Total Revenue \$18.4m, +55% (FY20: \$11.9m)
- FY21 Sales Revenue \$16.5m, +50% (FY20: 11.0m)
- 19.9% stake secured in Reckon Limited which reported FY21 NPAT at \$5.4m;
- Reckon has more than 106,000 business customers with potential synergies to be explored with Novatti's B2B payment and banking services;
- Visa and Mastercard merchant acquiring licenses aimed for September 2021, opening up merchant payment services for Novatti as a new addressable market;
- APRA resumed bank licence issuing in July 2021, Novatti now in pole position;
- Banking business partner BC Invest has \$1.1 billion loan book of mortgages, providing Novatti with the know-how to launch a lending business with minimal capital expenditure;
- Novatti to issue Australia's first Visa card that enables payment via cryptocurrency with Cryptospend engaging as a customer;
- Expansion of Novatti's SE Asia payments on RippleNet beyond the Philippines;
- Novatti was selected by Afterpay as NZ launch partner in April 2021.

Investment Case - Buy

Emerald Financial maintains its Buy rating on Novatti which is well positioned to secure its banking licence following the resumption of issuing in July 2021 following an 18 month hiatus by the regulator during the pandemic.

Upon granting of the licence, Novatti has significant digital payments infrastructure, regulatory payments licences and tech to quickly build a banking business. It comes at a time where traditional banking has lagged behind in innovation, leading customers to seek more customer-friendly products and services that are powered by entirely digital technology that doesn't require paperwork or attending in-branch meetings.

Even while waiting for their banking licence, Novatti has continued to grow its digital payments business which was highlighted by a 50% increase in sales revenue for FY21 to \$16.5 million.

Outlook:

BUY

Date:

16 Sep 2021

Price (13 Sep):

\$0.480

Ticker:

ASX: NOV

52-Week range:

\$0.205 - \$0.785

Market cap (AUD):

\$160.2m

Shares on issue

323.8m

	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



Novatti



This was achieved despite facing headwinds due to international border closures that dried up the international student market which had been a large market for their cross-border payment services. This has also led to a limited talent pool capable of rolling out new products that could be created from financial licences secured over the past 2 years.

Nonetheless, Novatti has continued to grow its revenue while one eye remains fixed on growth initiatives which may soon be linked to the 19.9% strategic stake invested to take an equity position in accounting software company Reckon (ASX: RKN) at \$1.00 per share.

Reckon rates highly according to Emerald Equities modelling but has potential for even further growth should they look to expand their product suite to include payment services for their 106,000 customers.

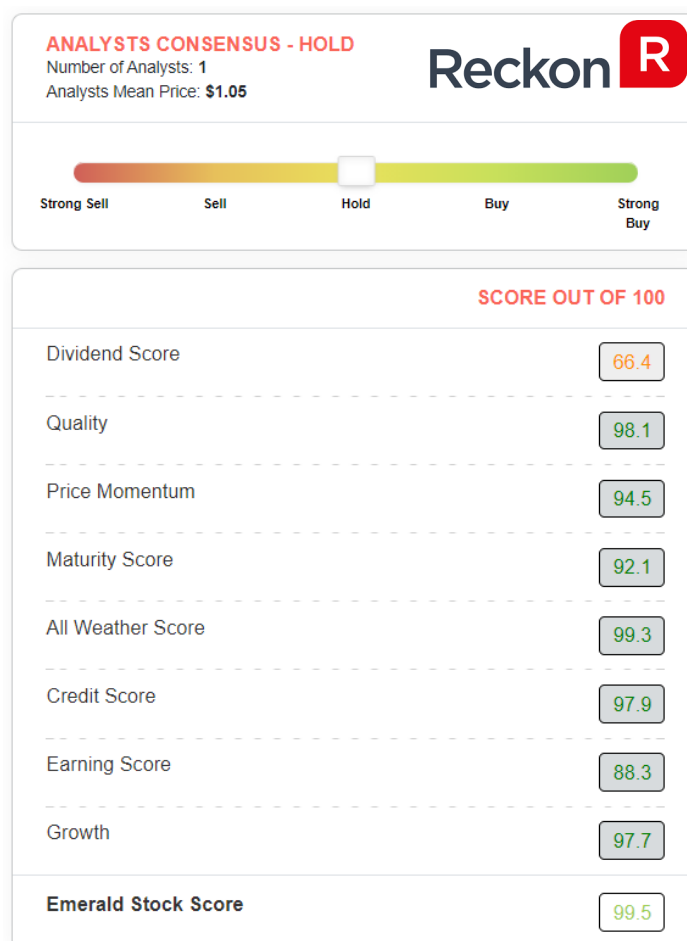
Emerald Financial expects that it is only a matter of time until a formal agreement is confirmed between the two companies which was classified as a low risk investment by Novatti given the existing profitability of Reckon which reported FY21 NPAT of \$5.4 million.

