

## Underpinning the back end for booming fintechs

Novatti is a fintech, namely a “wholesale neo-bank”, i.e. a digital payments company providing white label services to other fintechs. It provides investors with exposure to several fast-growing areas of the banking industry with operations in many countries around the world including Australia, New Zealand, the Philippines, European Union, UK and USA. 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.

## Key catalysts

We can identify several upcoming catalysts for Novatti’s growth, including:

- Increasing transaction volumes due to strong growth by partners including Afterpay, Ripple, Rent.com.au & Marqeta, which will flow through to increased revenues in its quarterly cash flow releases (Appendix 4Cs)
- The approval by APRA of its RAD1 licence
- Launch of Acquiring services
- Early growth of the Emersion subscription billing platform following the March 2021 launch in the US
- Traction with Reckon to integrate payments into its product and hence access its customer base

## Strong fundamentals

Novatti is currently targeting strong revenue growth, while running at a small loss, and appears set to do so again next financial year before potentially lifting profitability thereafter.

Novatti is well funded to do this, with at least 16 quarters of cash, based upon the seasonally elevated cash burn rate in the March quarter and its recent capital raisings.

## Valuation

We value NOV at A\$0.80 per share using a DCF of free cash flow to equity forecasting out 7 years before applying a terminal value. At the current share price, NOV is trading on 5.3x FY22 EV/revenue and 2.4x FY22 price to book, a considerable discount to its partner and peer comparative MQ. Full details are within.

# Novatti

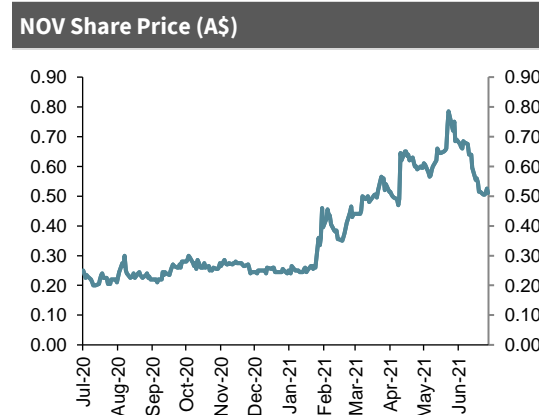
Novatti is a leading digital banking and payments fintech. It enables business to pay and be paid, from any device, anywhere. It does this by leveraging its ‘ecosystem’, which includes technology and platforms, extensive regulatory licences, and global commercial partnership.

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
Price	A\$0.49
Market cap	A\$153m
Valuation	A\$0.80

Company data	
Net cash (post SPP):	~A\$32.5m
Shares on issue:	300m

Next steps	
Appendix 4C	July 2021
FY21 Result	August 2021
AGM	November 2021



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# Financials

## NOVATTI GROUP LIMITED

NOV-AU

Year end 30 June, AUD unless otherwise noted

### MARKET DATA

Price	\$	0.49
Valuation	\$	0.80
52 week high / low	\$	0.00 - 0.79
Market capitalisation	\$m	147.1
Shares on issue (basic)	m	300.2
Options / rights / ESP / LTIP	m	35.4
Other equity	m	0.4
Shares on issue (fully diluted)	m	336.1
Out of the money options	m	0.6

### 12-MONTH SHARE PRICE PERFORMANCE



### INVESTMENT FUNDAMENTALS

	FY19A	FY20A	FY21E	FY22E	FY23E
Reported NPAT	\$m (4.0)	(11.5)	(11.4)	(9.9)	(2.4)
<b>Underlying NPAT</b>	<b>\$m (4.0)</b>	<b>(11.5)</b>	<b>(11.4)</b>	<b>(9.9)</b>	<b>(2.4)</b>
Reported EPS (diluted)	¢ (2.5)	(6.7)	(4.7)	(2.9)	(0.7)
<b>Underlying EPS (diluted)</b>	<b>¢ (2.5)</b>	<b>(6.7)</b>	<b>(4.7)</b>	<b>(2.9)</b>	<b>(0.7)</b>
...Growth	% n/a	167%	(31%)	(39%)	(77%)
<b>PER underlying</b>	<b>x (19.5)</b>	<b>(7.3)</b>	<b>(10.5)</b>	<b>(17.1)</b>	<b>(74.1)</b>
Operating cash flow per share	¢ (1.3)	(0.7)	(3.7)	(2.5)	(0.3)
Free cash flow per share	¢ (2.7)	0.5	(3.9)	(8.5)	(0.5)
<b>Price to free cash flow per share</b>	<b>x nm</b>	<b>1.0</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>
FCF yield	% (5.5%)	1.0%	(8.0%)	(17.4%)	(1.0%)

<b>Dividend</b>	<b>¢ 0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Payout	% 0.0	0.0	0.0	0.0	0.0
<b>Yield</b>	<b>% 0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Franking	% 0.0	0.0	0.0	0.0	0.0

<b>Enterprise value</b>	<b>\$m 145.7</b>	<b>150.2</b>	<b>140.5</b>	<b>127.4</b>	<b>129.2</b>
EV/Revenue	x 17.3	13.6	8.5	5.3	3.9
EV/Underlying EBITDA	x -66.1	-30.2	-21.1	-13.3	-86.9

Book value per share	¢ 3.7	-0.3	7.6	18.5	18.6
Price to book (NAV)	x 24.0	-303.0	7.9	2.4	2.4

Net tangible assets per share	¢ 0.9	-3.3	5.4	16.9	16.9
Price to NTA	x 99.6	-23.8	11.2	2.6	2.6

### KEY RATIOS

	FY19A	FY20A	FY21E	FY22E	FY23E
Net debt / (cash)	\$m (1.4)	3.0	(6.6)	(19.7)	(17.9)
Interest cover (Operating NPAT / net interest)	x nm	nm	(208.9)	(252.4)	(294.5)
Gearing (net debt / underlying EBITDA)	x 0.6	nm	1.0	2.1	12.0
Leverage (net debt / (net debt + equity))	x nm	1.2	nm	nm	nm

### DUPONT RATIOS

	FY19A	FY20A	FY21E	FY22E	FY23E
Return on Assets	% nm	nm	nm	nm	nm
Financial Leverage	x 2.7	-67.6	2.9	2.0	2.8
<b>Return on Equity</b>	<b>% nm</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>

### GROWTH PROFILE

	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	% n/a	30.7	49.7	44.9	39.9
Underlying EBITDA	% n/a	125.2	34.2	43.4	(84.4)
NPAT	% n/a	186.5	(1.0)	(13.1)	(75.4)
Underlying Profit	% n/a	186.5	(1.0)	(13.1)	(75.4)
Underlying EPS	% n/a	167.4	(30.7)	(38.6)	(76.9)
DPS	% n/a	n/a	n/a	n/a	n/a

### HALF YEARLY DATA

	2H20A	1H21A	2H21E	1H22E	2H22E
<b>Revenue</b>	<b>\$m 6.1</b>	<b>7.4</b>	<b>9.1</b>	<b>10.6</b>	<b>13.2</b>
Other income	\$m 0.0	0.0	0.0	0.0	0.0
Cash expenses	\$m -8.2	-9.9	-13.2	-17.6	-15.9
<b>Underlying EBITDA</b>	<b>\$m -2.1</b>	<b>-2.6</b>	<b>-4.1</b>	<b>-6.9</b>	<b>-2.6</b>
EBITDA	\$m -2.4	-3.1	-6.5	-7.1	-2.8
Depreciation, amortisation and impairment	\$m -0.5	-0.7	-0.7	-0.7	-0.7
<b>EBIT</b>	<b>\$m -2.9</b>	<b>-3.9</b>	<b>-7.2</b>	<b>-7.9</b>	<b>-3.6</b>
Associates and JVs	\$m 0.0	0.0	0.0	1.5	0.0
Net interest	\$m -1.8	-0.2	-1.6	-0.3	-0.3
<b>PBT</b>	<b>\$m -4.7</b>	<b>-4.1</b>	<b>-8.8</b>	<b>-6.7</b>	<b>-3.9</b>
Income tax	\$m 0.0	1.0	0.5	0.6	0.0
<b>NPAT</b>	<b>\$m -4.8</b>	<b>-3.1</b>	<b>-8.3</b>	<b>-6.1</b>	<b>-3.9</b>

### PROFIT AND LOSS

	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>\$m 8.4</b>	<b>11.0</b>	<b>16.5</b>	<b>23.9</b>	<b>33.4</b>
Other income	\$m 0.0	0.0	0.0	0.0	0.0
Cash expenses	\$m -10.6	-16.0	-23.1	-33.4	-34.9
<b>Underlying EBITDA</b>	<b>\$m -2.2</b>	<b>-5.0</b>	<b>-6.7</b>	<b>-9.6</b>	<b>-1.5</b>
EBITDA	\$m -3.0	-5.2	-9.6	-10.0	-1.9
Depreciation, amortisation and impairment	\$m -0.4	-3.9	-1.5	-1.5	-1.5
<b>EBIT</b>	<b>\$m -3.3</b>	<b>-9.1</b>	<b>-11.1</b>	<b>-11.4</b>	<b>-3.4</b>
Associates and JVs	\$m 0.0	0.0	0.0	1.5	1.5
Net interest	\$m -0.7	-2.4	-1.8	-0.6	-0.6
<b>PBT</b>	<b>\$m -4.0</b>	<b>-11.5</b>	<b>-12.9</b>	<b>-10.5</b>	<b>-2.4</b>
Income tax	\$m 0.0	0.0	1.5	0.6	0.0
<b>NPAT</b>	<b>\$m -4.0</b>	<b>-11.5</b>	<b>-11.4</b>	<b>-9.9</b>	<b>-2.4</b>

Weighted average diluted shares on issue	m	159.9	171.3	244.6	346.4	368.5
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### BALANCE SHEET

	FY19A	FY20A	FY21E	FY22E	FY23E
Cash & equivalents	\$m 1.8	2.6	7.1	19.7	17.9
Trade & other receivables	\$m 4.3	2.8	3.5	3.7	3.9
Financial assets - funds in trust	\$m 3.8	17.5	24.0	50.5	98.9
Investments accounted for using the equity method	\$m 0.0	0.0	0.8	3.1	3.1
Other investments	\$m 0.8	0.9	0.8	0.8	0.8
Net Property Plant And Equipment	\$m 0.6	0.6	0.5	0.5	0.5
Right of use assets	\$m 0.0	2.2	2.1	2.1	2.1
Intangibles	\$m 4.6	5.7	5.5	5.5	5.5
Deposits	\$m 0.1	0.2	8.6	36.2	38.1
Other	\$m 0.5	0.4	0.4	0.4	0.4
<b>Total Assets</b>	<b>\$m 16.5</b>	<b>32.8</b>	<b>53.2</b>	<b>122.4</b>	<b>171.1</b>

Trade and other payables	\$m 4.6	5.9	5.8	6.2	6.6
Settlement and remittance funds payable	\$m 3.8	17.5	23.8	50.0	98.1
Lease liabilities	\$m 0.1	2.5	2.3	2.3	2.3
Unearned revenue	\$m 0.0	0.2	0.3	0.3	0.3
Convertible note facilities	\$m 0.4	5.6	0.4	0.0	0.0
Employee benefits	\$m 0.6	1.0	1.2	1.2	1.3
Other	\$m 0.9	0.6	0.7	0.7	0.7
<b>Total liabilities</b>	<b>\$m 10.4</b>	<b>33.3</b>	<b>34.5</b>	<b>60.7</b>	<b>109.2</b>
Net assets	\$m 6.1	-0.5	18.7	61.7	61.8

