*September 30, 2013*

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

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2013**

November 6, 2013

*This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the three and nine months ended September 30, 2013, is prepared as at November 6, 2013, and should be read in conjunction with the accompanying unaudited condensed consolidated interim financial statements of Pollard and the notes therein as at September 30, 2013 and the audited consolidated financial statements of Pollard for the year ended December 31, 2012 and the notes therein. Results are reported in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards ("IFRS" or "GAAP").*

### *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, amortization and depreciation, unrealized foreign exchange gains and losses, mark-to-market gains and losses on foreign currency contracts and interest rate swaps, and certain non-recurring items including Conversion expenses, 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 unaudited consolidated results of Pollard for the three and nine months ended September 30, 2013. 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 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

| | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Instant Tickets | 89.9% | 90.3% | 89.2% | 89.1% |
| Charitable Gaming Products | 8.9% | 8.7% | 9.4% | 9.9% |
| Vending Machines | 1.2% | 1.0% | 1.4% | 1.0% |

### Geographic breakdown of revenue

| | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| United States | 56% | 49% | 54% | 54% |
| Canada | 20% | 22% | 21% | 20% |
| International | 24% | 29% | 25% | 26% |

The following financial information should be read in conjunction with the accompanying unaudited consolidated financial statements of Pollard and the notes therein as at and for the three and nine months ended September 30, 2013.

**SELECTED FINANCIAL INFORMATION**

(millions of dollars, except per share information)

| | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Sales | $48.1 | $44.1 | $137.4 | $121.5 |
| Cost of sales | 38.4 | 34.9 | 111.4 | 97.2 |
| Gross profit | 9.7 | 9.2 | 26.0 | 24.3 |
| *Gross profit as a % of sales* | *20.2%* | *20.9%* | *18.9%* | *20.0%* |
| Administration expenses | 3.9 | 3.3 | 11.0 | 10.0 |
| *Expenses as a % of sales* | *8.1%* | *7.5%* | *8.0%* | *8.2%* |
| Selling expenses | 1.9 | 1.4 | 5.1 | 4.6 |
| *Expenses as a % of sales* | *4.0%* | *3.2%* | *3.7%* | *3.8%* |
| Realized foreign exchange loss (gain) | (0.5) | 0.5 | (0.7) | 0.4 |
| *Loss (gain) as a % of sales* | *(1.0%)* | *1.1%* | *(0.5%)* | *0.3%* |
| Net income | 2.6 | 3.3 | 4.6 | 5.2 |
| *Net income as a % of sales* | *5.4%* | *7.5%* | *3.3%* | *4.3%* |
| Adjusted EBITDA | 6.3 | 5.9 | 16.4 | 14.5 |
| *Adjusted EBITDA as a % of sales* | *13.1%* | *13.4%* | *11.9%* | *11.9%* |
| Net income per share | $0.11 | $0.14 | $0.19 | $0.22 |

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Total Assets | $132.6 | $127.0 |
| Total Non-Current Liabilities | $85.0 | $83.4 |

**RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA**

(millions of dollars)

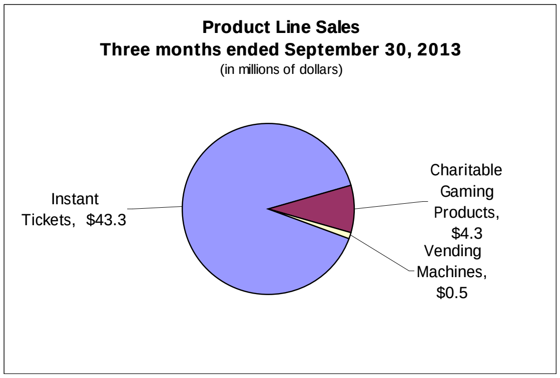
| | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Net income | $2.6 | $3.3 | $4.6 | $5.2 |
| Adjustments: | | | | |
| Amortization and depreciation | 2.0 | 1.9 | 5.9 | 5.6 |
| Interest | 0.8 | 0.8 | 2.6 | 2.5 |
| Unrealized foreign exchange (gain) loss | - | (0.9) | 0.5 | (0.6) |
| Income taxes | 0.9 | 0.8 | 2.8 | 1.8 |
| Adjusted EBITDA | $6.3 | $5.9 | $16.4 | $14.5 |

