# POLLARD BANKNOTE LIMITED

***June 30 - 2010***

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010**

August 4, 2010

*This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the three and six months ended June 30, 2010, is prepared as at August 4, 2010, and should be read in conjunction with the accompanying unaudited interim financial statements of Pollard and the notes therein as at June 30, 2010, and the audited financial statements of the Pollard Banknote Income Fund (the "Fund") and Pollard Banknote Limited Partnership ("Pollard LP") for the year ended December 31, 2009, and the notes therein. Results are reported in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").*

*On May 14, 2010, the Fund and Pollard LP completed the conversion (the "Conversion") to a publically traded corporation. As there was no substantive change in ultimate ownership after the Conversion it was accounted for under the continuity of interests method. As a result, one consolidated financial statement, incorporating both the Fund and Pollard LP, has been prepared. Comparative figures have been restated to reflect the combined results of both entities.*

## *Forward-Looking Statements*

*Certain statements in this report may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. When used in this document, such statements include such words as "may," "will," "expect," "believe," "plan" and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this document. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.*

## Use of Non-GAAP Financial Measures

Reference to "EBITDA" is to earnings before interest, taxes, amortization, unrealized foreign exchange gains and losses, mark-to-market gains and losses on foreign currency contracts and interest rate swaps, and certain non-recurring items including conversion expenses and warranty reserve accruals. EBITDA is an important metric used by many investors to compare issuers on the basis of the ability to generate cash from operations and management believes that, in addition to Net Income, EBITDA is a useful supplementary measure.

EBITDA is a measure not recognized under Canadian GAAP and does not have a standardized meaning prescribed by Canadian GAAP. Therefore, this measure may not be comparable to similar measures presented by other entities. Investors are cautioned that EBITDA should not be construed as an alternative to Net Income or Loss determined in accordance with Canadian GAAP as an indicator of Pollard's performance or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows.

## Basis of Presentation

The results of operations in the following discussions encompass the unaudited interim consolidated results of Pollard for the three and six months ended June 30, 2010. All figures are in millions except for per share amounts.

These consolidated financial statements reflect the entities conducting the business of manufacturing and selling lottery and gaming products of the Pollard group as a corporation subsequent to May 14, 2010 and as an income trust and limited partnership prior to the Conversion. All references to "common shares" collectively refer to Pollard's common shares on and subsequent to May 14, 2010 and Fund units and Class B and C limited partnership units prior to the Conversion. All references to "dividends" refer to dividends paid or payable to holders of Pollard common shares on and subsequent to May 14, 2010 and to distributions payable to Fund unitholders and Class B and C limited partnership unitholders prior to the Conversion. All references to "shareholders" refer collectively to holders of Pollard common shares on and subsequent to May 14, 2010 and to Fund unitholders and Class B and C limited partnership unitholders prior to the Conversion.

# POLLARD BANKNOTE LIMITED

## Overview

Pollard Banknote Limited ("Pollard") is one of the leading providers of products and services to lottery and charitable gaming industries throughout the world. Management believes Pollard is the largest provider of instant-win scratch tickets ("instant tickets") based in Canada and the second largest producer of instant tickets in the world.

Pollard produces and provides a comprehensive line of instant tickets and lottery services including: licensed products, distribution, retail telephone selling ("tel-sell"), marketing and instant ticket vending machines. In addition, Pollard's charitable gaming product line includes pull-tab (or break-open) tickets, bingo paper, pull-tab vending machines and ancillary products such as pull-tab counting machines. Pollard also markets products to the commercial gaming and security sector including such items as promotional scratch and win tickets, transit tickets and parking passes.

Pollard's lottery products are sold extensively throughout Canada, the United States and the rest of the world, wherever applicable laws and regulations authorize their use. Pollard serves over 45 instant ticket lotteries including a number of the largest lotteries throughout the world. Charitable gaming products are mostly sold in the United States and Canada where permitted by gaming regulatory authorities. Pollard serves a highly diversified customer base in the charitable gaming market of over 250 independent distributors with the majority of revenue generated from repeat business.

### Product line breakdown of revenue

| | Three months ended June 30, 2010 | Three months ended June 30, 2009 | Six months ended June 30, 2010 | Six months ended June 30, 2009 |
|---|---|---|---|---|
| Instant Tickets | 88.4% | 87.0% | 88.2% | 86.6% |
| Charitable Gaming Products | 10.7% | 12.2% | 10.9% | 12.3% |
| Vending Machines | 0.9% | 0.8% | 0.9% | 1.1% |

### Geographic breakdown of revenue

| | Three months ended June 30, 2010 | Three months ended June 30, 2009 | Six months ended June 30, 2010 | Six months ended June 30, 2009 |
|---|---|---|---|---|
| United States | 60% | 60% | 56% | 61% |
| Canada | 19% | 24% | 24% | 22% |
| International | 21% | 16% | 20% | 17% |

## Formation of the Corporation

Pollard was incorporated under the laws of Canada on March 26, 2010, for purposes of implementing the Conversion of the organization from an income fund to a corporation.

## Conversion to a Corporation

On January 28, 2010, the Trustees of the Fund, in conjunction with the Board of Directors of Pollard Banknote GP Limited, General Partner of Pollard LP, approved in principle a plan to convert Pollard Banknote Income Fund into a publicly traded corporation. On April 6, 2010, the Ontario Supreme Court of Justice approved the preliminary plan of arrangement for the Conversion. On May 6, 2010, the Unitholders of the Fund voted in favour of the Conversion and on May 13, 2010, the Ontario Securities Commission approved the final plan of arrangement.

The Conversion utilized legislative tax-free conversion options and became effective May 14, 2010. Pursuant to the terms of the Conversion, holders of Fund units received, in exchange for each of their Fund units, one common share of Pollard. Pollard Equities Limited, the holder of the Class B and Class C limited partnership units (collectively, the "Exchangeable LP Units") of Pollard LP and the associated Special Voting Units, received, in exchange for each group of one Exchangeable LP Unit (together with the accompanying Special Voting Unit), one common share of Pollard.

As a result of the Conversion, Pollard became the 100% owner of both the Fund and Pollard LP, with Pollard LP continuing to operate the business of manufacturing and selling lottery and gaming products.

Pollard is expected to pay a dividend that will be in line with typical dividend payout ratios for publicly traded corporations. The Board of Directors declared an initial dividend for the two month period ending June 30, 2010 at $0.02 per share. The dividend declared on August 4, 2010, for the period ending September 30, 2010, will reflect the full quarterly dividend of $0.03 per share.

