



COMPANY UPDATE

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NOVATTI GROUP (ASX:NOV)

09/12/21

Novatti

Aggressively investing in high growth opportunities with aspirations of being a major player in payments processing

Executive Summary

Having recently completed the development of critical payment and processing technology, Novatti has successfully transitioned to an aggressive growth phase, monetising many years of technical design. The Company has achieved growth both organically, and by acquisition. However, Novatti shares currently trade at close to their 52-week lows. Despite this, Novatti has shown consistent revenue growth illustrating a genuine market demand for their services.

Novatti specialises in cross border payments (remittance), card issuing, acquiring, subscription billing, plus several other financial technology services. The Company is structured via a network of global partners, and holds several key licences allowing the Company to operate across many jurisdictions worldwide.

Novatti has a market capitalisation of A\$98m (\$0.30 cents per share), with a run rate of around A\$24m per annum (excluding growth projections). With around A\$16m in cash and no debt Novatti trades on a revenue/enterprise value of 3.4x.

What Novatti Does

Novatti has developed technology capable of processing complex digital payments and transactions across multiple forms of payment options. The Company has built a network of partners and customers who use Novatti's payment technology to leverage and assist in growing their business. To grasp Novatti's market position it is paramount to

understand the role the Company plays and the services it provides. **The Company acts as an "enabler" of payments and transactions** made possible via in house intellectual property. In addition, the Company holds licences that underpin the most crucial aspect of the Company's business model.

Novatti's technology is designed to up, and cross-sell all divisions, with strategic investments that have transformed the company over a short period. The most recent being a 19.9 percent investment in [Reckon](#) (ASX code RKN), an ASX listed company with a market capitalisation of A\$113m. In addition, Novatti acquired [ATX Malaysia](#), a leading Southeast Asian financial technology company with a suite of complimentary services and strong year on year growth.

The potential game changer

Novatti is currently in late-stage application proceedings with the Australian Prudential Regulator Authority (APRA) for a restricted authorised deposit taking institution licence (ADI). Pending a successful outcome, the Company will have the opportunity to leverage its network and payment infrastructure to its full potential. We reference [JUDO Bank](#) having recently listed on the ASX with a market capitalisation of A\$2.4b.

Grasping the technology

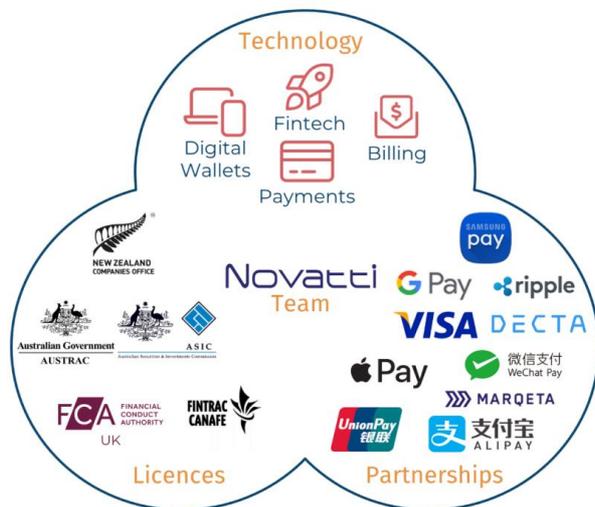
Built from the ground up, Novatti offers a modular service-based platform having successfully integrated many predominant payment providers via major international payment channels (Visa, Mastercard, EFTPOS). The platform allows for multiple payment options, Apple Pay, Google Pay, After Pay, Union Pay, plus many others, to communicate with each other facilitating transactions on behalf of the consumer.

Novatti's technology sits underneath a network with millions of transactions maintaining ledgers and balances ensuring the integrity of the payment ecosystem. Novatti's advantage over their competitors (Major Banks) is a more nimble business

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model with significantly less internal governance, allowing the Company to meet customer’s needs. This has been the key to Novatti’s early success in an industry with complex regulatory oversight. The ability to be flexible and customer focused provides invaluable white label bespoke solutions to a diverse range of consumers.