Further highlighting the growth potential of Novatti is their recent addition to the S&P/ASX All Technology Index, formally recognising Novatti as an emerging fintech, joining more than 30 established unicorns within the index of 81 ASX tech companies.

Australia's fintech industry was further thrust into the international spotlight following Afterpay's \$39 billion

takeover by Square, the largest in Australian corporate history.

Revenue generating products will continue to be the underlying trend behind the rise of Novatti's market cap where it is currently in line with industry benchmarks. Afterpay has been an odd outlier however.



Fintech Comparisons				
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 Group	NOV	18.4	160	8.7



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.

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.

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.

Reckon Synergies

In July 2021, Novatti surprised the market with a \$40 million capital raise of which \$22m was used to purchase 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 where 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, while the market was still largely in the dark about Novatti's intentions.

While no formal partnership agreement has been signed between the two companies, Novatti's investment needs to be viewed from a lens that highlights the business assets that Reckon has, beyond their low-cost alternative accounting software for small businesses.

Reckon has amassed more than 106,000 customers which is where the strategic value may lie.

As digital payment providers, all businesses require a payments company to settle their digital payment transactions which is where Novatti holds the key to unlocking new growth opportunities for Reckon. These businesses will typically pay 'merchant fees' to the payments company, normally around 1-2% of the transaction value.

At present, Reckon does not offer merchant payment services which means those 106,000 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 like Tyro (ASX: TYR). 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 106,000 business customers that already use Reckon accounting software, it equates to millions of dollars worth of merchant fees that may be of interest to Novatti

Example

Tracey's Sushi Bar operates in the Melbourne CBD where customers on average spend \$15 on lunch, primarily opting to pay with Paywave for a quick transaction.

From Monday to Friday, Tracey's Sushi Bar serves 120 customers a day with 100 paying via the tapping of their credit card.

100 customers x \$15 x 5 days = \$7,500 of sales revenue.

With a 1.5% merchant fee, Tracey's Sushi Bar pays \$112.50 per week in merchant fees to secure that \$7,500 in sales revenue. Over the course of the year, Tracey's Sushi Bar pays \$5,625 in merchant fees for a service that gives her customers a quick payment option.

*100 sushi bars = \$562,500 in annual merchant fees
1,000 sushi bars = \$5,625,000 in annual merchant fees
10,000 sushi bars = \$56,250,000 in annual merchant fees*

So why doesn't Reckon just do this themselves? They can't without a massive investment of capital to secure the relevant merchant acquiring and financial services licenses 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.