After conversion there was no substantive change in the ultimate ownership of Pollard. As a result, the Conversion will be accounted for under the continuity of interests method. One consolidated financial statement incorporating the results of both the Fund and Pollard LP will be prepared. Comparative figures will be restated reflecting the combined results of both entities. As the Canadian operations of Pollard are now taxable under the *Income Tax Act* (Canada), the difference between the tax values and the net book value of the Canadian assets and liabilities have been recorded as future tax assets and liabilities in the comparative figures.

The costs related to the Conversion of $0.7 million have been expensed in the second quarter.

## Kamloops Facility

On February 28, 2010, Pollard permanently closed its Kamloops production facility with all related production being transferred to its other facilities. A one-time facility closing accrual of $4.7 million was accrued in the fourth quarter of 2009, representing the estimated closing costs including employee severance. It is anticipated that the rationalization of facilities will result in significant reduced net annual operating costs, beginning in March 2010, of approximately $4 million on an annual basis.

## Sale of Kamloops Property

On June 25, 2010, the building and land formally used in the Kamloops operation was sold to an affiliate of Equities for total proceeds of $2.9 million resulting in a gain of $1.8 million. The selling price was based on an appraised value determined through an independent appraisal. Under certain circumstances if the affiliate of Equities re-sells the property to a third party for a price higher than $2.9 million, Pollard will receive additional proceeds up to a maximum of $0.2 million.

The following financial information should be read in conjunction with the accompanying financial statements of Pollard and the notes therein as at and for the three and six months ended June 30, 2010.

**RECONCILIATION OF NET INCOME (LOSS) TO EBITDA**

(millions of dollars)

| | Three months ended June 30, 2010 | Three months ended June 30, 2009 | Six months ended June 30, 2010 | Six months ended June 30, 2009 |
|---|---|---|---|---|
| Net Income (Loss) | ($1.0) | $9.1 | $0.8 | $7.2 |
| Adjustments: | | | | |
| Interest | 1.3 | 1.0 | 2.7 | 2.0 |
| Unrealized foreign exchange loss (gain) | 0.4 | (2.9) | (0.8) | (1.9) |
| Mark-to-market loss (gain) on foreign currency contracts and interest rate swaps | (0.5) | (5.9) | (1.8) | (4.1) |
| Amortization of de-designated hedges | 0.5 | - | 0.9 | - |
| Conversion costs | 0.7 | - | 0.7 | - |
| Warranty reserve | 0.7 | - | 0.7 | - |
| Income taxes | 1.4 | 1.5 | 1.8 | 1.4 |
| Amortization | 2.0 | 2.2 | 4.2 | 4.3 |
| EBITDA | $5.5 | $5.0 | $9.2 | $8.9 |

**SELECTED FINANCIAL INFORMATION**
(millions of dollars)

| | Three months ended June 30, 2010 | Three months ended June 30, 2009 | Six months ended June 30, 2010 | Six months ended June 30, 2009 |
|---|---|---|---|---|
| Sales | $43.2 | $49.5 | $84.4 | $96.5 |
| Cost of Sales | 35.5 | 40.0 | 69.1 | 78.9 |
| Gross Profit | 7.7 | 9.5 | 15.3 | 17.6 |
| *Gross Profit as a % of sales* | *17.8%* | *19.2%* | *18.1%* | *18.2%* |
| Selling and Administration Expenses | 5.3 | 5.6 | 10.1 | 11.3 |
| *Expenses as a % of sales* | *12.3%* | *11.3%* | *12.0%* | *11.7%* |
| Realized foreign exchange loss | 0.2 | 1.9 | 0.8 | 2.5 |
| *Loss as a % of sales* | *0.5%* | *3.8%* | *0.9%* | *2.6%* |
| Net Income (Loss) | (1.0) | 9.1 | 0.8 | 7.2 |
| *Net Income (Loss) as a % of sales* | *(2.3%)* | *18.4%* | *0.9%* | *7.5%* |
| EBITDA | 5.5 | 5.0 | 9.2 | 8.9 |

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Total Assets | $140.5 | $154.3 |
| Total Long Term Liabilities | $78.2 | $76.5 |

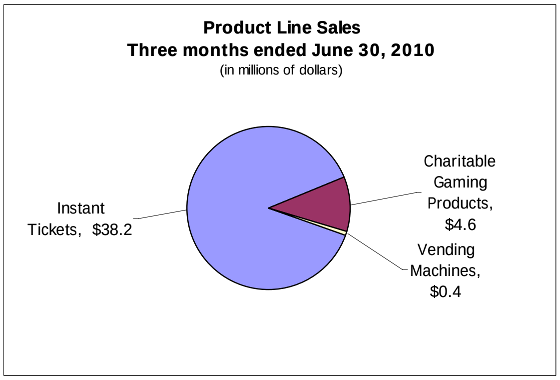
The selected financial and operating information has been derived from, and should be read in conjunction with, the consolidated financial statements of Pollard.

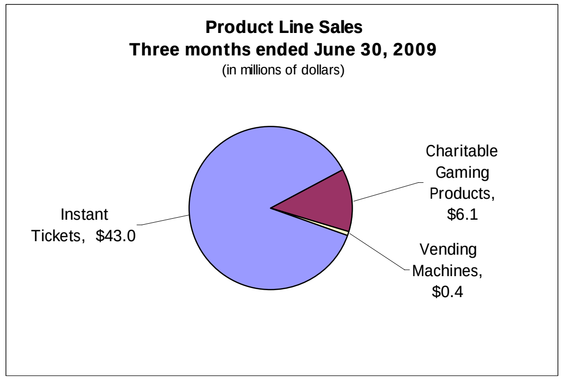
## REVIEW OF OPERATIONS

Financial and operating information has been derived from, and should be read in conjunction with, the consolidated financial statements of Pollard and the selected financial information disclosed in this MD&A.