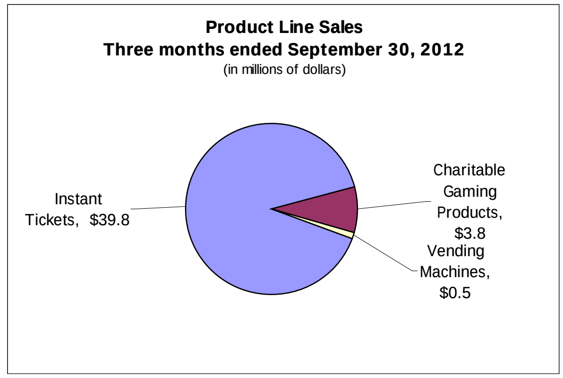
## REVIEW OF OPERATIONS

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

## ANALYSIS OF RESULTS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2013

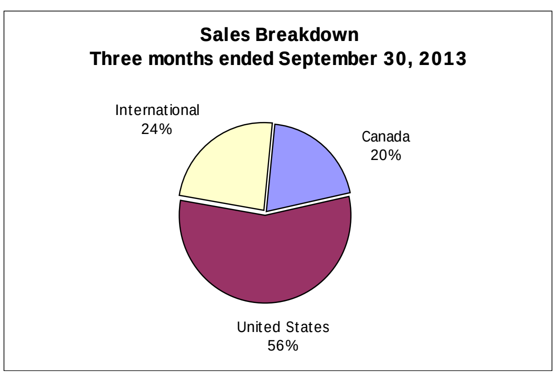
### Sales

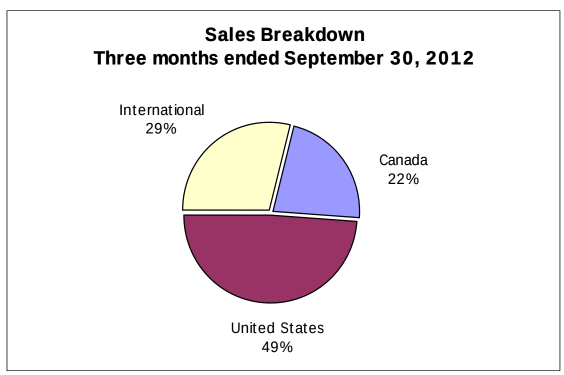



During the three months ended September 30, 2013, Pollard achieved sales of $48.1 million, compared to $44.1 million in the three months ended September 30, 2012. Factors impacting the $4.0 million sales increase were:

Instant ticket volumes for the third quarter of 2013 were higher than the third quarter of 2012 by 0.9% which, combined with an increase in our ancillary instant ticket products and services, increased sales by $2.3 million. In addition, a decrease in average selling price compared to 2012 reduced sales by $0.3 million. Charitable Gaming volumes increased during the quarter increasing sales by $0.3 million when compared to 2012, in addition, machine volumes also increased in the quarter relative to 2012 which further increased sales by $0.1 million.



During the three months ended September 30, 2013, Pollard generated approximately 64.6% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the third quarter of 2013 the actual U.S. dollar value was converted to Canadian dollars at $1.044, compared to a rate of $1.004 during the third quarter of 2012. This 4.0% increase in the U.S. dollar value resulted in an approximate increase of $1.2 million in revenue relative to the third quarter of 2012. Also during the third quarter of 2013, the Canadian dollar weakened against the Euro resulting in an approximate increase of $0.4 million in revenue relative to the third quarter of 2012.

### Cost of sales and gross profit

Cost of sales was $38.4 million in the third quarter of 2013 compared to $34.9 million in the third quarter of 2012. Cost of sales was higher in the quarter relative to 2012 as a result of increased instant ticket volumes and higher exchange rates on U.S. dollar transactions in the third quarter of 2013.

Gross profit was $9.7 million (20.2% of sales) in the third quarter of 2013 compared to $9.2 million (20.9% of sales) in the third quarter of 2012. This increase was due mainly to increased volumes of instant ticket and ancillary instant ticket products and services.

### Administration expenses

Administration expenses increased to $3.9 million in the third quarter of 2013 compared to $3.3 million in the third quarter of 2012 primarily as a result of increased compensation expenses, including incentive accruals, and higher professional fees.

### Selling expenses

Selling expenses increased to $1.9 million in the third quarter of 2013 compared to $1.4 million in the third quarter of 2012 primarily as a result of increased compensation expenses, including incentive accruals.

### 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 was $0.8 million in the third quarter of 2013 which was similar to $0.8 million in the third quarter of 2012.

*Foreign exchange gain and loss*

The net foreign exchange gain was $0.5 million in the third quarter of 2013 compared to a net gain of $0.4 million in the third quarter of 2012. The 2013 foreign exchange gain consisted of a realized foreign exchange gain of $0.5 million, comprised of a realized gain of $0.3 million on the increased value of U.S. dollar denominated receivables and $0.3 million realized gain on the sale of U.S. dollar forward contacts, partially offset by a $0.1 million realized loss on U.S. dollar denominated payables.

Within the 2012 foreign exchange gain was an unrealized foreign exchange gain of $0.9 million, relating to a $0.8 million unrealized foreign exchange gain on U.S. dollar denominated debt and a $0.1 million unrealized gain on U.S. dollar denominated payables. The realized loss of $0.5 million was comprised of realized losses on the decreased value of U.S. dollar denominated receivables.

### Adjusted EBITDA

Adjusted EBITDA was $6.3 million in the third quarter of 2013 compared to $5.9 million in the third quarter of 2012. The primary reasons for the increase in Adjusted EBITDA of $0.4 million were the increase in gross profit of $0.5 million and the increase in the realized foreign exchange gains of $1.0 million, partially offset by increased administration and selling expenses of $1.1 million.

