POLLARD BANKNOTE LIMITED

• ANNUAL REPORT 2012 •

CONTENTS

LETTER TO SHAREHOLDERS

We are very pleased to report to you much stronger financial results for 2012, with our Net Income more than doubling compared to 2011. This growth in profitability has been consistent with the objectives established for our company with our Change Initiative process, our multi-year strategic plan. This process, however, is far from complete and we expect to continue growing our profitability through 2013 and beyond.

The lottery industry has seen several years of record growth in retail sales, and 2012 was no exception. It is also worth noting that, among the lottery products, instant tickets continue to be the star of the portfolio. This gives us great encouragement that the overall market we serve is strong and we foresee that position of strength continuing in the future.

Lotteries worldwide continue to aggressively grow their product lines, expand their revenue sources and rework their structures, all to maximize their net returns for the various good causes they support. Within this dynamic, in addition to growing instant ticket sales, are many opportunities for private sector suppliers like Pollard to work in greater partnership to help lotteries meet their objectives. 2012 saw a number of these opportunities develop more fully.

Lotteries are exploring the internet more and more as a medium for distribution of gaming products and interacting with their customer base. While still early, the expansion of “iGaming” is an exciting opportunity for lotteries to continue to grow and also an exciting opportunity for Pollard to expand our sales of new product offerings.

Lotteries are also focusing on other ways to increase their returns through greater outsourcing of other aspects of their operations including the overall management of the lottery itself. As lotteries increase the number of products and services provided by private sector operators, we have greater opportunities to expand and deepen our relationships with our customers, ultimately leading to greater revenue and profit potential.

The above two examples are just some of the exciting developments that gained momentum in 2012. We will continue to monitor these trends going forward and are actively working to cultivate the resources within our company to be able to capitalize on these opportunities.

We are very proud of the results we achieved in 2012, particularly in light of the ongoing intense competition in the lottery supply space. As well, the Canadian dollar remained very strong relative to the U.S. dollar, which affects our overall financial results given our net exposure to U.S. dollar cash inflow. Despite these challenges, we are very pleased with the strong progress we made throughout this past year and are very confident about our future as we look ahead to 2013 and beyond.

Sales

Although our customer order volumes continued to grow in 2012, building further on the very strong growth we achieved in 2011, our actual sales totaled $162.4 million, which was in fact slightly lower than 2011 for a couple of specific reasons.

Our sales volumes were down very slightly compared to 2011, less than 1%, despite our production volumes increasing over 3% relative to 2011 (which had already increased over 13% from 2010). Our sales volume did not match our growth in orders and production volume due to the timing of certain shipments scheduled for early 2013, however the underlying strength of our order book is evident in the continuing growth of our production volumes.

Lower average selling prices reduced our revenue by $2.6 million reflecting the ongoing keen price competition and mix of orders that had slightly lower prices associated with the underlying products. However, we are pleased that during 2012 some of our key proprietary, higher value-added products began to gain traction and generate additional orders, the benefit of which we saw in the later part of 2012 and expect to see throughout 2013.

We had a reduction in the sales of two of our ancillary product lines. Our Lottery Management Services (LMS) revenue declined due to the closure of our Puerto Rico lottery operation in 2011. Our Licensed Games product line, which involves the sale of branded tickets and related merchandise for prize payouts, was also lower in 2012, reflecting a challenging marketplace for these very specific themed tickets. The combined effect of the decrease in these two areas accounts for approximately $5.0 million, or just over half of our overall decline in sales. We anticipate much stronger sales from these areas in 2013, especially Licensed Games.

Our customer contract portfolio remains very strong. During this past year we were successful in renewing a number of important existing customer relationships with such key lotteries as Connecticut, Massachusetts, Texas, Poland and France, to name but a few. Included in a number of these renewals are opportunities for Pollard to expand our share of their instant ticket product supply in comparison to our previous volume levels.

Our charitable gaming product line generated approximately $1.0 million lower revenue in 2012 reflecting lower volumes in bingo paper and pull-tabs. These lower volumes reflect the challenging environment within the charitable gaming market, as we believe we have maintained a consistent level of market share.

Despite lower revenue, margins and operating earnings were still strong from this product line in 2012.

Operations

In our letter to you last year we described two key operational initiatives underway during 2011 to improve our financial results: increasing capacity to produce higher volumes and improving our cost structure. In 2011 we significantly increased our production capacity enabling us to produce much higher volumes. That trend continued in 2012 as we saw production levels exceed the record high levels attained in 2011.

However, the main driver of our improved profits in 2012 is undoubtedly the tremendous success we achieved in reducing our costs. Our overall cost structure improved considerably during 2012 in a number of key areas including decreased waste levels, higher labour efficiency, increased machine uptime, dramatically lower rework and improved per unit costs due to levering our higher production volumes.

The result of these cost improvements is clearly evident in our gross margin. Despite a lower revenue amount, our absolute gross margin in 2012 increased by over $2.7 million to $32.9 million and our gross margin percentage improved to 20.3% from 17.5%.

The key driver for these cost improvements has been our formal Change Initiative process, which is a structured management process of identifying key opportunities for improvement, targeting specific resources to address the critical areas, and being responsible and accountable for producing the desired results. In 2012 we achieved a number of important successes in our cost improvement strategy, however we are confident that significant further opportunities remain, and pursuing those will continue to be a key objective in 2013.

Outlook for 2013

The lottery industry continues to be very healthy and indications are that 2013 will see further growth. Traditional instant tickets and internet related services such as frequent player clubs, gaming apps and social media products all are expected to generate strong growth at the retail level and, as a result, increased opportunities for Pollard. The key to capitalizing on these opportunities is our commitment to innovation and we will invest the resources necessary to lever Pollard knowledge to generate additional sales and profits.

We expect our volumes to continue the improving trends experienced in 2012. New contracts and increased orders from existing customers are anticipated to result in even higher production volumes in 2013. In addition, sales levels will also benefit from the delivery of orders produced in 2012 but not shipped until 2013. Our proprietary products such as Scratch FX® and PlayBook® have achieved significant traction in the marketplace and we expect increased sales of these specialty products in 2013. Our Licensed Games product sales are expected to be higher during 2013 as a result of a number of key licensed sales related to the Star Trek™ and Cadillac® licenses, among others.

Our 2012 results reflected the cost improvements that had been put in place over the last few years as part of our Change Initiative process. We will continue to focus on improving our cost structures in all of the key areas mentioned previously to continue to reduce per unit costs. While price competition remains strong in our industry, we expect that these initiatives will offset any effect from selling price reduction and allow us to maintain and improve the higher gross margins achieved in 2012. Additional press capacity brought on at the beginning of 2013 will support increased sales going forward and assist us in maximizing our production efficiencies.

2012 was a very successful year for Pollard, generating better financial results and laying additional groundwork for future improvements. Our successes are a direct consequence of the actions and commitment of our key stakeholders: our employees are unmatched in their passion and work ethic; our suppliers are unrivalled in their loyalty and innovation; our customers are unequalled in their drive for excellence and quality; our Directors are without peers in their devotion and acumen and we thank our dedicated shareholders for their continued backing and encouragement. We thank you all and look forward to greater success in 2013.

Douglas Pollard
Co-Chief Executive Officer

John Pollard
Co-Chief Executive Officer

DIRECTORS OF POLLARD BANKNOTE LIMITED

Lawrence Pollard
Chair Emeritus

Lawrence Pollard joined Pollard Banknote in 1947 and served as president of the company from 1960 until 1997. Mr. Pollard has served on the Board of Directors of a number of public and private companies. Currently Mr. Pollard serves on the Board of Directors of Gendis Inc., a public company, and several non-profit organizations. He has served as president of the Winnipeg Chamber of Commerce and was named Manitoba's Entrepreneur of the Year in 1991.

Gordon Pollard
Executive Chair

Gordon Pollard joined Pollard Banknote in 1989 as Vice President, Marketing. He became Co-Chief Executive Officer in 1997 and on May 1, 2011, was appointed Executive Chair of the Board of Directors. Prior to 1989, he practiced law with a major Manitoba firm specializing in corporate and securities law. Mr. Pollard has an LL.B. from the University of Manitoba and a B.A. from the University of Winnipeg.

Del Crewson

Del Crewson is a former senior partner and Vice-Chair of Deloitte and Touche LLP. He is a member of the Institute of Chartered Accountants of Manitoba and has been elected a "Fellow" of the Institute. Mr. Crewson serves on the Board of Directors of The Wawanesa Mutual Insurance Company, the Board of Trustees of Artis Real Estate Investment Trust, and is a member and on the advisory Board of the Manitoba Chapter of the Institute of Corporate Directors. He is also the Chair of the Audit and Evaluation Committee for the Department of Finance, Government of Canada and Chair of the Audit Committee for the Canadian Grain Commission. He is the past President of the Institute of Chartered Accountants of Manitoba and is a former Canadian Institute of Chartered Accountants Board and Executive Committee member.

Jerry Gray

Jerry Gray is Dean Emeritus of the I. H. Asper School of Business at the University of Manitoba where he also held the CA Manitoba Endowed Chair in Business Leadership. Dr. Gray is a Director and Chairman of the Board of Gendis, Inc. He has consulted with many major corporations in the United States and Canada in the areas of motivation, organizational design, manpower planning, managing change, management development, incentive system design, customer service, and strategic planning.

Garry Leach

Garry Leach is the CEO of Belcher Island Smelting & Refining Corp. (an investment corporation). From 1988 to 2004, Mr. Leach was President and CEO of Gerdau MRM Steel (Manitoba Rolling Mills) and its predecessors. Mr. Leach serves on the Board of Directors of GLM Industries. Mr. Leach has previously served on the Board of Directors for Gerdau Ameristeel (TSX, NYSE), Manitoba Hydro, the Canadian Steel Producers Association, (Ottawa), the Steel Manufacturers Association, (Washington), as well as the Business Council of Manitoba. Mr. Leach also served as Regent for the University of Winnipeg.

Douglas Pollard

Douglas Pollard is Co-Chief Executive Officer of Pollard Banknote. He joined Pollard Banknote in 1997 as Vice President, Lottery Management Services and on May 1, 2011, he was appointed Co-Chief Executive Officer. From 1997 to 1999 he was a Director and the General Manager of Imprimerie Spéciale de Banque, a subsidiary of Pollard Banknote based in Paris, France. Prior to 1997 Mr. Pollard was a Senior Consultant with PricewaterhouseCoopers. Mr. Pollard has an M.B.A. from The Richard Ivey School of Business at the University of Western Ontario and a B.A. from the University of Manitoba.

John Pollard

John Pollard is Co-Chief Executive Officer of Pollard Banknote. He joined the company in 1986 as Vice President, Finance and became Co-Chief Executive Officer in 1997. Prior to 1986, he was an associate with the accounting firm Deloitte & Touche LLP. Mr. Pollard has a B. Comm. from the University of Manitoba, and is a former member of the Institute of Chartered Accountants of Manitoba.

POLLARD BANKNOTE LIMITED

December 31, 2012

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

FOR THE YEAR ENDED DECEMBER 31, 2012

March 6, 2013

This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the year ended December 31, 2012, is prepared as at March 6, 2013, and should be read in conjunction with the accompanying audited financial statements of Pollard and the notes therein as at December 31, 2012. Results are reported in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards ("GAAP" or "IFRS").

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 "Adjusted EBITDA" is to earnings before interest, income taxes, depreciation and 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 facility closing reserve, conversion expenses, warranty reserve accruals, settlement loss on pension curtailment and restructuring costs. Adjusted 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, Adjusted EBITDA is a useful supplementary measure.

Adjusted EBITDA is a measure not recognized under GAAP and does not have a standardized meaning prescribed by GAAP. Therefore, this measure may not be comparable to similar measures presented by other entities. Investors are cautioned that Adjusted EBITDA should not be construed as an alternative to Net Income determined in accordance with 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 consolidated results of Pollard for the year ended December 31, 2012. All figures are in millions except for per share amounts.

POLLARD BANKNOTE LIMITED

Overview

Pollard Banknote Limited ("Pollard") is one of the leading providers of products and services to the 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, internet support, interactive gaming, Social Instants™ 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 50 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

	Year ended December 31, 2012	Year ended December 31, 2011
Instant Tickets	89%	89%
Charitable Gaming Products	10%	10%
Vending Machines	1%	1%

Geographic breakdown of revenue

	Year ended December 31, 2012	Year ended December 31, 2011
United States	53%	53%
Canada	21%	26%
International	26%	21%

Kamloops Facility

On February 28, 2010, Pollard permanently closed its Kamloops production facility with all related production being transferred to its other facilities. A facility closing accrual of $4.7 million was expensed in the fourth quarter of 2009, representing the estimated closing costs including employee severance. As of December 31, 2011, Pollard had expended the entire facility closing reserve.

A settlement loss on pension curtailment of $0.7 million relating to the former Kamloops employees' pensions was recognized in 2011 due to a decrease in the discount rate utilized to determine the pension obligation between the time the closure was announced and the time the final pension obligations were determined.

Sale of Property

On June 23, 2011, Pollard sold its building and land in Winnipeg, Manitoba to an affiliate of Pollard Equities Limited ("Equities") for total proceeds of $3.5 million resulting in a gain of $1.5 million. The selling price was based on the current fair market value determined through an independent appraisal. Pollard subsequently leased the property back for a five year term (with an option to renew for an additional five year term) for annual rent of $0.3 million.

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 $2.0 million. The selling price was based on the current fair market value determined through an independent appraisal.

Restructuring expense

During the third quarter of Fiscal 2011, the Government of Puerto Rico determined our operations were no longer allowed under current legislation. As a result the operations commenced winding up. Included in other expenses for Fiscal 2011, are expenses of $0.5 million reflecting the write off of assets associated with the operations and the related severance.

A restructuring expense of $1.2 million was incurred in Fiscal 2010. The expense includes approximately $0.9 million of costs relating to the elimination of approximately 30 salaried positions in Canada and the United States. In addition, due to changes in the local rules regulating scratch off lottery tickets, our Puerto Rico Lottery operation was restructured to comply with the new rules. Costs incurred of $0.3 million include the write off of existing inventory and the overhead costs incurred during the transition to the new product line.

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 year ended December 31, 2012.