## ANALYSIS OF RESULTS FOR THE THREE MONTHS ENDED JUNE 30, 2010

### Sales

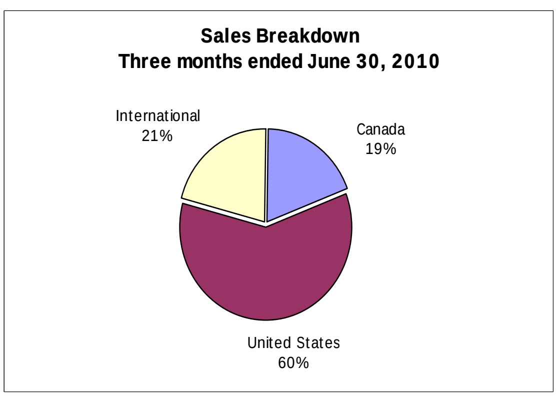


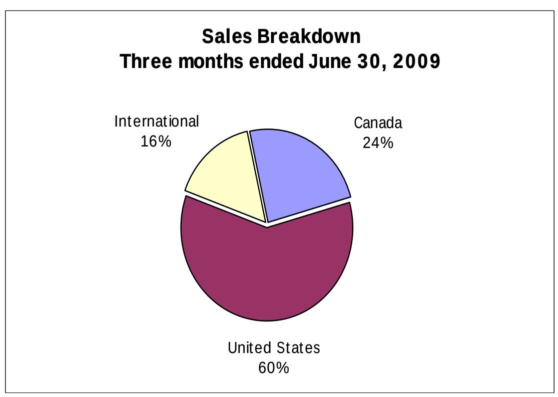




During the three months ended June 30, 2010, Pollard achieved sales of $43.2 million, compared to $49.5 million in the three months ended June 30, 2009. Factors impacting the $6.3 million sales decrease were:

*Strengthening of the Canadian dollar*

During the three months ended June 30, 2010, Pollard generated approximately 76% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the second quarter of 2010 the actual U.S. dollar value was converted to Canadian dollars at $1.04, compared to a rate of $1.19 during the second quarter of 2009. This 13% decrease in the U.S. dollar value resulted in an approximate decrease of $5.2 million in revenue relative to the second quarter of 2009. Also during the second quarter of 2010, the strengthening of the Canadian dollar against the Euro resulted in an approximate decrease of $0.5 million in revenue relative to the second quarter of 2009.



*Other*

Instant ticket volumes for the second quarter of 2010 were higher than the second quarter of 2009 which increased sales by $2.8 million. This was offset by a decrease in average selling price compared to 2009 which reduced sales by $3.4 million. Increased sales of related services such as our lottery management services generated an additional $0.5 million in sales. Charitable Gaming volume decreased during the quarter reducing sales by $0.5 million when compared to 2009.

### Cost of sales and gross margin

Cost of sales was $35.5 million in the second quarter of 2010 compared to $40.0 million in the second quarter of 2009. Lower exchange rates on U.S. dollar transactions in the second quarter of 2010 decreased cost of sales approximately $2.7 million. In addition, cost of sales was lower due to lower costs associated with the mix of production and the initial impact of cost saving associated with the closure of the Kamloops facility.

Gross profit decreased from $9.5 million (19.2% of sales) in the second quarter of 2009 to $7.7 million (17.8% of sales) in the second quarter of 2010 due mainly to the increased volume of lower priced work during the quarter and the impact of the stronger Canadian dollar.

### Selling and administration expenses

Selling and administration expenses were $5.3 million in the second quarter of 2010 which is lower than $5.6 million in the second quarter of 2009 due to certain cost containment strategies and the initial impact of savings generated from the closure of the Kamloops facility.

### Foreign exchange gain (loss)

Foreign exchange loss was $0.6 million in the second quarter of 2010 compared to a gain of $1.0 million in the second quarter of 2009. Within the 2010 foreign exchange loss are unrealized losses of $0.4 million, relating to a $0.7 million foreign exchange loss on U.S. dollar denominated debt (caused by the weakening of the Canadian dollar between the balance sheets dates of March 31, 2010 and June 30, 2010) offset by unrealized net gains of $0.3 million on U.S. dollar denominated receivables and payables, and $0.2 million in realized losses on write-downs of U.S. dollar denominated receivables.

In the second quarter of 2009 the foreign exchange gain consisted of an unrealized gain of $2.9 million relating to the foreign exchange on U.S. dollar denominated debt offset by $1.0 million in realized losses relating to forward hedge contracts (caused by fixed exchange rates in the hedges being lower than the actual rates) and $0.9 million in realized losses on write-downs of U.S. dollar denominated receivables.

### Interest rate swaps

A non-cash mark-to-market gain of $0.5 million was recorded during the quarter ending June 30, 2010 on interest rate swap contracts no longer designated as hedges. In addition, amortization of $0.5 of the previously recorded mark-to-market losses on these interest rate swaps, recorded as accumulated other comprehensive loss, was expensed in the second quarter of 2010.

### Gain on sale of property, plant and equipment

During the second quarter of 2010, Pollard disposed of a surplus building and land in Kamloops, British Columbia to an affiliate of Equities for total proceeds of $2.9 million resulting in a gain of approximately $1.8 million. The selling price was based appraised value as determined through an independent appraisal.

During the quarter ended June 30, 2009, Pollard disposed of a surplus building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of $3.4 million resulting in a gain of $1.7 million. The selling price was based on the current fair market value as determined through an independent appraisal.

### EBITDA

EBITDA was $5.5 million in the second quarter of 2010 compared to $5.0 million in the second quarter of 2009. The primary reasons for the increase in EBITDA were lower realized foreign exchange losses and lower selling and administration costs, partially offset by lower gross margin.

### Amortization

Amortization includes amortization of property and equipment and intangible assets and totaled $2.0 million during the second quarter of 2010 which is similar to $2.1 million during the second quarter of 2009.

### Interest

Interest expense increased from $1.0 million in the second quarter of 2009 to $1.3 million in the second quarter of 2010 due primarily to higher interest rates associated with the new syndicated credit facility completed on October 30, 2009.

### Conversion costs

Conversion expenses of $0.7 million, primarily legal and accounting fees, were expensed in the second quarter of 2010 relating to conversion of Pollard to a publically traded corporation.

### Warranty reserve

A non-cash warranty reserve of $0.7 million was accrued in the second quarter of 2010 relating to product produced in Fiscal 2009 for a specific customer as the originally delivered product no longer meets the contractual quality requirements.

### Employee profit sharing

Employee profit sharing costs decreased in the second quarter of 2010 to $0.1 million as compared to $0.6 million in the second quarter of 2009 due to reductions in income available for profit share. The mark-to-market gains on foreign currency contracts and interest rate swaps, as well as amortization of de-designated hedges, are excluded from the calculation of employee profit sharing.