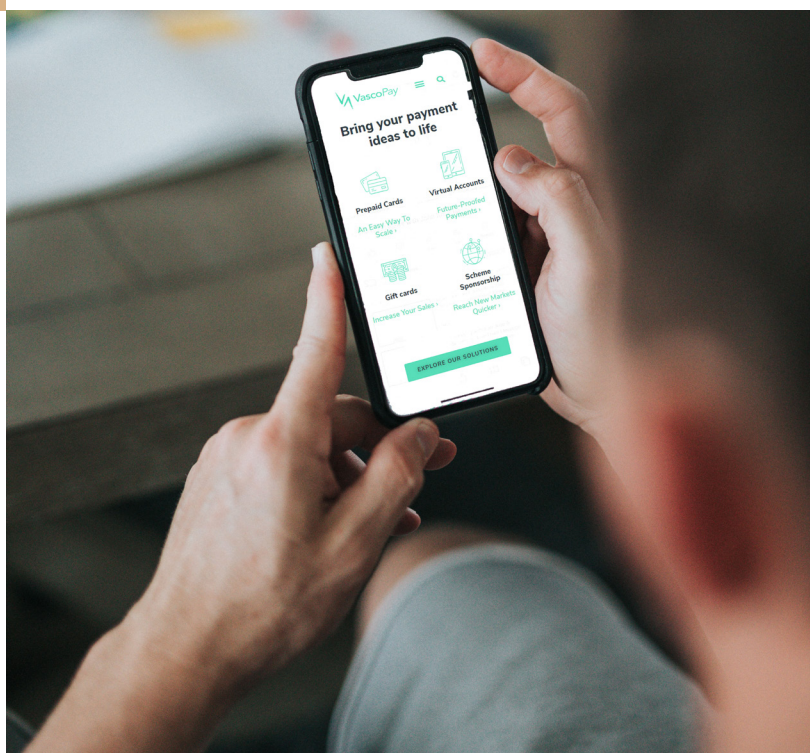
Beyond merchant acquiring, there are further synergies that can be realised between the two companies as Novatti's neobank rolls out new banking products, specifically ones that could be designed for small-to-medium enterprises (SMEs).

At present, Judo Bank is Australia's most successful neobank with its primary business 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 had a \$1.9 billion valuation as of June 2021 when raising \$124m for themselves.

While Novatti would still need to get through 12 months of its restricted banking license before being able to offer SME lending, the concept slots in nicely with Novatti's B2B service roadmap where its focus will be on merchant acquiring under their own Novatti brand before introducing SME lending in FY23 and beyond pending the unrestricted banking licence.

As well as the potential partnership opportunities that will come with their 19.9% stake, the Reckon business itself is profitable and delivers Novatti with an ongoing dividend on top of any capital gains.

For the Half Year ended 30 June 2021, Reckon increased its revenue by 5% to \$37.5 million and 18.6% increase in NPAT to \$5.4m. Shareholders were rewarded with a fully franked dividend of \$0.03 per share. With their 22,518,138 RKN shares, this delivered Novatti an interim dividend of \$675,544.



Novatti - Banking Licence Imminent

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 that no new applications would be approved for six months due to disruption of their general activities. This delay from APRA was extended until March 2021 which means Novatti's application review has now resumed with APRA issuing their first new license 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.

The timing of APRA's resumption of issuing coincides with investment commitments secured from BC Investment Group in May 2021. The investment included \$3m in funds via an institutional Placement and \$2m in seed capital for the banking business.

Of greater significance is the equity partner Novatti has secured, with BC Invest already having a strong lending presence in the Australian market with AUD\$1.1b of mortgage loans and 3,800 customers. This know-how to launch and operate a lending business offers Novatti the internal knowledge to quickly launch a lending business as it's banking services are rolled out to accelerate revenue-generating lending products.

Neobanks are a relatively new concept to the Australian market where the business models have proven hugely popular in the United States and Europe. Without the expenses and large capital overheads applicable to the traditional banks, digital banks are therefore able to offer customers greater value in banking products while having great digital accessibility to products and services.

Within the Australian market, 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. Outside of Xinja, neobanks have attracted further corporate attention as Australians continue seeking alternative banking and financial services than those offered by the major banks. This was most recently witnessed in the \$220 million takeover bid of neobank 86 400 by National Australia Bank (ASX: NAB) which already held an 18.6% stake.

The takeover was primarily aimed at accelerating NAB's digital strategy where 86 400 customers would be transitioned to NAB's digital-only UBank brand, as well as extracting the neobank's tech to upgrade their own.

Founded in 2019, 86 400 had more than 85,000 customers, \$375 million in deposits, \$270 million in approved residential mortgages, and 2,500 approved brokers at the time of the takeover bid.

This highlights the rapid growth neobanks can achieve in Australia through their customer-focused digital offerings, with Novatti in the box seat to secure their license now that APRA has resumed their review of licence applications.