SELECTED FINANCIAL INFORMATION

(millions of dollars, except per share information)

	(1) Year ended December 31, 2012	(1) Year ended December 31, 2011	(1) Year ended December 31, 2010	(2) Year ended December 31, 2009
Sales	**$162.4**	$172.0	$163.4	$191.8
Cost of Sales	**129.5**	141.9	134.2	153.0
Gross Profit	**32.9**	30.1	29.2	38.8
Gross Profit as a % of sales	***20.3%***	*17.5%*	*17.9%*	*20.2%*
Administration Expenses (1)	**13.6**	13.8	14.4	-
Expenses as a % of sales	***8.4%***	*8.0%*	*8.8%*	-
Selling Expenses (1)	**6.1**	6.3	6.0	-
Expenses as a % of sales	***3.8%***	*3.7%*	*3.7%*	-
Selling and Administration Expenses (2)	-	-	-	21.3
Expenses as a % of sales	-	-	-	*11.1%*
Net Income	**6.7**	3.1	1.8	15.0
Net Income as a % of sales	***4.1%***	*1.8%*	*1.1%*	*7.8%*
Adjusted EBITDA	**20.1**	22.6	18.2	21.3
Adjusted EBITDA as a % of sales	***12.4%***	*13.1%*	*11.1%*	*11.1%*
Adjusted EBITDA excluding gain on sale of property, plant and equipment and realized foreign exchange (loss) gain	**20.4**	17.9	17.3	24.1
As a % of sales	***12.6%***	*10.4%*	*10.6%*	*12.6%*
Earnings Per Share	**$0.28**	$0.13	$0.08	$0.64

	(1) December 31, 2012	(1) December 31, 2011	(1) December 31, 2010	(2) December 31, 2009
Total Assets	**$127.0**	$121.6	$126.3	$154.3
Total Long-Term Liabilities	**$83.4**	$77.2	$74.8	$78.1

(1) Amounts are based on International Financial Reporting Standards

(2) Amounts are based on previous Canadian GAAP

RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA

(millions of dollars)

	(1)	(1)	(1)	(2)
	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009
Net Income	**$6.7**	$3.1	$1.8	$15.0
Adjustments:				
Amortization and depreciation	**7.8**	8.4	8.6	8.9
Interest	**3.4**	4.4	5.2	4.4
Unrealized foreign exchange (gain) loss	**(0.1)**	3.8	(1.2)	(3.6)
Mark-to-market gain on foreign currency contracts and interest rate swaps	**-**	-	(2.1)	(10.4)
Amortization of de-designated hedges	**-**	-	1.2	0.6
Conversion costs	**-**	-	0.7	-
Warranty reserve	**-**	-	0.9	-
Settlement loss on pension curtailment	**-**	0.7	-	-
Restructuring expense	**-**	0.5	1.2	-
Facility closing	**-**	-	-	4.7
Income taxes	**2.3**	1.7	1.9	1.7
Adjusted EBITDA	**$20.1**	$22.6	$18.2	$21.3
Gain on sale of property, plant and equipment	**-**	1.5	2.0	1.7
Realized foreign exchange (loss) gain	**(0.3)**	3.2	(1.1)	(4.5)
Adjusted EBITDA excluding gain on sale of property, plant and equipment and realized foreign exchange (loss) gain	**$20.4**	$17.9	$17.3	$24.1

(1) Amounts are based on International Financial Reporting Standards

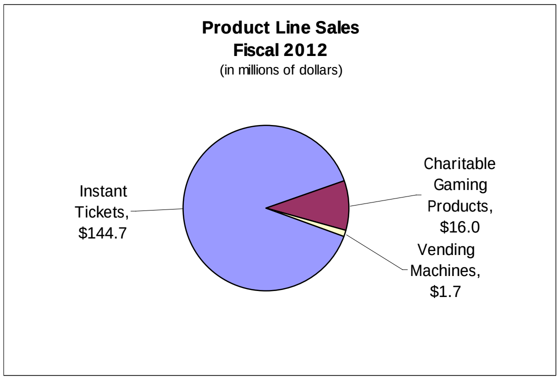
(2) Amounts are based on previous Canadian GAAP

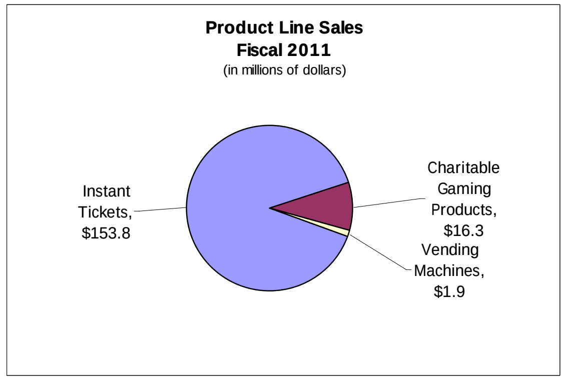
REVIEW OF OPERATIONS

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 YEAR ENDED DECEMBER 31, 2012

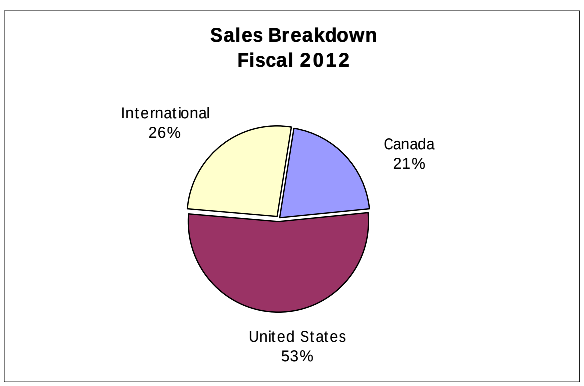
Sales

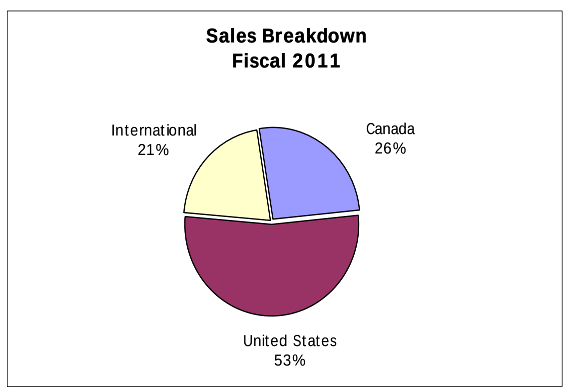




During the year ended December 31, 2012 ("Fiscal 2012" or "2012"), Pollard achieved sales of $162.4 million, compared to $172.0 million in the year ended December 31, 2011 ("Fiscal 2011" or "2011"). Factors impacting the $9.6 million sales decrease were:

Instant ticket sales volumes for Fiscal 2012 were slightly lower than Fiscal 2011 by 0.8% which decreased sales by $1.1 million. A reduction in our ancillary instant ticket products and services, primarily licensed games and lottery management services, decreased sales by $5.0 million. In addition, a decrease in average selling price compared to 2011 reduced sales by $2.6 million. Charitable Gaming average selling prices increased slightly compared to 2011, increasing sales by $0.2 million and a volume decrease reduced sales by $0.7 million. A decrease in the volume of machine sales decreased sales $0.2 million when compared to 2011.





During Fiscal 2012, Pollard generated approximately 66.9% (2011 – 65.5%) of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During Fiscal 2012 the actual U.S. dollar value was converted to Canadian dollars at $1.003 compared to a rate of $0.995 during Fiscal 2011. This 0.8% increase in the U.S. dollar value resulted in an approximate increase of $0.9 million in revenue relative to Fiscal 2011. Also during Fiscal 2012, the Canadian dollar strengthened against the Euro resulting in an approximate decrease of $1.1 million relative to Fiscal 2011.

Cost of sales and gross profit

Cost of sales was $129.5 million in Fiscal 2012 compared to $141.9 million in Fiscal 2011. Cost of sales was lower in Fiscal 2012 relative to Fiscal 2011 as a result of the cost savings generated by our Change Initiative process, including improved manufacturing yields and labour efficiencies, and a reduction in sales of ancillary instant ticket products. These reductions were partially offset by higher exchange rates on U.S. dollar transactions in 2012 which increased cost of sales approximately $0.5 million. Instant ticket production volumes in 2012 exceeded Fiscal 2011 by approximately 4%.

Gross profit was $32.9 million (20.3% of sales) in Fiscal 2012 compared to $30.1 million (17.5% of sales) in Fiscal 2011. This increase is due mainly to the cost savings generated by our Change Initiative process, partially offset by reduced ancillary instant ticket volume and lower average selling prices.

Administration expenses

Administration expenses of $13.6 million in Fiscal 2012 were similar to $13.8 million in Fiscal 2011.

Selling expenses

Selling expenses of $6.1 million in Fiscal 2012 were similar to $6.3 million in Fiscal 2011.

Other (income) expense

Other income was nil in Fiscal 2012 compared to income of $0.4 million in Fiscal 2011.

Within Fiscal 2011 other income was a $1.5 million gain on sale of property, plant and equipment, partially offset by restructuring expenses of $0.5 million and $0.7 million related to the settlement loss on pension curtailment.

Finance costs and income

Under IFRS, included in the income statement classification “finance costs” are interest, amortization of deferred financing costs and foreign exchange losses. Included in the income statement classification “finance income” are foreign exchange gains.

Interest expense

Interest expense decreased to $3.4 million in Fiscal 2012 from $4.4 million in Fiscal 2011 due primarily to the elimination of higher interest rates relating to certain interest rate swaps which expired on August 31, 2011, and the reduced average amount of long-term debt over the year compared to Fiscal 2011.

Foreign exchange loss

The net foreign exchange loss was $0.2 million in Fiscal 2012 compared to a net loss of $0.6 million in Fiscal 2011. Within the 2012 net foreign exchange loss are realized foreign exchange losses of $0.3 million comprised of $0.5 million realized loss on the decreased value of U.S. dollar denominated receivables and the conversion of U.S. dollars and Euros into Canadian dollars, partially offset by $0.2 million of realized gain relating to payments made on U.S. dollar denominated debt. Partially offsetting the realized foreign exchange losses are unrealized foreign exchange gains of $0.1 million comprised of an unrealized foreign exchange gain of $0.4 million on U.S. dollar denominated debt, partially offset by $0.3 million unrealized foreign exchange loss on U.S. denominated cash.

Within the 2011 foreign exchange loss are unrealized losses of $3.8 million relating to the unrealized foreign exchange loss on U.S. dollar denominated debt (caused by the reversal of previously recorded unrealized foreign exchange gains from the strengthening of the Canadian dollar which were realized upon repayment and the weakening of the value of the Canadian dollar versus the U.S. dollar at December 31, 2011, as compared to December 31, 2010). Partially offsetting this is a realized gain of $3.2 million, consisting of a $3.7 million realized gain relating to payments made on U.S. dollar denominated debt, offset by realized losses of $0.5 million on the decreased value of U.S. dollar denominated receivables and the conversion of U.S. dollars and Euros into Canadian dollars.

Adjusted EBITDA

Adjusted EBITDA was $20.1 million in Fiscal 2012 compared to $22.6 million in Fiscal 2011. The primary reasons for the decrease in Adjusted EBITDA were the absence of a gain on sale of property, plant and equipment of $1.5 million and lower realized foreign exchange gains (primarily related to the repayment of U.S. dollar denominated debt in 2011) of $3.5 million, partially offset by an increase in gross margin (net of amortization and depreciation) of $2.2 million.

Adjusted EBITDA excluding the gain on sale of property plant and equipment and realized foreign exchange gains and losses was $20.4 million in Fiscal 2012 compared to $17.9 million in Fiscal 2011.

Income taxes

Income tax expense was $2.3 million in Fiscal 2012, an effective rate of 26.0%, consistent with the expected domestic tax rate.

Income tax expense was $1.7 million in Fiscal 2011, an effective rate of 34.7%, as a result of permanent differences relating to the translation of the company's U.S. subsidiaries and differences relating to the foreign exchange impact of Canadian dollar dominated debt in the U.S. subsidiaries.

Amortization and depreciation

Amortization and depreciation, including depreciation of property and equipment and the amortization of deferred financing costs and intangible assets, totaled $7.8 million during Fiscal 2012 which decreased from $8.4 million during Fiscal 2011 due to certain intangible assets becoming fully amortized in Fiscal 2011.

Net Income

Net Income was $6.7 million in Fiscal 2012 compared to Net Income of $3.1 million in Fiscal 2011. The primary reasons for the increase were an increase in gross profit of $2.8 million, a combined decrease in selling and administrative expenses of $0.4 million, a decrease in interest expense of $1.0 million, a reduction in other expense of $1.1 million (as a result of an absence of $0.5 million restructuring expense and $0.7 million loss on pension curtailment) and a decrease in foreign exchange loss of $0.4 million. These increases in Net Income were partially offset by the absence of the $1.5 million gain on sale of property, plant and equipment and increased income taxes of $0.6 million.

Earnings per share increased to $0.28 per share in Fiscal 2012 from $0.13 in Fiscal 2011.

Liquidity and Capital Resources

Cash provided by operating activities

For the year ended December 31, 2012, cash flow provided by operating activities was $9.5 million compared to $11.6 million in Fiscal 2011. Changes in the non-cash component of working capital decreased cash flow from operations by $5.1 million for Fiscal 2012 (due primarily to increases in accounts receivable and inventory, partially offset by an increase in accounts payable and accrued liabilities), compared to a decrease of $1.7 million for Fiscal 2011 (due primarily to an increase in accounts receivable, a decrease in accounts payable and accrued liabilities and a decrease in provisions, partially offset by a decrease in inventory). Cash used for interest payments in Fiscal 2012 decreased to $3.4 million from $4.6 million in Fiscal 2011, which was partially offset by increase in cash used regarding the pension liability which increased to $1.6 million in Fiscal 2012 from $1.0 million in Fiscal 2011.

Cash used by investing activities

In the year ended December 31, 2012, cash used in investing activities was $7.8 million compared to cash provided by investing activities of $0.2 million provided in the year ended December 31, 2011. In Fiscal 2012 Pollard's capital expenditures were $6.5 million. As well, Pollard also expended $0.4 million on its investment in associate and $0.9 million on additions to intangible assets.

In Fiscal 2011, Pollard received proceeds from the sale of property, plant and equipment of $3.5 million, which were partially offset by $3.0 million in capital expenditures and $0.3 million on additions to intangible assets.

Cash used by financing activities

Cash used by financing activities was $1.4 million in the year ended December 31, 2012, compared to cash used by financing activities of $12.1 million in the year ended December 31, 2011. During Fiscal 2012 cash used by financing activities was comprised of $2.8 million in dividends paid and $0.2 million in increased deferred financing costs, which were partially offset by proceeds from long-term debt $1.6 million. Proceeds from long-term debt were used to finance increased investment in working capital and capital additions.

In Fiscal 2011, cash used by financing activities was comprised of repayments of long-term debt of $9.0 million and dividends paid of $2.8 million.

As at December 31, 2012, Pollard had unused committed credit facility of $10.9 million. This amount is available to be used for future working capital requirements, contractual obligations, capital expenditures and dividends.

ANALYSIS OF RESULTS FOR THE PERIOD OCTOBER 1, 2012 TO DECEMBER 31, 2012
FOURTH QUARTER OF 2012

SELECTED FINANCIAL INFORMATION

(millions of dollars)

	Three months ended December 31, 2012	Three months ended December 31, 2011
	(unaudited)	(unaudited)
Sales	$40.9	$44.6
Cost of Sales	32.3	35.8
Gross Profit	8.6	8.8
Administration	3.5	3.7
Selling	1.6	1.7
Other expense	0.1	0.8
Income from operations	3.4	2.6
Finance costs	1.3	1.1
Income before income taxes	2.1	1.5
Income taxes:		
Current (recovery)	0.1	(0.1)
Future (reduction)	0.5	(0.1)
	0.6	(0.2)
Net Income	$1.5	$1.7
Adjustments:		
Amortization and depreciation	2.2	2.0
Interest	0.9	1.0
Unrealized foreign exchange loss	0.4	-
Settlement loss on pension curtailment	-	0.7
Income taxes (recovery)	0.6	(0.2)
Adjusted EBITDA	$5.6	$5.2

Sales

During the three months ended December 31, 2012, Pollard achieved sales of $40.9 million, compared to $44.6 million in the three months ended December 31, 2011. Factors impacting the $3.7 million sales decrease were:

Instant ticket sales volumes for the fourth quarter of 2012 were lower than the fourth quarter of 2011 by 2.8%, which combined with a decrease in our ancillary instant ticket products and services, primarily licensed games and lottery management services, decreased sales by $1.7 million. Instant ticket sales volumes were lower due to the timing of certain shipments produced in the fourth quarter scheduled for delivery in 2013. In addition, a slight decrease in average selling price of instant tickets compared to 2011 decreased sales by $1.1 million. Charitable Gaming average selling prices for the quarter increased sales compared to 2011 by $0.3 million.

