Momentum continues to accelerate

Novatti's 3Q22 quarterly update highlighted that the company continues to accelerate forward. Revenues continue to rise rapidly, while cash burn has also increased modestly. Reflecting this, we lift our expense forecasts for FY22 and FY23 through changing our cost to income profile, and also allow for slightly higher other income across future years.

Earnings and valuation changes

We change our underlying and reported EPS estimates: FY22E: -13%, FY23E: -265%, FY24E: 263%. In FY23 and FY24, these movements appear large because they are on very small numbers around breakeven. We value NOV at A$1.05, up from 95c, using a DCF on free cash flows to equity with a cost of equity of 8.0%, referencing peer multiples to validate reasonableness. Full details are within.

Growing to scale new strategic focus

Rather than just growth, growing to achieve scale seems to be Novatti's refined strategic focus. Processing and ATX already have sufficient scale to be operating cashflow positive. Clearly, there are some business units, such as its banking team awaiting an ADI licence, and its acquiring team which only received its licences earlier this financial year, which will take some time to achieve this scale, although acquiring has the potential to overtake processing to become Novatti's largest business unit.

Debt to provide additional liquidity

Novatti are considering leveraging their existing assets to provide additional liquidity for the business, rather than raise additional equity, stating that there "is no intent to do any type of equity capital raise in the near to medium term." With its 3Q22 cash runway just below 2, we assume the company will borrow to strengthen its cash position in 4Q22. With cash generating businesses it is favourable for shareholders for Novatti to consider debt, even with its continued aggressive investment.

4Q22 set to be even stronger

Novatti also hinted at some of the additional activities in store for 4Q22 which should deliver further growth, including a full acquiring switch solution set to be live by June (which should also improve the profitability of acquiring), the EMD Agent licence in Europe obtained in April, and its partnership with Reckon, also announced in April initially adding payments into the Reckon One platform. It is also currently in the process of applying for an EMoney Issuing licence in Europe and continuing to work on obtaining a restricted ADI licence in Australia.

Novatti is a leading digital banking and payments fintech. It enables business to pay and be paid, from any device, anywhere. It does this by leveraging its 'ecosystem', which includes technology and platforms, extensive regulatory licences, and global commercial partnership.

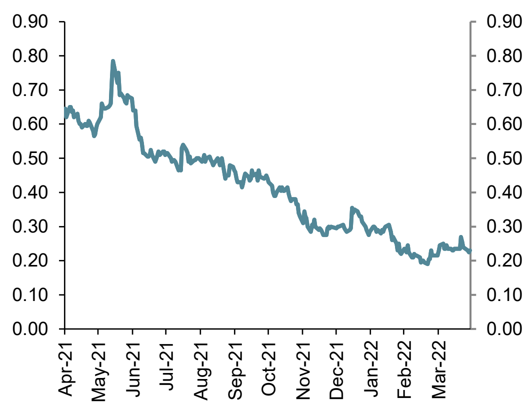
Its services capture the entire payments value chain. This includes issuing, such as prepaid Visa cards, acquiring, enabling merchants to accept payment from financial institutions, and processing, including cross-border transfers and automated invoicing.

Stock	NOV.ASX
Price	A$0.235
Market cap	A$78.8m
Valuation	A$1.05c (up from $0.95)

Company data	
Cash at 3Q22:	~A$8.4m
Shares on issue:	335.3m

Next steps	
4Q22 Appendix 4C	Late July 2022
FY22 final result	August 2022
ADI licence; EMI licence	Pending regulators

NOV Share Price (A$)



Glen Wellham, Senior Analyst

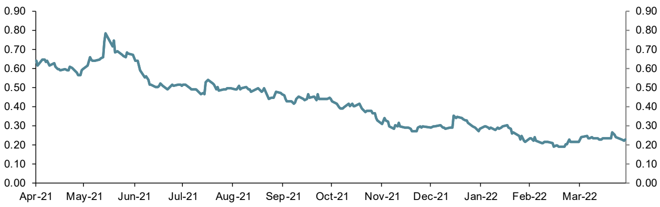
Financials

NOVATTI GROUP LIMITED — NOV-AU

Year end 30 June, AUD unless otherwise noted

MARKET DATA		
Price	**$**	0.235
Valuation	**$**	1.05
52 week high / low	$	0.19 - 0.79
Market capitalisation	**$m**	78.8
Shares on issue (basic)	m	335.3
Options / rights / ESP / LTIP	m	15.9
Other equity	m	0.0
Shares on issue (fully diluted)	m	351.2
Out of the money options	m	24