Novatti supports gift cards (card issuing), to complex digital wallet solutions. The platform is designed to support international transfers, accountable funds, loans, and banking type products, amongst many other everyday banking requirements. The approval of an ADI has potential to unlock further services the Company currently has within its capacity to offer.



Novatti and Visa – a pivotal partnership

[Vasco Pay](#) was the Company’s introduction to Visa. Visa liked the idea of Novatti pursuing a banking licence and subsequently became a principal issuer for Visa in May 2019. This relationship was considered a stroke of luck given Novatti’s little capability at the time. Visa saw an opportunity in Novatti’s ASX listing, licences, and aspirations of becoming an ADI.

Shortly after, Visa introduced [Marqeta](#) (a global competitor to Novatti) forming a partnership whereby Novatti would be Marqeta’s Australian [BIN sponsor](#). A banking identification number, or “BIN” sponsorship allows firms to process payments through an intermediary (Novatti). Whilst the two companies provide similar services, Marqeta does not have a licence to be a card issuer in Australia.

Novatti’s relationship with Visa has expanded into other geographies. The most recent example is through an Afterpay, Visa, Novatti collaboration in New Zealand (NZ), where Novatti will leverage its NZ licence with

Visa to enable Afterpay to issue Visa card solutions. This includes enabling Afterpay’s users to access Afterpay-branded payment cards in their digital wallet for use at participating merchants across NZ.



Revenue from this deal is immaterial during its initial stages, however the service has attractive margins, is reoccurring, scales well, and is easily replicated across additional geographies. The terms of the deal include a once off project set up fee, A\$50,000 per quarter for three years (increasing in years thereafter), and monthly transaction fees (dependent on the successful take up of the service). This is considered the standard structure of a card issuing agreement.

New Zealand is the first of many APAC regions where the trio is expected to expand. Currently Afterpay has a limited presence throughout this region. We anticipate Malaysia to be the next region of interest, with many to follow. Earnings from this relationship will become increasingly meaningful over time as Afterpay enter new markets. Whilst this is a relationship in its infancy, the drop through nature of the technology allows for a considerable portion of revenue to fall through to the bottom line.

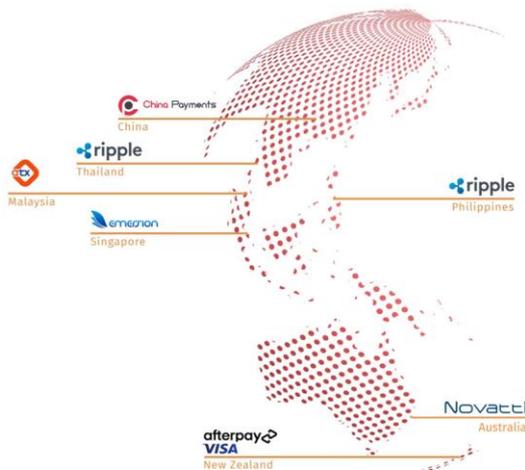
Managing Director of Novatti, Peter Cook, said:

“This new partnership with Afterpay again highlights Novatti’s digital banking and payments ecosystem in full operation, enabling innovative fintech companies to leverage our assets to bring new products and solutions to market. Working with Afterpay will see Novatti generate further revenue and value from existing assets, highlighting our increasing shift from a development to a monetisation phase.”

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Subscription Billing

Comprises roughly 12% of Novatti’s total revenue, derived primarily from the Company’s acquisition of [Emersion](#) on April 2, 2020. Emersion was acquired under distressed circumstances at the height of Covid - 19 uncertainty, having not been able to honour its convertible note obligations. Whilst the Company reported A\$300,000 of EBITDA, Emersion was losing around A\$100,000 per annum. Novatti valued the business at three times annual reoccurring revenue (ARR) of A\$1.4m (total revenue A\$1.7m) and agreed to pay A\$3- 3.5m (a discount to this multiple based on Covid-19 uncertainty). The transaction was executed via 16m shares (paid to equity and convertible note holders), with the remaining A\$1m paid in cash. The founder of Emersion, Paul Dundas, remains in the business driving U.S. operations.