### Income taxes

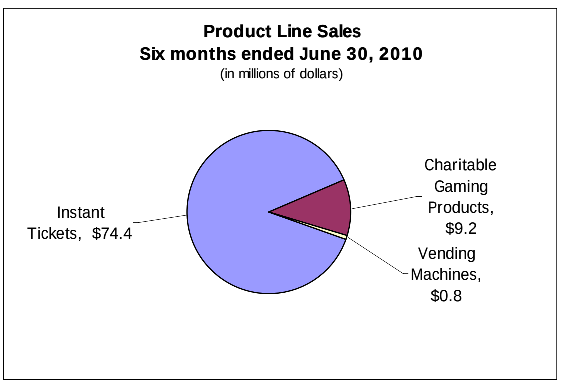
Income tax expense was $1.4 million in the second quarter of 2010, similar to $1.6 million in the second quarter of 2009. Income tax expense in both periods reflects that the Canadian operations of Pollard are now taxable.

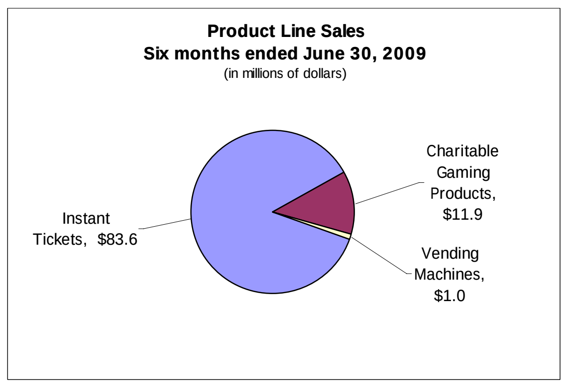
### Net Income (Loss)

Net Loss was $1.0 million in the second quarter of 2010 and in the second quarter of 2009 Net Income was $9.1 million. The primary reasons for the decline were an elimination of the non-cash mark-to-market gain on foreign exchange currency contracts of $5.9 million and a reduction in unrealized foreign exchange gains of $3.3 million. Additional differences include a lower gross margin and non-recurring expenses related to conversion and warranty reserve costs.

## ANALYSIS OF RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2010

### Sales

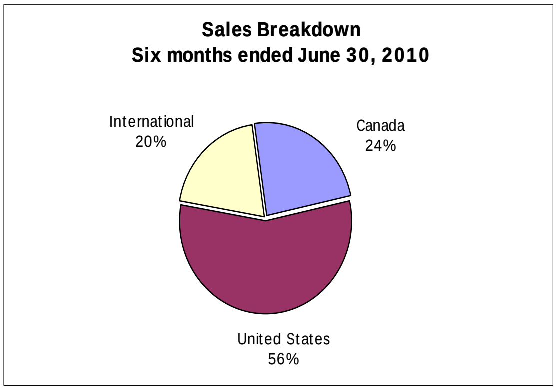


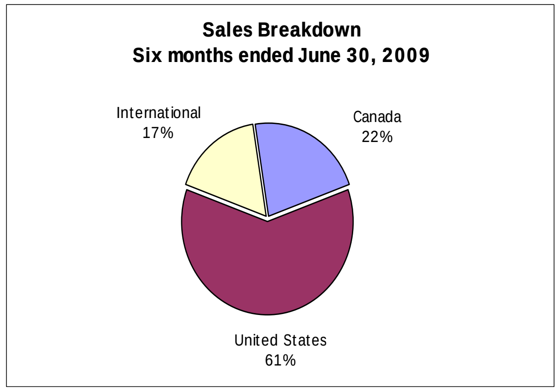




During the six months ended June 30, 2010, Pollard achieved sales of $84.4 million, compared to $96.5 million in the six months ended June 30, 2009. Factors impacting the $12.1 million sales decrease were:

*Strengthening of the Canadian dollar*

During the six months ended June 30, 2010, Pollard generated approximately 71% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the first six months of 2010 the actual U.S. dollar value was converted to Canadian dollars at $1.05, compared to a rate of $1.22 during the first six months of 2009. This 14% decrease in the U.S. dollar value resulted in an approximate decrease of $10.0 million in revenue relative to the first six months of 2009. In addition, during the six months ended June 30, 2010, the strengthening of the Canadian dollar against the Euro resulted in an approximate decrease of $0.8 million in revenue relative to the first six months of 2009.




*Other*

Instant ticket volumes for the first six months of 2010 were higher increasing sales by $5.2 million. A decrease in the average selling price of instant tickets reduced sales by $5.3 million compared to the first half of 2009. Charitable Gaming Products volumes were lower than the first six months of 2009 reducing revenues by $1.2 million.

### Cost of sales and gross margin

Cost of sales was $69.1 million in the six months ended June 30, 2010 compared to $78.9 million in the first six months of 2009. Lower exchange rates on U.S. dollar transactions in 2010 decreased cost of sales approximately $5.7 million. In addition, cost of sales were lower due to lower costs associated with the mix of production, lower costs of reproduction and the initial impact of cost savings associated with the closure of the Kamloops facility.

Gross profit decreased from $17.6 million (18.2% of sales) in the first six months of 2009 to $15.3 million (18.1% of sales) in the six months ended June 30, 2010, due to the impact of the strengthening Canadian dollar and a lower average selling price on instant ticket volumes.

### Selling and administration expenses

Selling and administration expenses were $10.1 million in the first six months of 2010 which is lower than $11.3 million in the six months ended June 30, 2009, due to savings associated with the closure of the Kamloops facility and lower travel costs.

### Foreign exchange gain (loss)

Within the 2010 foreign exchange gain (loss) is an unrealized gain of $0.9 million, consisting of $0.5 million gain on U.S. dollar denominated debt (caused by the strengthening of the Canadian dollar) and net gains of $0.4 million on U.S. dollar denominated receivables and payables. Offsetting the unrealized gains was $0.4 million in realized losses relating to forward hedge contracts (caused by a stronger Canadian dollar relative to fixed exchange rates in the hedges) and $0.5 million in realized losses on write-downs of U.S. dollar denominated accounts receivable.

In the six months ended June 30, 2009, the foreign exchange loss of $0.6 million consisted of an unrealized gain of $1.9 million relating to the foreign exchange on U.S. dollar denominated debt offset by $1.8 million in realized losses relating to forward hedge contracts (caused by fixed exchange rates in the hedges being lower than the actual rates) and $0.7 million in realized losses on write-downs of U.S. dollar denominated accounts receivable.