During the three months ended December 31, 2012, Pollard generated approximately 65.0% (2011 – 61.7%) of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the fourth quarter of 2012 the actual U.S. dollar value was converted to Canadian dollars at $0.997, compared to the rate of $1.029 during the fourth quarter of 2011. This 3.2% decrease in the value of the U.S. dollar value resulted in an approximate decrease of $0.9 million in revenue relative to 2011. Also during the quarter, the value of the Canadian dollar strengthened against the Euro resulting in an approximate decrease of $0.3 million in revenue relative to the fourth quarter of 2011.

Cost of sales and gross profit

Cost of sales was $32.3 million in the fourth quarter of 2012 compared to $35.8 million in the fourth quarter of 2011. Cost of sales was lower in the quarter relative to 2011 as a result of the cost savings generated by our Change Initiative process, including improved manufacturing yields and labour efficiencies, a reduction in sales of ancillary instant ticket products and lower exchange rates on U.S. dollar transactions. Production volumes in the fourth quarter of 2012 exceeded those in the comparable quarter of 2011 by approximately 3%.

Gross profit was $8.6 million (21.0% of sales) in the fourth quarter of 2012 compared to $8.8 million (19.7% of sales) in the fourth quarter of 2011. This decrease in absolute gross profit is due mainly to lower sales of ancillary instant ticket products and services and lower average selling price for instant tickets, largely offset by cost savings.

Administration expenses

Administration expenses were $3.5 million in the fourth quarter of 2012 which decreased compared to $3.7 million in the fourth quarter of 2011 as a result of reduced professional expenses.

Selling expenses

Selling expenses were $1.6 million in the fourth quarter of 2012 which decreased compared to $1.7 million in the fourth quarter of 2011 as a result of reduced salary expenses.

Finance costs and income

Under IFRS, included in the income statement classification "finance costs" are interest, amortization of deferred financing costs and foreign exchange losses. Included in the income statement classification "finance income" are foreign exchange gains.

Interest expense

Interest expense decreased to $0.9 million in the fourth quarter of 2012 from $1.0 million in the fourth quarter of 2011 due primarily to lower interest rates in the fourth quarter of 2012 compared to the fourth quarter of 2011.

Foreign exchange loss

The net foreign exchange loss was $0.3 million in the fourth quarter of 2012 compared to nil in the fourth quarter of 2011. Within the 2012 fourth quarter net foreign exchange loss was an unrealized foreign exchange loss of $0.4 million consisting of $0.2 million relating to unrealized foreign exchange loss on U.S. dollar denominated debt and $0.2 million relating to the unrealized loss on U.S. dollar denominated receivables. Partially offsetting the unrealized foreign exchange loss was $0.1 million realized foreign exchange gain on the increased value of Euro denominated receivables.

Adjusted EBITDA

Adjusted EBITDA was $5.6 million in the fourth quarter of 2012 compared to $5.2 million in the fourth quarter of 2011. The primary reasons for the increase in Adjusted EBITDA were the reduction in selling and administrative expenses of $0.3 million.

Income taxes

Income tax expense was $0.6 million in the fourth quarter of 2012, an effective rate of 28.6%, similar to the expected domestic tax rate.

Income tax recovery was ($0.2) million in the fourth quarter of 2011, an effective rate of (13.3%), as a result of permanent differences relating to the translation of the company's U.S. subsidiaries and differences relating to the foreign exchange impact of Canadian dollar dominated debt in the U.S. subsidiaries.

Amortization and depreciation

Amortization and depreciation, including depreciation of property and equipment and the amortization of deferred financing costs and intangible assets, totaled $2.2 million during the fourth quarter of 2012 which increased from $2.0 million during the fourth quarter of 2011 due to greater additions of property, plant and equipment in Fiscal 2012.

Net Income

Net Income was $1.5 million in the fourth quarter of 2012 compared to $1.7 million in the fourth quarter of 2011. The primary reasons for the decrease were an increase in foreign exchange loss and an increase in income taxes. These decreases to Net Income were partially offset by reduction in selling and administration expenses and a decrease in other expense (decrease in the pension settlement costs incurred in Fiscal 2011 of $0.7 million).

Earnings per share decreased to $0.06 per share in the fourth quarter of 2012 from $0.07 in the fourth quarter of 2011.

Quarterly Information
(unaudited)
(millions of dollars)

	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011
Sales	$40.9	$44.1	$40.8	$36.6	$44.6	$43.8	$44.4	$39.2
Adjusted EBITDA	5.6	5.9	5.3	3.4	5.2	5.9	7.6	3.9
Net Income (Loss)	1.5	3.3	1.0	0.9	1.7	(1.2)	1.7	0.9

Sales in Q3 2012 were higher primarily due to increases in volumes.

Adjusted EBITDA and Net Income in Q3 2012 were higher primarily due to higher gross profit achieved through higher sales volumes while obtaining cost efficiencies in cost of goods sold.

Sales in Q1 and Q2 2012 were lower primarily due to decreases in volumes and in average selling prices.

Sales in the final three quarters of 2011 were higher do to an increase in instant ticket volumes, offset partially by the strengthening of the Canadian dollar relative to the U.S. dollar.

Q2 2011 Adjusted EBITDA and Net Income include a gain on sale of property, plant and equipment of $1.5 million and a realized foreign exchange gain of $2.3 million on the repayment of U.S. dollar dominated debt.

Sales in Q1 2011 were lower primarily due to the strengthening of the Canadian dollar relative to the U.S. dollar and a decrease in average selling prices.

Productive Capacity

Management has defined productive capacity as the level of operations necessary to maintain a minimum Adjusted EBITDA of $20.0 million and 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 Adjusted EBITDA and cash flow. A number of factors impact the level of Adjusted EBITDA including physical plant capacity, machine capacity, nature of product and service offerings produced and mix of customers. Recent changes to productive capacity 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 Pollard's initial public offering ("IPO") in August 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 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 at Pollard's IPO.

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 operating income and cash flow. 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 Adjusted 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 finished goods 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, although production volumes are historically slightly lower in the first quarter relative to the rest of the year.

Non-cash working capital increased during 2012 due to higher accounts receivable and inventories, as a result of increased production volumes in the fourth quarter.

	December 31, 2012	December 31, 2011
Working Capital	$27.2	$23.2
Total Assets	$127.0	$121.6
Total Long-Term Liabilities	$83.4	$77.2

Credit Facility

Pollard’s credit facility, which was renewed effective June 29, 2012, 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 US$15.3 million for its U.S. subsidiaries. Borrowings under the credit facility bear interest at fixed and floating rates based on Canadian and U.S. prime bank rates, banker’s acceptances or LIBOR. At December 31, 2012, the outstanding letters of guarantee were $3.2 million and the remaining balance available for drawdown was $10.9 million.

Under the terms and conditions of the credit facility agreement Pollard is required to maintain financial covenants including working capital ratios, debt to income before interest, income taxes, depreciation and amortization (“Adjusted EBITDA”) ratios and certain debt service coverage ratios. As at December 31, 2012, and March 6, 2013, Pollard is in compliance with all covenants.

Under the credit facility, Pollard has agreed not to pay dividends in excess of the current quarterly amount of $0.03 per share if the debt to Adjusted EBITDA ratio is above a certain level. As at December 31, 2012, Pollard’s Adjusted EBITDA ratio is above the target level and as a result is restricted on the amount of dividends it can pay.

Under the credit facility the amount of the facility will be reduced on a quarterly basis by an amount calculated as 50% of the prior quarter's Excess Cash Flow. Excess Cash Flow is defined as Adjusted EBITDA less interest and cash income taxes paid. For the quarters ending June 30, 2012, to and including December 31, 2012, Excess Cash Flow can be reduced up to an aggregate of $2,000 of actual costs related to a specific capital expenditure. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. For the quarter ending December 31, 2012, the credit facility will be reduced by approximately $2.4 million as of May 15, 2013.

Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard's operating subsidiaries. The credit facility can be prepaid without penalties. Under the terms of the agreement, the credit facility is committed for a one year period, renewable June 30, 2013 ("Facility Expiry Date"). If the credit facility is not renewed, the loans are repayable one year after the Facility Expiry Date. As such, the credit facility has effectively a two year term expiring June 30, 2014.

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 December 31, 2012 and March 6, 2013, outstanding share data was as follows:

Common shares	23,543,158

Contractual Obligations

Pollard's subsidiaries rent premises and equipment under long-term operating leases. The following is a schedule by year of commitments and contractual obligations outstanding:

(millions of dollars)	Total	<1 Year	1-3 Years	4-5 Years	Thereafter
Long-term debt	$70.5	-	$70.5	-	-
Other long-term liabilities	$0.2	-	$0.2	-	-
Pension liability	$9.9	-	-	-	$9.9
Interest on long-term debt	$4.4	$3.0	$1.4	-	-
Operating leases	$23.2	$3.3	$6.2	$5.6	$8.1
Total	$108.2	$6.3	$78.3	$5.6	$18.0

Pension Obligations

Pollard sponsors four non-contributory defined benefit pension plans, of which three are final pay plans and one is a flat benefit plan. As of December 31, 2012, the aggregate fair value of the assets of Pollard's defined benefit pension plans was $24.2 million and the accrued benefit plan obligations were $34.1 million. Pollard's total annual funding contribution for all pension plans in 2013 is expected to be approximately $3.6 million, compared to $3.2 million in 2012, so long as long-term expectations of fund performance for the defined benefit plans are met.

Off-Balance Sheet Arrangements

Other than the operating leases described previously, Pollard has no other off-balance sheet arrangements.

Related Party Transactions

During the year, Pollard Equities Limited paid Pollard $0.07 million (2011 – $0.07 million) for accounting and administration fees.

During the year ended December 31, 2012, Pollard paid property rent of $3.0 million (2011 - $2.8 million) and $0.2 million (2011 – $0.2 million) in plane charter costs to affiliates of Equities.

During Fiscal 2011, Pollard sold a building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of $3.5 million resulting in a gain of $1.5 million. The selling price was based on the current fair market value as determined through an independent appraisal. Pollard subsequently leased the property back for a five year term (with an option to renew for an additional five year term) for an annual rent of $0.3 million. During Fiscal 2010, Pollard sold the building and land formally used in the Kamloops operation to an affiliate of Equities for total proceeds of $2.9 million resulting in a gain of $2.0 million. The selling price was based on the current fair market value determined through an independent appraisal.

Pollard has leased a building in Council Bluffs, Iowa from an affiliate of Equities for a ten year term, ending December 31, 2018, with annual lease payments of US$0.3 million.

A manufacturing facility in Winnipeg, Manitoba is leased from an affiliate of Equities for a 12 year 6 month period, ending March 31, 2021, at an annual base rate of approximately $2.4 million.

At December 31, 2012, Pollard owes Equities and its affiliates $1.4 million (2011 - $1.2 million) for rent and other expenses.

Critical Accounting Policies and Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting period. Management of Pollard regularly reviews its estimates and assumptions based on historical experience and various other assumptions that it believes would result in reasonable estimates given the circumstances. Actual results could differ from those estimates under different assumptions. The following is a discussion of accounting policies which require significant management judgment and estimation.

Impairment of goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired of Pollard's U.S. subsidiaries and the excess purchase price over the underlying carrying amount of the portion of the net assets sold as at August 5, 2005, as part of the 26.7% of Pollard sold in conjunction with the IPO, and is not amortized. Goodwill is subject to an annual impairment review. This requires an estimation of the "value in use" or "fair value less costs to sell" of the cash-generating units ("CGUs") to which goodwill is allocated. Estimating a value in use requires Pollard to make an estimate of the expected future cash flows from the CGUs and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

Employee future benefits

Accounting for defined benefit plans requires Pollard to use actuarial assumptions. These assumptions include the discount rate, expected rate of return on plan assets and the rate of compensation increases. These assumptions depend on underlying factors such as economic conditions, government regulations, investment performance, employee demographics and mortality rates.

Income taxes

Pollard is required to evaluate the recoverability of deferred income tax assets. This requires an estimate of Pollard's ability to utilize the underlying future income tax deductions against future taxable income before they expire. In order to evaluate the recoverability of these deferred income tax assets, Pollard must estimate future taxable income.

Future Changes in Accounting Policies

In November 2009, the International Accounting Standards Board ("IASB") issued IFRS 9 *Financial Instruments* ("IFRS 9 (2009)") and in October 2010, the IASB published amendments to IFRS 9 ("IFRS 9 (2010)"). In December 2011, the IASB issued an amendment to IFRS 9 to defer the mandatory effective date to annual periods beginning on or after January 1, 2015. IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classifications options in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In May 2011, the IASB issued the following group of new standards and amendments to existing standards relating to consolidations and joint ventures. Each of these new standards is effective for fiscal years beginning on or after January 1, 2013. In June 2012, the IASB issued *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interest in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)*, which is effective with the adoption of the applicable standard to which the amendments relate. In October 2012, the IASB published *Investment Entities (Amendments to IFRS 10, IFRS 11 and IFRS 12)*, providing an exception to the consolidation requirements in IFRS 10. The amendments apply to fiscal years beginning on or after January 1, 2014. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

- IFRS 10 *Consolidated Financial Statements* replaces the guidance on control and consolidation in IAS 27 *Consolidated and Separate Financial Statements* and Standing Interpretations Committee ("SIC") 12 *Consolidation – Special Purpose Entities*. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control.

- IFRS 11 *Joint Arrangements* replaces IAS 31 *Interests in Joint Ventures*. IFRS 11 reduces the types of joint arrangements to two: joint ventures and joint operations. IFRS 11 requires the use of equity accounting for interests in joint ventures, eliminating the existing policy choice of proportionate consolidation for jointly controlled entities under IAS 31. Entities that participate in joint operations will recognize their share of the assets, liabilities, revenue and expenses of the joint operation.

- IFRS 12 *Disclosure of Interests in Other Entities* replaces the disclosure requirements currently found in IAS 28 *Investments in Associates*.

- IAS 27 has been amended and renamed *Separate Financial Statements* and deals solely with separate financial statements and the guidance for which remains unchanged.

- IAS 28 has been amended to include joint ventures in its scope and to address changes in IFRS 10 through 12 as explained above.

In May 2011, the IASB published IFRS 13 *Fair Value Measurements* which replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance, with enhanced disclosure requirements for information about fair value measurements. IFRS 13 is required for fiscal years beginning on or after January 1, 2013. Prospective application is required. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

In June 2011, the IASB published an amended version of IAS 19 *Employee Benefits*. The amendments require actuarial gains and losses to be recognized immediately in other comprehensive income and past service cost must be recognized immediately in profit or loss. This amendment also requires that the expected return on plan assets recognized in profit or loss be calculated based on the rate used to discount the defined benefit obligation. Additional disclosures are also required. IAS 19 is required for fiscal years beginning on or after January 1, 2013. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In June 2011, the IASB published amendments to IAS 1 *Financial Statement Presentation*. The amendments require items presented in other comprehensive income to be separated into two groups, based on whether or not they may be recycled to the statement of income later. The amendments are effective for fiscal years beginning on or after July 1, 2012. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

In December 2011, the IASB published amendments to IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Offsetting Financial Assets and Liabilities*. These amendments are to be applied retrospectively. The amendments to IAS 32 provide clarification on the application of rules to offset financial assets and liabilities. These amendments are effective for fiscal years beginning on or after January 1, 2014. The amendments to IFRS 7 contain new disclosure requirements for financial assets and liabilities that are offset. These amendments are effective for fiscal years beginning on or after January 1, 2013. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

In May 2012, the IASB published *Annual Improvements to IFRSs – 2009-2011 Cycle* as part of its annual improvements process to make non-urgent but necessary amendments to IFRS. These amendments are effective for fiscal years beginning on or after January 1, 2013 with retrospective application. Pollard is currently assessing the impact of the amendments on its consolidated financial statements.