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS		FY20A	FY21A	FY22E	FY23E	FY24E
Reported NPAT	$m	(10.7)	(12.2)	(13.0)	(5.3)	0.2
Underlying NPAT	**$m**	**(10.7)**	**(12.2)**	**(13.0)**	**(5.3)**	**0.2**
Reported EPS (diluted)	¢	(6.2)	(5.4)	(4.0)	(1.5)	0.0
Underlying EPS (diluted)	**¢**	**(6.2)**	**(5.4)**	**(4.0)**	**(1.5)**	**0.0**
….Growth	%	148%	(14%)	(26%)	(62%)	(103%)
PER underlying	**x**	**(3.8)**	**(4.4)**	**(5.9)**	**(15.6)**	**531.5**
Operating cash flow per share	¢	(0.7)	(2.4)	(3.4)	(1.1)	0.4
Free cash flow per share	¢	0.5	(3.8)	(8.7)	(2.4)	(0.9)
Price to free cash flow per share	**x**	**0.5**	**nm**	**nm**	**nm**	**nm**
FCF yield	%	2.1%	(16.3%)	(37.1%)	(10.1%)	(3.6%)
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**	**81.8**	**74.9**	**68.9**	**77.3**	**80.3**
EV/Revenue	x	7.4	4.5	2.4	1.9	1.5
EV/Underlying EBITDA	x	-19.9	-14.4	-7.2	-26.0	32.7
Book value per share	¢	-0.3	3.6	12.2	12.3	13.4
Price to book (NAV)	x	-162.3	8.9	1.8	1.8	1.6
Net tangible assets per share	¢	-3.3	1.6	10.9	11.0	12.1
Price to NTA	x	-12.7	20.2	2.0	2.0	1.8

KEY RATIOS		FY20A	FY21A	FY22E	FY23E	FY24E
Net debt /(cash)	$m	3.0	(3.9)	(9.9)	(1.5)	1.5
Interest cover (Operating NPAT / net interest	x	(3.4)	(1.7)	45.5	(12.2)	1.4
Gearing (net debt / underlying EBITDA)	x	nm	0.7	1.0	0.5	0.6
Leverage (net debt / (net debt + equity)	x	1.2	nm	nm	nm	0.0

DUPONT RATIOS		FY20A	FY21A	FY22E	FY23E	FY24E
Return on Assets	%	nm	nm	nm	nm	0.02
Financial Leverage	x	-67.6	7.2	3.1	13.9	20.6
Return on Equity	**%**	nm	nm	nm	nm	0.35

GROWTH PROFILE		FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	%	30.7	49.8	76.4	43.0	28.6
Underlying EBITDA	%	(86.9)	(26.5)	(82.9)	68.8	182.5
NPAT	%	(165.4)	(14.8)	(6.5)	59.6	102.9
Underlying Profit	%	(264.5)	(25.3)	(14.9)	195.7	361.6
Underlying EPS	%	(147.8)	14.1	25.8	62.2	102.9
DPS	%	n/a	n/a	n/a	n/a	n/a

HALF YEARLY DATA		1H21A	2H21A	1H22A	2H22E	1H23E
Revenue	**$m**	7.4	9.1	11.1	18.0	17.9
Other income	$m	1.0	0.9	1.2	0.9	1.2
Cash expenses	$m	-10.0	-13.6	-18.2	-22.4	-20.5
Underlying EBITDA	**$m**	**-1.7**	**-3.6**	**-5.9**	**-3.6**	**-1.5**
EBITDA	$m	-2.2	-4.1	-8.6	-3.8	-1.7
Depreciation, amortisation and impairment	$m	-0.7	-0.7	-0.2	-0.8	-0.8
EBIT	**$m**	**-3.0**	**-4.8**	**-8.8**	**-4.6**	**-2.4**
Associates and JVs	$m	0.0	0.0	-1.6	0.0	0.0
Net interest	$m	-0.1	-4.3	0.5	-0.2	-0.2
PBT	**$m**	**-3.1**	**-9.1**	**-9.9**	**-4.8**	**-2.6**
Income tax	$m	0.0	0.0	-0.1	0.0	0.0
NPAT	**$m**	**-3.1**	**-9.1**	**-9.9**	**-4.8**	**-2.6**