Emersion

Assists businesses to engage with their customers, integrate systems, and automate business processes including sign-up ordering/provisioning, billing and rating usage, with embedded payments. Emersion’s services are known to save considerable hours of work per month (metric of measure provided), evidenced with [Contact Energy](#) (NZ), an energy and broadband provider with complex data records required to produce invoices based on varying cost combinations. Emersion successfully won this client from their incumbent service provider [SAP](#). The contract is for three years with a signing/integration fee, monthly fee, and volume fee/usage charges.

Growth (Emersion)

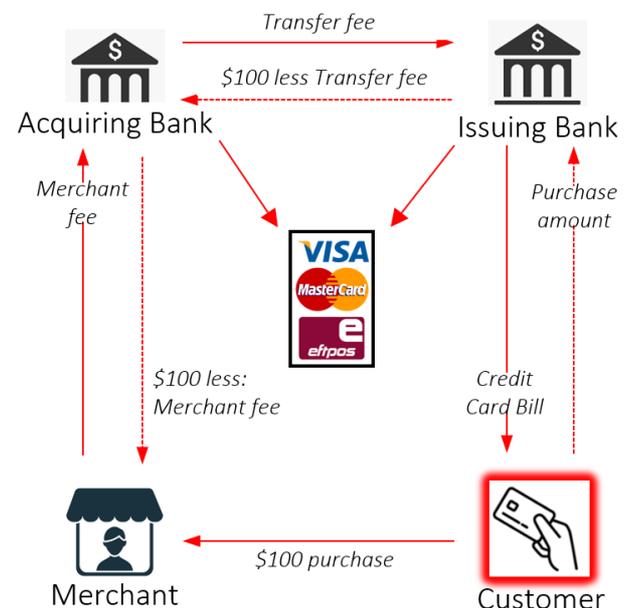
Novatti will focus on the U.S. given its size and archaic payment processing infrastructure. Currently revenue from the U.S. is negligible, with AUS/NZ/Singapore reporting revenue of A\$2.5m for FY21. Novatti believes

at end FY22 Emersion can generate total revenue of A\$5m (1-1.5m U.S.) with a CAGR of 30-50%. This being true, at end FY23 Emersion would generate around A\$10m revenue. On a revenue multiple of 10x the company would trade at a market capitalisation of A\$100m, which is significant given Novatti’s current market cap of A\$98m.

Emersion is not expected to turn a profit in the immediate future. Expenses will increase with the onboarding of a sales team both in the U.S. and domestically. Additionally, Emersion requires further senior management and executives. Subscription billing and acquiring have attractive margins and with early traction the business should scale well achieving critical mass. For comparison purposes [bill.com](#) and [zuora](#), both successful bill presentment and subscription billing platforms in the U.S., have shown to have value once industry presence and scale is achieved.

Understanding acquiring

An acquirer is known as a go between for all debit and credit card transactions. Acquirers manage the communication between the merchant (seller), customer (credit/debit card), Bank (where funds are held), Visa/Master Card/EFTPOS (payment scheme/network/rails). The Merchant Service Fee (1.7%) diagram below depicts the payment process.



*Acquiring typically charges a 1.7% fee to the merchant, in the above case \$1.70 on \$100.

* If Novatti introduces the merchant to the Acquiring Bank (sitting in the middle), of the 1.7% (or \$1.70) Novatti would have to pay to the Acquiring Bank 50% (or 0.85 cents).

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Acquiring currently contributes a small percentage to Novatti’s overall revenue, however it is anticipated to be a high growth division in the future. Novatti acknowledges this is an area of strong competition, although highlights the enormity of the global transformation to digital payments allowing for many players to compete.

Novatti officially entered the U.S. in April 21, targeting managed services providers focusing their market entry on industry type verticals, and marketplaces such as [Oracle](#), [Salesforce](#), [Quickbooks](#) and [ConnectWise](#) (U.S.), and [Xero](#) in Australia.