Industry Risks and Uncertainties

Pollard is exposed to a variety of business and industry risks. A summary of the major risks faced by Pollard is noted below.

Dependence on Key Products

Instant lottery tickets and related services accounted for approximately 89% of Pollard's Fiscal 2012 revenues. Pollard's financial results and condition are substantially dependent on the continued success and growth in sales of this product and the profitability of such sales. Competitive efforts by other manufacturers of similar or substitute products, shifts in consumer preferences or the introduction and acceptance of alternative product offerings could have a material adverse effect on Pollard's business, financial condition, liquidity and results of operations.

Economic Uncertainty

Considerable economic uncertainty and concern over possible recessions and economic downturns have dominated the news in the past few years. Instant lottery tickets account for approximately 89% of revenue and Pollard's financial results and condition are substantially dependent on the continued success and growth in sales of this product and the profitability of such sales. Historically the lottery industry, and particularly the instant ticket product lines, has not shown any significant negative impact during downturns in the economic cycles. At the present time Pollard foresees minimal impact on its operations or product demand due to the current uncertainty and volatility in the economic landscape. However, lotteries, similar to many government agencies, are increasingly under pressure to reduce costs and expenditures. As such, Pollard has witnessed downward pressure on its selling prices. Continued pressure on lotteries to reduce their costs may further negatively impact Pollard's selling prices. Significant shifts in consumer preferences or the introduction and acceptance of alternative product offerings could have a material adverse effect on Pollard's business, financial condition, liquidity and results of operations.

Inability to Sustain Sales or EBITDA Margins

Pollard's income depends upon its ability to generate sales to customers and to sustain its EBITDA margins. These margins are dependent upon Pollard's ability to continue to profitably sell lottery tickets and gaming products and to continue to provide products and services that make it the supplier of choice to its customers. If Pollard's costs of sales or operating costs increase, or other manufacturers of gaming products could compete more favourably with it, Pollard may not be able to sustain its level of sales or EBITDA margins.

Dependence on Major Customers

Pollard's 10 largest customers accounted for approximately 54% of its revenue during Fiscal 2012. Pollard's largest customer accounted for approximately 10% of Pollard's revenues during Fiscal 2012.

The nature of the worldwide lottery industry limits the absolute number of lottery operations. As is customary in the industry, Pollard does have long-term contracts with most of its customers. However, most allow the customer to cancel the contract at will and none guarantee volumes or order levels. A significant reduction of purchases by any of Pollard's largest customers could have a material adverse effect on Pollard's business, financial condition, liquidity and results of operations including the amount of cash available for dividends to shareholders.

Exchange Rate Fluctuation

A significant portion of Pollard's revenues and expenses, principally related to its U.S. operations and to the purchase of raw materials, are denominated in U.S. dollars. Furthermore, although certain raw materials may be purchased in Canadian dollars, they may have inputs that are denominated in foreign currencies. Any changes in the exchange rate between the Canadian dollar and these foreign currencies could have a material effect on the results of Pollard.

For the purposes of financial reporting, any change in the value of the Canadian dollar against the U.S. dollar during a given financial reporting period would result in a foreign exchange loss or gain on the translation of any U.S. dollar monetary assets and liabilities. Further, Pollard's reported earnings could fluctuate materially as a result of revenues and expenses denominated in U.S. dollars under Canadian GAAP. There can be no assurance that changes in the currency exchange rate will not have a material adverse effect on Pollard or on its ability to maintain a consistent level of dividends in Canadian dollars.

Additional Capital Requirements

Pollard believes that its future operating income will be sufficient to fund operations and planned capital expenditures. However, Pollard may be required to raise additional capital in the future if it decides to make additional acquisitions or significant additional capital expenditures.

The availability of future borrowings and access to capital markets for longer-term future financing depends on prevailing conditions and the acceptability of financing terms offered. There can be no assurances that future borrowings or equity financing will be available or available on acceptable terms.

Competition

The instant ticket and charitable gaming business is highly competitive, and Pollard faces competition from a number of domestic and foreign instant ticket manufacturers and other competitors. Pollard currently has two instant ticket competitors in North America: Scientific Games Corporation and Gtech Printing Corporation. Charitable gaming competitors include a number of manufacturers such as Arrow International, Inc., International Gamco, Inc. and Universal Manufacturing, Inc. Internationally, there are a number of lottery instant ticket vendors which compete with Pollard including Scientific Games, Gtech, and the Eagle Press Group of Companies.

Some of Pollard's competitors have longer operating histories, greater name recognition, larger customer bases and greater financial, technical and marketing resources than Pollard. These resources may allow them to respond more quickly than Pollard can to new or emerging technologies and to changes in customer requirements. It may also allow them to devote greater resources than Pollard can to the development, promotion and sale of their products. Pollard's competitors may also engage in more extensive research and development, undertake more far-reaching marketing campaigns and adopt more aggressive pricing policies. The market for Pollard's products is highly competitive at both the lottery and charitable gaming levels. Pollard expects competition to continue to be intense because of capacity in its markets. Pollard also faces competition from emerging and existing lottery and charitable gaming products, such as internet gaming products and video lottery terminals. Competition from these and other gaming products may weaken demand for Pollard's products.

Licensing and Regulatory Requirements

Pollard is subject to regulation in most jurisdictions in which its products are sold or used by persons or entities licensed to conduct gaming activities. The gaming regulatory requirements vary from jurisdiction to jurisdiction and licensing, other approval or finding of suitability processes with respect to Pollard, its personnel and its products, can be lengthy and expensive. Many jurisdictions have comprehensive licensing, reporting and operating requirements with respect to the sale and manufacture of bingo and bingo related products, including bingo paper and pull-tab tickets. These licensing requirements have a direct impact on the conduct of the day-to-day operations of Pollard. Generally, gaming regulatory authorities may deny applications for licenses, other approvals or findings of suitability for any cause they may deem reasonable. There can be no assurance that Pollard, its products or its personnel will receive or be able to maintain any necessary gaming licenses, other approvals or findings of suitability. The loss of a license in a particular jurisdiction will prohibit Pollard from selling products in that jurisdiction and may prohibit Pollard from selling its products in other jurisdictions. The loss of one or more licenses held by Pollard could have an adverse effect on the business.

Certain jurisdictions require extensive personal and financial disclosure and background checks from persons and entities beneficially owning a specific percentage (typically five percent or more) of a vendor's securities. The failure of beneficial owners of Pollard's securities to submit to background checks and provide such disclosure could result in the imposition of penalties upon these beneficial owners and could jeopardize the award of a lottery contract to Pollard or provide grounds for termination of an existing lottery contract.

Income and Other Taxes

Pollard and its incorporated subsidiaries are subject to Canadian federal and provincial, and U.S. federal, state and withholding taxes. As taxing regimes change their tax basis and rates or initiate reviews of prior tax returns, Pollard could be exposed to increased costs of taxation, which would reduce the amount of funds available for operations.

Intellectual Property

Pollard's commercial success depends, in part, on its ability to secure and protect intellectual property rights that are important to its business, including patent, trademark, copyright and trade secret rights, to operate without infringing third party intellectual property rights and to avoid having third parties circumvent the intellectual property rights that Pollard owns or licenses. In particular, the patents and trademarks Pollard owns or licenses may not be valid or enforceable. In addition, Pollard cannot be certain that its proprietary technology affords a competitive advantage, does not infringe third party rights, or will not need to be altered in response to competing technologies. Pollard also cannot be certain that technologies developed in the future will be the subject of valid and enforceable intellectual property rights.

In addition, litigation may be necessary to determine the scope, enforceability and validity of third party intellectual property rights or to establish Pollard's intellectual property rights. Regardless of merit, any such litigation could be time consuming and expensive, divert management's time and attention, subject Pollard to significant liabilities, require Pollard to enter into costly royalty or licensing agreements, or require Pollard to modify or stop using intellectual property that it owns or licenses.

Interest Rates

Pollard has certain floating rate loans and may be negatively impacted by increases in interest rates, the effects of which would be to reduce net income and the amount of cash available for operations and on its ability to maintain a consistent level of dividends in Canadian dollars.

Future Acquisition and Integration Risks

To grow by acquisition, Pollard must identify and acquire suitable acquisition candidates at attractive prices and successfully integrate any acquired businesses with its existing operations. If the expected synergies from acquisitions do not materialize or Pollard fails to successfully integrate any new businesses into its existing business, Pollard's financial performance could be significantly impacted. To the extent that businesses acquired by Pollard or their prior owners failed to comply with or otherwise violated applicable laws, Pollard, as a successor owner, may be financially responsible for these violations.

In connection with future acquisitions by Pollard, there may be liabilities that Pollard failed or was unable to discover in its due diligence prior to the consummation of the acquisition. The discovery of any material liabilities could have a material adverse effect on Pollard's business, financial condition, liquidity and results of operations or future prospects.

Financial Instruments

Pollard is exposed to financial risks that arise from fluctuations in interest rates and foreign exchange rates and the degree of volatility of these rates, liquidity risk and credit risk. Pollard uses financial instruments, from time to time, to manage these risks.

Pollard's risk management policies are established to identify and analyze the risks, to set appropriate risk limits and controls to monitor risks and adherence to limits. The Audit Committee oversees how management monitors compliance with Pollard's risk management policies and procedures. The Audit Committee is assisted in its oversight role by Internal Audit, who undertakes regular reviews of risk management controls and utilizes the annual risk assessment process as the basis for the annual audit plan.

Risk Exposure

Currency risk

Pollard sells a significant portion of its products and services to customers in the United States and to international customers where sales are denominated in U.S. dollars. In addition, a significant portion of its cost inputs are denominated in U.S. dollars. Pollard also generates a small amount of revenue in currencies other than Canadian and U.S. dollars, primarily in Euros.

In addition, translation differences arise when foreign currency monetary assets and liabilities are translated at foreign exchange rates that change over time.

Interest rate risk

Pollard is exposed to interest rate risk relating to its fixed and floating rate instruments. Fluctuation in interest rates will have an effect on the valuation and repayment of these instruments.

Credit risk

Credit risk in the risk of financial loss if a customer or counterpart to a financial instrument fails to meet its financial obligations.

Liquidity risk

Liquidity risk is the risk that Pollard will not be able to meet its financial obligations as they fall due.

Risk Management

Currency risk

Pollard utilizes a number of tools to manage its foreign currency risk including sourcing its manufacturing facilities in the U.S. and sourcing other cost of sales in U.S. dollars.

Two manufacturing facilities are located in the U.S. and a significant amount of cost inputs for all production facilities are denominated in U.S. dollars, offsetting a large portion of the U.S. dollar revenue in a natural hedge.

Pollard also has the ability to utilize various financial instruments to hedge U.S. dollar exposure including the use of foreign currency forward contracts. As at December 31, 2012, Pollard has no contracts outstanding.

A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian and U.S. dollar would decrease/increase the income before income taxes by $0.1 million for the year ended December 31, 2012 (2011 – $0.2 million).

As at December 31, 2012, the amount of financial liabilities denominated in U.S. dollars exceeds the amount of financial assets denominated in U.S. dollars by approximately $5.6 million. A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the U.S. dollar would result in a decrease/increase in net income of approximately $0.03 million.

Interest rate risk

A 50 basis point decrease/increase in interest rates would result in an increase/decrease in income before income taxes of $0.4 million for the year ended December 31, 2012.

Credit risk

Credit risk on Pollard's accounts receivable is minimized since they are mainly from governments and their agencies and are collected in a relatively short period of time. Credit risk on foreign currency and interest rate swap contracts is minimized since the counterparties are restricted to Schedule 1 Canadian financial institutions.

The carrying amount of accounts receivable is reduced through the use of an allowance account and any adjustment to the allowance account is recognized in the statement of income within selling and administration expense. When a receivable balance is considered uncollectible, it is written off against the allowance account.

Liquidity risk

Pollard's approach is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. Pollard maintains a committed credit facility including up to $70.0 million for its Canadian operations and up to US$15.3 million for its U.S. subsidiaries. At December 31, 2012, the unused balance available for drawdown was $10.9 million.

The 2013 requirements for capital expenditures, working capital and dividends are expected to be financed from cash flow provided by operating activities and unused credit facility. Pollard enters into contractual obligations in the normal course of business operations.

Outlook

The instant ticket market experienced good growth in 2012 and indications are that this trend has continued in early 2013. Instant tickets have been one of the most successful product lines for lotteries around the world. Jurisdictions are using these games to maximize their returns, which generates opportunities for Pollard to work in partnership with lotteries in achieving their objectives.

Our volumes for the first quarter in 2013 are expected to be significantly higher than has traditionally occurred in the first quarter in previous years. This reflects both higher overall order quantities from our customer base and higher volumes of some of our proprietary products. We expect to see higher volume levels continue throughout 2013.

We anticipate our industry will continue to be extremely competitive with pricing being an important factor in winning work. To offset this, our focus will continue to be on both innovation, to develop proprietary, value-added features to bolster our selling prices, and reducing our cost structure to protect our gross margin.

2012 witnessed lower sales in our licensed games product line, however licensed games sales are expected to generate much higher revenue in 2013 due to a number of key licensed products including *Star Trek*™ and Cadillac® themed tickets.

Our pull-tab and bingo paper product lines (charitable gaming) continue to generate solid returns and we anticipate similar results in 2013. While the overall market for charitable gaming products is not growing, we will continue our focus on effective cost management to maintain our margins. Within this product line our vending machine business has shown some strong growth driven by some new product introduction coupled with the ongoing increase in the acceptance of self retailing. While still a small part of our overall business, incremental sales will have a positive impact on our operating margins and profit.

The lottery industry itself is seeing a number of new developments mirroring other changes in the technological, political and economic landscape. Lottery involvement with gaming on the internet (or "Igaming") continues to be an area of ongoing interest within lotteries, particularly in North America. A rapidly evolving regulatory environment, coupled with pressures on lotteries to generate greater funds, has resulted in a number of lotteries actively working on gaming products delivered through this media. Frequent players clubs, second chance drawings, interactive games and other products are examples of offerings being marketed by lotteries. Similarly there has been an increase in lotteries, again particularly in the U.S., looking to outsource more of their activities, including the overall management of the lottery operation. The model of increased roles for the private sector has been successfully used in lotteries around the world for many years and we expect this trend to continue. Increased private sector involvement (often referred to as "privatization") provides opportunities for Pollard to expand our role in our customer's operations and increase our revenue base.

While these developments are relatively new, we will continue to monitor and develop unique products that will allow us to take advantage of these new opportunities to partner with lotteries in their pursuit of maximizing their ability to generate funds for good causes.

2013 will be the third year of our Change Initiatives, a formal management process used to both improve our cost structure and grow our volumes. The success achieved under this program has been a key factor in our improved operating and financial results and will continue to be front and center in 2013.