### Income taxes

Income tax expense was $0.9 million in the third quarter of 2013, an effective rate of 24.9%, compared to the statutory rate of 26.3%, due to 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.

Income tax expense was $0.8 million in the third quarter of 2012, an effective rate of 18.7%, compared to the statutory rate of 26.8%, due to 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 $2.0 million during the third quarter of 2013 as compared to $1.9 million during the third quarter of 2012, the increase was due primarily to higher depreciation of property, plant and equipment.

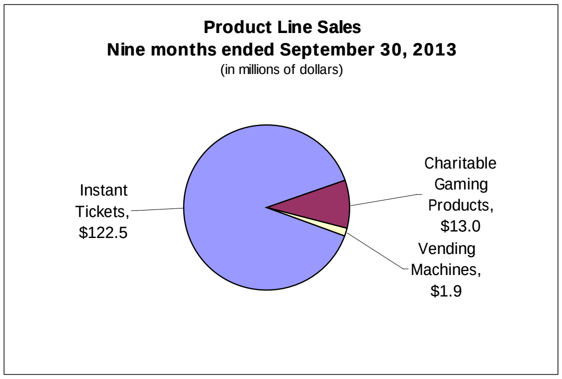
### Net income

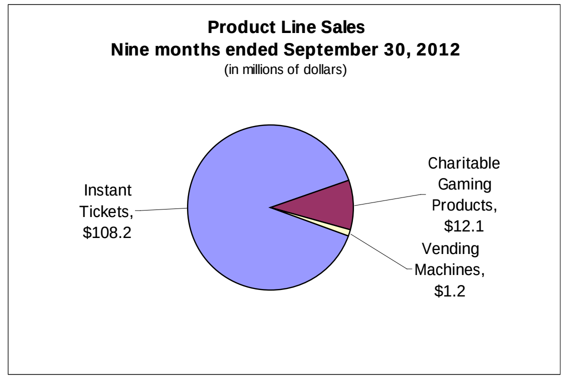
Net income was $2.6 million in the third quarter of 2013 compared to a Net income of $3.3 million in the third quarter of 2012. The primary reasons for the $0.7 million decrease were an increase of $1.1 million in selling and administrative expenses, partially offset by an increase in gross profit of $0.5 million.

Net income per share decreased to $0.11 per share in the third quarter of 2013 from a Net income per share of $0.14 in the third quarter of 2012.

## ANALYSIS OF RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013

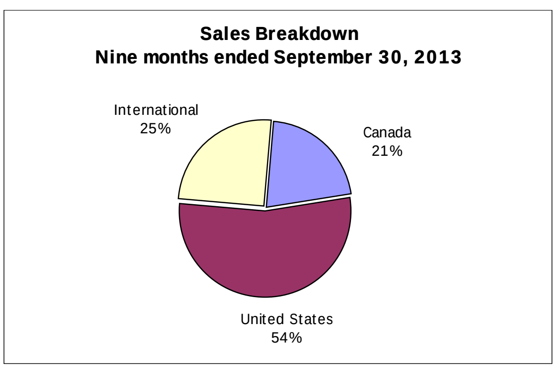
### Sales

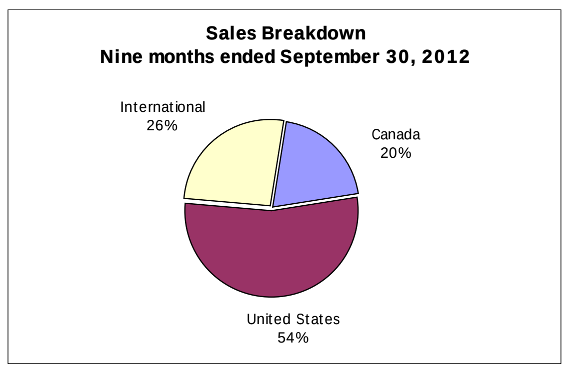



During the nine months ended September 30, 2013, Pollard achieved sales of $137.4 million, compared to $121.5 million in the nine months ended September 30, 2012. Factors impacting the $15.9 million sales increase were:

Instant ticket volumes for the first nine months of 2013 were higher by 9.2% than the first nine months of 2012 which, combined with an increase in our ancillary instant ticket products and services, increased sales by $12.5 million. Charitable Gaming volumes were higher than the first nine months of 2012 increasing sales by $0.6 million. In addition, an increase in average selling price further increased sales by $0.1 million. An increase in machine volumes in the first nine months of 2013 increased sales by $0.6 million when compared to 2012.




During the nine months ended September 30, 2013, Pollard generated approximately 66.7% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the first nine months of 2013 the actual U.S. dollar value was converted to Canadian dollars at $1.022, compared to a rate of $1.005 during the first nine months of 2012. This 1.7% increase in the U.S. dollar value resulted in an approximate increase of $1.5 million in revenue relative to the first nine months of 2012. In addition, during the nine months ended September 30, 2013, the weakening of the Canadian dollar against the Euro resulted in an approximate increase of $0.6 million in revenue relative to the first nine months of 2012.