Contributed equity	\$m 24.1	26.7	51.2	96.7	96.7
Reserves	\$m 2.2	2.4	3.6	3.6	3.6
Retained earnings	\$m -20.1	-29.5	-36.2	-38.6	-38.4
<b>Shareholder's equity</b>	<b>\$m 6.1</b>	<b>-0.5</b>	<b>18.7</b>	<b>61.7</b>	<b>61.8</b>

### CASH FLOW

	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Basic shares on issue</b>	<b>m 166.9</b>	<b>185.2</b>	<b>244.2</b>	<b>332.7</b>	<b>332.7</b>
<b>Net Income (Cashflow)</b>	<b>\$m -5.0</b>	<b>-11.0</b>	<b>-11.4</b>	<b>-9.9</b>	<b>-2.4</b>
Depreciation & Amortization	\$m 0.4	0.9	1.5	1.5	1.5
Change in Net Operating Assets	\$m 1.8	2.5	-0.7	-0.6	-0.7
Other Non-Cash Items, Total	\$m 0.6	6.3	1.6	0.4	0.4
Other	\$m 0.0	0.0	0.0	0.0	0.0
<b>Operating cash flow</b>	<b>\$m -2.1</b>	<b>-1.2</b>	<b>-9.1</b>	<b>-8.7</b>	<b>-1.2</b>

Capital expenditure	\$m -0.5	-1.3	-0.3	2.7	-0.3
Acquisitions/divestment/other	\$m -2.1	-0.2	0.1	-23.3	0.0
<b>Investing cash flow</b>	<b>\$m 2.2</b>	<b>3.7</b>	<b>13.9</b>	<b>41.9</b>	<b>-0.4</b>

Equity (including convertible)	\$m 1.8	0.1	14.2	42.3	0.0
Debt (including convertible)	\$m 0.4	3.8	0.1	0.0	0.0
Leases	\$m 0.0	-0.2	-0.4	-0.4	-0.4
<b>Financing cash flow</b>	<b>\$m 2.2</b>	<b>3.7</b>	<b>13.9</b>	<b>41.9</b>	<b>-0.4</b>

<b>Net cash flow</b>	<b>\$m -2.5</b>	<b>1.0</b>	<b>4.7</b>	<b>12.7</b>	<b>-1.9</b>
Free cash flow	\$m -4.3	0.8	-9.6	-29.6	-1.9

Source: Company reports and MST Access estimates

## Investment thesis

### The opportunity

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.

### 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.

### Recent Events

NOV has made the following key announcements since the start of the calendar year:

- 12-Jul-21 Share Purchase Plan Booklet
- 2-Jul-21 Capital Raising and Strategic Stake Expands Growth Strategy
- 30-Jun-21 Strategic Stake in Reckon Limited and Capital Raising
- 3-May-21 Funding Commitments & Strategic Partner for Banking Business
- 30-Apr-21 Appendix 4C and Quarterly Update
- 29-Apr-21 Afterpay partners with Novatti in New Zealand
- 9-Apr-21 Banking business converting note buy back
- 9-Apr-21 Ripple partnership live to Philippines
- 30-Mar-21 Emersion launches in US ahead of strong forecast growth
- 17-Mar-21 Novatti fintech underpins LITT social media platform
- 11-Mar-21 Lifepay moves to commercial launch
- 26-Feb-21 Half Yearly Report and Accounts
- 24-Feb-21 Lifepay platform is launched leveraging Novatti technology
- 15-Feb-21 Response to ASX Price Query
- 29-Jan-21 Appendix 4C and Quarterly Update
- 22-Jan-21 Novatti Visa Prepaid cards now supported by Apple Pay
- 20-Jan-21 Visa licences Novatti to issue cards in New Zealand

## Potential Near-Term Catalysts

- Receiving the COVID-19 delayed Restricted Authorised Deposit Institution (RADI) aka restricted banking licence from APRA
- Successful application with Visa and Mastercard to become an acquirer, strengthening its current position of being an aggregator
- Increased use of Novatti's services by existing customers experiencing rapid growth, such as Afterpay
- Growth of associates
- Appendix 4C updates, with one due in July 2021
- Conversion of convertible note by 31 July 2021
- Full year results, due to be released in August 2021
- Reduction in COVID-19 levels globally leading to an increase in economic activity and resumption of travel
- Continued international expansion, including growth of the recently launched Emersion subscription billing platform in the US and addition of additional countries and partners to the Ripple network
- Building a relationship with Reckon, following its acquisition of a strategic stake in the company
- Further acquisitions strengthening breadth and depth of service offerings.

## Valuation

We value NOV at A\$0.80 per share using a DCF of free cash flow to equity forecasting out 7 years before applying a terminal value.

Figure 1 –MST Access valuation of Novatti

Current date		20-Jul-21														
Next balance date		30-Jun-21														
		Jun-21	Dec-21	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
Free cash flow to equity	A\$m	-7.9	-26.1	-3.5	-1.0	-0.8	0.4	0.4	1.1	1.5	2.3	3.1	3.7	5.2	5.6	7.9
Discounted cash flow	A\$m	0.0	-25.4	-3.3	-0.9	-0.7	0.3	0.3	0.9	1.2	1.7	2.3	2.6	3.6	3.7	5.1
Sum of discount streams	A\$m	-8.7	CAPM													
Future value into perpetuity	A\$m	384.4	Risk free rate				2.00%									
NPV of terminal value	A\$m	248.2	Equity beta				1.5									
add adjusted net cash	A\$m	32.5	Equity risk premium				3.00%									
Value of total equity	A\$m	272.0	Cost of equity				6.5%									
Diluted shares on issue	m	336.1														
Value per share	A\$	0.80	Terminal growth				3.0%									

Source: Company reports, MST Access estimates

This valuation approach, as well as peer valuation multiples are detailed in the “Key Valuation Considerations” chapter later in this report.

## Risks and Sensitivities

We elaborate on Novatti's risks and sensitivities later in this report. In summary, they can be expressed as:

- Macroeconomic impacts having key influences on our valuation including:
  - Economic conditions, influencing exchange rates, interest rates, inflation and bad debts.
  - Equity and debt markets, influencing investment returns and risk premiums.
- The significant number of regulatory Requirements that Novatti as a Financial Institution is subject to, and could suffer from adverse changes to the requirements. While the following list is for Australia, similar regulations also exist in the other jurisdictions where Novatti operates:
  - 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.
- Growing pains 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.
- Reputational risks could threaten Novatti's entire business model and social license to operate.
- Technology changes can provide opportunities to grow and disruptive threats to Novatti's existing business model
- Execution risks around its plans for Reckon given the lack of prior notice to the company prior to acquiring a 19.9% strategic stake
- Access to underlying banking services
- Market & shareholder support.

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## Payments processing industry overview

The payments industry is part of the global financial sector, but sometimes payment providers are instead classified as IT stocks – either for their outsourced data processing, or because they are application service providers.

Payment platforms can differ by country in terms of their availability, local banking support and merchant and consumer adoption. Some advanced economies seem trapped in time, with older physical payment methods retaining significant levels of profitability, while regulatory requirements or market power have stifled innovation and the adoption of faster, more convenient, digital payment methods common in other countries.

Some prominent examples of this include:

- Germany – Germans still big users of physical cash, and have relatively low credit card adoption.
- Japan – Japanese convenience store counters remain popular for bill payments.
- USA – cheques are still a predominant method of bill payment across the United States of America.

Novatti operations are global, with a presence in several countries, including Australia, New Zealand, the Philippines, China, European Union, UK, and US, and it seeks to grow through providing payment technology to a wide range of traditional financial institutions and increasingly fintechs, as well as providing remittance services – an area which major Australian banks have been retreating from due to insufficient anti-money laundering compliance, and which has led to record fines for Westpac and Commonwealth Bank issued by AUSTRAC.

Offering cutting edge digital solutions, Novatti with its fintech partners is disrupting legacy analogue payment methods, enabling it to scale efficiently alongside the growth achieved by its fintech partners.

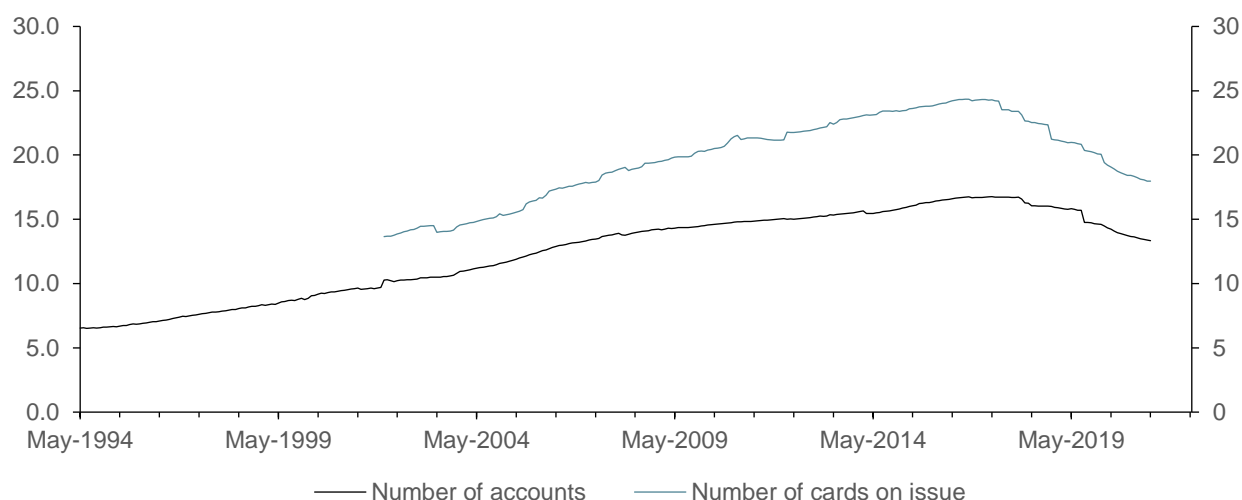
## Recent RBA payments system data highlights extent of disruption underway

In Australia, payments disruption is in full force. Stagnant market of mature existing players being challenged by fintech innovation:

- Cheques are a mere fraction of the volumes they used to be; and while they continue to serve high value transactions in the property space, electronic exchange settlement platforms like PEXA are encouraging a further transition away from cheques to real time settlements and real time payments; after smaller payments moved away from using cheques over a decade ago with the growth of BPay, something that Novatti has exposure to through its ChinaPayments business, which allows users of UnionPay, AliPay and WeChatPay to make BPay payments.
- Credit cards are also on the decline, fuelled by the rise of a diverse range of Buy-Now-Pay-Later providers. Novatti has some exposure to this growth through its payment processing partnerships with some of these providers.
- The growth of tap-and-pay cards (namely EMV tap-and-go/payWave technology) leading to the development of ApplePay, SamsungPay and Google Pay, has made paying by card faster and far more convenient, leading to a decline in cash usage, which has experienced a further step down with COVID-19.
- The growth of online shopping has led to an increase in demand for online payments through payment processors such as Paypal, Square, Stripe and Shopify, a service which is not well catered to by traditional card-present merchant terminal providers, including the major banks and specialist payment processors such as Tyro and SmartPay. COVID-19 has supercharged the growth in online shopping, resulting in a step-change level of adoption which does not appear to have receded as lockdown restrictions have eased.