### EBITDA

EBITDA was $9.2 million in the first six months of 2010 compared to $8.9 million in the six months ended June 30, 2009. The primary reasons for the increase in EBITDA are lower realized foreign exchange losses, lower selling and administrative costs and lower profit share expense, partially offset by lower gross margin and other income.

### Amortization

Amortization includes amortization of property and equipment and intangible assets and totaled $4.1 million during the six months ended June 30, 2010 which is similar to $4.3 million during the first six months of 2009.

### Interest

Interest expense increased from $2.0 million in the first six months of 2009 to $2.7 million in the first six months 2010 due primarily to higher interest rates associated with the new syndicated credit facility completed on October 30, 2009.

### Mark-to-market gain on foreign currency contracts

A non-cash gain of $0.8 million was recorded in the first six months of 2010, compared to a non-cash gain of $4.1 million recognized in the first six months of 2009. On March 12, 2010, Pollard sold its remaining foreign currency contracts.

### Interest rate swaps

A non-cash mark-to-market gain of $0.9 million was recorded during the first six months of 2010 on interest rate swap contracts no longer designated as hedges. In addition, amortization of $0.8 of the previously recorded mark-to-market losses on these interest rate swaps, recorded as accumulated other comprehensive loss, was expensed in the first two quarters of 2010.

### Gain on sale of property, plant and equipment

During the first six months of 2010, Pollard disposed of a surplus building and land in Kamloops, British Columbia to an affiliate of Equities for total proceeds of $2.9 million resulting in a gain of approximately $1.8 million. The selling price was based on appraised value as determined through an independent appraisal.

During the six months ended June 30, 2009, Pollard disposed of a surplus building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of $3.4 million resulting in a gain of $1.7 million. The selling price was based on the current fair market value as determined through an independent appraisal.

### Conversion costs

Conversion expenses of $0.7 million, primarily legal and accounting fees, were expensed in the second quarter of 2010 relating to conversion of Pollard to a publically traded corporation.

### Warranty reserve

A non-cash warranty reserve of $0.7 million was accrued in the second quarter of 2010 relating to product produced in Fiscal 2009 for a specific customer as the originally delivered product no longer meets the contractual quality requirements.

### Employee profit sharing

Employee profit sharing costs decreased to $0.3 million in the first six months of 2010 compared to $0.5 million for the first six months of 2009 due to a reduction in income available for profit share. The mark-to-market gains on foreign currency contracts and interest rate swaps, as well as amortization of de-designated hedges, are excluded from the calculation of employee profit sharing.

### Income taxes

Income tax expense was $1.9 million in the first six months of 2010 compared to $1.4 million in the first six months of 2009. The income tax expense is higher due to differences relating to the foreign exchange impact of Canadian dollar denominated debt in U.S. subsidiaries. Income tax expense in both periods reflects that the Canadian operations of Pollard are now taxable.

### Net Income

Net Income was $0.8 million in the first six months of 2010 compared to $7.2 million in the first six months of 2009. The primary reasons for the decline were an elimination of the non-cash mark-to-market gain on foreign exchange currency contracts of $3.3 million and a reduction in unrealized foreign exchange gains of $1.0 million. Additional differences include a lower gross margin, higher income taxes and non-recurring expenses related to conversion and warranty reserve costs.

**Quarterly Information**
(unaudited)
(millions of dollars)

| | Q2 2010 | Q1 2010 | Q4 2009 | Q3 2009 | Q2 2009 | Q1 2009 | Q4 2008 | Q3 2008 |
|---|---|---|---|---|---|---|---|---|
| Sales | $43.2 | $41.2 | $46.9 | $48.4 | $49.5 | $47.0 | $50.2 | $44.1 |
| EBITDA | 5.5 | 3.7 | 5.6 | 6.3 | 5.0 | 3.9 | 8.0 | 8.0 |
| Net Income (Loss) | (1.0) | 1.8 | - | 7.8 | 9.1 | (1.9) | (5.9) | 1.7 |

Fluctuations in Sales, EBITDA, and Net Income (Loss) will vary by quarter depending on the timing of contract awards, changes in customer budgets, ticket inventory levels, lottery retail sales and mark-to-market adjustments to financial instruments.

Sales in Q1 2010 and Q2 2010 were lower due to the strengthening of the Canadian dollar relative to the U.S. dollar and a decrease in average selling prices.

Sales in 2009 were higher due to the weaker Canadian dollar over the year relative to the U.S. dollar.

Net Loss in Q4 2009 was primarily due to the impact of the Kamloops facility closure accrual.

Net Income in Q2 2009 and Q3 2009 was higher primarily due to higher mark-to-market gains on foreign currency contracts. Q2 2009 and Q2 2010 include a gain on sale of property, plant and equipment.

Net Loss in Q1 2009 was incurred primarily due to lower levels of gross profit.

Net Income in Q3 2008 was lower and a Net Loss in Q4 2008 was incurred, primarily due to the non-cash mark-to-market loss on our foreign currency contracts.

**Liquidity and Capital Resources**

*Cash provided by operating activities*

For the three and six months ended June 30, 2010, cash flow provided by operating activities was $1.0 million and $0.7 million, compared to cash flow provided by operations of $0.4 million and $4.1 million, for the comparable periods in 2009.

Changes in the non-cash component of working capital provided a decrease in cash flow from operations of ($0.2) million for the three months ended June 30, 2010, compared to a decrease of ($1.2) million for the three months ended June 30, 2009. For the six months ended June 30, 2010, changes in the non-cash component of working capital provided a decrease in cash flow from operations of ($2.4) million compared to an increase of $0.1 million during the comparable period in 2009. For the three months ended June 30, 2010, the decrease in non-cash working capital was primarily the result of a decrease in accounts payable, partially offset by decreased accounts receivable and inventory at the end of the quarter.

*Cash provided by investing activities*

In the three and six months ended June 30, 2010, cash provided by investing activities was $2.5 million (net) and $2.3 million (net). This is net of ($0.4) million and ($0.6) million capital expenditures. Cash provided by investing activities included $2.9 million in proceeds from the sale of property, plant and equipment in the three and six months ended June 30, 2010.

*Cash provided by financing activities*

Cash used by financing activities was ($0.8) million and ($0.9) million in the three and six months ended June 30, 2010. Dividend payments were the primary use of cash in the three months ended June 30, 2010 and dividend payments partially offset by an increase in long-term debt were the main factors impacting cash in the six months ended June 30, 2010.