We are focused on improving the strength of our balance sheet through utilizing our free cash flow to pay down our debt, allowing increased flexibility for future investment in business opportunities and expansion capital expenditures.

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 and effectiveness of the disclosure controls and procedures. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the disclosure controls and procedures as defined in Multilateral Instrument 52-109 are designed appropriately and are effective at providing 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 and effectiveness of the internal controls over financial reporting. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the internal controls over financial reporting as defined in Multilateral Instrument 52-109 are designed appropriately and are effective at providing reasonable assurance of achieving the financial reporting objectives.

No changes were made in Pollard's internal control over financial reporting during the year ended December 31, 2012, 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 for the year ended December 31, 2012, is available on SEDAR at www.sedar.com.

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

Consolidated Financial Statements of

POLLARD BANKNOTE LIMITED

Years ended December 31, 2012 and 2011

POLLARD BANKNOTE LIMITED

Management's Report

The accompanying consolidated financial statements and all the information contained in the annual report of Pollard Banknote Limited ("Pollard") are the responsibility of management and have been approved by the Board of Directors of Pollard. Financial and operating data elsewhere in the annual report is consistent with the information contained in the financial statements. The financial statements and all other information have been prepared by management in accordance with Canadian generally accepted accounting principles. The financial statements include some amounts and assumptions based on management's best estimates which have been derived with careful judgment.

In fulfilling its responsibilities, management of Pollard has developed and maintains a system of internal accounting controls. These controls are designed to ensure that the financial records are reliable for preparing the financial statements. The Board of Directors of Pollard carries out its responsibility for the financial statements through the Audit Committee. The Audit Committee reviews Pollard's annual consolidated financial statements and recommends their approval by the Board of Directors. The auditors have full access to the Audit Committee with and without management present.

The consolidated financial statements have been audited by KPMG LLP Chartered Accountants, whose opinion is contained in this annual report.

"John Pollard"

JOHN POLLARD
Co-Chief Executive Officer

"Robert Rose"

ROBERT ROSE
Chief Financial Officer

March 6, 2013

KPMG LLP
Chartered Accountants
Suite 2000 – One Lombard Place
Winnipeg MB R3B 0X3
Canada

Telephone (204) 957-1770
Fax (204) 957-0808
Internet www.kpmg.ca

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Pollard Banknote Limited

We have audited the accompanying consolidated financial statements of Pollard Banknote Limited, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Pollard Banknote Limited as at December 31, 2012 and 2011 and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

March 6, 2013

Winnipeg, Canada

Pollard Banknote Limited
Consolidated Statements of Financial Position
(*In thousands of Canadian dollars*)

	December 31, 2012	December 31, 2011
Assets		
Current assets		
Cash	$ 4,982	$ 5,059
Accounts receivable	16,301	15,514
Inventories (note 5)	21,726	17,361
Prepaid expenses and deposits	1,760	2,020
Total current assets	44,769	39,954
Non-current assets		
Property, plant and equipment (note 6)	30,113	29,219
Equity investment (note 7)	204	-
Goodwill (note 8)	35,703	35,902
Intangible assets (note 9)	11,840	12,294
Deferred income taxes (note 10)	4,324	4,253
Total non-current assets	82,184	81,668
Total assets	$ 126,953	$ 121,622

		December 31, 2012		December 31, 2011

Liabilities and Shareholders' Equity

Current liabilities				
Accounts payable and accrued liabilities	$	16,162	$	15,654
Provisions (note 11)		12		21
Dividends payable		706		706
Income taxes payable		700		338
Total current liabilities		17,580		16,719
Non-current liabilities				
Long-term debt (note 12)		70,485		69,077
Other long-term liabilities		195		210
Pension liability (note 13)		9,902		4,742
Deferred income taxes (note 10)		2,781		3,213
Total non-current liabilities		83,363		77,242
Shareholders' equity				
Share capital (note 14)		73,209		73,209
Reserves		(826)		(326)
Deficit		(46,373)		(45,222)
Total shareholders' equity		26,010		27,661
Commitments and contingencies (note 15)				
Total liabilities and shareholders' equity	$	126,953	$	121,622

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"D.C. Crewson" Director

"John Pollard" Director

Pollard Banknote Limited
Consolidated Statements of Income
(*In thousands of Canadian dollars, except for share amounts*)

Years ended December 31

		2012		2011
Sales	$	162,427	$	172,040
Cost of sales		129,576		141,953
Gross profit		32,851		30,087
Administration		13,590		13,805
Selling		6,124		6,250
Other (income) expense (note 16)		40		(390)
Income from operations		13,097		10,422
Finance costs (note 17)		4,751		6,367
Finance income (note 17)		(648)		(766)
Income before income taxes		8,994		4,821
Income taxes (note 10)				
Current		1,078		831
Deferred		1,261		843
		2,339		1,674
Net income	$	6,655	$	3,147
Basic and diluted net income per share	$	0.28	$	0.13
Weighted average number of shares outstanding		23,543,158		23,543,158

See accompanying notes to consolidated financial statements.

Pollard Banknote Limited
Consolidated Statements of Comprehensive Income
(*In thousands of Canadian dollars*)

Years ended December 31

	2012	2011
Net income	$ 6,655	$ 3,147
Other comprehensive income (loss)		
Foreign currency translation differences – foreign operations	(500)	335
Unrealized gain on derivatives designated as cash flow hedges, net of income tax of $116	-	258
Defined benefit plans actuarial losses, net of income tax reduction of ($1,795) and ($1,535)	(4,981)	(4,133)
Other comprehensive loss – net of income tax	(5,481)	(3,540)
Comprehensive income (loss)	$ 1,174	$ (393)

See accompanying notes to consolidated financial statements.

Pollard Banknote Limited

Consolidated Statements of Changes in Equity

(*In thousands of Canadian dollars*)

Year ended December 31, 2012

		Attributable to equity holders of Pollard Banknote Limited				
		Share capital	**Translation reserve**	**Hedging reserve**	**Deficit**	**Total equity**
Balance at January 1, 2012	$	73,209	(326)	-	(45,222)	27,661
Net income		-	-	-	6,655	6,655
Other comprehensive income (loss)						
Foreign currency translation differences – foreign operations		-	(500)	-	-	(500)
Defined benefit plans actuarial loss, net of income tax reduction of ($1,795)		-	-	-	(4,981)	(4,981)
Total other comprehensive loss	$	-	(500)	-	(4,981)	(5,481)
Total comprehensive income (loss)	$	-	(500)		1,674	1,174
Dividends to owners of Pollard Banknote Limited		-	-	-	(2,825)	(2,825)
Balance at December 31, 2012	$	73,209	(826)	-	(46,373)	26,010

Year ended December 31, 2011

		Attributable to equity holders of Pollard Banknote Limited				
		Share capital	**Translation reserve**	**Hedging reserve**	**Deficit**	**Total equity**
Balance at January 1, 2011	$	73,209	(661)	(258)	(41,411)	30,879
Net income		-	-	-	3,147	3,147
Other comprehensive income (loss)						
Foreign currency translation differences – foreign operations		-	335	-	-	335
Unrealized gain on derivatives designated as cash flow hedges, net of income tax of $116		-	-	258	-	258
Defined benefit plans actuarial loss, net of income tax reduction of ($1,535)		-	-	-	(4,133)	(4,133)
Total other comprehensive income (loss)	$	-	335	258	(4,133)	(3,540)
Total comprehensive income (loss)	$	-	335	258	(986)	(393)
Dividends to owners of Pollard Banknote Limited		-	-	-	(2,825)	(2,825)
Balance at December 31, 2011	$	73,209	(326)	-	(45,222)	27,661

Pollard Banknote Limited

Consolidated Statements of Cash Flows

(*In thousands of Canadian dollars*)

Years ended December 31

	2012	2011
Cash increase (decrease)		
Operating activities		
Net income	$ 6,655	$ 3,147
Adjustments		
Income taxes	2,339	1,674
Amortization and depreciation	7,850	8,356
Interest expense	3,382	4,434
Unrealized foreign exchange (gain) loss	(129)	3,815
Loss on equity investment	204	-
Gain on sale of property, plant and equipment	-	(1,479)
Interest paid	(3,350)	(4,590)
Income tax paid	(726)	(1,100)
Change in pension liability	(1,582)	(1,045)
Change in non-cash operating working capital (note 19)	(5,138)	(1,658)
	9,505	11,554
Investing activities		
Additions to property, plant and equipment	(6,511)	(2,938)
Proceeds from sale of property, plant and equipment	-	3,483
Equity investment (note 7)	(408)	-
Additions to intangible assets	(888)	(322)
	(7,807)	223
Financing activities		
Proceeds from (repayment of) long-term debt	1,623	(9,039)
Change in other long-term liabilities	(7)	(13)
Additions to deferred financing charges	(201)	(215)
Dividends paid	(2,825)	(2,825)
	(1,410)	(12,092)
Foreign exchange loss on cash held in foreign currency	(365)	(31)
Change in cash position	(77)	(346)
Cash position, beginning of year	5,059	5,405
Cash position, end of year	$ 4,982	$ 5,059

See accompanying notes to consolidated financial statements.

1. Reporting entity:

Pollard Banknote Limited ("Pollard"), formerly 7510101 Canada Limited, was incorporated under the laws of Canada on March 26, 2010.

The consolidated financial statements of Pollard as at and for the year ended December 31, 2012, comprise Pollard and its subsidiaries. Pollard is primarily involved in the manufacture and sale of lottery and gaming products.

The overall impact of seasonality does not have a significant impact on the operations of Pollard, although instant ticket volumes are historically slightly lower in the first quarter relative to the rest of the year.

2. Basis of preparation:

(a) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

On March 6, 2013, Pollard's Board of Directors approved these consolidated financial statements.

(b) Basis of preparation:

These consolidated financial statements have been prepared on a historical cost basis, except for the following material items in the statement of financial position:

- Derivative financial instruments are measured at fair value;
- The pension liability is recognized as the net total of the pension asset/liability plus unrecognized past service cost and the present value of the defined benefit obligation.

These statements are presented in Canadian dollars, Pollard's functional currency, and all values are rounded to the nearest thousand (except share and per share amounts) unless otherwise indicated.

2. Basis of preparation (continued):

(c) Use of estimates and judgments:

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Information about judgments, assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next period are as follows:

Impairment of goodwill:

Pollard determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the “value in use” or “fair value less costs to sell” of the cash-generating units (“CGUs”) to which goodwill is allocated. Estimating a value in use requires Pollard to make an estimate of the expected future cash flows from the CGUs and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Further details are provided in Note 8.

Employee future benefits:

Accounting for defined benefit plans requires Pollard to use actuarial assumptions. These assumptions include the discount rate, expected rate of return on plan assets and the rate of compensation increases. These assumptions depend on underlying factors such as economic conditions, government regulations, investment performance, employee demographics and mortality rates. See Note 13 for further information.

Income taxes:

Pollard is required to evaluate the recoverability of deferred income tax assets. This requires an estimate of Pollard’s ability to utilize the underlying future income tax deductions against future taxable income before they expire. In order to evaluate the recoverability of these deferred income tax assets, Pollard must estimate future taxable income. Further details are provided in Note 10.

3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

(a) Principles of consolidation:

These consolidated financial statements include the accounts of Pollard and all its subsidiaries. Subsidiaries are entities which are under Pollard's control, where control is defined as the power to govern financial and operating policies of an entity so as to obtain benefits from its activities. Pollard holds 100% of the voting rights in, and therefore controls, its subsidiaries.

All inter-company balances and transactions, and any unrealized income and expenses arising from inter-company transactions, have been eliminated.

(b) Revenue recognition:

Revenue is recognized when persuasive evidence of an arrangement exists, significant risks and benefits of ownership are transferred, the sales price to the customer is fixed or is determined and collection of the resulting receivable is reasonably assured. The significant risks of ownership and benefits of ownership are normally transferred in accordance with the shipping terms agreed to with the customer. Volume rebates are accrued and recorded as a reduction to sales based on historical experience and management's expectations regarding sales volume. Revenues relating to license and royalty sales and lottery management services are recognized pursuant to the terms of the applicable contracts.

(c) Leases:

One of Pollard's subsidiaries has leasing operations which consist principally of the leasing of Pull-Tab Vending Machines ("PTVM") with various private establishments. These leases are classified as finance leases. The PTVM leases have terms of three years. The net investment in these leases consists of the present value of the future minimum lease payments. Interest income is recognized in other income based on a pattern reflecting a constant periodic return on the net investment in the finance lease.

(d) Inventories:

Raw materials, work-in-process and finished goods are valued at the lower of cost and net realizable value. The cost of raw material inventory is based on its weighted average cost and includes all costs incurred to acquire the materials. In addition to the direct costs of conversion, the cost of work-in-process and finished goods, which Pollard manufactures, also includes an appropriate share of production overheads based on normal operating capacity.

3. Significant accounting policies (continued):

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion.

(e) Goodwill:

Goodwill is comprised of the excess sale price over the underlying carrying amount of the net assets sold as at August 5, 2005, as part of the 26.7% of Pollard LP sold in conjunction with the Initial Public Offering ("IPO") and the excess purchase price over the underlying carrying amount of the net assets acquired of Pollard's U.S. subsidiaries. Goodwill is not amortized but is subject to an annual impairment review to ensure its recoverable value remains greater than, or equal to, book value.

(f) Intangible assets:

Deferred development:

Development expenditures are recognized as an intangible asset only if Pollard can demonstrate that the development costs can be measured reliably, the product is technically and commercially feasible, future economic benefits are probable and Pollard has sufficient resources to complete development and to use or sell the asset. The expenditures capitalized include the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use and borrowing costs incurred in respect of qualifying assets. Other development expenditures are expensed as incurred.

Capitalized development expenditures are measured at cost less accumulated amortization and accumulated impairment losses.

Other intangible assets:

Intangible assets that are acquired by Pollard and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses.

Intangible assets are amortized, on a straight-line basis, over their useful lives as follows:

Asset	Rate
Customer assets	16 years
Patents	20 years
Computer software	5 years
Deferred development	2 to 7 years

3. Significant accounting policies (continued):

Amortization methods, useful lives and residual value are reviewed each annual reporting date and adjusted prospectively if appropriate.

(g) Property, plant and equipment:

Property, plant and equipment (“PP&E”) are stated at cost less investment tax credits, accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour and related fringes, other costs directly attributable to bringing the assets to working condition for their intended use and borrowing costs incurred in respect to qualifying assets. Major spare parts are treated as PP&E when they can be used only in connection with PP&E and they have a useful life greater than a year.

An item of PP&E is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. The gain or loss on disposal of an item of PP&E is determined by comparing the proceeds from disposal with the carrying value of the PP&E and is recognized in the income statement on a net basis.

The cost of each component of an item of PP&E is depreciated over its estimated useful life on a straight-line basis. Land is not depreciated. The estimated useful lives for the current and comparative periods are as follows:

Asset	Rate
Buildings	10 to 30 years
Leasehold improvements	Term of lease
Equipment	2 to 11 years
Furniture, fixtures and computers	3 to 9 years

Depreciation methods, useful lives and residual values are reviewed each annual reporting date and adjusted prospectively if appropriate.