Processing/transaction revenue

Novatti holds an Australian Financial Services Licence (AFSL) and AUSTRAC licence which allows Corporate Authorised Representatives (CAR’s). Presently 14 Companies are registered to provide financial services and products on their behalf. Revenue from this generates roughly A\$500,000 per annum and is pegged to transactions as a CAR grows. Given the higher risks associated with ensuring registered CAR’s are compliant, Novatti’s primary focus is structured around developing strategic partnerships.

or revenue stream. This model only works if these companies continue to grow.

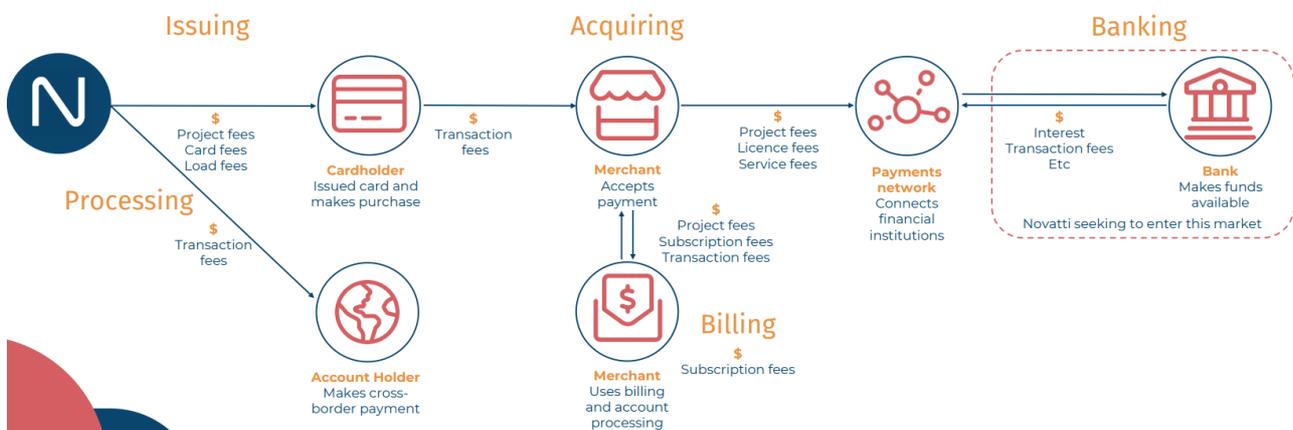
Understanding the transactional value through organisations of all types and sizes

Novatti’s modular turnkey solutions are able to seamlessly integrate with many types of organisations. Understanding where Novatti sits in the payment process is paramount as it underpins the sustainability of the Company’s recurring revenue.

Novatti’s platform is incredibly difficult to replicate, requires significant upfront capital, is labour intensive, and requires multiple licences and rare skills from a finite pool of data and code technicians. Whilst the Company has larger competitors ([Emerchants](#), AUS and Marqeta, U.S., plus others. Novatti should be able to co-exist and compete given the rate at which the payments and transaction industry is forecast to grow (historically a compound annual growth rate of 11.3%).

Trade finance, a significant opportunity in processing

A relatively new initiative in early-stage discussions. Novatti is exploring the ability to partner with trade finance providers, with potential to unlock frequent large-scale transactions. Digital card payments provide



Existing CAR’s (preferably) are financial technology entities that require the use of Novatti’s technology. These entities range from automated billing, superannuation clearing houses, e-wallet providers, and so on. Novatti’s objective is to find businesses that require the Company’s services with the ability to grow together. In some instances, such as [Lifepay](#) and [Splitpay](#), Novatti provided services and technology in exchange for equity ownership. Novatti will look to incubate smaller companies, providing resources in the hope of benefiting from an appreciating equity position

the financier an extra layer of protection, assisting debt recovery, and avoiding the possibility for negligent or fraudulent behavior.

Capturing the whole transaction cycle

The purchase of a retail Qantas travel package through an agent requires multiple transactions (hire car, hotel booking, travel insurance, airline tickets). Whilst there is only one payment from the consumer to the agent, Novatti sees an opportunity to partner with the agent capitalising on every transaction.