### Cost of sales and gross profit

Cost of sales was $111.4 million in the nine months ended September 30, 2013, compared to $97.2 million in the first nine months of 2012. Cost of sales were higher in 2013 relative to 2012 as a result of increased instant ticket volumes and higher exchange rates on U.S. dollar transactions in the nine months ending September 30, 2013.

Gross profit increased to $26.0 million (18.9% of sales) in the first nine months of 2013 from $24.3 million (20.0% of sales) in the nine months ended September 30, 2012. This increase was due mainly to increased volumes of instant ticket and ancillary instant ticket products and services.

### Administration expenses

Administration expenses increased to $11.0 million in the first nine months of 2013 from $10.0 million in the first nine months of 2012 primarily as a result of increased compensation expenses, including incentive accruals, and higher professional fees.

### Selling expenses

Selling expenses increased to $5.1 million in the first nine months of 2013 from $4.6 million in the first nine months of 2012 primarily as a result of increased compensation expenses, including incentive accruals.

### 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 was $2.6 million in the first nine months of 2013 which was similar to $2.5 million in the first nine months of 2012.

*Foreign exchange gain and loss*

The net foreign exchange gain was $0.2 million in the first nine months of 2013 compared to a net gain of $0.2 million in the first nine months of 2012. Within the 2013 net foreign exchange gain was unrealized losses of $0.5 million, relating to unrealized foreign exchange loss on U.S. dollar denominated debt. Within the net foreign exchange gain was a realized gain of $0.7 million, consisting of $0.6 million in realized gains on the increased value of U.S. dollar denominated receivables and $0.3 million realized gain on the sale of U.S. dollar forward contacts, partially offset by a $0.2 million realized loss on U.S. dollar denominated payables.

Within the 2012 net foreign exchange gain are unrealized gains of $0.6 million, relating to unrealized foreign exchange gains on U.S. dollar denominated debt. Within the net foreign exchange gain was a realized loss of $0.4 million consisting of $0.6 million in realized losses 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 realized gains of $0.2 million relating to payments made on U.S. dollar denominated debt.

### Adjusted EBITDA

Adjusted EBITDA was $16.4 million in the first nine months of 2013 compared to $14.5 million in the first nine months of 2012. The primary reasons for the increase in Adjusted EBITDA of $1.9 million were the increase in gross profit of $2.2 million (net of amortization and depreciation) and the increase in the realized foreign exchange gains of $1.1 million, partially offset by increased administration and selling expenses of $1.5 million.

### Income taxes

Income tax expense was $2.8 million in the first nine months of 2013, an effective rate of 38.2%, compared to the statutory rate of 26.3%, due to 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.

Income tax expense was $1.8 million in the first nine months of 2012, an effective rate of 25.3%, compared to the statutory rate of 26.8%, due to 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 amortization of deferred financing costs and intangible assets, totaled $5.9 million during the first nine months of 2013 compared to $5.6 million during the first nine months of 2012, the increase was due primarily to increased depreciation of property, plant and equipment.

### Net income

Net income was $4.6 million in the first nine months of 2013 compared to $5.2 million in the first nine months of 2012. The primary reasons for the decrease in Net income of $0.6 million were the increase in selling and administration expenses of $1.5 million and the increase in income tax expense of $1.0 million, partially offset by an increase in gross profit of $1.7 million.

Net income per share decreased to $0.19 per share in the nine months ending September 30, 2013, from $0.22 in the first nine months of 2012.

## Liquidity and Capital Resources

*Cash provided by operating activities*

For the nine months ended September 30, 2013, cash flow provided by operating activities was $7.8 million compared to cash flow provided of $5.1 million for the first nine months of 2012. Changes in the non-cash component of working capital decreased cash flow from operations by $3.9 million for the nine months ended September 30, 2013 (due primarily to increase in accounts receivables and prepaids, partially offset by decrease in inventory), compared to a decrease of $5.3 million for the nine months ended September 30, 2012 (due primarily to increases in accounts receivable, inventories and prepaids).

*Cash used by investing activities*

In the nine months ended September 30, 2013, cash used by investing activities was $6.0 million compared to cash used of $4.6 million in the first nine months of 2012. In the nine months ended September 30, 2013, capital expenditures were $4.1 million and Pollard also expended $1.9 million on additions to intangible assets primarily related to licensing fees and implementation costs, including capitalized internal costs, for ERP software.

In the nine months ended September 30, 2012, capital expenditures were $3.7 million. In addition, Pollard further expended $0.4 million on its investment in associate and $0.5 million on intangible assets.

*Cash provided by financing activities*

Cash provided by financing activities was nil in the nine months ended September 30, 2013, compared to cash provided of $0.2 million in the nine months ended September 30, 2012.

During the first nine months of 2013 proceeds from long-term debt of $2.2 million were offset by dividends paid of $2.1 million and an increase in deferred financing of $0.1 million. Proceeds from long-term debt were used to finance increased investment in non-cash working capital and capital and intangible additions.

During the first nine months of 2012 proceeds from long-term debt of $2.5 million were partially offset by dividends paid of $2.1 million and an increase in deferred financing of $0.2 million. Proceeds from long-term debt were used to finance increased investment in non-cash working capital and capital additions.

