NOVATTI GROUP LTD (ASX: NOV)

FINANCIAL TECHNOLOGY AND SERVICES

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Outlook - BUY

Novatti's international payment service business continues to grow, highlighted by the strong growth in H1 FY20 which saw 27.9% growth in revenue as its flagship business continued its upward trajectory, anchored by four consecutive quarters of revenue growth.

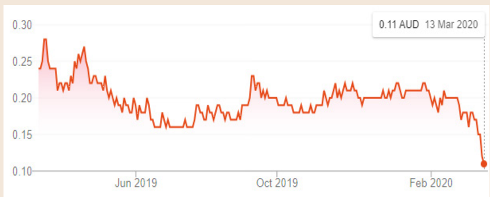
In parallel with the payments business, Novatti is expected to be granted a restricted banking licence in the first half of 2020 and capitalise on a rapidly rising trend in the banking sector where 1 in 4 Australians are considering moving their savings to a digital bank. Upon granting of the licence, funding of the digital bank will be taken over by the new banking subsidiary which has already secured funding for operations.

Based on the recent rounds of investment into Novatti's banking service business and their 50% equity stake, Emerald Financial view the fundamental payments business as undervalued in a sector where greater regulatory surveillance has opened up significant integration opportunities for Novatti to leverage their payments technology, secure further recurring revenue and identify growth opportunities worthy of investment.

Existing agreements with WeChat Pay, Alipay, Bank of Shanghai, IBM World Wire, SendFX, SplitPay and Visa Inc are strong signs of industry confidence in the services provided by Novatti. Its larger network of B2B international payment facilitators opens up an opportunity for rapid customer acquisition from the untapped migrant market for digital banking services in Australia.

Date	**13 Mar 2020**
Price (13 Mar):	$0.11
Ticker:	ASX: NOV
52-Week range:	$0.11-$0.31
Market cap (AUD):	$18.37m
Shares on issue	167m

	FY19	FY18	FY17
Revenue ($m)	8.89	6.36	3.54
EBITDA ($m)	-4.25	-4.71	-4.65
NPAT ($m)	-4.95	-2.07	-4.72



Vertical integration of the digital bank into Novatti's existing payments business is expected to see greater transaction revenue for Novatti's flagship business whilst growth in the banking service opens up significant earnings potential over the coming years as a first-mover in the migrant digital banking space.

Company Summary

Novatti Group Limited (ASX: NOV) is an Australian fintech company which operates in three key spaces within the financial services industry - international payment transactions, banking, and growth project incubation.

International payment services are the core business units with cash voucher service Flexepin, international remittance service Flexewallet, China bill payment service Chinapayments.com and prepaid credit card processor Vasco Pay being the key revenue drivers for Novatti via recurring SaaS fees and transaction processing.

Expanding on their existing fintech infrastructure, Novatti has submitted an application to APRA for a banking licence. This follows banking sector regulatory changes in 2017 enabling consumers to gain access to a greater range of competitive banking products and introduction of digital banks in Australia.

Novatti announced in January 2020 that strategic investors had committed $18m in cash and technology into Novatti's banking subsidiary. Following the investment, Novatti's 50% stake in the division is valued at $20m.

Currently with their application for a banking licence pending, Novatti are expected to be granted a restricted licence within FY20, before which will lead to the launch of a digital banking business in conjunction with their application for a full banking licence.

Novatti has established business partnerships through existing B2B payment service networks which will enable the rapid expansion of their digital banking services. Upon launch of their digital bank, Novatti will primarily be targeting migrants with their service offering positioned to significantly disrupt existing mediums of migrant banking services in Australia.

RADI Licence Application & Digital Bank Fintech Disruption

The RADI banking licence is expected to be granted to Novatti B Holding Company (NBHC) in early 2020 at which point full funding has been secured for the launch of their new digital banking service.

Digital banks are a relatively new concept to the Australian market, with three currently in operation. However, none are listed publicly, nor do any of them target the market Novatti intends to.

Without the expenses and large capital overheads applicable to the traditional banks, digital banks are able to offer customers greater value in banking products.

Volt Bank offers a deposit interest rate of 2.15% (variable), up to $245,000, with no minimum deposit requirement. Comparatively, Commonwealth Bank offers a variable rate of 1.65% for the first 5 months before reverting to 0.10% p.a through their standard NetBank Saver.

Xinja currently offers a bank account and prepaid card with zero account, card, currency conversion fees, or ATM fees. They intend to roll out home loans in 2020.

86400 (pronounced 86-400, the number of seconds in a day) is offering a deposit interest rate of 2.25% (variable) up to $100,000 but requires $1k to be deposited each month to get this rate. They are also offering home loans, with their owner-occupier, principal and interest, loans coming in at a comparison rate of 3.18% (variable), and a fixed loan rate of 3.12% (3-year fixed) p.a., in addition to benefits like unlimited overpayment. On the same loan structure, ANZ are currently offering a comparison rate of 4.89%, their 3-year fixed comparison rate coming in at 4.42%*.