Cash provided by financing activities was $14.9 million and $9.3 million in the three and six months ended June 30, 2009. Cash was provided by a net increase in long-term debt of $19.8 million when Pollard LP's credit facilities were renewed on June 30, 2009 and the demand operating facility was replaced by a committed facility. This was offset by dividends of ($4.1) million and ($9.7) million in the three and six months ended June 30, 2009.

As at June 30, 2010, Pollard had unused committed debt facility of $12.6 million. This amount is available to be used for future working capital requirements, contractual obligations, capital expenditures and dividends.

### ***Productive Capacity***

Management has defined productive capacity as the level of operations necessary to maintain the current cash flow target of $13.4 million on an annualized basis. Due to varying factors implicit in the nature of the lottery industry and the instant ticket market, productive capacity can best be measured through a financial output such as EBITDA and cash flow. A number of factors impact the level of EBITDA including physical plant capacity, machine capacity, nature of product and service offerings produced and mix of customers. Changes to productive capacity since August 5, 2005, have occurred primarily through expenditures on fixed assets and improved processes and other internal improvement measures, offset by the impacts of changes in foreign exchange relationships, primarily the strengthening of the Canadian dollar relative to the U.S. dollar and the Euro, and the closure of the Kamloops facility in February 2010. There have been no increases in productive capacity due to acquisitions since August 5, 2005.

Pollard's strategy with respect to productive capacity is to expend the required funds and resources to maintain the assets required to generate the targeted cash flow. In addition, dependent on certain market conditions and limitations on available funds, projects are incurred to increase cash inflow or decrease cash outflow. The nature of the lottery industry does not in itself lead to significant obsolescence risk with the operating assets. To grow productive capacity, ongoing investment in new technology, new fixed assets and new intangible assets is required. Pollard utilizes a number of individual strategies to maintain and grow productive capacity including a capital expenditure budget and a rigorous formal approval process, flexible individual customer management relationships and structured maintenance programs throughout all of the facilities.

An important component to managing and growing productive capacity is the management of certain intangible assets, including customer contracts and relationships, patents, computer software, assembled workforce and goodwill. Certain of these assets are reflected in Pollard's financial statements due to the use of continuity of interest method of accounting during the transfer of the business August 5, 2005.

Management focuses on maintaining and growing the value of the customer relationship through winning contract renewals, pursuing and obtaining new contracts and assisting existing customers growing their instant ticket product lines. Regular commitment to research and development allows continual development of patents, software and additional technological assets that maintain and increase future distributable cash. Detailed cost benefit analysis is performed for any significant investment of funds or resources in order to minimize the associated risks that these assets will not be able to generate the expected level of cash flow. Where new opportunities are identified, such as a new marketing opportunity or a new machine or process able to reduce input costs, consideration is given to revise plans and take advantage of these prospects.

Certain risks are associated with projects aimed at increasing the productive capacity, including increases in working capital, acquisition or development of intellectual property, development of additional products or services and purchases of fixed assets. If these investments fail to increase EBITDA and cash flow, then productive capacity will ultimately decrease over time due to the consumption of these investment resources. The impact on productive capacity may also depend upon the completion and start up timing of certain investment projects.

### *Working Capital*

Net non-cash working capital varies throughout the year based on the timing of individual sales transactions. The nature of the lottery industry is few individual customers who generally order large dollar value transactions. As such, the change in timing of a few individual orders can impact significantly the amount required to be invested in inventory or receivables at a particular period end. The high value, low volume of transactions results in some significant volatility in non-cash working capital, particularly during a period of rising volumes. Similarly, the timing of the completion of the sales cycle through collection can significantly impact non-cash working capital.

Instant tickets are produced specifically for individual clients resulting in a limited investment in inventory. Customers are predominantly government agencies, which result in regular payments. These factors assist in a reasonably quick turnover in net working capital. There are a limited number of individual customers, and therefore net investment in working capital is managed on an individual customer by customer basis, without the need for company wide benchmarks.

The overall impact of seasonality does not have a material impact on the carrying amounts in working capital.

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Working Capital | $29.9 | $25.9 |
| Total Assets | $140.5 | $154.3 |
| Total Long Term Liabilities | $78.2 | $76.5 |

***Credit Facilities***

Pollard's credit facility consists of one committed term bank loan facility. The committed term bank loan facility provides loans of up to $70.0 million for its Canadian operations and up to $25.8 million (US$25.0 million) for its U.S. subsidiaries. Borrowings under these credit facilities bear interest at fixed and floating rates based on Canadian and U.S. prime bank rates, banker's acceptances or LIBOR. At June 30, 2010, the outstanding letters of credit were $5.1 million and the remaining balance available for drawdown was $12.6 million.

As at June 30, 2010, Pollard had entered into interest rate swap contracts to fix the interest rates on approximately 34% of the long-term debt for a period of two months and an additional 20% of the long-term debt for a period of 14 months. These interest rate swaps allow Pollard LP and one of its subsidiaries to receive interest at floating rates and pay interest at a fixed rate.

Under the terms and conditions of the credit facility agreement Pollard LP is required to maintain financial covenants including working capital ratios, debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratios and certain debt service coverage ratios. As at June 30, 2010 and August 4, 2010 Pollard is in compliance with all covenants.

Pollard believes that its credit facility and ongoing cash flow from operations will be sufficient to allow it to meet ongoing requirements for investment in capital expenditures, working capital and dividends at existing business levels.

***Outstanding Share Data***

As at August 4, 2010 and June 30, 2010, outstanding share data was as follows:

| | |
|---|---|
| Common shares | 23,543,158 |

Prior to the Conversion, the total number of limited partnership units in Pollard LP was 23,543,158 and the total number of Fund units, including Special Voting Units, was 23,543,158.

***Contractual Obligations***

There have been no material changes to Pollard's contractual obligations since December 31, 2009, that are outside the normal course of business.

***Off-Balance Sheet Arrangements***

There have been no material changes to Pollard's off-balance sheet arrangements since December 31, 2009, that are outside the normal course of business.

### Financial Instruments

The financial instruments of Pollard remain substantially unchanged from those identified in the MD&A for Pollard LP and Fund for the year ended December 31, 2009.

### Critical Accounting Policies and Estimates

The critical accounting policies and estimates are substantially unchanged from those identified in the MD&A for Pollard LP and Fund for the year ended December 31, 2009.