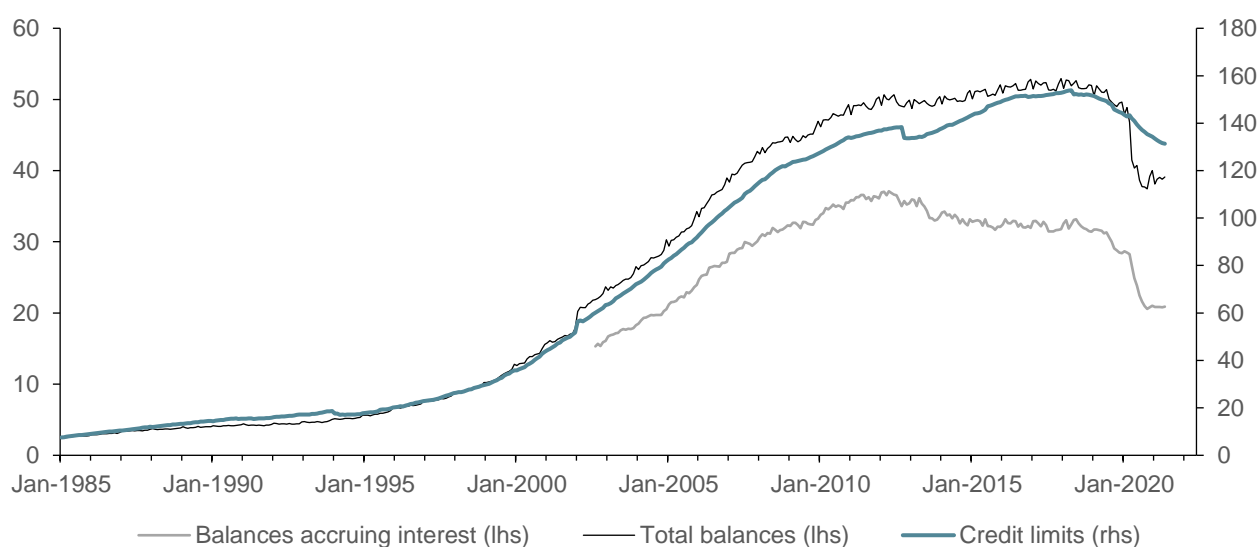
Figure 2 –Numbers of credit and charge accounts (millions) in Australia



Source: Reserve Bank of Australia Payments Payment System, Credit and Charge Cards Table C1 Original Series Aggregate Data

The BNPL industry in Australia and New Zealand has experienced strong growth since its emergence over the past decade, and BNPL services are quickly becoming a mass market solution. Driven by the desire for clear and simple payment plans, Australians and New Zealanders have started to shift away from traditional 'plastic' credit cards. Credit and charge account numbers and card numbers are back at July 2007 levels.

Figure 3 –Value of credit and card charge balances and credit limits (A\$bn) in Australia



Source: Reserve Bank of Australia Payments Payment System, Credit and Charge Cards Table C1 Original Series Aggregate Data

Balances accruing interest are back at December 2004 levels; total balances are back at December 2006 levels, having bottomed at October 2006 levels; and credit limits are back at May 2011 levels.

There are several key payment provider competitors in Australia, including the major banks, large supermarket chains who operate their own merchant processing, and specialist providers such as PayPal, Tyro and SmartPay. Other countries in which Novatti operates generally have similar structures to Australia.



## Prepaid cards

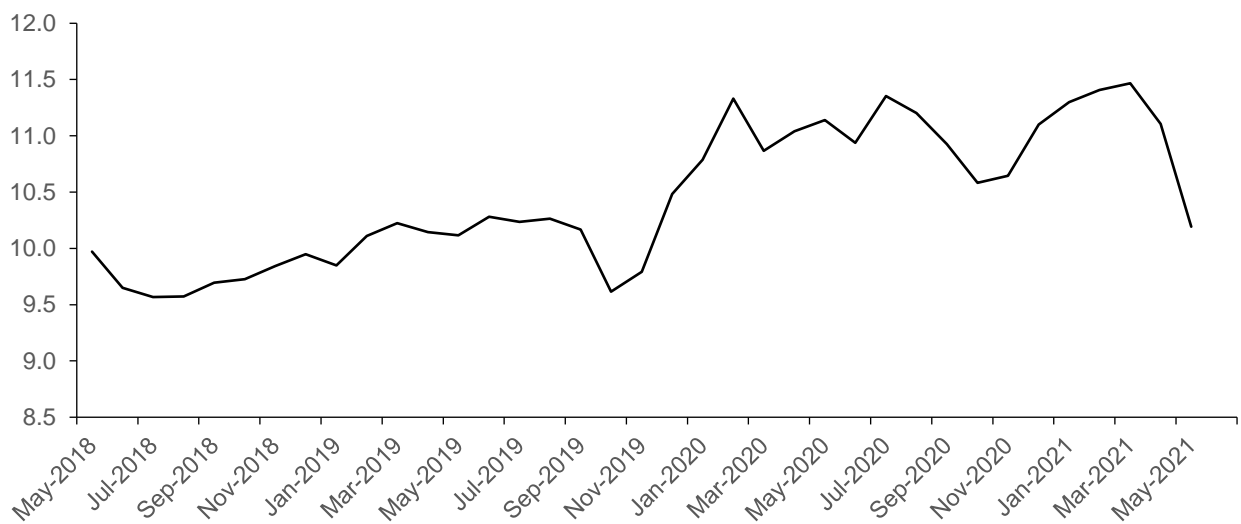
One area of particular interest in the payments space is pre-paid cards, which is a relatively concentrated segment of the market provided by a handful of smaller institutions including Indue, Heritage Bank, Novatti, CUSCAL and EML Payments.

The use of prepaid card technology is how the NSW Government's Opal public transport cards can be loaded onto phones and other smart portable devices; also how airline frequent flyer foreign currency cards work.

While the number of prepaid cards is increasing, the value held on these cards is decreasing – however this could be a short term phenomenon attributable to COVID-19 disruptions, leading to a decrease in international travel and public transport usage.

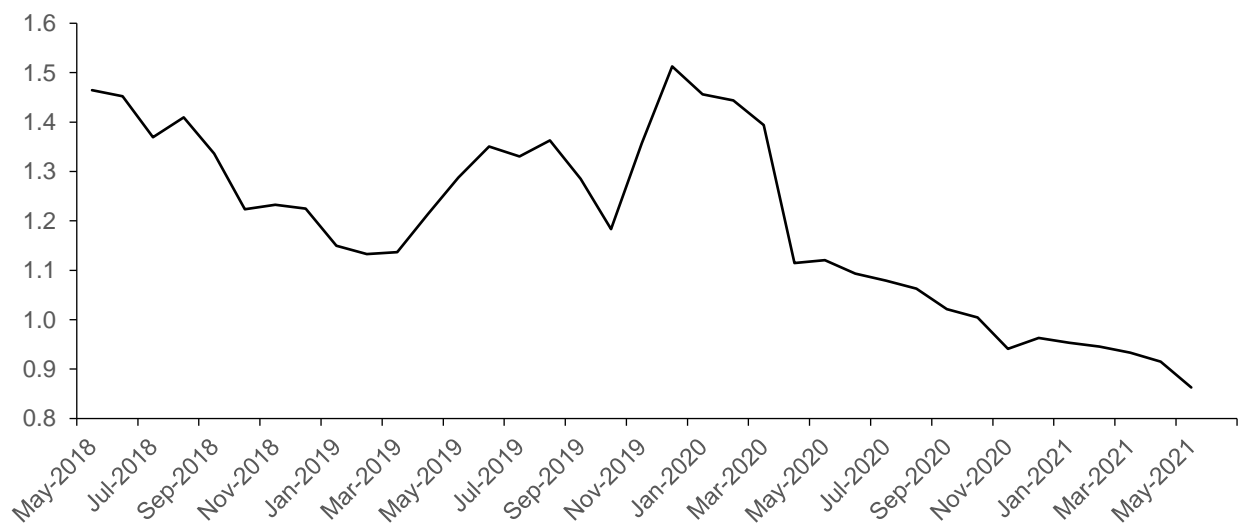
Novatti provides white label prepaid card services, which is proving to be in demand due to the growth of fintechs seeking to provide new, flexible products to consumers, as well as employers seeking an easier way to manage expenses and cashflow.

Figure 4 –Number of prepaid cards in Australia (millions)



Source: Reserve Bank of Australia Payments C2.2 Prepaid cards dataset

Figure 5 –Value held on of prepaid cards in Australia (A\$bn)



Source: Reserve Bank of Australia Payments C2.2 Prepaid cards dataset

While EML Payments, along with CBA, Westpac and NAB have faced some AUSTRAC AML/CTF regulatory concerns recently, we believe that Novatti is less likely to face such issues given its continued investment in compliance as a central business activity as part of growing its business and comparatively small business size. Indeed, it seems less likely that Novatti may suffer the same cultural issues that Westpac has given its core values focus on respect, collaboration and accountability.

Figure 6 –Novatti Core Values

#### **Flexibility – customer-centric**

We provide a flexible and practical approach to customer requirements.

#### **Collaboration – build one team**

We actively communicate to achieve the best results. Respect and acknowledge all stakeholders' inputs and experiences by working together.

#### **Innovation – challenge status quo**

We believe that meaningful and productive deviations are the result of observing challenges and opportunities from new angles and exercising our curiosity.

#### **Respect – honour relationships**

We treat our team members, customers, partners and suppliers with mutual respect and sensitivity, recognising the importance of diversity. We respect all individuals and cultures and value their contributions in all aspects of the business.

#### **Accountability – everyone is accountable**

We accept responsibility for our actions and deliver on our promises. We make and support business decisions through vast experiences, good judgement, and ownership of outcomes.

Source: Company reports

## Buy Now Pay Later

There has been substantial growth in the buy-now-pay-later (BNPL) sector in Australia in recent years, with the number of providers, and value of transactions processed increasing rapidly. These businesses typically charge much higher merchant fees. While the BNPL sector remains a small proportion of the entire payments system, the Reserve Bank of Australia is proposing a light touch approach to regulation; which could change in coming years if the sector continues to grow strongly leading to it representing a major portion of the payments system, and could also change if there is significant opposition to its proposals released in its consultation paper released in late May 2021.

Figure 7 –RBA BNPL payments surcharge proposals

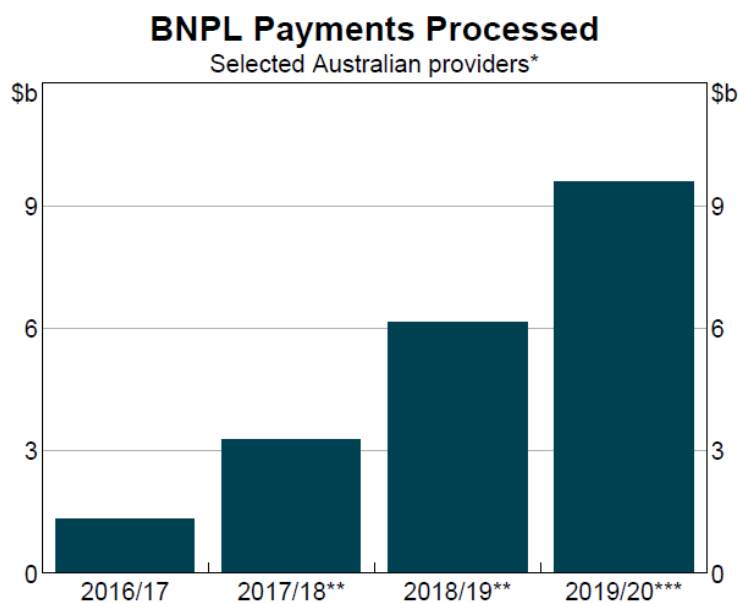
### 1.4 Surcharging

The Board is not proposing to make changes to the surcharging rules introduced after the previous review of card payments regulation in 2015–16, because these rules are seen to be working well. **The Board is not proposing to require any 'buy now, pay later' (BNPL) providers to remove their no-surcharge rules at this time but considers that a policy case could emerge in the future and will keep this issue under review.**

Source: Reserve Bank of Australia Review of Retail Payments Regulation Consultation Paper May 2021

The limited impact of the BNPL sector on online payments is clear from the RBA's calculations of the share of online payments by method – PayPal continues to hold multiple times the share that BNPL providers hold. Online payments are one type of digital payments that Novatti is targeting, with several of its business lines fitting under different categories including Debt cards (i.e. prepaid cards), BPay (China Payments), and BNPL.