The carrying value of property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

3. Significant accounting policies (continued):

(h) Investment in associate:

Pollard accounts for its investment in associate using the equity method of accounting as it has significant influence, but not control. Significant influence is presumed to exist when Pollard holds between 20 and 50 percent of the voting power of another entity. The consolidated financial statements include Pollard's share of the income and expenses and equity movements of the entity accounted for under the equity method of accounting, which are recorded on a three month delayed basis.

(i) Financial instruments:

Non-derivative financial assets

Pollard initially recognizes loans and receivables on the date that they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which Pollard becomes a party to the contractual provisions of the instrument. Pollard derecognizes a financial asset when the contractual rights to the cash flows from the asset expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, Pollard has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. Pollard classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity financial assets, loans and receivables and available-for-sale financial assets.

i) Financial assets at fair value through profit or loss

A financial asset is classified as financial assets at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Attributable transaction costs are recognized in net income as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in net income. Pollard has no non-derivative financial assets classified as financial assets at fair value through profit or loss.

3. Significant accounting policies (continued):

ii) Held-to-maturity financial assets

If Pollard has the positive intent and ability to hold debt securities to maturity, then such financial assets are classified as held-to-maturity. Held-to-maturity assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses. Pollard has no financial assets classified as held-to-maturity.

iii) Loans and receivables

Loans and receivables are financial assets with fixed or determined payments that are not quoted in the active market. Such assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses, and the net gain or loss is included in finance income. Pollard has classified cash and accounts receivable as loans and receivables.

iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the previous categories. Subsequent to initial recognition, available-for-sale financial assets are measured at fair value and changes therein, other than impairment losses and foreign exchange differences, are recognized in other comprehensive income and are presented in the fair value reserve in equity. When an investment is derecognized, the gain or loss accumulated in equity is reclassified to net income. Pollard has no financial assets classified as available-for-sale.

Non-derivative financial liabilities

All non-derivative financial liabilities are classified as other financial liabilities and are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method and the net gain or loss is included in finance costs.

Pollard classifies accounts payable and accrued liabilities, dividends payable, long-term debt and other long-term liabilities as other financial liabilities.

3. Significant accounting policies (continued):

Share Capital

Common stock is classified as equity. Incremental costs directly attributable to the issue of common stock are recognized as a deduction from equity, net of any tax effects.

Derivatives and hedge accounting

Pollard may use certain derivative financial instruments to manage risks of fluctuation in interest rates and foreign exchange rates. Pollard does not engage in the trading of these derivative financial instruments for profit. On initial designation of the derivative as the hedging instrument, Pollard formally documents the relationship between the hedging instrument and the hedging item, including the risk management objectives and strategy in undertaking the hedge transaction and the hedged risk, together with the methods that will be used to assess the effectiveness of the hedging relationship. Pollard makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, of whether the hedging instruments are expected to be “highly effective” in offsetting the change in the fair value or cash flows of the respective hedged items attributable to the hedged risk, and whether the actual results of each hedge are within a range of 80 – 125 percent.

Derivatives are recognized initially at fair value and attributable transaction costs are recognized in net income as incurred. Subsequent to initial recognition, derivatives are measured at fair value and changes are accounted for as follows:

i) Cash flow hedges

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognized asset or liability, the effective portion of changes in the fair value of the derivative is recognized in other comprehensive income and presented in the hedging reserve in equity. Any ineffective portion of changes in fair value of the derivative is recognized immediately in net income. If the hedging instrument no longer meets the criteria for hedge accounting, then hedge accounting is discontinued prospectively. This results in the amortization of the respective derivative’s cumulative changes in fair value in the hedging reserve, over the remaining term of the derivative. Any adjustments to fair value after discontinuing hedge accounting are recognized immediately in net income as finance income or loss.

3. Significant accounting policies (continued):

ii) Other non-trading derivatives

When a derivative financial instrument is not designated in a hedge relationship that qualifies for hedge accounting, all changes in its fair value are recognized immediately in net income as finance income or loss.

(j) Translation of foreign currencies:

The functional currency for each of Pollard's subsidiaries is the currency of the primary economic environment in which the entity operates. Transactions in foreign currencies are translated to the respective functional currencies of each entity within the consolidated group using the exchange rates in effect at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rates prevailing at the end of the reporting period. Non-monetary items measured at historical cost in a foreign currency are translated to the functional currency using the exchange rate prevalent at the date of acquisition. Non-monetary items denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate prevalent at the date that the fair value was determined. Foreign currency differences arising from translation are recognized in net income, except for exchange differences arising on the translation of financial instruments qualifying as a cash flow hedge, which are recognized directly in other comprehensive income ("OCI").

The results and financial position of entities within the consolidated group that have a functional currency different from the presentation currency are translated into Canadian dollars as follows: assets and liabilities are translated at the exchange rate prevailing at the end of the reporting period; income and expenses are translated at the average rate for the reporting period; all resulting exchange differences are recognized in other comprehensive income. On disposal of a foreign operation, the deferred cumulative amount recognized in OCI relating to that particular foreign operation is recognized in net income.

(k) Employee future benefits:

Defined contribution plans

Pollard's U.S. subsidiaries maintain two defined contribution plans in the United States. The obligation to contribute to these plans is recognized as an employee benefit expense as incurred.

3. Significant accounting policies (continued):

Defined benefit plans

Pollard maintains four non-contributory defined benefit pension plans in Canada and the United States, three being final pay plans and one being a flat benefit plan. None of the plans have indexation features.

The costs of Pollard's defined benefit plans are recognized over the period in which employees render service to Pollard in return for the benefits. The defined benefit obligations associated with the plans are actuarially determined using the projected unit credit method pro-rated on service and management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. The present value of the defined benefit obligations are determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that have maturity terms approximating the maturity terms of the related obligation and that are denominated in the currency in which the benefits will be paid. The expected return on pension plan assets is calculated on the fair value of the assets as of the year-end date.

Past service costs are recognized as an expense on a straight line basis over the average period until the benefits becomes vested. If the benefits have vested, past service costs are recognized in net income immediately.

Actuarial gains and losses that arise in calculating the present value of the defined benefit obligation and the fair value of plan assets are recognized immediately in other comprehensive income.

Pollard's pension asset is limited to the total of any unrecognized past services costs and the present value of economic benefits available in the form of any future refunds form the plan or reductions in future contributions to the plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to Pollard's plans. An economic benefit is available to Pollard if it is realizable during the life of the plan, or on settlement of the plan liabilities.

(l) Income taxes:

Current income tax and deferred income tax are recognized in the statement of income except to the extent that the tax relates to items recognized directly in equity or in other comprehensive income. Current income tax is the expected tax payable or receivable on the taxable income or loss for the period and any adjustment to tax payable in respect to previous years. Current income tax expense includes withholding taxes.

3. Significant accounting policies (continued):

Deferred income tax is recorded to reflect the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities and their tax basis. Deferred income tax assets and liabilities are determined based on the enacted or substantively enacted tax rates, which are expected to be in effect when the underlying items of income and expense are expected to be realized.

Deferred income tax is not recognized for: temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future, taxable temporary differences arising on the initial recognition of goodwill or temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss.

Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment, except if it relates to an item previously recognized in equity, in which case the adjustment is made to equity.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax liabilities and assets, and they are levied by the same taxation authority on the same taxable entity, or on different tax entities which intend to settle their current income tax assets and liabilities on a net basis.

(m) Provisions:

Provisions are recognized when Pollard has a present legal or constructive obligation as a result of a past event that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

Restructuring

A provision for restructuring is recognized when Pollard has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly.

3. Significant accounting policies (continued):

(n) Impairment:

Financial assets

Financial assets classified as loans and receivables, held-to-maturity and available-for-sale are assessed at each reporting period date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. Evidence of impairment may include default or delinquency by a debtor, indications that a debtor will enter bankruptcy or economic conditions that correlate with defaults. Pollard has neither available-for-sale or held-to-maturity instruments.

For loans and receivables, Pollard first assesses whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If Pollard determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assess them for impairment. Individually assessed assets with an impairment loss are not included in the collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial assets original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment is increased or reduced by adjusting the allowance account, through the income statement.

Non-financial assets

The carrying amount of Pollard's non-financial assets, other than inventories and deferred income tax assets, are reviewed at each reporting date to determine whether there is an indication that an asset may be impaired. If any such indication exists, or when the annual impairment testing for an asset is required, Pollard estimates the asset's recoverable amount. For goodwill the recoverable amount is estimated as of December 31 each year. An impairment loss is recognized if the carrying amount of an asset or its related CGU exceeds its estimated recoverable amount.

3. Significant accounting policies (continued):

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset of CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of cash inflows of other assets or CGUs.

Impairment losses are recognized in net income. Impairment losses recognized in respect to CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other asset in the CGU on a pro rata basis. An impairment loss in respect to goodwill is not reversed. In respect to other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss can only be reversed to the extent that the asset's carrying value that would have been determined, net of amortization, if no impairment had been recognized.

(o) Finance costs and finance income:

Finance costs comprise interest expense on borrowings, amortization of deferred financing costs and net foreign exchange losses.

Borrowing costs that are not directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are expensed in the period incurred using the effective interest method.

Finance income comprises net foreign exchange gains.

4. Future accounting standards:

In November 2009, the International Accounting Standards Board ("IASB") issued IFRS 9 *Financial Instruments* ("IFRS 9 (2009)") and in October 2010, the IASB published amendments to IFRS 9 ("IFRS 9 (2010)"). In December 2011, the IASB issued an amendment to IFRS 9 to defer the mandatory effective date to annual periods beginning on or after January 1, 2015. IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classifications options in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

4. Future accounting standards (continued):

In May 2011, the IASB issued the following group of new standards and amendments to existing standards relating to consolidations and joint ventures. Each of these new standards is effective for fiscal years beginning on or after January 1, 2013. In June 2012, the IASB issued *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interest in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)*, which is effective with the adoption of the applicable standard to which the amendments relate. In October 2012, the IASB published *Investment Entities (Amendments to IFRS 10, IFRS 11 and IFRS 12)*, providing an exception to the consolidation requirements in IFRS 10. The amendments apply to fiscal years beginning on or after January 1, 2014. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

- IFRS 10 *Consolidated Financial Statements* replaces the guidance on control and consolidation in IAS 27 *Consolidated and Separate Financial Statements* and Standing Interpretations Committee ("SIC") 12 *Consolidation – Special Purpose Entities*. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control.

- IFRS 11 *Joint Arrangements* replaces IAS 31 *Interests in Joint Ventures*. IFRS 11 reduces the types of joint arrangements to two: joint ventures and joint operations. IFRS 11 requires the use of equity accounting for interests in joint ventures, eliminating the existing policy choice of proportionate consolidation for jointly controlled entities under IAS 31. Entities that participate in joint operations will recognize their share of the assets, liabilities, revenue and expenses of the joint operation.

- IFRS 12 *Disclosure of Interests in Other Entities* replaces the disclosure requirements currently found in IAS 28 *Investments in Associates*.

- IAS 27 has been amended and renamed *Separate Financial Statements* and deals solely with separate financial statements and the guidance for which remains unchanged.

- IAS 28 has been amended to include joint ventures in its scope and to address changes in IFRS 10 through 12 as explained above.

In May 2011, the IASB published IFRS 13 *Fair Value Measurements* which replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance, with enhanced disclosure requirements for information about fair value measurements. IFRS 13 is required for fiscal years beginning on or after January 1, 2013. Prospective application is required. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

(In thousands of Canadian dollars, except for share amounts)

4. Future accounting standards (continued):

In June 2011, the IASB published an amended version of IAS 19 *Employee Benefits*. The amendments require actuarial gains and losses to be recognized immediately in other comprehensive income and past service cost must be recognized immediately in profit or loss. This amendment also requires that the expected return on plan assets recognized in profit or loss be calculated based on the rate used to discount the defined benefit obligation. Additional disclosures are also required. IAS 19 is required for fiscal years beginning on or after January 1, 2013. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In June 2011, the IASB published amendments to IAS 1 *Financial Statement Presentation*. The amendments require items presented in other comprehensive income to be separated into two groups, based on whether or not they may be recycled to the statement of income later. The amendments are effective for fiscal years beginning on or after July 1, 2012. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

In December 2011, the IASB published amendments to IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Offsetting Financial Assets and Liabilities*. These amendments are to be applied retrospectively. The amendments to IAS 32 provide clarification on the application of rules to offset financial assets and liabilities. These amendments are effective for fiscal years beginning on or after January 1, 2014. The amendments to IFRS 7 contain new disclosure requirements for financial assets and liabilities that are offset. These amendments are effective for fiscal years beginning on or after January 1, 2013. Pollard does not expect the new standards and amendments to have a material impact on its consolidated financial statements.

In May 2012, the IASB published *Annual Improvements to IFRSs – 2009-2011 Cycle* as part of its annual improvements process to make non-urgent but necessary amendments to IFRS. These amendments are effective for fiscal years beginning on or after January 1, 2013 with retrospective application. Pollard is currently assessing the impact of the amendments on its consolidated financial statements.

5. Inventories:

		December 31, 2012		December 31, 2011
Raw materials	$	5,713	$	5,275
Work-in-process		843		689
Finished goods		15,170		11,397
	$	21,726	$	17,361

(In thousands of Canadian dollars, except for share amounts)

5. Inventories (continued):

During 2012 Pollard recorded reversals of previous inventory write-downs of $24 representing a decrease in the obsolescence reserves and write-downs of $27 due to changes in foreign exchange rates.

During 2011 Pollard recorded inventory write-downs of $381 representing an increase in the obsolescence reserves and reversals of previous write-downs of $42 due to changes in foreign exchange rates.

The cost of sales reflects the costs of inventory including direct material, direct labour and manufacturing overheads.

6. Property, plant and equipment:

Cost		Land	Buildings	Leasehold improvements	Equipment	Spare parts	Furniture, fixture and computers	Total
Balance at January 1, 2011	$	1,080	12,669	1,349	108,032	-	3,945	127,075
Additions/reclassifications		-	(206)	362	2,779	-	3	2,938
Disposals		(277)	(3,372)	-	(10)	-	-	(3,659)
Effect of movements in exchange rates		-	-	11	67	-	-	78
Balance at December 31, 2011	$	803	9,091	1,722	110,868	-	3,948	126,432
Additions/reclassifications		-	88	145	5,280	980	18	6,511
Disposals		-	-	(31)	(152)		(57)	(240)
Effect of movements in exchange rates		-	-	(22)	(134)		-	(156)
Balance at December 31, 2012	$	803	9,179	1,814	115,862	980	3,909	132,547

(In thousands of Canadian dollars, except for share amounts)

6. Property, plant and equipment (continued):

Accumulated depreciation		Land	Buildings	Leasehold improvements	Equipment	Spare parts	Furniture, fixture and computers	Total
Balance at January 1, 2011	$	-	4,585	763	85,152	-	2,698	93,198
Depreciation for the year			351	98	4,909	-	242	5,600
Disposals/reclassifications			(1,653)	7	(9)	-	-	(1,655)
Effect of movements in exchange rates			-	10	60	-	-	70
Balance at December 31, 2011	$	-	3,283	878	90,112	-	2,940	97,213
Depreciation for the year			320	135	4,956	-	191	5,602
Disposals/reclassifications			-	(31)	(152)	-	(57)	(240)
Effect of movements in exchange rates			-	(24)	(117)	-	-	(141)
Balance at December 31, 2012	$	-	3,603	958	94,799	-	3,074	102,434

Carrying amounts		Land	Buildings	Leasehold improvements	Equipment	Spare parts	Furniture, fixture and computers	Total
At December 31, 2011	$	803	5,808	844	20,756	-	1,008	29,219
At December 31, 2012	$	803	5,576	856	21,063	980	835	30,113

7. Equity investment:

		December 31, 2012		December 31, 2011
Balance – beginning of year	$	-	$	-
Initial investment		408		-
Equity loss		(204)		-
Balance – end of year	$	204	$	-

Pollard has entered into an agreement with Palm Commerce Information and Technology (China) Co., Ltd. for the establishment of Shenzhen Palm Commerce & Pollard Banknote Technology Co., Ltd.. As per the agreement, Pollard completed its capital investment of US$400, representing 40% of the registered capital of the corporation, in January 2012. The entity was established to provide distribution and validation systems to provincial lottery operations in China. In July 2012, the entity successfully completed its first system installation with its initial provincial lottery customer.