### International Financial Reporting Standards

In January 2006, the Accounting Standards Board of Canada ("AcSB") announced that accounting standards in Canada are to converge with the International Financial Reporting Standards ("IFRS"). Canadian publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Pollard established a four part planning framework in 2008 to ensure an effective and efficient transition regarding the introduction of International Financial Reporting Standards ("IFRS") in 2011:

| | Step | Timing |
|---|---|---|
| 1. | Scoping the Effort | (completed 2008) |
| 2. | Enabling the Resources | (Q3 2008 - Q4 2010) |
| 3. | Executing the Plan | (Q3 2009 - Q1 2011) |
| 4. | Monitoring the Process | (2008 - 2011) |

Step 1 has been completed. Steps 2, 3 and 4 are currently ongoing. All detailed execution steps continue to be consistent with the times identified in the planning framework.

1. Scoping the Effort

A project team was identified utilizing both internal resources and where necessary, external resources. Formal timelines were established and appropriate training was received by all team members including participation in a number of externally led in-depth programs, ongoing formal review of updates and regularly scheduled meetings to confirm ongoing status.

2. Enabling the Resources

A review was undertaken of current accounting policies in comparison to the standards under IFRS. Differences were identified and documented, with those applicable to Pollard specifically reviewed to determine changes required and impact on current financial disclosure, systems and business activities.

3. Executing the Plan

Based on the differences identified in step #2, specific analysis was prepared identifying the preliminary recommended accounting policies (where choices are required) and analysis began to calculate the impact of on the opening transition balance sheet as at January 1, 2010. This analysis is planned to be completed in Q3 2010. A detailed seminar was held with the Audit Committee to review the preliminary recommendations relating to accounting policy choices and impact on other areas.

4. Monitoring the Process

Detailed quarterly updates have been prepared and presented to the Board of Directors and the Audit Committee of Pollard. Regular meetings are held to review the status of the transition plan and these will continue throughout 2010 and 2011.

The IFRS transition plan covers five main areas of Pollard's operations.

## A Accounting Policies

1. Future Accounting Policy Choices

Significant future accounting policy alternatives under IFRS have been reviewed. Recommendations, where choices are required, have been identified by management and approved in principle by the Audit Committee. Final approval is expected in the third quarter of 2010. Where differences exist with current Canadian GAAP analysis is being performed to quantify these differences.

2. Mandatory and Optional Exemptions

The balance sheet at the transition date of January 1, 2010 is projected to be completed and subject to review by the external auditors in the third quarter of 2010. IFRS #1 identifies certain voluntary and mandatory exemptions from adopting IFRS policies at transition date. Management has identified the optional exemptions to be utilized by Pollard and these have been approved in principle by the Audit Committee. Final approval is expected in the third quarter of 2010.

For a summary of Pollard's future accounting policies and optional exemptions under IFRS #1 please see the following chart on page 21.

Preliminary Assessment

The impact on the opening balance sheet, including Shareholder's Equity, has not yet been determined and will be finalized upon final confirmation of the exemptions available under IFRS #1 and completion of the transitional balance sheet.

The future impact on the statements of operations and cash flow have not been determined, pending completion of the impact of revising amortization based on a detailed component approach for fixed assets. Currently management does not believe the impact will be materially different under IFRS compared to Canadian GAAP on a go forward basis.

## B Internal Controls over Financial Reporting

Upon finalization of the accounting policy choices on transition and for the future, any necessary changes will be implemented to the internal controls over financial reporting ("ICFR") during the last two quarters of 2010. Appropriate review and testing of any new or changed controls will also occur during this time frame.

Based on our preliminary estimate of the impact of the new accounting standards not being significant, management does not expect impact on the ICFR to be significant and will focus on the key environment controls and management review and involvement to ensure the transition to IFRS is appropriately controlled.

## C Disclosure Controls and Procedures

Pollard will ensure its key stakeholders are informed about the anticipated effects of the IFRS transition including disclosure in our MD & A and we will provide quarterly updates throughout 2010 in our interim MD & A.

## D Information Systems

Our general ledger and financial reporting system is currently structured to allow for IFRS implementation without significant changes. The current fixed asset system allows for detailed component analysis to be tracked separately. No other major systems are expected to need significant changes.

## E Business Activities

A review of business related activities was undertaken during the scoping phase to identify issues that need to be addressed due to the transition to IFRS. The syndicated credit facility completed October 30, 2009, includes an allowance to reflect any potential impact based on IFRS adjustments. Other documents are being reviewed to determine any other required adjustments.

## IFRS 1 – First-time Adoption of IFRSs and Future Accounting Policy Changes

The initial adoption of IFRSs has required Pollard to review each of its accounting policies and determine whether or not a change is required or permitted under IFRSs and whether any amended policy is required to be applied on a retrospective or prospective basis. IFRS 1 generally requires retrospective application of the new policies but prospective application is required or permitted in some instances.

The below table is a high-level summary of the significant accounting policies of Pollard and the impact of adopting the new standard under IFRS 1. New standards under IFRS 1 that do not apply to Pollard have not been listed.

| Accounting Policy | Policy change expected on transition to IFRSs | Is there an IFRS 1 exemption available? | Will the IFRS 1 exemption be applied? |
|---|---|---|---|
| **ELECTIVE EXEMPTIONS** | | | |
| Business Combinations | Yes | Yes | Yes |
| Fair Value or Revaluation as deemed Cost – Property, Plant and Equipment | No | Yes | No |
| Borrowing Costs | Yes | Yes | Yes |
| Employee Benefits – Actuarial Gains and Losses | Yes | Yes | Yes |
| Employee Benefit Plans – Defined Benefit Plans Disclosures | Yes | Yes | Yes |
| Cumulative Translation Differences | Yes | Yes | Yes |

**Business Combinations**

IFRS 3 will be applied prospectively in the opening IRFS statement of financial position and prior business combinations will not be restated due to Pollard choosing to apply the IFRS 1 exemption for business combinations prior to January 1, 2010. As required by the prospective application requirements relating to IFRS 3, Pollard will test its goodwill for impairment in accordance with IFRS at the date of transition.

**Property, Plant and Equipment**

Under the requirements of IAS 16, the company will continue to account for all property, plant and equipment ("PP&E") under the cost model. There are options available under the new standard to account for PP&E on a fair market value basis.