Figure 8 –BNPL payments processed



\* Includes services offered by Afterpay, FlexiGroup, Openpay and Zip Co; Openpay is only included in financial years 2018/19 and 2019/20

\*\* Afterpay and FlexiGroup include both Australia and New Zealand payments

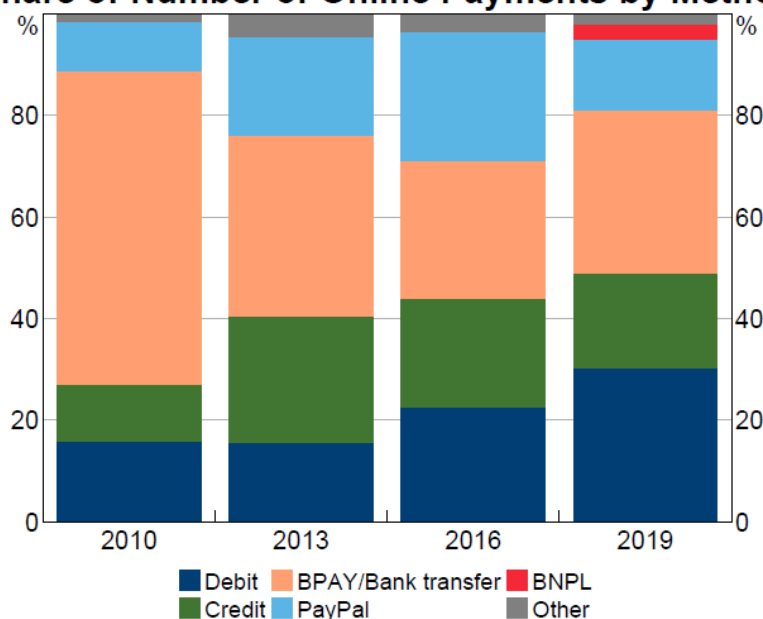
\*\*\* Afterpay, Zip Co and FlexiGroup include both Australia and New Zealand payments; Openpay includes both Australia and United Kingdom

Sources: Afterpay; FlexiGroup; Openpay; Zip Co

Source: Reserve Bank of Australia Bulletin March 2021

Figure 9 –Share of online payments by method

### Share of Number of Online Payments by Method



Source: RBA calculations, based on data from Colmar Brunton, Ipsos and Roy Morgan Research

Source: Reserve Bank of Australia Bulletin March 2021

Novatti (and other card issuers) seem clear of regulatory intervention for the foreseeable future around its digital wallet capabilities, having invested into providing capabilities for Apple Pay, Google Pay and Samsung Pay, which means that it can focus on improving the returns on its existing investments in this space.

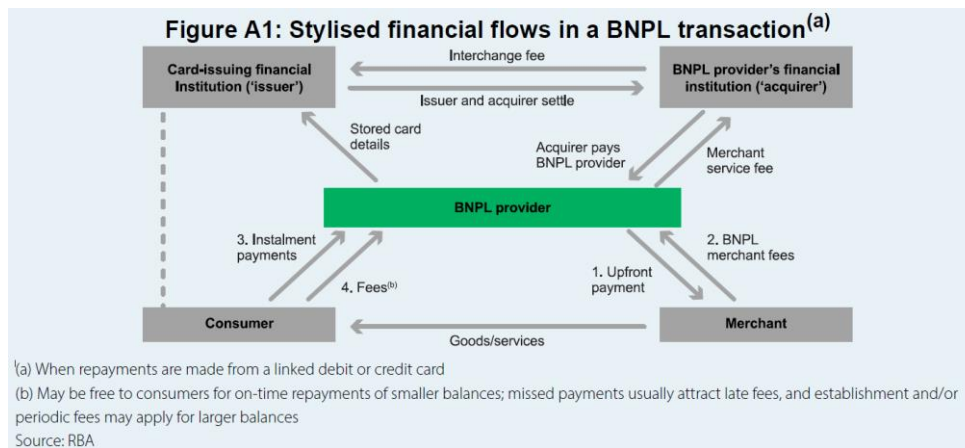
Figure 10 –RBA digital wallet proposals

- No regulatory action in the digital wallet market at this stage, but ongoing close monitoring of domestic and international developments. While the Bank's power to regulate in this area under current legislation is not entirely clear, this may be clarified following the Treasury's Review of the Australian Payments System (the Treasury Review).

Source: Reserve Bank of Australia Review of Retail Payments Regulation Consultation Paper May 2021

Novatti being both a card issuer and acquirer allows it to collect both interchange fees and merchant fees.

Figure 11 –Stylised financial flows in a BNPL transaction – NOV can provide both issuer and acquirer services

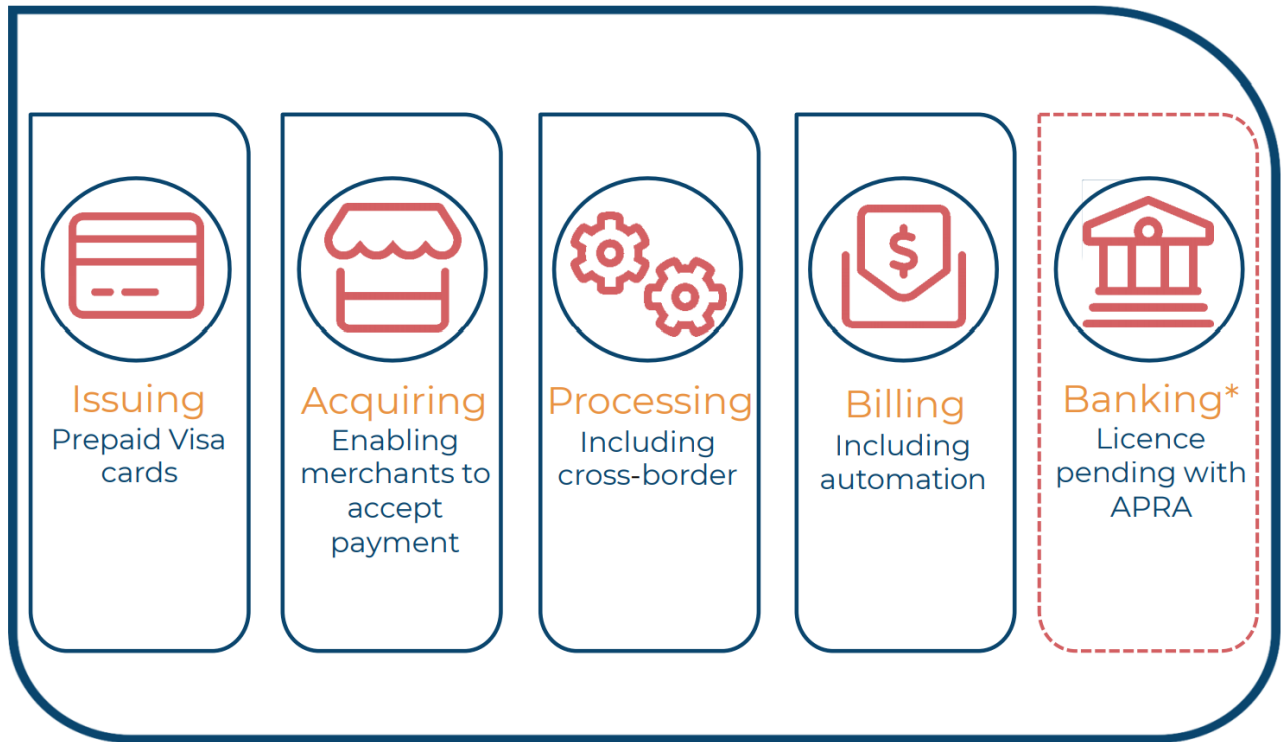


Source: Reserve Bank of Australia Bulletin March 2021

## Overview of Novatti's business

Novatti is a leading digital banking and payments fintech. It provides the services that enables financial transactions to take place on any device, anywhere, providing businesses with everything they need to pay and be paid.

Figure 12 –Novatti services



Source: Company reports

Novatti's business functionally operates through several different divisions in conjunction with its long term strategy of creating its banking division and monetizing its shareholding:

- **Processing Services** - consisting of its previously reported Technology Services and Transaction Services, processing more than \$2 billion in transactions annually, and expanding into business to business (B2B) payments.
  - **Technology Services** - Develops, deploys and supports specialised mobile and alternative payment technology, primarily through the deployment of the Novatti Platform and includes the Basis2 enterprise software billing solution which provides a technologically advanced billing and CIS solution to service providers in the utilities industry, having been acquired from Prophecy International several years ago. We suspect that Novatti's recent acquisition of 19.9% of Reckon will also be included within this segment.
  - **Transaction Services** – This business division consists of several services including
    - **Flexewallet and Flexe Payments:** Provides a comprehensive global network that interconnects emerging payment platforms, remittance operators, financial institutions, retailers, utilities and all types of telecommunications operators
    - **Flexepin:** Offers customers an alternative payment method in the form of a prepaid cash voucher. Vouchers can be used for a multitude of payments methods such as prepaid account top-ups and for secure online payment for goods and services. Vouchers are available in a variety of currencies and locations globally.
- **Issuing Services** – This business division consists of several services including

- Issuing of white label programs under its Visa Principal Issuer Licence
- Its Digital Payments Accelerator which provides BIN Sponsorship whereby Australian and New Zealand access is provided to Visa Issuing for larger international companies such as Marqeta and Afterpay.
- Vasco Pay Pty Ltd: Providing reloadable Visa prepaid cards.
- **Acquiring Services** – Provision of merchant acceptance services for Visa, Mastercard, Amex, China Union Pay, direct debit etc.
  - Extends Novatti's earlier acquiring services which had historically been focussed on China wallet payments
  - Currently applying for full acquiring licences with Visa and Mastercard
  - Enables businesses to accept payments online for e-commerce, including several online marketplaces, and also mobile point-of-sale.
- **Billing Services** – This business division's go to market brand is Emersion and follows the acquisition of the Emersion business in April 2020
  - **Emersion** integrates diverse business applications, such as subscription billing, payments and provisioning, into existing business platforms such as Customer Relationship Management Software. Emersion integrates into more than 70 software platforms, including Salesforce, Xero, ConnectWise
  - The Emersion platform was launched in the US in March 2021 with Novatti now scaling up the staffing and marketing into the US. Novatti doubled customer acquisition within 6 months of completing the acquisition of Emersion.
- **Banking** – this division consists of:
  - Novatti IBA Pty Ltd, on approval as a Restricted ADI or its banking licence by APRA, Novatti IBA Pty Ltd will offer new banking services to Australian customers, particularly leveraging its existing network of customers.
  - Novatti has derisked the capital requirements it faces in respect of its bank by bringing in BC Invest, a subsidiary of Far East Consortium, as a strategic partner, thus reducing its percentage ownership and hence proportion of capital funding it is required to provide for the bank.
  - By providing additional value-added services to existing customers, the bank is expected to increase margins for Novatti's existing businesses.
- **Novatti Group Limited** - the group holding company.