Source: Company reports and MST Acccess estimates

PROFIT AND LOSS		FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	**$m**	**11.0**	**16.5**	**29.1**	**41.6**	**53.5**
Other income	$m	0.8	1.9	2.1	2.1	2.1
Cash expenses	$m	-16.0	-23.6	-40.7	-46.6	-53.1
Underlying EBITDA	**$m**	**-4.1**	**-5.2**	**-9.5**	**-3.0**	**2.5**
EBITDA	$m	-4.3	-6.3	-10.8	-3.4	2.1
Depreciation, amortisation and impairment	$m	-3.9	-1.5	-0.9	-1.5	-1.5
EBIT	**$m**	**-8.2**	**-7.8**	**-11.7**	**-4.9**	**0.6**
Associates, JVs and fair value adjustments	$m	0.0	0.0	-1.6	0.0	0.0
Net interest	$m	-2.4	-4.5	0.3	-0.4	-0.4
PBT	**$m**	**-10.6**	**-12.2**	**-13.0**	**-5.3**	**0.2**
Income tax	$m	0.0	0.0	-0.1	0.0	0.0
NPAT	**$m**	**-10.7**	**-12.2**	**-13.0**	**-5.3**	**0.2**
Weighted average diluted shares on issue	m	171.3	228.8	328.6	351.2	351.2

BALANCE SHEET		FY20A	FY21A	FY22E	FY23E	FY24E
Cash & equivalents	$m	2.6	8.8	20.1	11.7	8.7
Trade & other receivables	$m	2.8	4.1	5.1	5.4	5.8
Financial assets - funds in trust	$m	17.5	39.0	60.5	508.2	858.8
Investments accounted for using the equity method	$m	0.0	0.8	0.8	0.8	0.8
Other investments	$m	0.9	1.0	22.0	22.0	22.0
Net Property Plant And Equipment	$m	0.6	0.5	0.5	0.5	0.5
Right of use assets	$m	2.2	1.9	1.8	1.8	1.8
Intangibles	$m	5.7	5.0	4.5	4.5	4.5
Deposits	$m	0.2	2.2	8.1	12.9	16.7
Other	$m	0.4	0.3	3.8	3.8	3.8
Total Assets	**$m**	**32.8**	**63.8**	**127.1**	**571.5**	**923.3**
Trade and other payables	$m	5.9	6.8	8.4	8.9	9.4
Settlement and remittance funds payable	$m	17.5	38.6	60.0	503.6	851.1
Lease liabilities	$m	2.5	2.2	2.1	2.1	2.1
Unearned revenue	$m	0.2	0.2	0.2	0.2	0.2
Borrowings, including convertible notes	$m	5.6	4.9	10.2	10.2	10.2
Employee benefits	$m	1.0	1.5	1.7	1.8	1.9
Other	$m	0.6	0.6	0.3	0.3	0.3
Total liabilities	**$m**	**33.3**	**54.9**	**82.8**	**527.1**	**875.2**
Net assets	$m	-0.5	8.9	44.2	44.4	48.0
Contributed equity	$m	26.7	44.1	90.1	90.1	90.1
Reserves	$m	2.4	3.8	4.6	4.6	4.6
Retained earnings	$m	-29.5	-41.0	-53.6	-53.5	-49.8
Shareholder's equity	**$m**	**-0.5**	**8.9**	**41.1**	**41.2**	**44.9**
Basic shares on issue	m	185.2	244.2	335.3	335.3	335.3

CASH FLOW		FY20A	FY21A	FY22E	FY23E	FY24E
Net Income (Cashflow)	$m	-11.0	-12.3	-14.7	-5.3	0.2
Depreciation & Amortization	$m	0.9	1.5	1.5	1.5	1.5
Change in Net Operating Assets	$m	2.5	-2.8	-2.4	-0.9	-1.0
Other Non-Cash Items, Total	$m	6.3	5.2	-1.2	0.8	0.8
Other	$m	0.0	2.9	5.5	0.0	0.0
Operating cash flow	**$m**	**-1.2**	**-5.4**	**-11.3**	**-3.9**	**1.5**
Capital expenditure	$m	-1.3	-2.4	-0.8	-0.3	-0.3
Acquisitions/divestment/other	$m	-0.2	-0.3	-25.7	-4.0	-4.0
Investing cash flow	**$m**	**-1.5**	**-2.6**	**-26.4**	**-4.2**	**-4.2**
Equity	$m	0.1	15.1	39.6	0.0	0.0
Debt (including convertible)	$m	3.8	-0.4	9.4	0.0	0.0
Leases	$m	-0.2	-0.3	-0.3	-0.3	-0.3
Financing cash flow	**$m**	**3.7**	**14.4**	**48.8**	**-0.3**	**-0.3**
Net cash flow	**$m**	**1.0**	**6.3**	**11.0**	**-8.4**	**-3.0**
Free cash flow	$m	0.8	-8.7	-28.6	-8.4	-3.0