Under IFRS 1 there is an exemption available whereby an organization can elect at its opening transitional balance sheet to revalue some or all of its PP&E on a fair market value basis rather than cost. Pollard will not be electing this exemption.

International Accounting Standard ("IAS") 16 also requires that assets be depreciated at the significant parts level. Pollard is currently finalizing its categorization and recalculating the impact of restating depreciation on this basis. This restatement will be applied both retrospectively (ie an adjustment to retained earnings and PP&E at the transitional opening balance sheet) as well as prospectively. Management does not believe any adjustments arising from this depreciation change will be material.

**Borrowing Costs**

Under IAS 27 companies are required to capitalize borrowing costs directly attributable to acquisitions or construction activities under certain circumstances. Historically Pollard has not capitalized borrowing costs and after adoption of IFRS will be required to prospectively capitalize borrowing costs for qualifying assets. Pollard will elect the IFRS 1 exemption and not retrospectively restate our financials to reflect the capitalization of borrowing costs.

#### Employee Benefits – Actuarial Gains and Losses

Under adoption of IFRS 1 companies have the choice to recognize all cumulative unrecognized Actuarial Gains and Losses ("AGL") at the date of transition. Pollard will be electing this exemption and will be recognizing retrospectively the cumulative unrecognized AGL in retained earnings at time of transition.

Companies also currently have the option to account for prospective AGL's using a variety of methods including full recognition in income or recognizing over a period of time utilizing the corridor method. Pollard will continue to use the corridor method, which recognizes AGL's into income over a period of time only if the absolute amount exceeds a certain level relative to the assets and liabilities of the pension plan. Under Canadian GAAP Pollard currently also follows the corridor method.

#### Employee Benefit Plans – Defined Benefit Plans Disclosures

Under IFRS 1 a company can elect not to provide the extensive historical disclosures required under IAS 19. Pollard will elect the exemption to exclude the extensive disclosure on transition.

#### Cumulative Translation Differences

Under IFRS 1 a first-time adopter can elect not to restate and recalculate the Cumulative Translation Differences ("CTA") in accordance with the new standard. If an adopter uses this exemption the CTA difference is deemed to be zero at the transition date. Pollard will elect to utilize this exemption and the CTA related to translations differences will be deemed to be zero.

### Related Party Transactions

Pollard has not entered into any significant transactions with related parties during the six months ended June 30, 2010, which are not disclosed in the unaudited interim financial statements.

### Industry Risks and Uncertainties

The risk factors affecting Pollard remain substantially unchanged from those identified in the MD&A for Pollard LP and Fund for the year ended December 31, 2009.

### Outlook

The outlook for retail sales of instant lottery tickets is for moderate growth over the next few quarters. Indications within the overall lottery industry appear that there are some signs of increasing growth reflecting the overall improvement in retail sales as the world economy shows signs of improvement. In addition, increased expansion of instant tickets, particularly outside of North America, has generated higher retail sales growth. We anticipate our own instant ticket volumes to also reflect a slow but steady growth when compared to last year. We also expect the mix of product for the remainder of 2010 to reflect a great percentage of higher value products.

We have no major contracts coming due in 2010 when extensions are considered. During the quarter we announced that Pollard has been named as the new primary instant ticket supplier to the Minnesota Lottery. Production under this contract will be expected to begin in the third quarter of 2010.

The Canadian dollar remained strong relative to the U.S. dollar during the quarter. We manage our currency exposure risk to the U.S. dollar through our natural hedges including sourcing purchase inputs in U.S. currency, utilizing U.S. dollar denominated debt to hedge balance sheet exposure and efficiently using our U.S. based production facilities. A strong Canadian dollar does place negative pressure on our operating margins. In addition, we generate a small portion of our revenue in Euros. Over the last few quarters the Euro has weakened significantly relative to the Canadian dollar. As we have no natural hedges denominated in Euros any weakening in the Euro relative to the Canadian dollar will have a negative impact on our operating margins.

We will see improvements in our cost structure over the second half of 2010 due to the closing of the Kamloops facility. In addition we have undertaken a number of initiatives internally to improve our cost structure and efficiencies and we believe this focus will allow for additional cost savings over the next few quarters.

Pollard's conversion from an income trust to a publicly traded corporation was completed during the second quarter. After the Conversion, effective May 14, the Canadian operations of Pollard will now be subject to regular rates of corporate taxation on their taxable income.

Licensed product volume was lower than normal in the second quarter, a trend which started in the first quarter of 2010. Historically licensed product volumes were greater in the last half of the year, reflecting the run-up to the holiday season, and we believe this trend will continue in 2010 although unlikely to achieve the same overall margin levels of last year.

Our balance sheet is beginning to see the impact of our changes made to improve our cash flow including controlled capital expenditures and our new dividend policy. There are a number of business factors that will impact our cash resources in the near term including the continued payments of the Kamloops severance amounts and investments required in non-cash working capital for new client commitments such as the recently awarded primary contract for the Minnesota Lottery.

Pollard Banknote believes that its credit facilities and ongoing cash flow from operations will be sufficient to allow it to meet ongoing requirements for investment in capital expenditures, working capital and dividends at existing business levels.

## Disclosure Controls and Procedures

Under Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings," issuers are required to document the conclusions of the Chief Executive Officer and Chief Financial Officer (the "Certifying Officers") regarding the design of the disclosure controls and procedures. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the design of the disclosure controls and procedures as defined in Multilateral Instrument 52-109 will provide reasonable assurance of achieving the disclosure objectives.

## Internal Controls over Financial Reporting

Under Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings," issuers are required to document the conclusions of the Certifying Officers regarding the design of the internal controls over financial reporting. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the design of the internal controls over financial reporting as defined in Multilateral Instrument 52-109 will provide reasonable assurance of achieving the financial reporting objectives.

No changes were made in Pollard's internal control over financial reporting during the six months ended June 30, 2010, that have materially affected, or are reasonably likely to materially affect, Pollard's internal control over financial reporting.

## Additional Information

Shares of Pollard Banknote Limited are traded on the Toronto Stock Exchange under the symbol PBL.

Additional information relating to Pollard, including the Audited Consolidated Financial Statements and the Annual Information Form of Pollard LP and Fund for the year ended December 31, 2009, is available on SEDAR at www.sedar.com.

Pollard Banknote Limited
1499 Buffalo Place
Winnipeg, Manitoba R3T 1L7
(204) 474-2323
www.Pollardbanknote.com