(In thousands of Canadian dollars, except for share amounts)

8. Goodwill:

Goodwill is comprised of $30,620 (2011- $30,620), representing the excess purchase price over the underlying carrying amount of the net assets sold, as at August 5, 2005, as a result of the 26.7% of Pollard LP sold as part of Pollard Banknote Income Fund's IPO with the remaining $5,083 (2011- $5,282) from Pollard's purchase of its U.S. subsidiaries. Goodwill has been allocated to CGUs for impairment testing in this manner, as described in the table below.

		December 31, 2012		December, 31, 2011
Lottery	$	30,620	$	30,620
Charitable games		5,083		5,282
	$	35,703	$	35,902

During 2012 the value of goodwill decreased $199 (2011 – increased $100) as a result of changes in foreign exchange rates.

For both the Lottery and Charitable games CGUs the recoverable amounts have been determined based on a value in use calculation using cash flow projections from financial forecasts approved by senior management. These forecasts cover a period of five years and reflect an estimate of a terminal value. Included in these forecasts is an assumption of a 3% growth rate which was based on historical trend and expected future performance.

The calculation of value in use for the CGUs described above are most sensitive to the following key assumptions on which management has based its cash flow projections to undertake impairment testing of goodwill:

- Revenue and related gross margin
- Foreign exchange rates
- Discount rates
- Growth rates

Revenue and related gross margin

Projected cash flows from revenue assumes the continuation of recent historical trends adjusted for expected new contract wins, anticipated contract renewal pricing pressures and the expected impact of sales initiatives in conjunction with certain production efficiencies that are being developed or are expected to be developed.

(In thousands of Canadian dollars, except for share amounts)

8. Goodwill (continued):

Foreign exchange rates

A significant portion of revenue is denominated in U.S. dollars offset by a portion of U.S. dollar denominated costs. In addition, certain financial assets and liabilities are denominated in U.S. currency. Projected cash flows assume an estimated exchange rate between Canadian dollars to U.S. dollars based on expected exchange rates during the forecast period.

Discount rates

Discount rates were calculated based on the estimated cost of equity capital and debt capital considering data and factors relevant to the economy, the industry and the CGUs. These costs were then weighted in terms of a typical industry capital structure to arrive at an estimated weighted average cost of capital. The after-tax discount rates applied to the cash flow projections for the CGUs described above were as follows:

Lottery	10.0%
Charitable Games	11.0%

Growth rates

Growth rates are based on estimated sustainable long-term growth rates of the CGUs.

Management believes that any reasonable possible change in any of the key assumptions on which the cash generating unit's recoverable amounts are based would not cause the unit's carrying amounts to exceed its recoverable amount.

9. Intangible assets:

Cost		Customer assets	Patents	Deferred development	Computer software	Total
Balance at January 1, 2011	$	18,645	4,745	482	229	24,101
Additions – internally developed		-	73	249	-	322
Balance at December 31, 2011	$	18,645	4,818	731	229	24,423
Additions – internally developed		-	137	428	323	888
Balance at December 31, 2012	$	18,645	4,955	1,159	552	25,311

(In thousands of Canadian dollars, except for share amounts)

9. Intangible assets (continued):

Accumulated amortization		Customer assets	Patents	Deferred development	Computer software	Total
Balance at January 1, 2011	$	6,306	3,768	56	229	10,359
Amortization for the year		1,165	491	114	-	1,770
Balance at December 31, 2011	$	7,471	4,259	170	229	12,129
Amortization for the year		1,165	45	132	-	1,342
Balance at December 31, 2012	$	8,636	4,304	302	229	13,471

Carrying amounts		Customer assets	Patents	Deferred development	Computer software	Total
At December 31, 2011	$	11,174	559	561	-	12,294
At December 31, 2012	$	10,009	651	857	323	11,840

Customer assets, $3,874 of patents and $229 of computer software were recognized as a result of the excess purchase price over the underlying carrying amount of the intangible assets acquired as at August 5, 2005, as part of the 26.7% of Pollard LP sold in conjunction with the IPO. As at December 31, 2011, computer software and patents recognized at IPO were fully amortized. Customer assets will continue to be amortized until Fiscal 2021. Deferred development and the remainder of patents, $1,081 (2011 - $944) and computer software, $323 (2011 – nil), were internally developed.

Amortization of intangible assets in 2012 of $1,342 (2011 – $1,770), was included in cost of sales.

10. Income taxes:

Income tax expense

		2012		2011
Current income tax expense	$	1,078	$	831
Deferred income tax expense		1,261		843
Total income tax expense	$	2,339	$	1,674

(In thousands of Canadian dollars, except for share amounts)

10. Income taxes (continued):

Income tax recognized in other comprehensive income (loss)

		Amount before tax	Tax benefit	2012 Amount Net of tax	Amount before tax	Tax (expense) benefit	2011 Amount Net of tax
Unrealized gain (loss) on derivatives designated as cash flow hedges	$	-	-	-	374	(116)	258
Defined benefit plans actuarial loss		(6,776)	1,795	(4,981)	(5,668)	1,535	(4,133)
	$	(6,776)	1,795	(4,981)	(5,294)	1,419	(3,875)

Reconciliation of effective tax rate

	2012		2012	2011		2011
Net income for the year		$	6,655		$	3,147
Total income tax expense			2,339			1,674
Income before income taxes		$	8,994		$	4,821
Income tax using Pollard's domestic tax rate	26.3%		2,365	28.3%		1,364
Withholding taxes and other items	(0.1%)		(12)	2.1%		102
Effect of non-taxable items related to foreign exchange	(0.2%)		(14)	4.3%		208
	26.0%	$	2,339	34.7%	$	1,674

(In thousands of Canadian dollars, except for share amounts)

10. Income taxes (continued):

Deferred income tax assets and liabilities

Recognized deferred income tax assets and liabilities

Deferred income tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2012	2011	2012	2011	2012	2011
Property, plant and equipment	$ 78	65	$ (1,035)	(1,570)	$ (957)	(1,505)
Intangible assets	1,134	1,461	(4,219)	(4,438)	(3,085)	(2,977)
Inventories	134	157	-	-	134	157
Employee benefits	4,184	2,391	(1,352)	(921)	2,832	1,470
Unrealized foreign exchange (gains) and losses	1,864	1,552	(700)	(637)	1,164	915
Unused tax losses	1,266	2,914	-	-	1,266	2,914
Other	189	111	-	(45)	189	66
Tax assets (liabilities)	$ 8,849	8,651	$ (7,306)	(7,611)	$ 1,543	1,040

Movement in temporary differences during the year

	Balance January 1, 2011	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2011	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2012
Property, plant and equipment	$ 2,128	(3,633)	-	(1,505)	548	-	(957)
Intangible assets	(3,174)	197	-	(2,977)	(108)	-	(3,085)
Derivatives	135	(19)	(116)	-	-		-
Inventories	89	68	-	157	(23)	-	134
Employee benefits	240	(305)	1,535	1,470	(433)	1,795	2,832
Provisions	87	(87)	-	-	-	-	-
Unrealized foreign exchange (gains) and losses	926	(11)	-	915	249	-	1,164
Unused tax losses	-	2,914	-	2,914	(1,648)	-	1,266
Other	(24)	90	-	66	123	-	189
Tax assets (liabilities)	$ 407	(786)	1,419	1,040	(1,292)	1,795	1,543

(In thousands of Canadian dollars, except for share amounts)

10. Income taxes (continued):

Recognized in the consolidated statements of financial position as follows:

		December 31, 2012		December 31, 2011
Deferred income tax - asset	$	4,324	$	4,253
Deferred income tax - liability		(2,781)		(3,213)
	$	1,543	$	1,040

Recognized in the consolidated statements of income as follows:

		2012		2011
Deferred income tax expense	$	(1,261)	$	(843)
Finance income		(31)		57
	$	(1,292)	$	(786)

Amounts included in finance income relate to unrealized foreign exchange.

11. Provisions:

		Restructuring reserve
Balance at January 1, 2011	$	1,006
Provision made during the year		506
Provision utilized during the year		(1,491)
Balance at December 31, 2011	$	21

		Restructuring reserve
Balance at January 1, 2012	$	21
Provision made during the year		-
Provision utilized during the year		(9)
Balance at December 31, 2012	$	12

(In thousands of Canadian dollars, except for share amounts)

11. Provisions (continued):

Restructuring reserve

During the third quarter of 2011, the Government of Puerto Rico determined our operations were no longer allowed under current legislation. As a result the operations commenced winding up. Included in other (income) expense are expenses of $486, comprised of $384 related to the write-off of assets associated with the operations and $104 for the related severance costs.

In the fourth quarter of 2010, approximately 30 salaried positions were eliminated in Canada and the United States. The restructuring expense recorded in that quarter included severance payments and related fringe cost totaling approximately $886 with approximately $500 paid out in 2011.

On November 5, 2009, Pollard announced the closing of its Kamloops production facility effective February 28, 2010. In 2009 a facility closing provision of $4,746 was incurred primarily representing employee severance and related fringe costs. The cash outlays related to the facility closing accrual were expended, starting March 1, 2010, over a period of approximately two years, consistent with the terms of their salary and benefit continuance based on their individual weeks of severance.

12. Long-term debt:

	December 31, 2012	December 31, 2011
Credit facility, interest of 3.5% to 5.0% payable monthly, maturing 2014	$ 70,815	$ 69,769
Deferred financing charges, net of amortization	(330)	(692)
	$ 70,485	$ 69,077

Included in the total credit facility balance is a U.S. dollar loan balance of US$13,597 (2011 – US$14,480).

Effective June 29, 2012, Pollard's subsidiaries Pollard Holdings Limited Partnership and Pollard Holdings, Inc. renewed their credit facility. The credit facility provides loans of up to $70,000 for its Canadian operations and up to US$15,297 for its U.S. subsidiaries. Borrowings under the credit facility bear interest at fixed and floating rates based on Canadian and U.S. prime bank rates, banker's acceptances or LIBOR. At December 31, 2012, the outstanding letters of guarantee drawn under the credit facility were $3,248 (December 31, 2011 - $2,163).

(In thousands of Canadian dollars, except for share amounts)

12. Long-term debt (continued):

Under the terms and conditions of the credit facility agreement Pollard is required to maintain certain financial covenants including working capital ratios, debt to income before interest, income taxes, depreciation and amortization ("Adjusted EBITDA") ratios and certain debt service coverage ratios. As at December 31, 2012, Pollard is in compliance with all financial covenants.

Under the terms of the credit facility the amount of the facility will be reduced on a quarterly basis by an amount calculated as 50% of the prior quarter's Excess Cash Flow. Excess Cash Flow is defined as Adjusted EBITDA less scheduled principal indebtedness payments (if any), interest and cash income taxes paid. For the quarters ending June 30, 2012, to and including December 31, 2012, Excess Cash Flow can be reduced up to an aggregate of $2,000 of actual costs related to a specific capital expenditure. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. Based on the Adjusted EBITDA ratio obtained in the quarter ending December 31, 2012, the credit facility will be reduced by approximately $2,400 as of May 15, 2013. As of December 31, 2012, Pollard has unused credit facility available of $10,928 (December 31, 2011 - $17,659).

Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard's operating subsidiaries. The credit facility can be prepaid without penalties. Under the terms of the agreement effective June 29, 2012, the credit facility is committed for a one year period, renewable June 30, 2013 ("Facility Expiry Date"). If the credit facility is not renewed, the loans are repayable one year after the Facility Expiry Date. As such, the credit facility has effectively a two year term expiring June 30, 2014.

13. Pension liability:

		December 31, 2012		December 31, 2011
Fair value of benefit plan assets	$	24,195	$	20,214
Present value of benefit plan obligations		(34,097)		(24,956)
Net pension liability	$	(9,902)	$	(4,742)

Pollard sponsors non-contributory defined benefit plans providing pension benefits to its employees. Pollard has four pension plans of which three are final pay plans and one is a flat benefit plan. None of the plans have indexation features. The measurement date for all the plans is December 31. The two plans of the U.S. subsidiaries require valuations annually with the last valuations being as of January 1, 2012. One of the Canadian plans of Pollard requires valuation every year with the last valuation as of December 31, 2011. Pollard's other Canadian plan's last valuation was as of January 1, 2008. Pollard's U.S. subsidiaries also maintain two defined contribution plans. The pension expense for these defined contribution plans is the annual funding contribution by the subsidiaries.

(In thousands of Canadian dollars, except for share amounts)

13. Pension liability (continued):

Pollard expects to contribute $3.6 million to its defined benefit plans in 2013.

The benefit plan assets are held in trust and are invested as follows:

	December 31, 2012	December 31, 2011
Equities	59.4%	58.0%
Bonds	35.2%	35.8%
Cash and cash equivalents	5.4%	6.2%
	100.0%	100.0%

Information about Pollard's defined benefit plans, in aggregate, is as follows:

	2012	2011
Benefit plan assets		
Fair value, beginning of year	$ 20,214	$ 21,946
Actual return on plan assets	1,883	(676)
Employer contributions	3,237	3,333
Benefits paid	(1,039)	(4,426)
Other	(100)	37
Fair value, end of year	$ 24,195	$ 20,214
Accrued benefit plan obligations		
Balance, beginning of year	$ 24,956	$ 22,048
Current service cost	1,653	1,723
Interest cost	1,340	1,311
Benefits paid	(1,039)	(4,426)
Actuarial loss	7,334	3,567
Settlement loss on curtailment	-	726
Other	(147)	7
Balance, end of year	34,097	24,956
Net pension liability	$ (9,902)	$ (4,742)

(In thousands of Canadian dollars, except for share amounts)

13. Pension liability (continued):

The total net cost for Pollard's defined benefit and defined contribution pension plans recognized in cost of sales is as follows:

	2012	2011
Net defined benefit plans cost		
Current service cost	$ 1,653	$ 1,723
Interest on plan obligations	1,340	1,311
Actual return on plan assets	(1,883)	676
Difference between expected return and actual return on plan assets	644	(1,966)
Net defined benefit plans cost	1,754	1,744
Defined contribution plans cost	169	150
Net pension plans cost	$ 1,923	$ 1,894

Settlement loss on curtailment

On November 5, 2009, Pollard announced the closing of its Kamloops production facility effective February 28, 2010. A pension settlement loss of $726, included in other (income) expenses relating to the former Kamloops employees' pensions, was recognized in 2011 due to a decrease in the discount rate utilized to determine the pension obligations between the time the closure was announced and the time the final pension obligations were determined.