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Similar to trade finance, this is an early-stage initiative.

A real world example

Nimble a pay day (cash) lender (unable to acquire a AFSL), currently has limited control over where customers spend their loan. Novatti is exploring the opportunity of issuing a card to collect data on where customers spend their loan, how much, and monitor their capacity to repay their borrowing over what time frame. The ability to monetise this data is where the value lies for both Nimble and Novatti. The company seeks to learn consumer habits and predict trends in consumer spending. A customer who borrows to spend at a particular store, at a certain time, provides valuable data to merchants who can in turn use this information for target advertising.

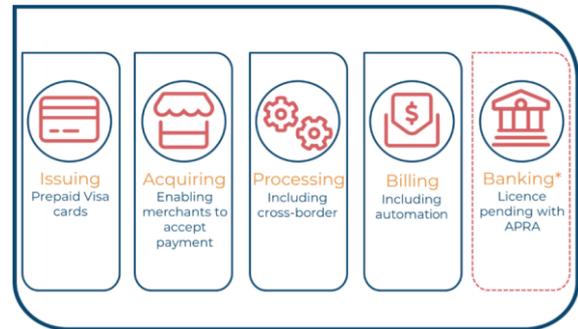
Internal expense payables via virtual cards

Novatti’s solution to substitute archaic employee cheque and expense payments with a virtual card is a huge opportunity. As society rapidly transitions to the digital world, organisations are increasingly looking for efficient and innovative ways to streamline operations.

Novatti in recent months has significantly bolstered their sales executive team with the appointment of several key personnel who are focused on delivering an outbound sales strategy to educate companies on the many benefits that come with digital payments.

Virtual cards open the gateway to immense power with the aggregation of data allowing an organisation to make informed decisions based on the behaviour and spending habits of its employees. A virtual card has a unique reference number that can be linked to an employee for multiple payment purposes. The card can be programmed with an expiry date, and capped at a pre-determined dollar value, to be transacted only at pre-approved merchants eliminating the potential for fraudulent and dishonest use.

These are only a few of the many benefits virtual cards can provide. It is Novatti’s goal to become a card issuer and payment solution provider for these types of organisations.



Novatti’s point of difference - a platform that can integrate plug-ins and ad-on’s seamlessly for organisations of all sizes under a turn key bespoke solution. Novatti is a facilitator of payments and transactions, not a payments company which the Company is often mistaken for.

Novatti believes the technology they provide is superior to several competing products given the inability for others to integrate payments solutions for anything more complex than card issuing. The connectivity into Novatti’s partners BPAY, Union Pay, Visa, Ripple, Apple Pay, Google Pay and others, are incredibly complex processes with few having the expertise.

Novatti’s technology is its primary asset, with compliance, licences and a highly experienced support team equally as important and critical to Novatti’s success.

Authorised deposit taking institution (banking licence)

Novatti updated the market on November 30 stating the Company has entered the last phase with the Australian Prudential Regulator of Australia (APRA) for the approval of a restricted banking licence (typically awarded within 90 days). This process was disrupted due to Covid-19 however the Company is well progressed and confident an ADI should be granted without further delay.

Novatti has secured A\$10.5m from investors provided regulatory approval is obtained before the end of February 2022. The Company has been cautious in their communication with the market due to the sensitivity surrounding the application process. We understand Novatti has been incredibly thorough in its application and continues to work alongside APRA maintaining a good relationship. We see no reason why an ADI won’t be awarded within the time frame provided.

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An ongoing opportunity in cross border payments (remittance)

Remittance refers to the transfer of money. It is particularly important in many developing nations, where international cross border payments make up a significant portion of the country’s GDP. Globally, remittances are around US\$500b per annum in value. Cross border payments is Novatti’s largest revenue contributor which the Company continues, and expects to experience ongoing growth.

Research and development

A great deal of the heavy lifting has been in terms of technology and platform development. The Company will now look to maintain and refine the platform tweaking and building upon the current framework, improving the customer’s offering. This is positive for Novatti as additional I.T headcount is not needed allowing the business to scale favourably, given the high costs.