Processing Services is Novatti's largest business unit with relatively stable revenues, and we expect it to continue to be for the foreseeable future, boosted by the expansion of Novatti's subscription billing services internationally and recent acquisition of a 19.9% strategic stake in Reckon, with Novatti noting the tight synergy between business automation software and payment processing, with the potential for strong economic returns from cross-selling. Eventually other business units will grow to be larger than processing services, although this will likely take a few years to occur.

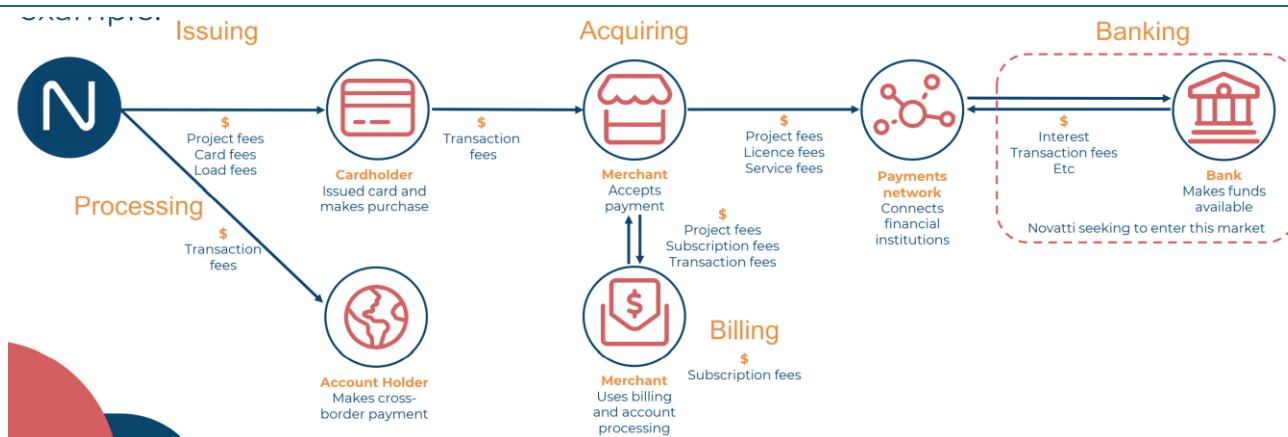
Novatti's banking division RADI licence was delayed by APRA pausing the issue of new prudential licences for a year due to COVID in 2020. Plans for a restricted banking licence have been in train since mid-2017, and it now has in place the appropriate equity funding for when it receives this long-awaited licence in order to capitalise on it.

Various combinations of Processing Services and either Issuing, Acquiring and Transaction Services have created several partnerships with rapidly growing innovative fintechs, including Afterpay, Ripple, rent.com.au and Marqeta, as well as LITT, and LifePay.

Billing Services will continue to grow with the expansion of the Emersion platform.

The group holding company is where its ownership of associates is held, and the group continues to take an active interest in assisting incubating new fintech businesses.

Figure 13 –Business mix



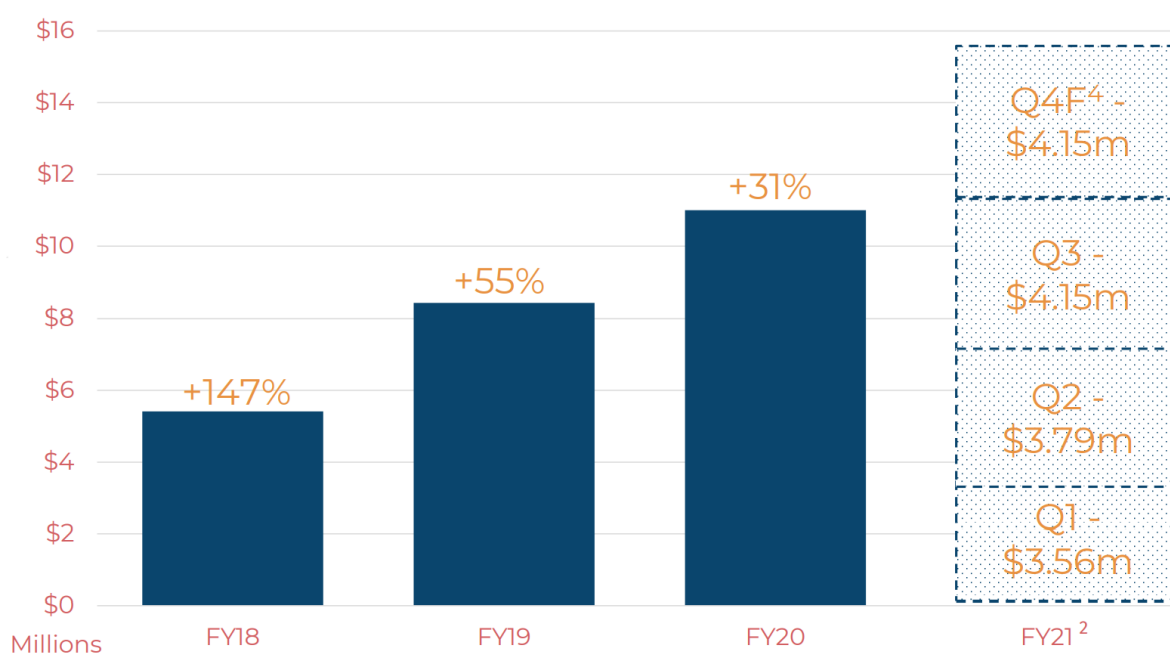
Source: Company reports, MST Access estimates

## Outlook commentary

Figure 14 –Growth track record

- Strong track record of delivering consistent, long term growth, particularly in sales revenue
- Quarterly sales revenue currently growing at 37% year-on-year<sup>1</sup>

## Annual Sales Revenue



<sup>1</sup> See Novatti ASX Release – Quarterly Update March FY21 – 30 April 2021.

<sup>2</sup> Based on Novatti results for September, December, and March FY21 quarters, as released to the ASX on 26 October 2020, 29 January 2021, and 30 April 2021 respectively.

<sup>3</sup> Based on management expectations for H2FY21F.

<sup>4</sup> Based on management expectations for Q4FY21.

Source: Company reports, MST Access estimates



With Novatti about to report its annual results, we expect the company will again deliver strong quarterly revenue growth on pcip, with the company recently guiding 4Q21 to be flat on 3Q21 in its presentations discussing the acquisition of its strategic stake in Reckon, and may also outline its strategic goals for the year ahead alongside its result.

## The opportunity

Investors in Novatti gain sizeable exposure to the mega trend of the shift away from cash to digital payments, the explosion of fintechs, the disruption of the traditional banking sector and the growth in Chinese payments out of Australia.

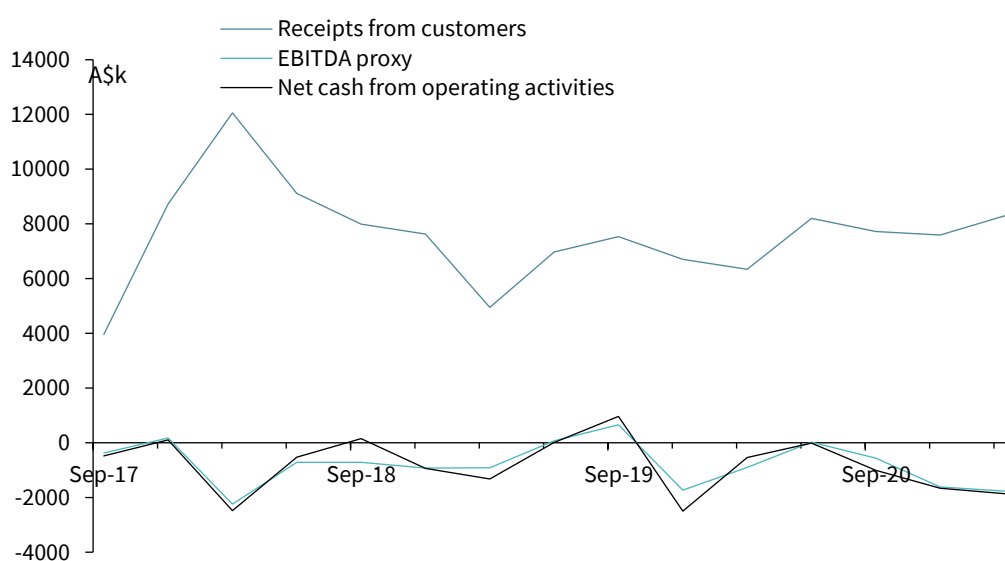
Novatti's continued success is underpinned by its proven ability to quickly produce, adapt and distribute innovative financial solutions. Being a provider of white label financial technology to a wide range of global partners naturally gives it the security of numerous diverse income streams many of which are reoccurring.

The company has several regulatory and vendor licences which provide its business a 'moat', equity stakes underpinning business relationships with several key associates, and its viability is supported by its strong net cash position.

## Cash runway

Novatti continues to attract substantial revenue receipts from its customers, and the company is currently running at a small loss generally each quarter, although the magnitude of this loss varies. Revenues didn't take a large hit due to COVID, and continue to trend up since bottoming in early 2019, albeit with some variation.

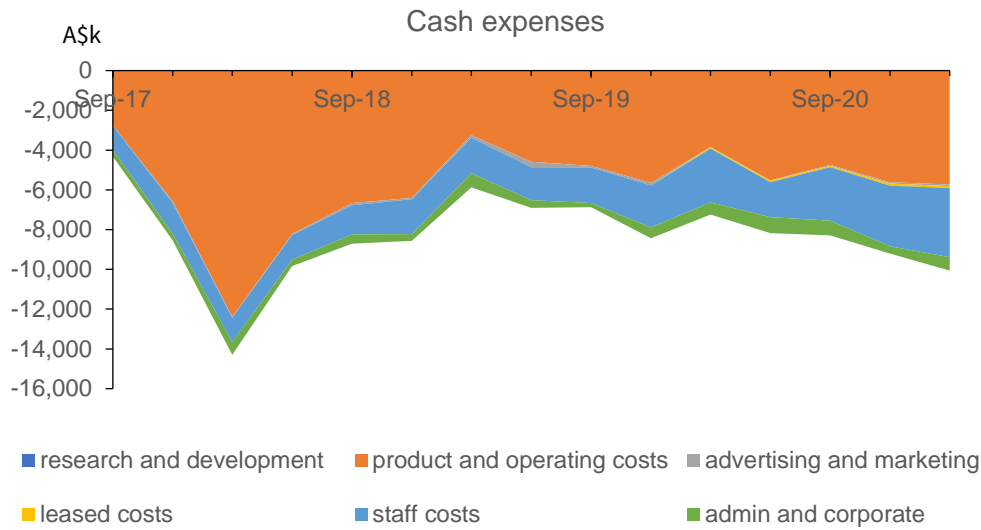
Figure 15 – Quarterly cash receipts and operating cashflow



Source: Company reports, MST Access estimates

Cash expenses are tightly controlled, and are dominated by product and operating costs, although staff costs have increased modestly in recent years, in line with its growing team and an aspiration to attract industry leaders.