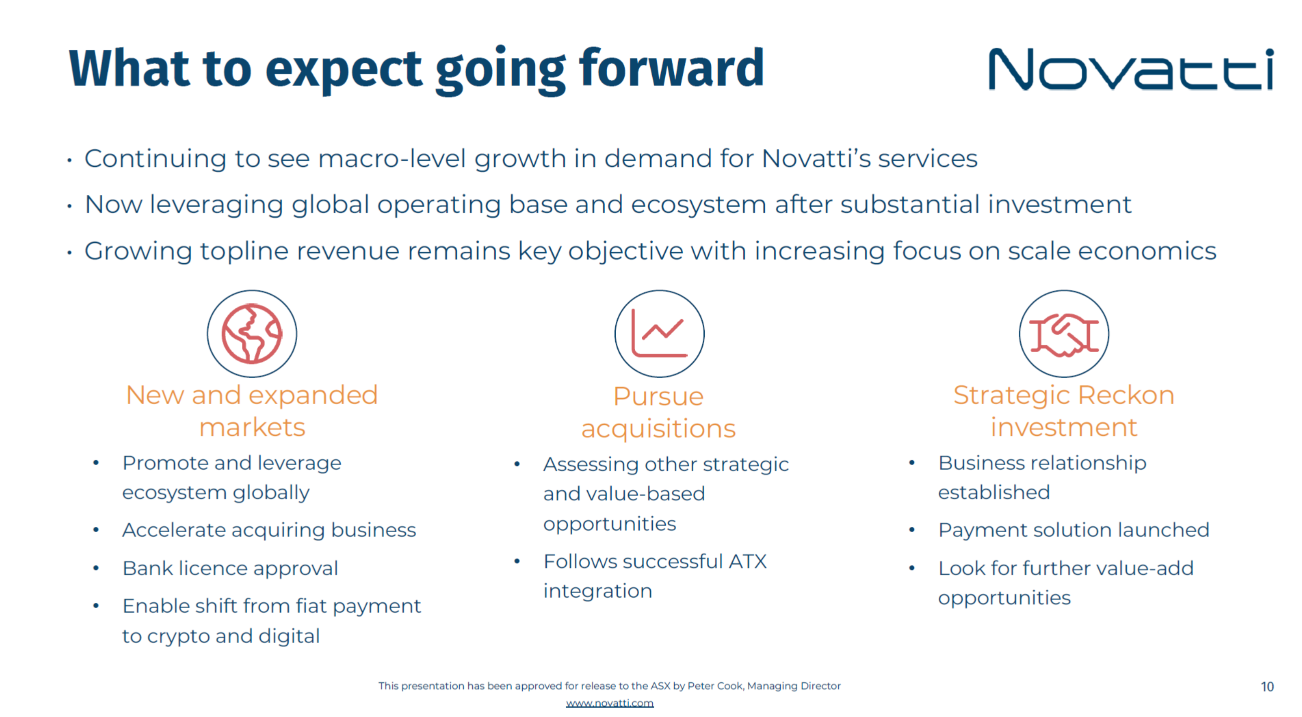
Source: Company reports and MST Access estimates

Quarterly Activities Report and Appendix 4C Cashflow Analysis

Outlook highlights focus shift toward achieving scale to improve profitability

Novatti offered the following outlook commentary as part of a presentation alongside its quarterly activities report, highlighting that while it continues to focus on growing revenues, it is also now ensuring that its business segments achieve scale to become profitable.