As at September 30, 2013, Pollard had unused committed debt facility of $11.2 million. This amount is available to be used for future working capital requirements, contractual obligations, capital expenditures and dividends.

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

| | Q3 2013 | Q2 2013 | Q1 2013 | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 | Q4 2011 | Q3 2011 |
|---|---|---|---|---|---|---|---|---|---|
| Sales | $48.1 | $44.9 | $44.4 | $40.9 | $44.1 | $40.8 | $36.6 | $44.6 | $43.8 |
| Adjusted EBITDA | 6.3 | 4.9 | 5.2 | 5.6 | 5.9 | 5.3 | 3.4 | 5.2 | 5.9 |
| Net income (loss) | 2.6 | 1.0 | 1.0 | 1.5 | 3.3 | 1.0 | 0.8 | 1.7 | (1.2) |

Sales in Q1, Q2 and Q3 2013 and in Q3 2012 were higher primarily due to increases in volumes.

Adjusted EBITDA in Q3 2013 was higher due to higher gross profit achieved through higher sales volumes and increased realized foreign exchange gains.

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

### *Productive Capacity*

Management has defined productive capacity as the level of operations necessary to maintain a minimum Adjusted EBITDA of $22.0 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 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.

As at September 30, 2013, Pollard's investment in non-cash working capital increased $3.9 million compared to December 30, 2012. This increase was primarily as a result of increased investment in accounts receivables, as a result of increased sales at the end of the third quarter of 2013, and higher prepaid expenses and deposits.

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Working Capital | $32.4 | $27.2 |
| Total Assets | $132.6 | $127.0 |
| Total Non-Current Liabilities | $85.0 | $83.4 |

### *Credit Facility*

Pollard's credit facility, which was renewed effective June 28, 2013, consists of one committed term bank loan facility. The committed term bank loan facility provides loans of up to $75.0 million for its Canadian operations and up to US$11.0 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 September 30, 2013, the outstanding letters of guarantee were $1.6 million (December 31, 2012 - $3.2 million) and the remaining balance available for drawdown was $11.2 million (December 31, 2012 - $10.9 million).

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, amortization and depreciation ("Adjusted EBITDA") ratios and certain debt service coverage ratios. As at September 30, 2013 and November 6, 2013, Pollard is in compliance with all 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), maintenance capital expenditures (to a maximum of $3.5 million per year), pension deficit installments (to a maximum of $2.0 million for fiscal 2013 and $2.7 million for fiscal 2014), interest and cash income taxes paid. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. For the quarter ending September 30, 2013, the credit facility will be reduced by approximately $2.1 million as of November 29, 2013.

Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard and its operating subsidiaries. The credit facility can be prepaid without penalties. Under the terms of the agreement effective June 28, 2013, the credit facility is committed for a one year period, renewable June 30, 2014 ("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, 2015.

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 September 30, 2013 and November 6, 2013, outstanding share data was as follows:

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

## Contractual Obligations

There have been no material changes to Pollard's contractual obligations since December 31, 2012, that are outside the normal course of business.

## Off-Balance Sheet Arrangements

There have been no material changes to Pollard's off-balance sheet arrangements since December 31, 2012, that are outside the normal course of business.

## Financial Instruments

During the third quarter Pollard entered into foreign currency forward contracts to convert Euro €0.5 million per month into Canadian dollars from September 2013 to August 2014. The foreign currency contracts are recognized in the statement of financial position at fair value (which at September 30, 2013 was nil), with changes in fair value recognized in the statement of income.

During the second quarter Pollard entered into foreign currency forward contracts to convert $1 million U.S. dollars per month into Canadian dollars from July 2013 to December 2014. In September 2013, Pollard sold its remaining open U.S. dollar forward contracts, realizing a gain of $0.3 million. As of September 30, 2013, Pollard has no U.S. dollar foreign exchange forward contracts.

## Critical Accounting Policies and Estimates

The preparation of the financial statements in conformity with Canadian 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 judgement 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.

## Related Party Transactions

Pollard has not entered into any significant transactions with related parties during the nine months ended September 30, 2013, which are not disclosed in the unaudited condensed consolidated interim financial statements.

## Industry Risks and Uncertainties

The risk factors affecting Pollard remain substantially unchanged from those identified in the MD&A for Pollard for the year ended December 31, 2012.

## Outlook

The instant ticket lottery market continues to show robust growth as lotteries worldwide seek to maximize funds for their various good causes. Consistent with these goals, many lotteries are looking for ways to maintain their strong growth records including reaching out to their suppliers for new innovative ways to assist these objectives. Areas such as outsourcing management services, improved management of retail spaces, expanded distribution and additional involvement of the internet and social media are all avenues of opportunity for both the lotteries and the suppliers serving them, such as Pollard. The underlying sales of instant tickets have shown strong growth over the course of the last few years and we anticipate this growth will continue at these strong levels for the foreseeable future.

Our volumes for the remainder of 2013 and into 2014 are expected to be at similar or slightly higher levels than those experienced in 2013. In addition, sales of premium and proprietary products have grown generating a positive impact on average selling prices and margins. We expect these value-added items to continue to play an important role moving forward.