Figure 16 – Cash expenses

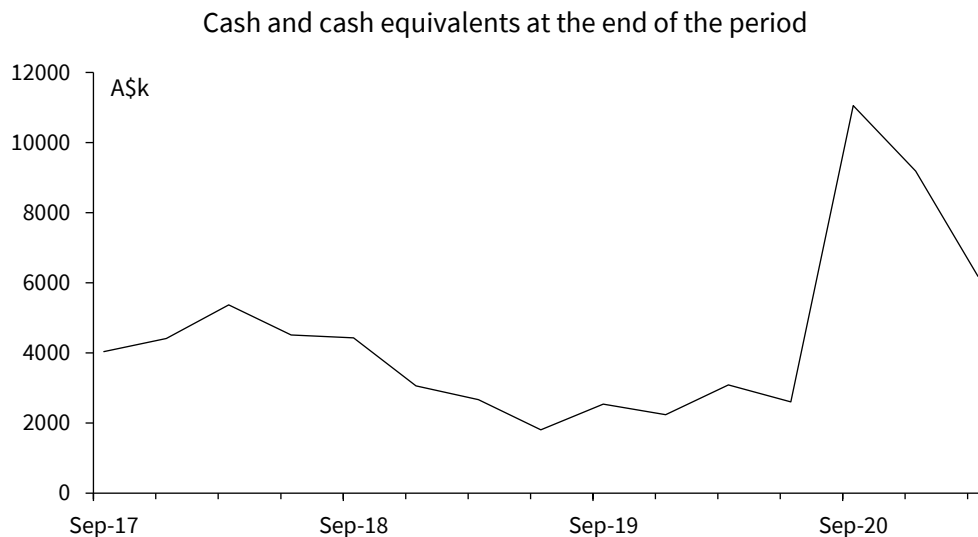


Source: Company reports, MST Access estimates

The group's overall cash position has benefited from:

- the placement made in late FY20, which lifted its cash position above levels where it has been kept historically, and
- its capital raising at the start of FY22 earlier this month and share purchase plan closing in early August 2021.

Figure 17 – Cash holdings A\$M



Source: Company reports, MST Access estimates

At the rate of its cash burn during the March quarter, the company had 3.3 periods of cash remaining; however this will have increased due to its recent placement with its bank co-investor and capital raising, which we adjust for, suggesting the company now has in excess of 17 quarters of cash remaining. It may also be due a forthcoming R&D refund which would further boost its cash position and prospective runway. This runway may be even longer, given the March quarter, on which the calculation is based, is historically one of NOV's weaker quarters, and the continued growth of its payments services.

Figure 18 – Cash runway

	2021 Q3 A\$k	Adjustments A\$k	Adjusted A\$m
Net cash from / (used in) operating activities	-1,866		-1,866
Cash and cash equivalents at quarter end	6,184	26,500	32,684
Unused finance facilities available at quarter end	0		0
Total available funding available	6,184		32,684
Estimated periods of funding available	3.3		17.5

Source: Company reports, MST Access estimates

## Key valuation considerations

Our key assumptions underlying the growth in NOV's income over the next few years are listed below. We believe that, on balance, these assumptions are on the conservative side of potential growth outcomes.

Figure 19 –Key Modelling Assumptions

### Revenue growth

- We expect revenue growth to continue to accelerate, reflecting increasing traction of products, geographic expansion and increased scope.
- We are looking for around 50% revenue growth in FY21, with the growth rate dropping by around 5 percentage points a year over the following few years.

### Cash expense growth

- We expect a hockey stick profitability pattern for recent investments, where some costs come ahead of revenue, before revenue outpaces costs.
- Cash costs are expected to continue to increase in FY22 and FY23, but at a much slower growth rate than forecast in FY21.

### One off cash costs

- Likely again feature in FY21 and FY22 attributable to its acquisition of its stake in Reckon and ongoing acquisition appetite.

### Depreciation and amortisation

- Will likely remain around current levels, given much of its software development is immediately expensed.

### Associates

- The contribution from associates should increase in future years reflecting the contribution from the acquisition of just under 20% of Reckon.

### Interest and Finance costs

- These will continue to remain elevated due to interchange fees, card network and similar charges in future years.
- The full conversion of the convertible bond does see total net interest and finance costs fall FY21 on FY20.

### Tax

- The company continues to benefit from R&D rebates; however these are likely to end in FY22 as NOV's revenue crosses the \$20m threshold.
- We do not envisage the company paying any meaningful amount of income tax until such time as the company becomes profitable.

### Shares on issue

- The current share purchase plan is fully taken up by existing shareholders.

Source: Company reports, MST Access estimates

## Income statement

These assumptions lead us to project the following earnings for NOV:

Figure 20 – Projected Income Statement

		2019	2020	2021	2022	2023
<b>Revenue</b>	A\$	8,416,464	11,003,666	16,471,092	23,863,464	33,390,016
Other income	A\$	0	0	4,871	0	0
<b>Cash expenses</b>	A\$	-10,621,687	-15,969,376	-23,142,281	-33,423,300	-34,877,466
<b>Underlying EBITDA</b>	A\$	-2,205,223	-4,965,710	-6,666,318	-9,559,835	-1,487,450
<b>One off cash expenses</b>	A\$	-744,810	-190,383	-2,974,034	-400,000	-400,000
<b>EBITDA</b>	A\$	-2,950,033	-5,156,093	-9,640,352	-9,959,835	-1,887,450
Depreciation and amortisation	A\$	-389,337	-904,815	-1,480,736	-1,480,736	-1,480,736
Impairment of capitalised bank licencing costs	A\$	0	-3,012,715	0	0	0
<b>EBIT</b>	A\$	-3,339,370	-9,073,623	-11,121,088	-11,440,571	-3,368,186
Share of net profit of joint ventures accounted for using the equity method	A\$	-40	17,322	22,569	1,512,322	1,512,322
Interest received	A\$	10,282	8,745	23,067	0	0
Occupancy costs	A\$	-336,365	-144,720	-181,344	-181,344	-181,344
Finance charges	A\$	-75,664	-1,366,425	-1,419,360	-400,000	-400,000
Gain on embedded value derivative - convertible note facility into Novatti Group	A\$	0	-726,942	0	0	0
Foreign currency translation loss	A\$	-248,644	-181,631	-217,983	0	0
<b>Net Interest</b>	A\$	-650,391	-2,410,973	-1,795,620	-581,344	-581,344
<b>Profit before tax</b>	A\$	-3,989,801	-11,467,274	-12,894,139	-10,509,593	-2,437,208
Government grants	A\$	0	0	963,680	0	0
Research and development grant	A\$	0	0	540,000	600,000	0
Income tax expense	A\$	-29,759	-46,791	-6,826	0	0
<b>Net tax</b>	A\$	-29,759	-46,791	1,496,854	600,000	0
<b>NPAT</b>	A\$	-4,019,560	-11,514,065	-11,397,285	-9,909,593	-2,437,208

Source: Company reports, MST Access estimates

## Balance Sheet

We project the following financial position for NOV:

Figure 21 – Projected Balance Sheet

		Jun-19 2019	Jun-20 2020	Jun-21 2021	Jun-22 2022	Jun-23 2023
<b>Current Assets</b>						
Cash & equivalents	A\$	1,806,924	2,599,878	7,052,081	19,747,742	17,877,440
Trade & other receivables	A\$	4,287,947	2,784,991	3,453,427	3,663,741	3,886,863
Financial assets - funds in trust	A\$	3,754,633	17,452,001	23,997,728	50,455,222	98,892,235
Other investments	A\$	0	560,000	200,000	200,000	200,000
Loan to listed entity	A\$	200,610	200,000	0	0	0
Prepayments	A\$	312,162	160,133	380,808	380,808	380,808
<b>Total Current Assets</b>	<b>A\$</b>	<b>10,362,276</b>	<b>23,757,003</b>	<b>35,084,043</b>	<b>74,447,513</b>	<b>121,237,346</b>
<b>Non-Current Assets</b>						
Investments accounted for using the equity r	A\$	5,224	22,456	776,306	3,076,306	3,076,306
Other investments	A\$	800,000	300,000	626,000	626,000	626,000
Net Property Plant And Equipment	A\$	623,124	572,509	489,915	489,915	489,915
Right of use assets	A\$	0	2,244,594	2,079,035	2,079,035	2,079,035
Goodwill	A\$	0	0	0	0	0
Other Intangibles	A\$	4,645,343	5,703,440	5,500,455	5,500,455	5,500,455
Deposits	A\$	99,739	239,567	8,639,555	36,194,465	38,059,054
<b>Total Non-Current Assets</b>	<b>A\$</b>	<b>6,173,430</b>	<b>9,082,566</b>	<b>18,111,266</b>	<b>47,966,176</b>	<b>49,830,765</b>
<b>Total Assets</b>	<b>A\$</b>	<b>16,535,706</b>	<b>32,839,569</b>	<b>53,195,309</b>	<b>122,413,690</b>	<b>171,068,111</b>
<b>Current Liabilities</b>						
Trade and other payables	A\$	4,641,419	5,854,239	5,831,095	6,186,208	6,562,948
Settlement and remittance funds payable	A\$	3,754,633	17,452,001	23,796,993	50,033,178	98,065,028
Lease liabilities	A\$	0	245,027	260,787	260,787	260,787
Unearned revenue	A\$	937,160	860,863	813,274	813,274	813,274
Convertible note facilities	A\$	402,506	1,100,000	440,000	0	0
Employee benefits	A\$	508,095	920,714	1,055,656	1,119,946	1,188,150
<b>Total Current Liabilities</b>	<b>A\$</b>	<b>10,243,813</b>	<b>26,432,844</b>	<b>32,197,805</b>	<b>58,413,393</b>	<b>106,890,188</b>
<b>Non-Current Liabilities</b>						
Lease liabilities	A\$	117,334	2,233,365	2,086,619	2,086,619	2,086,619
Convertible note facilities	A\$	0	4,544,578	0	0	0
Employee benefits	A\$	51,502	114,345	113,871	113,871	113,871
Other non-current liabilities	A\$	0	0	132,500	132,500	132,500
<b>Total Non-Current Liabilities</b>	<b>A\$</b>	<b>168,836</b>	<b>6,892,288</b>	<b>2,332,990</b>	<b>2,332,990</b>	<b>2,332,990</b>
<b>Total Liabilities</b>	<b>A\$</b>	<b>10,412,649</b>	<b>33,325,132</b>	<b>34,530,795</b>	<b>60,746,383</b>	<b>109,223,178</b>
Net Tangible Assets	A\$	1,477,714	-6,189,003	13,164,059	56,166,852	56,344,477
<b>Net Assets</b>	<b>A\$</b>	<b>6,123,057</b>	<b>-485,563</b>	<b>18,664,514</b>	<b>61,667,307</b>	<b>61,844,932</b>
<b>Equity</b>						
Contributed equity	A\$	24,074,324	26,684,947	51,230,273	96,670,273	96,670,273
Reserves	A\$	2,180,965	2,376,730	3,617,374	3,617,374	3,617,374
Retained earnings	A\$	-20,132,232	-29,547,240	-36,183,132	-38,620,340	-38,442,714
Non-controlling interests	A\$	0	0	0	0	0
<b>Total Equity</b>	<b>A\$</b>	<b>6,123,057</b>	<b>-485,563</b>	<b>18,664,514</b>	<b>61,667,307</b>	<b>61,844,932</b>

Source: Company reports, MST Access estimates

## Cash flow

We project the following cash flows for NOV:

Figure 22 – Projected Cash flow

		2019	2020	2021	2022	2023
<b>Cash Flows from Op. Activities</b>						
Net Income	A\$	-4,954,313	-10,960,326	-11,397,285	-9,909,593	-2,437,208
Depreciation & Amortization	A\$	389,337	904,815	1,480,736	1,480,736	1,480,736
Share based payments	A\$	391,138	1,601,659	774,034	400,000	400,000
Equity investments received for services rendered	A\$	0	-60,000	0	0	0
Share of joint venture profit	A\$	-40	-17,322	0	0	0
Unrealised foreign exchange gain	A\$	248,664	201,017	0	0	0
Impairment of capitalised bank licencing costs	A\$	0	3,010,255	0	0	0
Non-cash finance charges	A\$	5,054	1,900,119	0	0	0
Gain on convertible notes	A\$	0	-726,942	790,968	0	0
Movements in reserves	A\$	0	374,596	0	0	0
Change in Net Operating Assets	A\$			0	0	0
Increase in trade and other receivables	A\$	-2,398,156	-12,666,053	-668,436	-210,314	-223,121
Increase in trade and other payables	A\$	3,760,425	15,015,183	23,144	-355,114	-376,740
Increase in employee benefits	A\$	177,763	262,229	-134,468	-64,289	-68,205
Increase in deferred income	A\$	276,628	-76,297	47,589	0	0
Other	A\$			0	0	0
<b>Net Cash Flows from Op. Activities</b>	A\$	<b>-2,103,500</b>	<b>-1,237,067</b>	<b>-9,083,718</b>	<b>-8,658,574</b>	<b>-1,224,538</b>
<b>Cash Flows from Investing Activities</b>						
Cash Acquisitions	A\$	-2,062,628	-190,000	-270,000	-23,300,000	0
Property, Plant, and Equipment	A\$	-527,511	-51,477	-101,730	-60,000	-60,000
Intangible assets	A\$	0	-1,138,788	-170,000	-200,000	-200,000
Security deposits	A\$	0	-146,952	0	3,000,000	0
Disposals	A\$	0	850	360,000	0	0
<b>Net cash flows from investing activities</b>	A\$	<b>-2,590,139</b>	<b>-1,526,367</b>	<b>-181,730</b>	<b>-20,560,000</b>	<b>-260,000</b>
<b>Cash flows from financing activities</b>						
Proceeds from issue of shares	A\$	1,972,094	133,750	15,204,000	45,000,000	0
Share issue transaction costs	A\$	-132,009	0	-960,000	-2,700,000	0
Proceeds from issue of convertible note facility	A\$	400,000	4,600,000	0	0	0
Cost of debt - convertible note facilities	A\$	0	-355,866	0	0	0
Proceeds from borrowings	A\$	0	400,000	200,000	0	0
Repayment of borrowings	A\$	0	-800,000	-122,601	0	0
Repayment of lease liabilities	A\$	0	-239,865	-385,764	-385,764	-385,764
<b>Net cash flows from financing activities</b>	A\$	<b>2,240,085</b>	<b>3,738,019</b>	<b>13,935,635</b>	<b>41,914,236</b>	<b>-385,764</b>
<b>Net increase in cash held</b>	A\$	<b>-2,453,574</b>	<b>974,585</b>	<b>4,670,187</b>	<b>12,695,662</b>	<b>-1,870,301</b>
Cash at beginning of the period	A\$	4,509,142	1,806,924	2,599,878	7,052,081	19,747,742
Foreign Exchange Rate Adjustments	A\$	-248,644	-181,631	-217,984	0	0
Misc. Cash Flow Adjustments	A\$	0	0	0	0	0
<b>Cash at the end of the year</b>	A\$	<b>1,806,924</b>	<b>2,599,878</b>	<b>7,052,081</b>	<b>19,747,742</b>	<b>17,877,441</b>
<b>Free Cash Flow to Equity</b>	A\$	<b>-4,293,659</b>	<b>840,835</b>	<b>-9,573,813</b>	<b>-29,604,338</b>	<b>-1,870,301</b>

Source: Company reports, MST Access estimates

## Valuation

We value NOV at A\$0.80 per share using a DCF of free cash flow to equity forecasting out 7 years before applying a terminal value

Figure 23 –MST Access valuation of Novatti

Current date		20-Jul-21														
Next balance date		30-Jun-21														
		Jun-21	Dec-21	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
Free cash flow to equity	A\$m	-7.9	-26.1	-3.5	-1.0	-0.8	0.4	0.4	1.1	1.5	2.3	3.1	3.7	5.2	5.6	7.9
Discounted cash flow	A\$m	0.0	-25.4	-3.3	-0.9	-0.7	0.3	0.3	0.9	1.2	1.7	2.3	2.6	3.6	3.7	5.1
Sum of discount streams	A\$m	-8.7	CAPM													
Future value into perpetuity	A\$m	384.4	Risk free rate				2.00%									
NPV of terminal value	A\$m	248.2	Equity beta				1.5									
add adjusted net cash	A\$m	32.5	Equity risk premium				3.00%									
Value of total equity	A\$m	272.0	Cost of equity				6.5%									
Diluted shares on issue	m	336.1														
Value per share	A\$	0.80	Terminal growth				3.0%									

Source: Company reports, MST Access estimates

## Comparative Multiples

Figure 24 – Selected Peer Valuation Multiples sorted by EV/1 year forward revenue

Company Name	EV/Forward Revenue	EV/Forward EBITDA	Forward P/E
EML Payments Limited (ASX:EML)	6.0x	20.8x	36.7x
Tyro Payments Limited (ASX:TYR)	5.8x	131.7x	NM
Smartpay Holdings Limited (NZSE:SPY)	3.8x	15.6x	NM0
<b>Australian peer average</b>	<b>5.2x</b>	<b>56.0x</b>	<b>36.7x</b>
Marqeta, Inc. (NasdaqGS:MQ)	31.5x	NM	NM
Visa Inc. (NYSE:V)	20.6x	29.5x	39.4x
Mastercard Incorporated (NYSE:MA)	20.1x	34.5x	46.0x
PayPal Holdings, Inc. (NasdaqGS:PYPL)	12.7x	42.9x	60.8x
Payfare Inc. (TSX:PAY)	10.4x	NM	NM
Paymentus Holdings, Inc. (NYSE:PAY)	9.7x	168.3x	NM
Amadeus IT Group, S.A. (BME:AMS)	8.1x	27.1x	93.1x
Fidelity National Information Services, Inc. (NYSE:FIS)	7.9x	17.4x	21.8x
Network International Holdings plc (LSE:NETW)	7.8x	18.9x	41.5x
Paysafe Limited (NYSE:PSFE)	6.0x	18.1x	85.3x
WEX Inc. (NYSE:WEX)	5.9x	15.4x	21.4x
Fiserv, Inc. (NasdaqGS:FISV)	5.8x	14.7x	19.7x
Square, Inc. (NYSE:SQ)	5.3x	115.0x	150.3x
Worldline SA (ENXTPA:WLN)	5.2x	20.0x	31.4x
PayPoint plc (LSE:PAY)	3.9x	7.9x	11.4x
The Western Union Company (NYSE:WU)	2.2x	8.3x	11.1x
<b>International peer average</b>	<b>10.2x</b>	<b>38.4x</b>	<b>48.7x</b>
<b>Novatti Group Limited (ASX:NOV (FY22))</b>	<b>5.3x</b>	<b>NM</b>	<b>NM</b>

Source: IBES, Capital IQ, 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 Figure 24.

With Novatti being the Australian partner for Marqeta, we see that as its main peer, despite it being the most expensive of our peer group, trading on 31.5x 1 year forward revenue. In comparison, on our forecasts Novatti is trading on 8.5x EV/FY21 revenues, which it is due to report in August, and 5.3x EV/FY22 revenue.

## Governance and Sustainability

### Board and Management Have Significant Alignment with Investors

While it is a little disappointing that one of Novatti's independent non-executive directors has not acquired an equity interest in the company, he does at least have some options. It is notable that its non-executive directors (including Chairman), in addition to its MD, receive share based compensation, significantly improving alignment with investors.

Figure 25 –NOV Board Composition

Director	Position*	Committees	Shares	Options	Total interest	% SOI
Peter Cook	MD	Audit, Risk, Compliance	11,107,904	5,000,000	16,107,904	6.9%
Peter Pawlowitsch	Chair, NED	Audit, Risk, Compliance	3,182,662	3,000,000	6,182,662	2.7%
Paul Burton	NED	Chair Audit, Risk, Compliance	263,158	1,000,000	1,263,158	0.5%
Kenneth Lai	NED	Audit, Risk, Compliance	13,116,118	1,000,000	14,116,118	6.1%
Steven Zhou	NED	Audit, Risk, Compliance	0	1,000,000	1,000,000	0.4%

\*Non-Executive Director (NED). Source: Company reports, MST Access estimates

With no female directors, Novatti falls short of meeting the 30% 2021 target set by the ASX Governance Council. The addition of two female directors would be required to come close to this target, and if one of the existing male board members were to step down, the company would then meet this ASX governance target.

The board currently features a majority of independent non-executive directors, thus meeting another ASX Governance Council target.; and its board committees have historically been chaired by independent directors. Furthermore, all board members appear to have significant relevant past experience and skills to direct the company.

#### Peter Cook - Managing Director

Peter has over 25 years' experience as a director and executive with multiple companies, including Unidial Pty Ltd and Ezipin Canada Inc. Peter's career has been largely based on founding and leading telecommunications and payments companies in Australia, Canada, Africa and Asia. Peter is a founder of Novatti and is the CEO and Managing Director of Novatti Group Limited. Peter is a regular speaker and thought leader on innovation and payments. Peter is a Responsible Manager for the ASIC AFSL for Novatti's subsidiary Flexewallet Pty Ltd.

Peter was previously a Non-Executive Director of Senetas (ASX:SEN) from Jun 1999 to Jan 2006, and P2P Transport Limited (ASX:P2P) from Dec 2018 – Sep 2020.

Peter is a graduate of the Royal Military College, Duntroon; has completed a BSc (UNSW), a Grad Dip Computing (Canberra) and the Graduate Diploma in Securities course from the Securities Institute of Australia. Peter is a Graduate Member of the Australian Institute of Company Directors.

#### Peter Pawlowitsch – Non Executive Chairman

Peter Pawlowitsch is an accountant by profession with extensive experience as a director and officer of ASX-listed entities. He brings to the team experience in operational management, business administration and project evaluation in the IT, hospitality and mining sectors during the last 15 years.

Peter is Chairman of Family Zone Cyber Safety and a non-executive director of Dubber Corporation Limited, VRX Silica Ltd, all ASX-listed companies.

Peter holds a Bachelor of Commerce from the University of Western Australia, is a current member of the Certified Practising Accountants of Australia and also holds a Masters of Business Administration from Curtin University.

### Paul Burton - Non-Executive Director

Paul Burton has over 14 years of leadership experience in the payments industry and was the CEO of Datacash Group Plc, a payments gateway company bought by Mastercard. Datacash had a significant presence in Africa and Paul steered the company's expansion in that market. Paul, a qualified chartered accountant, entered the payments industry in 2001 when he joined Proc-Cyber Services as a Financial Controller, which was later acquired by Datacash. He was the CEO of Datacash in 2012 when he left to offer management consulting services to a number of global payment processing companies.

Paul is a director of Novatti, TransferBridge and Flexewallet.

Paul holds a Bachelor of Commerce from Rhodes University and Honours Bachelor of accounting science from University of South Africa. Paul is a current member of the Chartered Accountant of South Africa.

### Kenneth Lai - Non-Executive Director

Kenneth Lai is the managing director and wholly owner of Prestige Team Limited, an investment company which, together with its subsidiaries, holds an investment portfolio in Hong Kong and Southeast Asia. Prestige Team Limited has interests in real estate, payment processing, digital marketing and information technology support services. Kenneth has funded and invested in various Silicon Valley technology funds focusing on business opportunities within Asia. He also co-founded Legend World Development Technology Limited, a limited liability company incorporated in Hong Kong, which provides information technology solutions and integrated marketing solutions to business setups, and in which he is a shareholder and advisor.