Figure 1 –Novatti Outlook

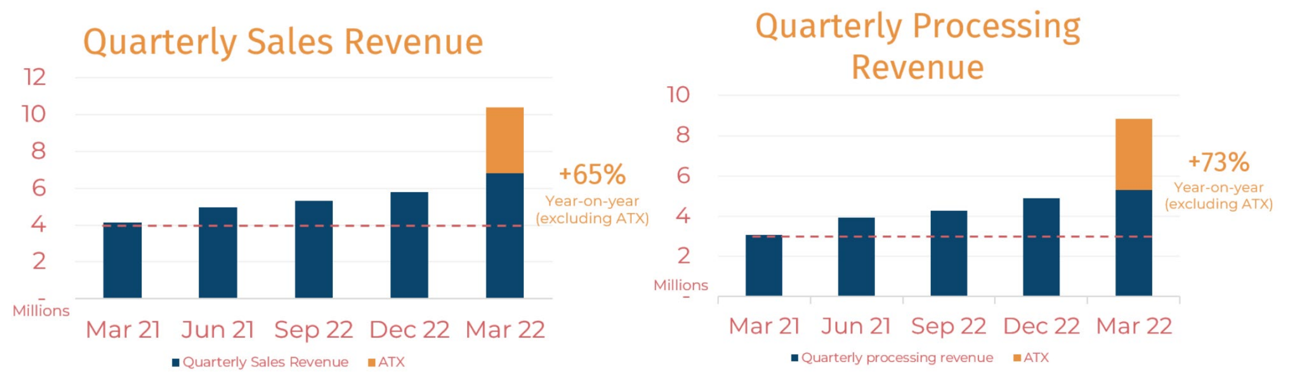


Source: Company reports, MST Access estimates

Record 3Q22 revenue

Novatti achieved record revenues again in 3Q22, with sales revenues hitting $10.8m, with the compound growth quarter on quarter possibly even accelerating, prior to the incremental growth provided by its acquisition of ATX. With the rapid growth being achieved in acquiring, the proportion of revenues from payment processing fell to 51%, despite another record quarter for payment processing, with $5.3m achieved in the quarter.

Figure 2 –Novatti quarterly revenue trends



Source: Company reports

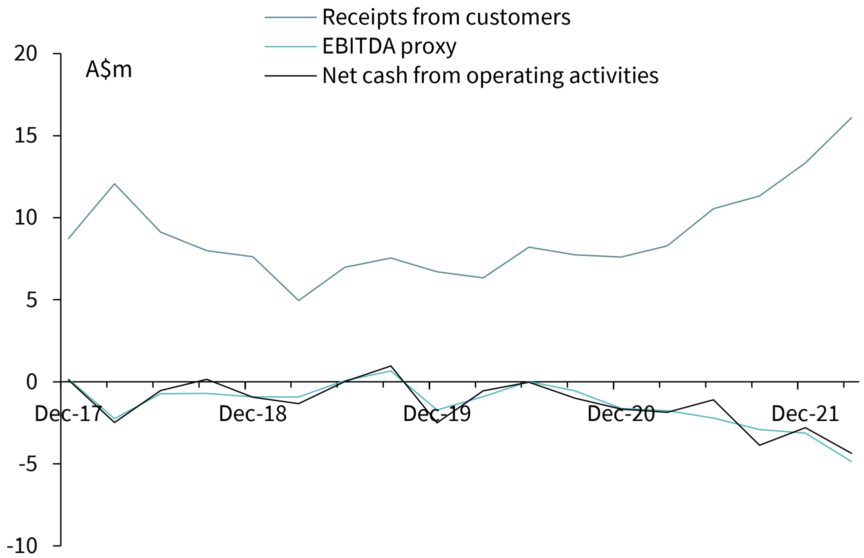
The strong contribution from ATX reportedly included some lumpy government related transactions at a lower margin, and go a long way to explaining why ATX's performance in the quarter was so strong. While incrementally accretive, and encouraging expansion o the ATX customer base, it does provide a misleading view by overstating ATX's underlying performance.

The partnership with Reckon, announced in early 4Q22, should further accelerate growth, however it will take some time before Novatti's products are fully integrated into Reckon's. Similarly, the EMD Agent licence received early in 4Q22 should also enable it to grow its Flexibin services in Europe; and we note it is currently in the process of applying for an EMoney Issuing (EMI) licence in Europe, which once received should allow it to further accelerate its growth.

Cash receipts continue to rise

Novatti's cash receipts continued to climb rapidly over the past quarter. However, some of its business units are still subscale and cash consumptive – which isn't surprising, given that acquiring only received its licences within the past year, and that the banking division is still waiting on APRA approving an ADI licence before it can begin business operations. This led to a modest increase in the operating cashflow deficit; however with the company now focused on achieving scale in its business units, we expect that this operating deficit will shrink in future quarters.