Our strong volumes are supported by our very extensive contract portfolio. During the past quarter we were very pleased to be awarded a new primary contract with the Maryland Lottery, an important long standing customer of Pollard whose new contract was won in a competitive bid process after the completion of our existing contract.  The successful bid award for a new primary contract with the Vermont Lottery and key contract extensions with leading lotteries like the Ohio Lottery and the Norwegian Lottery highlights the continued strength of the Pollard franchise within the lottery sector. We have no other material customer contracts that come due in 2013 (when extensions are considered) and will continue to aggressively pursue requests for proposals and other opportunities within the lottery industry as they come up for bid.

Unique proprietary premium products such as our patented Scratch FX® and Playbook games as well as licensed properties have been instrumental in driving sales for our lottery customers which in turn has allowed Pollard to build relationships with new customers and generate higher sales with existing customers.  We expect these key difference makers to continue to be very significant in the future and Pollard is committed to invest the appropriate resources in developing innovative ideas into new products and services such as those noted above in order to generate additional sales opportunities.

Our charitable gaming segment continues to perform well in the face of an overall market that is flat. Charitable gaming products consist of bingo paper, pull-tabs and related vending machines chiefly sold in bingo halls, taverns, legions and other venues often supported by various charities.  We expect the overall market to continue to be stable, with ongoing internal focus on cost improvements, efficiency gains and select introduction of new products and niche markets expected to support ongoing results in this area.

Budgeted capital expenditures for the remainder of 2013 and early 2014 are expected to be at similar levels to expenditures incurred in the first nine months of 2013.

Pollard believes our ongoing cash flow from operations and our current bank facility capacity 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") for the interim period regarding the design of the disclosure controls and procedures. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the design of the disclosure controls and procedures as defined in Multilateral Instrument 52-109 will provide reasonable assurance of achieving the disclosure objectives.

## Internal Controls over Financial Reporting

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

No changes were made in Pollard's internal control over financial reporting during the three and nine months ended September 30, 2013, that have materially affected, or are reasonably likely to materially affect, Pollard's internal control over financial reporting.

## Additional Information

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

Additional information relating to Pollard, including the Audited Consolidated Financial Statements and the Annual Information Form of Pollard for the year ended December 31, 2012, is available on SEDAR at www.sedar.com.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(204) 474-2323<br>
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Condensed Consolidated Interim Financial Statements of

# POLLARD BANKNOTE LIMITED

(unaudited)

Nine months ended September 30, 2013

These condensed consolidated interim financial statements have not been audited or reviewed by the Company's independent external auditors, KPMG LLP.

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

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash | $ 6,897 | $ 4,982 |
| Accounts receivable | 18,776 | 16,301 |
| Inventories (note 5) | 21,685 | 21,726 |
| Prepaid expenses and deposits | 3,566 | 1,760 |
| Total current assets | 50,924 | 44,769 |
| Non-current assets | | |
| Property, plant and equipment | 30,366 | 30,113 |
| Equity investment (note 6) | 125 | 204 |
| Goodwill | 35,952 | 35,703 |
| Intangible assets | 12,247 | 11,840 |
| Deferred income taxes | 3,005 | 4,324 |
| Total non-current assets | 81,695 | 82,184 |
| Total assets | $ 132,619 | $ 126,953 |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | $ 16,389 | $ 16,174 |
| Dividends payable | 706 | 706 |
| Income taxes payable | 1,449 | 700 |
| Total current liabilities | 18,544 | 17,580 |
| Non-current liabilities | | |
| Long-term debt (note 7) | 73,388 | 70,485 |
| Other non-current liabilities | 241 | 195 |
| Pension liability | 8,773 | 9,902 |
| Deferred income taxes | 2,567 | 2,781 |
| Total non-current liabilities | 84,969 | 83,363 |
| Shareholders' equity | | |
| Share capital | 73,209 | 73,209 |
| Reserves | (197) | (826) |
| Deficit | (43,906) | (46,373) |
| Total shareholders' equity | 29,106 | 26,010 |
| Total liabilities and shareholders' equity | $ 132,619 | $ 126,953 |

See accompanying notes to condensed consolidated interim financial statements.

## Pollard Banknote Limited

**Condensed Consolidated Statements of Income**

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

(unaudited)

| | **Three months ended September 30, 2013** | Three months ended September 30, 2012 | **Nine months ended September 30, 2013** | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Sales | **$ 48,138** | $ 44,113 | **$ 137,353** | $ 121,494 |
| Cost of sales | **38,403** | 34,878 | **111,401** | 97,202 |
| Gross profit | **9,735** | 9,235 | **25,952** | 24,292 |
| Administration | **3,957** | 3,259 | **10,991** | 10,048 |
| Selling | **1,891** | 1,448 | **5,099** | 4,567 |
| Other (income) expense (note 8) | **14** | (95) | **(179)** | (48) |
| Income from operations | **3,873** | 4,623 | **10,041** | 9,725 |
| Finance costs (note 9) | **896** | 953 | **3,132** | 3,418 |
| Finance income (note 9) | **(515)** | (447) | **(515)** | (648) |
| Income before income taxes | **3,492** | 4,117 | **7,424** | 6,955 |
| Income taxes (note 10) | **869** | 769 | **2,838** | 1,763 |
| Net income | **$ 2,623** | $ 3,348 | **$ 4,586** | $ 5,192 |
| Basic and diluted net income per share | **$ 0.11** | $ 0.14 | **$ 0.19** | $ 0.22 |
| Weighted average number of shares outstanding | **23,543,158** | 23,543,158 | **23,543,158** | 23,543,158 |

See accompanying notes to condensed consolidated interim financial statements.