*Based on owner-occupier, principal and interest, $500k loan ($700k property valuation), over 25 years.

All three of the aforementioned digital banks have an offering available to Australians however Novatti's target audience remains untapped - migrants.

With their existing B2B network of international payment providers and strategic partners already secured as cornerstone investors in NBHC, Novatti is expected to rapidly grow customer acquisition through affiliate marketing. This will enable migrants to open digital bank accounts in Australia prior to arrival and transact across borders through Novatti's existing payment service infrastructure. This will grow Novatti's customer base in preparation for its full banking licence application to significantly increase banking services to migrant customers, which will include credit cards, home and business loans, alongside international transactions between Australia and their home country.

Since the emergence of digital banks in Australia, neobank Xinja has reported more than $100 million in deposits as banking customers seek an alternative to traditional banking systems. These deposits were accepted over the course of 19 days when the company had planned to do $120 million in deposits for the year.

In 2017, USD $16.8 billion was sent from Australia to other countries. Substantial growth from $3.7b in 2011. Of the $16.8b sent from Australia, China was the preferred destination country with $3b, followed by India at $2b[(1)].

Payments Technology, Anti-Money Laundering & Fintech Incubation

In recent years, the Australian Transaction Reports and Analysis Centre (AUSTRAC) has been thoroughly investigating companies that deal with cross-border payments in a bid to protect Australian shores from illegal money laundering.

Two of the more high-profile cases revolved around Westpac (ASX: WBC) and Crown Resorts (ASX: CWN) but with heightened regulation and monitoring of cross-border payments, there is a major growth opportunity for Novatti and its payment processing software for operation, compliance and reporting purposes.

This is the technology which will form a pillar of their banking subsidiary business and its value was highlighted in March 2020 when Novatti confirmed an incubation partnership with Rent.com.au to redevelop RentPay - a 'next generation' rental payments app which provides Novatti with exposure to the lucrative rental payments market.

Between their award-winning payments processing technology and Visa Principal Issuer status, Novatti has a clear growth strategy to leverage their intellectual property, regulatory licences and industry standing to identify clear growth opportunities in the fintech space for projects which will have minimal impact on operating expenses.

This industry trend has been highlighted by large ASX-listed companies acknowledging the changing nature of business where innovation is significantly disrupting sectors like banking and supermarkets.

This has seen Commonwealth Bank (ASX: CBA) commit funding to their subsidiary X15 ventures which will launch 25 innovative new businesses over the next 5 years and Woolworths (ASX: WOW) to do target similar incubator projects through their subsidiary W23.

By offering their highly valued payments processing technology and unblemished relationship with AUSTRAC, Novatti can exchange their tech for small stakes in innovative fintech projects which also secure recurring revenue for payments processed.

Operational Performance and H1 Earnings

Novatti has continued a strong run of operational performance with organic growth in sales through FY19 and H1 FY20.

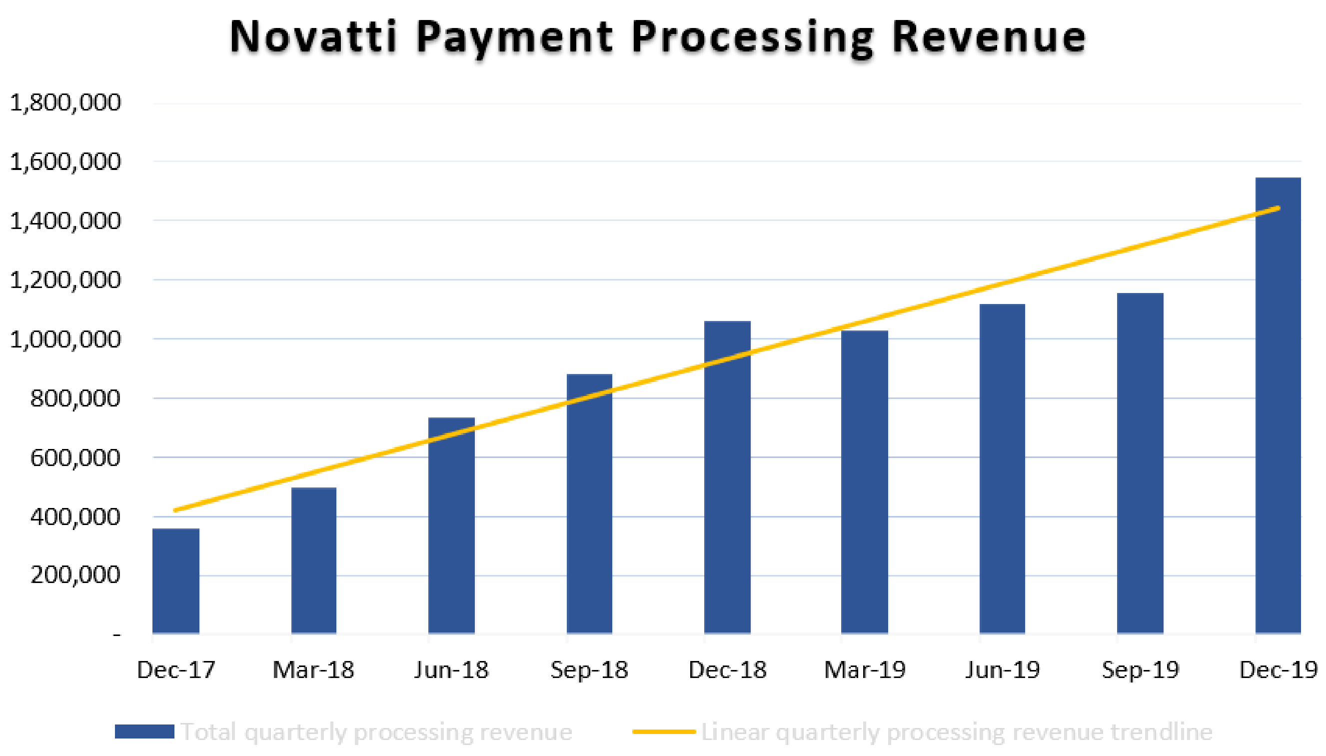
Strong organic growth in line with the Company's pivot from being just a payment service business to a diversified fintech operator has seen Novatti turn cash-flow positive in Q4 FY19 with further growth in Q1 FY20.