Figure 3 – Quarterly cash receipts and operating cashflow



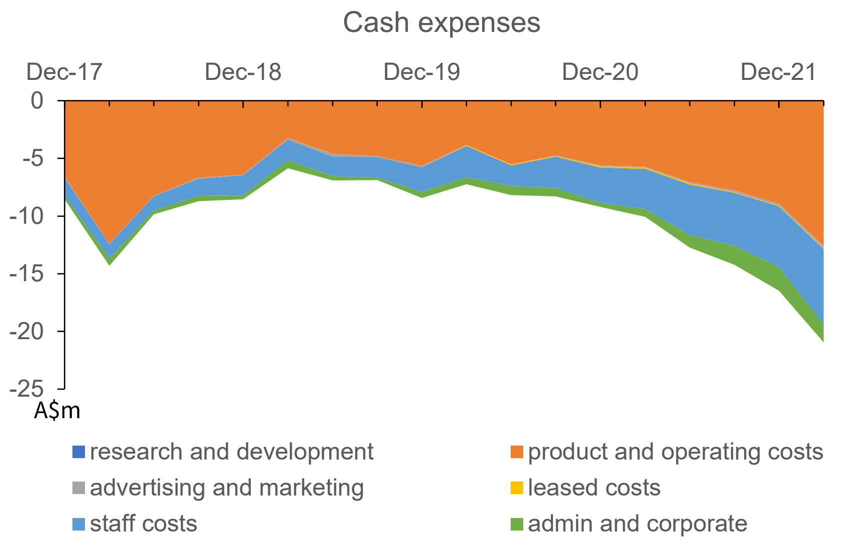
Source: Company reports, MST Access estimates

Operating expenses increasing too

Reflecting the additional costs added by ATX, and consistent with Novatti's articulated strategy of increasing its investments to grow the company, its product and operating costs, staff costs all increased in 3Q22, although showing that it does carefully manage costs, admin and corporate costs decreased.

We continue to believe that the relationship between these costs and revenues is a J curve, where Novatti needs to invest ahead of revenues, in areas such as compliance and technology, but after a few years revenues begin to exceed these costs and its investments will become profitable.

Figure 4 – Cash operating expenses

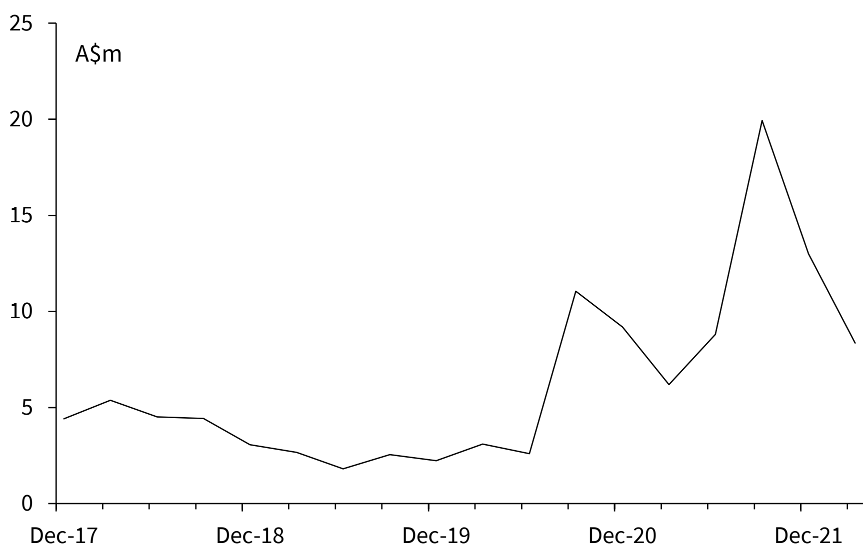


Source: Company reports, MST Access estimates

No equity raise coming as leverage to be used to extend cash runway

Novatti's cash at the end of December 2021 was $8.4m, having decreased predominantly due to its operating cash burn and investments during the quarter.

Figure 5 – Novatti quarterly cash balance



Source: Company reports, MST Access estimates

As its Appendix 4C states, Novatti at 31 March had just 1.9 quarters of future cash available at the pace of operating cash burn during the March quarter.

Novatti's management are adamant that there is no equity raise coming to increase its cash position; rather it is going to increase its leverage through secured borrowings to provide liquidity – a position articulated in its Appendix 4C and repeated during its investor presentation. To us this suggests it is increasingly confident of its operations generating operating cashflow – likely some currently, and more in the future. Furthermore, now that it has achieved a partnership with Reckon, it could look to reduce its holding in Reckon, although given the likely partnership synergies which should lift the value of its Reckon stock in time, this would likely be an option of last resort.