Actuarial Assumptions

The principal actuarial assumptions used in measuring at the reporting date are as follows:

	2012	2011
Discount rate	4.1% to 4.5%	5.0% to 5.5%
Expected long-term rate of return on plan assets	5.0% to 6.5%	5.0% to 6.5%
Rate of compensation increase	0% to 3.0%	0% to 3.0%

The expected long-term rate of return is based on the portfolio as a whole using historical rates without adjustments.

(In thousands of Canadian dollars, except for share amounts)

13. Pension liability (continued):

Experience (gain) loss

		2012		2011
Experience (gain) loss arising on plan assets	$	(558)	$	2,101
Experience loss arising on plan liabilities	$	7,334	$	3,567

Actuarial gains and losses recognized in other comprehensive income

		2012		2011
Amount accumulated in deficit, beginning of year	$	(5,599)	$	(1,466)
Recognized during the year		(4,981)		(4,133)
Amount accumulated in deficit, end of year	$	(10,580)	$	(5,599)

Historical information

		December 31, 2012	December 31, 2011	December 31, 2010
Fair value plan assets	$	24,195	20,214	21,946
Accrued benefit plan obligation		(34,097)	(24,956)	(22,048)
Net pension liability	$	(9,902)	(4,742)	(102)

		2012	2011	2010
Experience (gain) loss arising on plan assets	$	(558)	2,101	(384)
Experience loss arising on plan liabilities	$	7,334	3,567	2,428

(In thousands of Canadian dollars, except for share amounts)

14. Share capital:

		December 31, 2012		December 31, 2011
Authorized				
Unlimited common shares				
Unlimited preferred shares				
Issued				
23,543,158 common shares	$	73,209	$	73,209
	$	73,209	$	73,209

Ownership restrictions:

The holders of the common shares are entitled to one vote in respect to each common share held, subject to the Board of Directors ability to take constraint actions when a person, or group of persons acting in concert acquires, agrees to acquire, holds, beneficially owns or controls, either directly or indirectly, a number of shares equal to or in excess of 5% of the common shares (on a non-diluted basis) issued and outstanding ("Ownership Threshold"). The Board of Directors, in its sole discretion, can take the following constraint actions:

- place a stop transfer on all or any of the common shares believed to be in excess of the Ownership Threshold;
- suspend all voting and/or dividend rights on all or any of common share held believed to be in excess of the Ownership Threshold;
- apply to a court seeking an injunction to prevent a person from acquiring, holding, owning, controlling and/or directing, directly or indirectly, common shares in excess of the Ownership Threshold; and/or
- make application to the relevant securities commission to effect a cease trading order or such similar restriction, until the person no longer controls common shares equal to or in excess of the Ownership Threshold.

In addition, if a Gaming Regulatory Authority has determined that ownership by a holder of common shares is inconsistent with its declared policies, the Board of Directors is entitled to take constraint action against such shareholder. Any person who controls common shares equal to or in excess of the Ownership Threshold, may be required to file an application, be investigated and have suitability as a shareholder determined by a Gaming Regulatory Authority, if such Gaming Regulatory Authority has reason to believe such ownership would otherwise be inconsistent with its declared policies. The shareholder must pay all the costs of the investigation incurred by any such Gaming Regulatory Authority.

14. Share capital (continued):

Capital management:

Pollard's objectives in managing capital are to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Pollard also strives to maintain an optimal capital structure to reduce the overall cost of capital.

In the management of capital, Pollard includes long-term debt, share capital and deficit, but excludes reserves. The Board of Directors regularly monitors the levels of debt, equity and dividends.

Pollard monitors capital on the basis of funded debt to Adjusted EBITDA, working capital ratio and debt service coverage. Pollard has externally imposed capital requirements as determined through its bank credit facility. As at December 31, 2012, Pollard is in compliance with all financial covenants.

Dividends:

Dividends are paid on the common shares within 15 days of the end of each quarter and are fully discretionary, as determined by the Board of Directors of Pollard, subject to restrictions imposed under its credit facility. Under the credit facility, Pollard has agreed not to pay dividends in excess of the current quarterly amount of $0.03 per share if the debt to Adjusted EBITDA ratio is above a certain level. As at December 31, 2012, Pollard's Adjusted EBITDA ratio is above the target level and as a result is restricted on the amount of dividends it can pay.

On November 6, 2012, a dividend of $0.03 per share was declared, payable on January 15, 2013, to the shareholders of record on December 31, 2012.

There were no other changes in Pollard's approach to capital management during the current period.

(In thousands of Canadian dollars, except for share amounts)

15. Commitments and contingencies:

Certain Pollard subsidiaries rent premises and equipment under long-term operating leases. The following is a schedule by fiscal year of rental payment commitments under operating leases outstanding:

2013	$	3,300
2014		3,191
2015		3,006
2016		2,839
2017		2,757
Thereafter		8,143

Pollard's subsidiaries are contingently liable for outstanding letters of guarantee in the amount of $3,248 at December 31, 2012 (2011 - $2,163). These letters of guarantee are part of Pollard's credit facility and are secured as disclosed in Note 12.

During 2011 Pollard entered into a sale leaseback with an affiliate of Pollard Equities Limited ("Equities") for land and building in Winnipeg, Manitoba (Equities owns approximately 73.5% of Pollard's outstanding shares). The property was sold for $3,473 and leased back for five years (with an option to renew for an additional five year term) at an annual lease rate of approximately $313. The sale value was determined through independent appraisal. See Note 20 for further description.

During 2008 Pollard entered into a sale leaseback with an affiliate of Equities for land and building in Council Bluffs, Iowa. The property was sold for CDN$4,081 and leased back for ten years at an annual lease rate of approximately US$260. The sale value was determined through independent appraisal. Also in 2008 Pollard entered into a lease with an affiliate of Equities for a manufacturing facility in Winnipeg, Manitoba. The lease was for a 12 year 6 month period, ending March 31, 2021, at an annual base rate of approximately $2,424.

Pollard has agreed to indemnify Pollard's current and former directors and officers from and against liability and costs in respect of any action or suit against them in connection with the execution of their duties of office, subject to certain usual limitations. No claims with respect to such occurrences have been made and, as such, no amount has been recorded in these financial statements with respect to these indemnifications.

(In thousands of Canadian dollars, except for share amounts)

16. Other (income) expense:

		2012		2011
Gain on sale of property, plant and equipment	$	-	$	(1,479)
Loss on equity investment (note 7)		204		-
Restructuring expense		-		486
Settlement loss on pension curtailment		-		726
Other income		(164)		(123)
	$	40	$	(390)

17. Finance costs and finance income:

Finance costs:		2012		2011
Foreign exchange loss	$	806	$	1,366
Interest		3,382		4,434
Amortization of deferred financing costs		563		567
	$	4,751	$	6,367

Finance income:		2012		2011
Foreign exchange gain	$	(648)	$	(766)
	$	(648)	$	(766)

18. Personnel expenses:

		2012		2011
Wages and salaries	$	54,554	$	55,707
Benefits and government payroll remittances		8,514		8,120
Profit share		1,107		776
Expenses related to defined contribution plans		169		150
Expenses related to defined benefit plans		1,754		2,470
	$	66,098	$	67,223

(In thousands of Canadian dollars, except for share amounts)

19. Supplementary cash flow information:

		2012		2011
Change in non-cash operating working capital:				
Accounts receivable	$	(1,096)	$	(596)
Inventories		(4,589)		675
Prepaid expenses and deposits		(116)		(18)
Accounts payable and accrued liabilities		672		(734)
Provisions		(9)		(985)
	$	(5,138)	$	(1,658)

20. Related party transactions:

During the year ended December 31, 2012, Pollard paid property rent of $3,002 (2011 - $2,844) and $245 (2011 - $211) in plane charter costs to affiliates of Equities. During the year, Equities paid Pollard $72 (2011 - $72) for accounting and administration fees.

Key management personnel are those having authority and responsibility for planning, directing and controlling the activities of the company. The Board of Directors and the Executive Committee are considered key management personnel.

Key management personnel compensation comprised:

		2012		2011
Wages, salaries and benefits	$	2,427	$	2,502
Profit share		9		6
Expenses related to defined benefit plans		239		214
	$	2,675	$	2,722

At December 31, 2012, included in accounts payable and accrued liabilities is an amount owing to Equities and its affiliates for rent and other expenses of $1,449 (2011 - $1,209).

During the second quarter of Fiscal 2011, Pollard disposed of a building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of $3,473 resulting in a gain of $1,469. The selling price was based on the current fair market value as determined through an independent appraisal. Pollard subsequently leased the property back for a five year term (with an option to renew for an additional five year term) for annual rent of $313.

(In thousands of Canadian dollars, except for share amounts)

20. Related party transactions (continued):

Significant subsidiaries:	Country of establishment	Percent Ownership Interest	
		December 31, 2012	December 31, 2011
Pollard Holdings Limited Partnership	Canada	100	100
Pollard Banknote Limited Partnership	Canada	100	100
Pollard Holdings, Inc.	U.S.	100	100
Pollard (U.S.) Ltd.	U.S.	100	100
Pollard Games, Inc.	U.S.	100	100

21. Sales to major customers:

For the year ended December 31, 2012, sales to one customer amounted to approximately 10 percent of consolidated sales (2011 - 12 percent).

22. Segmented information:

Pollard's operations consist of one reporting segment principally in the manufacturing and sale of lottery and charitable gaming products. Geographic distribution of sales, property, plant and equipment and goodwill are as follows:

	2012	2011
Sales:		
Canada	$ 33,431	$ 44,692
U.S.	86,503	90,920
Other	42,493	36,428
	$ 162,427	$ 172,040

	December 31, 2012	December 31, 2011
Property, plant and equipment and goodwill:		
Canada	$ 50,497	$ 49,144
U.S.	15,319	15,977
	$ 65,816	$ 65,121

23. Financial instruments:

The fair value of a financial instrument is the estimated amount that Pollard would receive or pay to terminate the instrument agreement at the reporting date. The following methods and assumptions were used to estimate the fair value of each type of financial instrument by reference to various market value data and other valuation techniques as appropriate.

The fair values of accounts receivable, accounts payable and accrued liabilities, provisions and dividends payable approximate their carrying values given their short-term maturities.

The fair value of the long-term debt approximates the carrying value due to the variable interest rate of the debt.

The fair value of the other long-term liabilities approximates the carrying value based on the expected settlement amount of these liabilities.

Certain financial instruments recorded at fair value on the statements of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on the quoted prices observed in active markets for identical assets or liabilities

Level 2 - valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market data by correlation or other means

Level 3 - valuation techniques with significant unobservable market inputs

A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

As at December 31, 2012, the cash recorded at fair value is classified as level one.

(In thousands of Canadian dollars, except for share amounts)

24. Financial risk management:

Pollard has exposure to the following risks from its use of financial instruments:

Credit risk
Liquidity risk
Currency risk
Interest rate risk

Pollard's risk management polices are established to identify and analyze the risks, to set appropriate risk limits and controls and to monitor risks and adherence to limits. The Audit Committee oversees how management monitors compliance with Pollard's risk management policies and procedures. The Audit Committee is assisted in its oversight role by Internal Audit, who undertakes regular reviews of risk management controls and utilizes the annual risk assessment process as the basis for the annual internal audit plan.

Credit risk

The following table outlines the details of the aging of Pollard's receivables and the related allowance for doubtful accounts:

	December 31, 2012	December 31, 2011
Current	$ 13,003	$ 11,174
Past due for 1 to 60 days	2,808	3,818
Past due for more than 60 days	499	671
Less: Allowance for doubtful accounts	(9)	(149)
	$ 16,301	$ 15,514

Liquidity risk

Liquidity risk is the risk that Pollard will not be able to meet its financial obligations as they fall due. Pollard's approach is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. In addition, Pollard maintains a committed credit facility including up to $70,000 for its Canadian operations and up to US$15,297 for its U.S. subsidiaries. At December 31, 2012, the unused balance available for drawdown was $10,928 (2011 - $17,659).

The 2013 requirements for capital expenditures, working capital and dividends are expected to be financed from cash flow provided by operating activities and the unused credit facility. Pollard enters into contractual obligations in the normal course of business operations.

24. Financial risk management (continued):

Currency risk

Pollard sells a significant portion of its products and services to customers in the United States and to international customers where sales are denominated in U.S. dollars. In addition, a significant portion of its cost inputs are denominated in U.S. dollars. Pollard also generates a small amount of revenue in currencies other than the Canadian and U.S. dollar, primarily in Euros.

A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian and U.S. dollar would decrease/increase the income before income taxes due to changes in operating cashflow by approximately $120 for year ended December 31, 2012 (2011 - $150).

In addition, translation differences arise when foreign currency monetary assets and liabilities are translated at foreign exchange rates that change over time. As at December 31, 2012, the amount of financial liabilities denominated in U.S. dollars exceeds the amount of financial assets denominated in U.S. dollars by approximately $5,622 (2011 - $6,182).

A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the U.S. dollar would result in a decrease/increase in net income of approximately $28 for the year ended December 31, 2012 (2011 - $31).

Interest rate risk

Pollard is exposed to interest rate risk relating to its fixed and floating rate instruments. Fluctuation in interest rates will have an effect on the valuation and repayment of these instruments.

A 50 basis point decrease/increase in interest rates would result in an increase/decrease in income before income taxes of approximately $354 for the year ended December 31, 2012 (2011 - $349).

The Board of Directors of Pollard Banknote Limited

Lawrence Pollard CHAIR EMERITUS
Gordon Pollard EXECUTIVE CHAIR
Del Crewson [1]
Jerry Gray [1,2]
Garry Leach [1]
John Pollard
Douglas Pollard

1 Member of the Audit Committee, Compensation Committee and the Governance and Nominating Committee
2 Lead Director

Senior Management

John Pollard
CO-CHIEF EXECUTIVE OFFICER

Douglas Pollard
CO-CHIEF EXECUTIVE OFFICER

Riva Richard
GENERAL COUNSEL AND EXECUTIVE VICE PRESIDENT, LEGAL AFFAIRS

Robert Rose
EXECUTIVE VICE PRESIDENT, FINANCE AND CHIEF FINANCIAL OFFICER

Robert Stewart
EXECUTIVE VICE PRESIDENT, MANUFACTURING

Jennifer Westbury
EXECUTIVE VICE PRESIDENT, SALES AND MARKETING

Robert Young
EXECUTIVE VICE PRESIDENT, OPERATIONS

Investor Relations

Robert Rose
1499 Buffalo Place
t: 204-474-2323
e: winnipeg@pollardbanknote.com

Stock Exchange Listing

The Toronto Stock Exchange - PBL

Independent Auditors

KPMG LLP,
Winnipeg, Manitoba

Transfer Agent

Computershare Trust Company of Canada,
Toronto, Ontario

Bankers

The Toronto-Dominion Bank,
Winnipeg, Manitoba

HSBC Bank,
Edmonton, Alberta

Head Office

1499 Buffalo Place,
Winnipeg, Manitoba, R3T 1L7
t: 204-474-2323
f: 204-453-1375

Manufacturing Facilities

Winnipeg, Manitoba, Canada
1499 Buffalo Place, R3T 1L7
140 Otter Street, R3T 0M8

Barrhead, Alberta, Canada
6203 46th Street, T7N 1A1

Sault Ste. Marie, Ontario, Canada
300-45 White Oak Drive East, P6B 4J7

Ypsilanti, Michigan, USA
775 James L. Hart Parkway, 48197

Council Bluffs, Iowa, USA
504 34th Avenue, 51501