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

| | | **Three months ended September 30, 2013** | | Three months ended September 30, 2012 | | **Nine months ended September 30, 2013** | | Nine months ended September 30, 2012 |
|---|---|---|---|---|---|---|---|---|
| Net income | **$** | **2,623** | $ | 3,348 | **$** | **4,586** | $ | 5,192 |
| Other comprehensive income (loss) | | | | | | | | |
| Foreign currency translation differences – foreign operations | | **(274)** | | (414) | | **629** | | (403) |
| Other comprehensive income (loss) – net of income tax | | **(274)** | | (414) | | **629** | | (403) |
| Comprehensive income | **$** | **2,349** | $ | 2,934 | **$** | **5,215** | $ | 4,789 |

See accompanying notes to condensed consolidated interim financial statements.

**Pollard Banknote Limited**

**Condensed Consolidated Statements of Changes in Equity**

(*In thousands of Canadian dollars*)

(unaudited)

**For the nine months ended September 30, 2013**

| | | Attributable to equity holders of Pollard Banknote Limited | | | |
|---|---|---|---|---|---|
| | | **Share capital** | **Translation reserve** | **Deficit** | **Total equity** |
| Balance at January 1, 2013 | $ | 73,209 | (826) | (46,373) | 26,010 |
| Net income | | - | - | 4,586 | 4,586 |
| Other comprehensive income | | | | | |
| Foreign currency translation differences – foreign operations | | - | 629 | - | 629 |
| Total other comprehensive income | $ | - | 629 | - | 629 |
| Total comprehensive income | $ | - | 629 | 4,586 | 5,215 |
| Dividends to owners of Pollard Banknote Limited | | - | - | (2,119) | (2,119) |
| Balance at September 30, 2013 | $ | 73,209 | (197) | (43,906) | 29,106 |

**For the nine months ended September 30, 2012**

| | | Attributable to equity holders of Pollard Banknote Limited | | | |
|---|---|---|---|---|---|
| | | **Share capital** | **Translation reserve** | **Deficit** | **Total equity** |
| Balance at January 1, 2012 | $ | 73,209 | (326) | (45,222) | 27,661 |
| Net income | | - | - | 5,192 | 5,192 |
| Other comprehensive loss | | | | | |
| Foreign currency translation differences – foreign operations | | - | (403) | - | (403) |
| Total other comprehensive loss | $ | - | (403) | - | (403) |
| Total comprehensive income (loss) | $ | - | (403) | 5,192 | 4,789 |
| Dividends to owners of Pollard Banknote Limited | | - | - | (2,119) | (2,119) |
| Balance at September 30, 2012 | $ | 73,209 | (729) | (42,149) | 30,331 |

See accompanying notes to condensed consolidated interim financial statements.

**Pollard Banknote Limited**

**Condensed Consolidated Statements of Cash Flows**

(*In thousands of Canadian dollars*)

(unaudited)

| | **Nine months ended September 30, 2013** | Nine months ended September 30, 2012 |
|---|---|---|
| Cash increase (decrease) | | |
| Operating activities | | |
| Net income | **$ 4,586** | $ 5,192 |
| Adjustments | | |
| Income taxes | **2,838** | 1,763 |
| Amortization and depreciation | **5,853** | 5,655 |
| Interest expense | **2,581** | 2,510 |
| Unrealized foreign exchange (gain) loss | **523** | (596) |
| Loss on equity investment | **79** | 147 |
| Interest paid | **(2,624)** | (2,519) |
| Income tax paid | **(937)** | (714) |
| Change in pension liability | **(1,171)** | (1,052) |
| Change in non-cash operating working capital (note 11) | **(3,880)** | (5,336) |
| | **7,848** | 5,050 |
| Investing activities | | |
| Additions to property, plant and equipment | **(4,106)** | (3,717) |
| Investment in associate (note 6) | **-** | (408) |
| Additions to intangible assets | **(1,873)** | (492) |
| | **(5,979)** | (4,617) |
| Financing activities | | |
| Proceeds from long-term debt | **2,242** | 2,485 |
| Change in other non-current liabilities | **36** | (57) |
| Additions to deferred financing charges | **(137)** | (157) |
| Dividends paid | **(2,119)** | (2,119) |
| | **22** | 152 |
| Foreign exchange gain (loss) on cash held in foreign currency | **24** | (264) |
| Change in cash position | **1,915** | 321 |
| Cash position, beginning of period | **4,982** | 5,059 |
| Cash position, end of period | **$ 6,897** | $ 5,380 |

See accompanying notes to condensed consolidated interim financial statements.