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

Earnings estimate changes

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

Figure 6 –Earnings estimates for Novatti

		FY22E			FY23E			FY24E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	A$m	29.1	29.1	0.0%	41.6	41.6	0.0%	53.5	53.5	0.0%
Underlying EBITDA	A$m	-8.1	-9.5	-18.2%	0.9	-3.0	-448.2%	2.2	2.5	11.4%
EBIT	A$m	-10.2	-11.7	-14.3%	-1.0	-4.9	-366.1%	0.3	0.6	82.3%
Profit before tax	A$m	-11.5	-13.0	-12.7%	-1.4	-5.3	-264.8%	-0.1	0.2	262.9%
NPAT (reported)	A$m	-11.6	-13.0	-12.7%	-1.4	-5.3	-264.8%	-0.1	0.2	262.9%
EPS (underlying)	cps	-3.5	-4.0	-12.7%	-0.4	-1.5	-264.8%	0.0	0.0	262.9%
EPS (reported)	cps	-3.5	-4.0	-12.7%	-0.4	-1.5	-264.8%	0.0	0.0	262.9%
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:

- Lifting our expense assumptions for FY22 and FY23.
- Lifting our other income assumption slightly.

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

Valuation

We value NOV at A$1.05 per share (up from $0.95 ps) using a DCF of free cash flow to equity forecasting out 7 years before applying a terminal value. We continue to assume a cost of equity of 8.0% (consisting of an equity risk premium of 6% and beta of 1) and a terminal growth rate of 3%.

Figure 7 –MST Access valuation of Novatti

Current date		29-Apr-22														
Next balance date		30-Jun-22														
		Jun-22	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26	Dec-26	Jun-27	Dec-27	Jun-28	Dec-28	Jun-29
Free cash flow to equity	**A$m**	**5.1**	**-6.3**	**-2.1**	**-4.7**	**1.8**	**1.4**	**3.0**	**3.6**	**5.2**	**5.5**	**8.1**	**8.4**	**11.9**	**10.2**	**16.9**
Discounted cash flow	**A$m**	**5.0**	**-5.9**	**-1.9**	**-4.2**	**1.5**	**1.1**	**2.4**	**2.7**	**3.7**	**3.8**	**5.4**	**5.5**	**7.4**	**6.1**	**9.7**

Sum of discount streams	A$m	42.3	**CAPM**	
Future value into perpetuity	A$m	542.0	Risk free rate	2.00%
NPV of terminal value	A$m	312.2	Equity beta	1
add net cash	A$m	12.90	Equity risk premium	6.00%
Value of total equity	**A$m**	**367.40**	Cost of equity	8.0%
Diluted shares on issue	m	351.2		
Value per share	**A$**	**1.05**	Terminal growth	3.0%

Source: Company reports, MST Access estimates

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

While Novatti currently has its primary industry classification as application service provider under software, we believe a more appropriate industry classifications are:

- internet merchant services within the information technology sector, which encompasses payment processors, payment service providers and gateways, and payment wallets, as well as

- electronic funds transfer and transaction services within specialised finance.

Using these industry classifications we believe deliver a more appropriate peer group to which to compare Novatti.

Refining these screens deliver the peers and respective multiples in the following figure.