Kenneth holds a Bachelor of Science degree majoring in Computer Science from the University of Auckland, New Zealand, and has over 14 years of leadership experience in the payments industry, including Datacash Group Plc, a payments gateway company acquired by Mastercard.

### Steven Zhou - Non Executive Director

Steven Zhou is an experienced executive with payments industry experience in both China and Australia. Steven has recently aided Novatti in a number of deals involving new business operations between Australia and China. He is the founder of Lifepay Pty Ltd and other fintech startups.

## Senior Management

### Peter Cook - Managing Director

Peter Cook has 25 years' experience as a director and executive with companies including Coopers & Lybrand (now PWC), Catsco Pty Ltd and Advanced Network Management Pty Ltd (Telstra joint venture company) and many start-up technology companies.

Peter's career has been largely based on founding and leading multiple telecommunications and payments companies. Unidial Pty Ltd, Total Tel Limited, Long Distance Direct Pty Ltd, Electronic Recharge Pty Ltd, Ezipin Australia Pty Ltd and Ezipin Canada Inc are such examples and all with successful exits to private and public companies. Peter was a Non-Executive Director and Deputy Chairman of Senetas (ASX:SEN) from June 1999 to January 2006.

Peter has completed a BSc (UNSW), a Grad Dip Computing (Canberra) and the Graduate Diploma in Securities course from the then Securities Institute of Australia. Peter is a Graduate Member of the Australian Institute of Company Directors.

### Alan Munday - Chief Operating Officer

Alan Munday has 25 years' experience as a director, executive, and management consultant including with KPMG, Senetas (ASX: SEN), Granite Investment Group, Total Tel International (TTI) and other companies. Alan has been associated with Novatti and its predecessors from 2002 including a period in the role of managing international partner channels and sales.

Alan has considerable experience in establishing and developing early stage companies and helping develop and execute new business strategies. He is recognised for providing innovative and insightful solutions to ensure clients achieved their business objectives. Alan entered the business sector following 15 years' service in the Australian Army, including 2 years in the US Army HQ Washington as part of an IT systems and network communications project.

Alan is a director of Novatti (Malaysia) Sdn Bhd.

Alan has an MBA (Swinburne), Masters in IR and ER (Monash) and other academic awards in business. He is a certified company director (UCLA, USA) and has studied at the USA National Defense University, Computer Institute. He is a member of the Australian Institute of Management and a member of the Australian Institute of Company Directors.

### Steven Stamboultgis - Chief Financial Officer

Steven Stamboultgis has more than 25 years' finance experience, having worked with companies including Foster's Brewing Group, Pauls Milk and Parmalat Australia.

As Chief Financial Officer at Praemium Limited (ASX: PPS), Steven was responsible for the company's financial reporting requirements and was a member of the team that assisted the company list on the ASX.

Recently, Steven was Chief Financial Officer and Company Secretary for Urbanise.com Ltd (ASX: UBN).

Steven holds a bachelor's degree in accounting, a master's degree in commercial law and is a certified practising accountant.

### A concentrated share register

Novatti has a concentrated share register, with the top 20 shareholders owning ~58.6% of shares on issue.

Furthermore, it appears that there are several major shareholders which might be considered to be foreign under FIRB rules, which could create additional approval requirements under Financial Sector ownership restrictions, should these owners (acting as a controlling block) exceed 20% of the share register.

Novatti's latest disclosures of top 20, substantial and management shareholders, prior to its recent capital raising, reveal two significant shareholders and that its directors hold 11.8% of the company, providing solid shareholder alignment.

Figure 26 – Significant shareholders prior to recent capital raising

	Number	Number	% Held
<b>Top 20 Holders</b>		<b>141,691,052</b>	<b>58.57%</b>
<b>including substantial holders:</b>			
Brayter Limited		46,631,507	19.28%
Qing Li		22,907,452	9.47%
<b>and Director interests:</b>			
Kenneth Lai		13,116,118	5.42%
Peter Cook (Corangamite Pty Ltd)		11,507,904	4.76%
Peter Pawlowitsch		3,582,662	1.48%
Paul Burton		263,158	0.11%
<b>Director Interests Total</b>		<b>28,469,842</b>	<b>11.77%</b>

Source: Company reports, MST Access estimates

### A few key service providers based interstate

While NOV is based in Melbourne, and has its Auditors and Bankers based in Melbourne, it has its Solicitors and Share registry based in Perth. Historically this would not be a problem; however, COVID-19 has highlighted the benefits and risks for all of these service providers to be located in the same city as the company; given the unexpected imposition

of travel restrictions and border controls. We have observed a recent example of a similar situation where this has caused difficulty, and increased legal costs, for another company.

## Sustainability and ESG considerations

We use the Value Reporting Foundation's five-dimension sustainability framework for considering how Novatti's sustainability and ESG considerations influence the potential valuation of the company.

### Environment

Novatti does not provide financing, so doesn't finance any environmentally damaging activities. Even once it receives its banking licence, it is likely to be consumer and SME focused, rather than on large industrial customers which would undertake environmentally damaging activities. Novatti's bank may wish to follow the lead of several other financial institutions and secure funding from the Clean Energy Finance Corporation in order to facilitate very low interest rate lending for green home improvement projects such as solar cells, batteries and electrifying (replacing gas) heating and cooking equipment.

Being a technology business, its main environmental impact will be from its Scope 2 emissions attributable to its power consumption, likely primarily attributable to its systems running in datacentres.

While the company has not made any disclosures as to its power consumption or scope 2 emissions, we believe that its scope 2 emissions should be relatively easy to reduce given the increasing proportion of green power available in power grids worldwide.

### Social Capital

Money laundering has tarnished the reputation and respectability of correspondent and remittance banking, to the stage where major financial institutions, including several of Australia's major banks, have exited this segment of the industry due to the onerous compliance requirements, leaving a relative service drought which Novatti is meeting. However, correspondent banking is a key essential service, helping lift out of poverty millions of people worldwide who receive funds from family members in other countries. Novatti's solid compliance functionality should limit risks in this area, and its compliance function is a section of the business that management is cognisant needs to be adequately resourced, which we believe is what differentiates it from major banks which have suffered AML/CTF problems with the regulator, AUSTRAC.

Furthermore, Novatti's payments rails provide services to innovative companies driving payments innovation supporting the unbanked and underbanked – enabling it to grow into substantial markets with little to no competition. The strong growth of its partners, such as Marquetta and Afterpay, highlight the potential growth it can coat-tail on through providing the payments functionality to these companies.

Both of these attributes highlight the important positive impacts on communities provided by Novatti, and why we believe these deliver Novatti a strong social licence to operate.

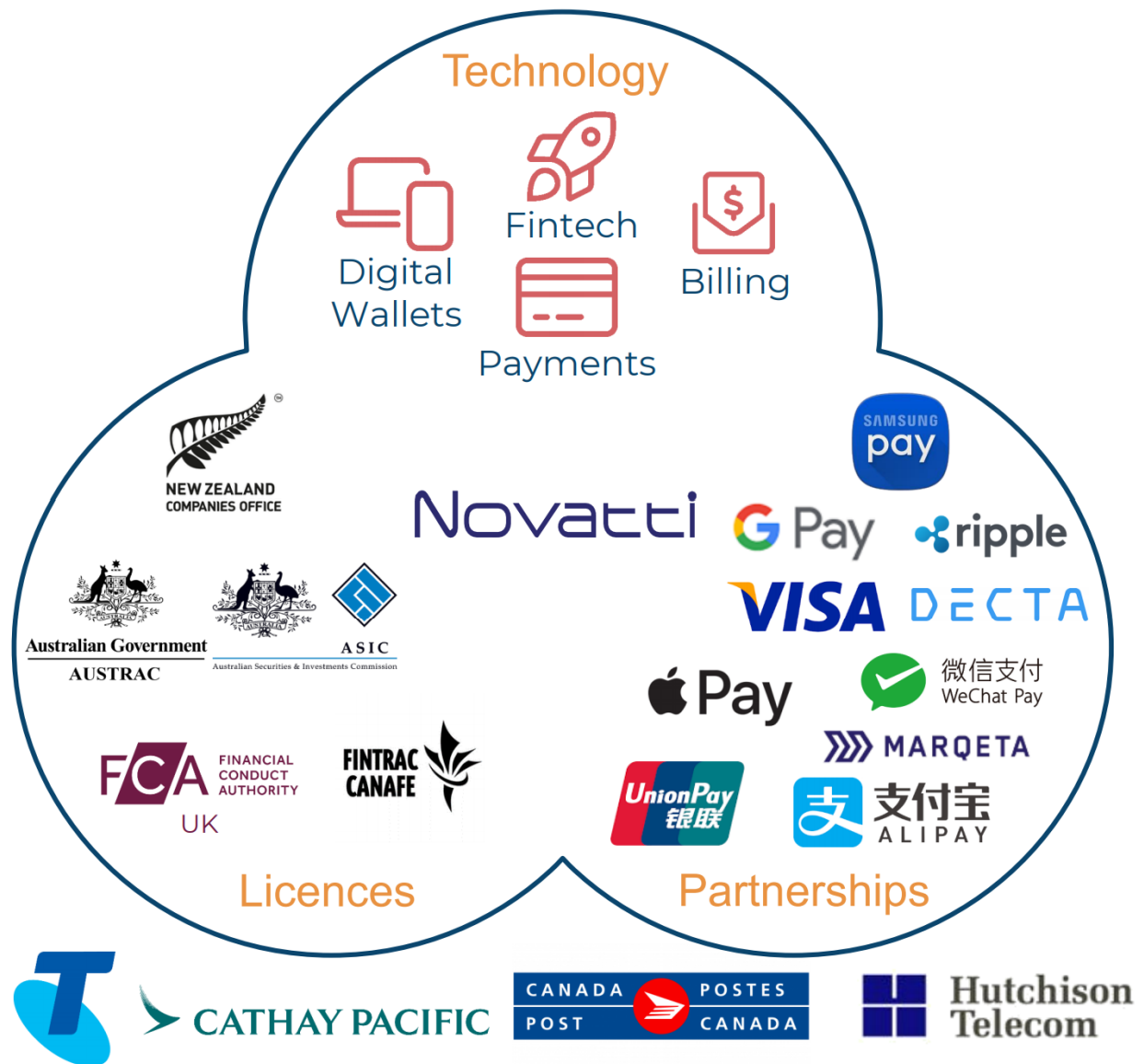
### Human Capital

The banking and digital payments industry is not an industry which results in significant hazards to workers.

Novatti has a diverse team, with respectable gender representation a tier below its senior management level. We suspect that in time, as the company grows, this representation will be reflected at its senior management level.

The combination of intellectual capital required for regulatory licencing, technology licences and business partnerships is difficult to replicate and provides a substantial moat for the business.

Figure 27 – Moat provided by a trifecta of technology, licences and partnerships difficult to replicate



Source: Company reports, MST Access estimates

## Leadership

As elaborated above in our discussion of governance, Novatti benefits from a board and senior management team with substantial relevant experience as well as a growing compliance team.

Clearly the biggest leadership risks include the loss of key management personnel as well as regulatory compliance issues with key regulators including ASIC, APRA and AUSTRAC arising from adverse social impacts and the brand damage that may arise from these issues and impacts.

## Innovation

Being a digital payments provider, there are very little environmental and adverse social impacts associated with the company's products. The company does not produce products, other than potentially plastic pre-paid cards, with adverse environmental impacts.

The company's Digital Payments Accelerator enabling fintechs to bring new innovative products to market again is a positive social good, enabling positive social capital impacts.

## 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.



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