Compliance

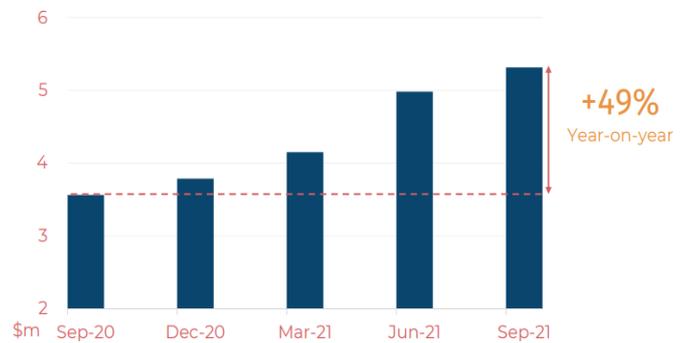
The global footprint of Novatti’s operations require ongoing maintenance and monitoring. Currently the Company has 11 employees in Compliance (six in Melbourne), with Evian Gillier Head of Compliance based in Greece. Novatti has 30 entities globally with considerable responsibilities to maintain under their AFSL. The Compliance headcount will continue to increase however with better scale.

Financials

Novatti’s revenue from underlying operations has experienced rapid growth over the past two years (albeit from a small base). Currently the Company has around A\$16m cash (post ATX acquisition upfront payment A\$3.96m), market capitalisation A\$98m (30 cents per share), with an enterprise value of A\$82m. Inclusive of ATX revenue, assuming no growth the Company has a full year revenue run rate A\$24.2m (trading on a 3.4x revenue/EV).

If the Company can maintain its stated year on year sales revenue growth of 49% (A\$36m FY revenue) the Company currently trades on a forward revenue/EV multiple of 2.3x. These figures have been calculated on a non-dilutive basis for simplistic purposes and are not anticipated to change materially based on options yet to vest.

Quarterly Sales Revenue



Quarterly Processing Revenue



Whilst from a revenue multiple perspective the Company screens as attractive. The investor must however contrast revenue with cash burn. For the past two years Novatti have reported a statutory net loss of A\$11.8m and A\$10.9m (FY21, FY20 respectively). Unless the Company can improve its margins in subsequent years, Novatti undoubtedly will need to raise further capital.

Summary

There can be no argument of Novatti’s ambition to grow. The Company’s transformation over the previous 24 months has been rapid.

Novatti’s business model and technology platform/framework has been designed for the purpose of up and cross selling their customer base to maximise the average revenue per user. As can be seen through Novatti’s two most recent investments (Reckon and ATX), the Company is effectively looking to buy access to client data and increase the size of their footprint by entering new markets. Both investments will allow Novatti the opportunity to integrate their technology. Whilst in theory this makes sense, these ventures are still unproven, and it is unknown to what degree of success the Company will have.

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Novatti has considerable ongoing marketing, sales, and compliance costs. Upon reaching critical mass the Company has the ability to scale extraordinarily well, with almost an unlimited runway for growth.

Early indications are positive for Novatti, however the next six months are crucial to see if the Company can continue to organically grow revenue in their high growth aforementioned divisions. Providing solid earnings growth and approval of an ADI we believe Novatti has the ability to be a serious player in the financial technology industry.

We note the Company's share price has been on a steady decline since the placement of A\$45m at A\$0.55 cents per share (17.2% discount to the 5-day trading volume weighted average price of A\$0.664 cents to June 29 2021). We can speculate why the share price has declined from a macroeconomic perspective based on a broader decline in Energy, Growth and Technology. However, from a company specific fundamental perspective, providing Novatti can continue to grow its top line, whilst showing evidence of improving margins, we believe the market will look upon this positively.

Overall, an investment in Novatti is for the high-risk investor who is comfortable with the Company's high levels of cash burn, and the likelihood of having to raise further capital.

Digital payment and processing is not a new concept, however the industry is arguably still early in the cycle and it remains to be seen if Novatti can capitalise on what we anticipate to be a high growth industry in years to come.

Before making an investment decision it is advised speaking to an Adviser.



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