Highlighting continued growth in the transactions business, Novatti released a market update on 23 January 2019 reporting revenues for Q2 FY20 had increased from $1.16m to $1.55, a 45% YOY increase prior to the full release of Q2 activities and cash flow reports.

Whilst Novatti reported a net loss of $4.9m in FY19, the company has since reported two very strong quarters in line with business growth from existing payment services.

The launch of a digital bank, expected in early 2020 is expected to see an increase in operational expenses for minimal revenues in the first 12 months of operation. However, this will be fundamental to Novatti advancing the banking service business in order to secure a full banking license, which will open up significantly more earnings opportunities.

Operating expenses associated with the launch of the digital bank have been primarily secured via the latest investment round, enabling Novatti to meet Tier 1 capital requirements for a restricted license to be granted by the Australian Prudential Regulation Authority (APRA), as well as working capital.



Operating segment information

Consolidated - 30 June 2019	Novatti Platform $	Billing Solutions $	Transaction Services $	Banking Services $	Novatti Group Limited $	Total $
Revenue						
Sales to external customers	2,289,873	2,224,146	3,902,445	-	-	**8,416,464**
Intersegment sales						
Total sales revenue	2,289,873	2,224,146	3,902,445	-	-	**8,416,464**
Other revenue	-	-	-	-	463,656	**463,656**
Total revenue excluding interest revenue	2,289,873	2,224,146	3,902,445	-	463,656	**8,880,120**
EBITDA	(1,771,002)	248,963	(1,793,756)	(66,231)	(872,562)	**(4,254,588)**
Depreciation and amortisation	(43,021)	(198,153)	(63,509)	-	(84,654)	**(389,337)**
Interest revenue	4,760	-	15	-	5,507	**10,282**
Finance costs	(29,637)	(795)	(39,508)	-	(5,724)	**(75,664)**
Other costs	(9,899)	(28,849)	(176,499)	-	-	**(215,247)**
Profit/(loss) before income tax expense	(1,848,799)	21,166	(2,073,257)	(66,231)	(957,433)	**(4,924,554)**
Income tax expense	-	(29,759)	-	-	-	**(29,759)**
Profit/(loss) after income tax expense	(1,848,799)	(8,593)	(2,073,257)	(66,231)	(957,433)	**(4,954,313)**

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Current Market Valuation - Undervalued

In the funding round announced by Novatti on 6 January 2020, the new $18m investment from Fortune Fund and Sydney Digital Currency Exchange brought the post-money valuation of Novatti's banking business to $40m, of which 50% is owned by Novatti, whose equity stake is valued at $20m.

Novatti is currently trading with a market cap of around $25m.

Revenue multiple averages within the fintech payments space can fluctuate depending on the business development stage, but will generally be greater than 4x revenues for an established business, of which Novatti's existing payment services business classifies as.

Using FY19 figures, this would have had Novatti valued fairly, however, the company's revenue figures are trending upwards where Emerald Financial forecasts $11m+ in revenue for FY20 when factoring Q1 revenue of $2.47m, an increase of 32% from the corresponding FY19 Quarter. This revenue is coming solely from the established payment services business.

With the recent round of funding identifying $20m in equity value for Novatti, the perceived value of the current business is only $5m which grossly undervalues a business which is on track to deliver $11+ million in revenue for FY20 at a time when Novatti's total operating expenses will decrease significantly upon granting of their banking licence, enabling access to secured funds, external to current cash reserves.

Disclaimer

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Please note past performance is not a reliable indicator of future performance.

All Figures in this report were correct as of 13th March 2020.

Directors of Emerald Financial Group hold shares in NOV.

NOV has engaged Principal IR on retainer to assist with Investor Communications

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

Footnotes

[1] https://paymentinstitutions.eu/wp-content/uploads/2017/08/2012_western-union-remittancereportaustralia.pdf