Novatti FY21 Financial Performance

Novatti's FY21 results were highlighted by a 50% increase in sales revenue to \$16.5 million where the Company overcame substantial headwinds to post the impressive result. Prior to the onset of COVID-19, migrant populations were a major source of revenue for Novatti with the international student population essentially disappearing overnight when the pandemic commenced.

The increase in revenue can be attributed to Novatti's rise as a fintech partner of choice amongst international companies looking to enter new markets - accepting payments - that can do so by leveraging Novatti's regulatory licences and fintech. Being selected by Afterpay as their launch partner in New Zealand, the buy-now-pay-later giant was able to enter the NZ market by partnering with Novatti which issued the Visa cards.

These cards were then linked to Afterpay customer accounts that could be used for mobile payment at stores in New Zealand courtesy of Novatti's partnerships with Apple Pay, Samsung Pay and Google Pay.

While Novatti's NPAT loss of \$11.8 million raised some



questions, the Company doubled its headcount over the year. Investment in their people coincided with pandemic-enforced international border closures which have had a big impact on the labour market for tech developers where international markets had previously been a much larger talent pool than Australia's domestic one.

This has forced Australian tech companies to spend more on recruitment and salaries but comes at a time where Novatti needs to strike now in order to roll out

new products that monetise the licenses they have been securing over the past 2 years.

When accounting for non-cash line items, the underlying EBITDA was a \$4.3 million loss however the Company remains very well funded following their \$40 million cap raise in July 2021 of which \$18m was retained for working capital after securing their 19.9% stake in Reckon.

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		
Items that may be reclassified subsequently to profit or loss		
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)



Novatti Review of Operations - Year Ended 30 June 2021

	2021 \$'000	2020 \$'000	Change \$'000	Change %
Net loss from operations	(11,843)	(10,960)	(883)	8%
Add:				
Interest	(35)	(9)	(26)	289%
Less:				
Depreciation and amortisation	1,481	906	575	63%
Finance charges	1,507	1,367	140	10%
Indirect tax expenses	29	157	(128)	(82%)
EBITDA	(8,661)	(8,539)	(322)	4%
Add back/(less)				
Vesting of share-based payments	2,087	1,332	755	57%
Investments at fair value through profit and loss	(366)	-	(366)	-
Loss on embedded derivative	2,860	727	2,133	293%
Impairment of capitalised bank licensing costs	-	3,013	(3,013)	(100%)
Underlying EBITDA*	(4,280)	(3,467)	(813)	23%
Cash	8,798	2,600	6,198	238%
Operating cash flow	(5,399)	(1,236)	(4,163)	337%

Novatti - Cryptocurrency Payments Gateway

At the forefront of the digital payments trend, 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.”

In July 2021, it was confirmed that Sydney-based startup CryptoSpend had been approved by Visa for a card that will allow users to pay for goods in a store using their cryptocurrency with the cards to be issued by Novatti.

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.

It will be the first time cryptocurrencies can be spent on a card issued in Australia, and highlights global moves by Visa and Mastercard to make it easier to spend Bitcoin and other digital currencies to pay for everyday items. The card will be issued by Novatti and be accessible via mobile payment through their tech, essentially enabling users to tap their phone which instantly exchanges Bitcoin to AUD for a merchant to be paid instantly in that same AUD amount.

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 and Indonesia have been mentioned.

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.

Business Risks

Licensing

The banking license and merchant acquiring license are both mission critical to Novatti and their future plans. Both licences are required to increase their revenue-generating range of products and services.

Regulatory Changes

Money laundering continues to be a focal point amongst Australian regulators where Novatti carries single party risk via AUSTRAC. While Novatti, to date, has never fallen foul to the regulators, any potential investigation would pose risks to Novatti just like any other operator in the payments sector.

International Border Closures

Prior to the onset of a global pandemic, a large segment of Novatti's cross-border payments emanated from Asia, in particular from families of international students studying in Australia and incoming migrants. The risks have been born into Novatti's performance since March 2020 when Australia first shut its international borders.



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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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