Figure 8 –Selected peer comparable companies' valuation multiples

Identifier (RIC)	Company Name	Enterprise Value US$m	Trailing EV/Revenue	Forward EV/Revenue	P/NTA	P/B
NOV.AX	Novatti Group Ltd	17.2	7.1	n.a.	2.0	22.6
EML.AX	EML Payments Ltd	-964.9	-1.3	n.a.	-20.0	3.0
SMP.AX	SmartPay Holdings Ltd	114.8	6.9	n.a.	65.7	8.2
TYR.AX	Tyro Payments Ltd	421.7	7.7	1.8	17.6	10.4
SQ2.AX	Block Inc	n.a.	n.a.	3.3	19.5	n.a.
MQ.O	Marqeta Inc	3,645.5	14.6	5.1	3.4	5.9
V	Visa Inc	474,398.6	19.9	16.5	-37.9	13.6
MA	Mastercard Inc	377,711.4	19.0	17.1	-92.3	48.2
PYPL.O	PayPal Holdings Inc	107,200.7	8.7	3.8	13.3	10.1
AMA.MC	Amadeus IT Group SA	32,709.2	11.2	6.9	-7.0	7.2
NETW.L	Network International Holdings PLC	2,102.3	7.0	4.8	-14.9	3.6
FIS	Fidelity National Information Services Inc	81,915.7	6.1	5.5	-3.0	1.4
PAY.TO	Payfare Inc	200.3	7.3	2.6	6.4	8.1
FISV.O	Fiserv Inc	89,028.6	5.5	5.4	-3.6	2.2
WEX	WEX Inc	8,838.2	4.2	4.6	-2.7	3.4
PSFE.K	Paysafe Ltd	3,071.0	2.5	2.0	-0.9	1.1
PAYP.L	PayPoint plc	532.9	3.5	3.5	-22.3	10.3
WLN.PA	Worldline SA	16,186.7	5.5	3.5	-4.1	1.5
WU	Western Union Co	8,690.6	1.8	2.0	-3.6	19.8

Source: IBES, Refinitiv

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

Other equity market considerations such as short sales; any likely forthcoming changes in index inclusion; depth of stock research coverage; composition of and change in the mix of investors (such as founders, board and staff, domestic institutions, foreign institutions, and retail investors) are not incorporated in our valuation; however investors should consider such factors if they seek to develop a price target for the company.

Updated Investment thesis

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

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

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

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

We think that the diversification that Novatti has in its business model across a variety of technology, licenses and partnerships should provide it with some resilience to these disruptive developments which appear set to be launched later this calendar year by Visa and Apple; however, it does again highlight that there meaningful potential downside risks for Novatti and its stock.

Given the recent sell off in the stock and its peers, it is trading well below our assessed intrinsic valuation for the company, although perhaps doesn't look quite as attractive on some multiples relative to peers.

Key Risks and Sensitivities

Macroeconomic impacts

Key influences on our valuation include:

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

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

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

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

Regulatory Requirements

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

- Anti-money laundering and counter terrorist financing requirements administered by Austrac;
- Authorised Deposit Institution regulation administered by the Australian Prudential Regulatory Authority;
- Foreign Investment restrictions administered by the Foreign Investment Review Board;
- Privacy requirements administered by the Privacy Commissioner;
- Financial Service licencing and Credit licencing requirements administered by the Australian Securities and Investments Commission (ASIC);
- Australian Consumer Law and unfair contract terms contained in the Corporations Act administered by the Australian Competition and Consumer Commission (ACCC);
- Restrictions on merchant pricing, or interchange fees, administered by the Reserve Bank of Australia (RBA) leading to fee compression;
- Taxation legislation administered by the Australian Taxation Office (ATO);
- Accounting standards required under the Corporations Act administered by the Australian Accounting Standards Board (AASB) and ASIC;
- Design and distribution obligations, several of which will be governed by contract law.

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

- Novatti needs to keep ownership by any single foreign shareholder below 20% in order to be considered an Australian institution. Several of its investments, including its yet-to-be-licenced banking subsidiary, sit right on this threshold. Any investor over this 20% threshold needs to meet APRA's fit and proper test. This may limit its ability to raise additional finance in excess of pro-rata rights to Australian investors unless it seeks the Treasurer's approval.

- As a payment processor, Novatti has substantial regulatory compliance requirements, including with AML/CTF regulations, APRA and ASIC requirements. Failure to comply could see the company face civil and criminal prosecution, substantial fines, and potentially the loss of key licenses enabling it to operate various services.

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

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

Growing pains

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

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

Reputational risks

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

Technology Changes

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

Market & Shareholder Support

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

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

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

Company Description

Novatti is a leading digital banking and payments fintech. It provides services that enable financial transactions to take place digitally, on any device, anywhere. It does this by leveraging its 'ecosystem', which includes technology and platforms, extensive regulatory licences, and global commercial partnership.

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

Novatti holds all necessary regulatory licences and registrations, including an Australian Financial Services Licence (No 448066) through its subsidiary Flexewallet Pty Ltd, registration in New Zealand as a Financial Services Provider (FSP613789) through subsidiary Flexewallet (NZ) Limited, is registered with AUSTRAC as a Remittance Network Provider, and has applied to APRA for a restricted banking licence through its subsidiary Novatti IBA Pty Ltd. It is also in the process of applying for an EMoney Issuing (EMI) licence in Europe.

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