## 1. Reporting entity:

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

The condensed consolidated interim financial statements of Pollard as at and for the nine months ended September 30, 2013, comprise Pollard, Pollard's subsidiaries and its interest in an associate. Pollard is primarily involved in the manufacture and sale of lottery and gaming products.

Pollard's consolidated financial statements as at and for the year ended December 31, 2012, are available at www.sedar.com.

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

## 2. Basis of preparation:

(a) Statement of compliance:

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standards ("IAS") 34 *Interim Financial Reporting* and do not include all of the information required for full annual consolidated financial statements.

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

(b) Use of estimates and judgements:

The preparation of condensed consolidated interim financial statements requires management to make judgements, 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.

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying Pollard's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended December 31, 2012.

## 3. Significant accounting policies:

Except for the accounting policies described below, these condensed consolidated interim financial statements follow the same significant accounting policies as described and used in Pollard's

## 3. Significant accounting policies (continued):

consolidated financial statements for the year ended December 31, 2012 and should be read in conjunction with those reports. The following new standards and amendments did not have a material impact on the condensed consolidated interim financial statements.

In May 2011, the International Accounting Standards Board ("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.

- International Financial Reporting Standards ("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.

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.

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

## 3. Significant accounting policies (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.

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.

## 4. Future accounting standards:

In November 2009, the 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.

## 5. Inventories:

| | **September 30, 2013** | December 31, 2012 |
|---|---|---|
| Raw materials | **$ 6,718** | $ 5,713 |
| Work-in-process | **919** | 843 |
| Finished goods | **14,048** | 15,170 |
| | **$ 21,685** | $ 21,726 |

During the third quarter of 2013 Pollard recorded inventory write-downs of $143 representing an increase in the obsolescence reserves and inventory write-downs of $64 due to changes in foreign exchange rates. During the nine months ended September 30, 2013, Pollard recorded inventory write-downs of $360 representing an increase in the obsolescence reserves and a reversal of previous write-downs of $41 due to changes in foreign exchange rates.

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

## 5. Inventories (continued):

During the third quarter of 2012 Pollard recorded inventory write-downs of $30 due to changes in foreign exchange rates. During the nine months ended September 30, 2012, Pollard recorded inventory write-downs of $53 representing an increase in the obsolescence reserves and a reversal of previous write-downs of $2 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. Equity investment:

| | | **Nine months ended September 30, 2013** | | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Balance – beginning of period | **$** | **204** | $ | - |
| Initial investment | | **-** | | 408 |
| Equity loss | | **(79)** | | (147) |
| Balance – end of period | **$** | **125** | $ | 261 |

In 2012 Pollard 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.

## 7. Long-term debt:

| | | **September 30, 2013** | | December 31, 2012 |
|---|---|---|---|---|
| Credit facility, interest of 3.19% to 4.75% payable monthly, maturing 2015 | **$** | **73,583** | $ | 70,815 |
| Deferred financing charges, net of amortization | | **(195)** | | (330) |
| | **$** | **73,388** | $ | 70,485 |

Included in the total credit facility balance is a U.S. dollar loan balance of US$13,541 (December 31, 2012 - US$13,597).

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

## 7. Long-term debt (continued):

Effective June 28, 2013, Pollard's subsidiaries Pollard Holdings Limited Partnership and Pollard Holdings, Inc. renewed their credit facility. The credit facility provides loans of up to $75,000 for its Canadian operations and up to US$11,041 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 September 30, 2013, the outstanding letters of guarantee drawn under the credit facility were $1,554 (December 31, 2012 - $3,248).

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, amortization and depreciation ("Adjusted EBITDA") ratios and certain debt service coverage ratios. As at September 30, 2013, 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), maintenance capital expenditures (to a maximum of $3,500 per year), pension deficit installments (to a maximum of $2,000 for fiscal 2013 and $2,700 for fiscal 2014), interest and cash income taxes paid. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. For the quarter ending September 30, 2013, the credit facility will be reduced by approximately $2,142 as of November 29, 2013. As of September 30, 2013, Pollard has unused credit facility available of $11,235 (December 31, 2012 - $10,928).

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 28, 2013, the credit facility is committed for a one year period, renewable June 30, 2014 ("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, 2015.

## 8. Other (income) expense:

| | **Three months ended September 30, 2013** | Three months ended September 30, 2012 | **Nine months ended September 30, 2013** | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Loss on equity investment (note 6) | **$ 37** | $ 38 | **$ 79** | $ 147 |
| Other | **(23)** | (133) | **(258)** | (195) |
| | **$ 14** | $ (95) | **$ (179)** | $ (48) |

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

## 9. Finance costs and finance income:

| Finance costs: | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Foreign exchange loss | $ - | $ - | $ 279 | $ 490 |
| Interest | 831 | 811 | 2,581 | 2,510 |
| Amortization of deferred financing costs | 65 | 142 | 272 | 418 |
| | $ 896 | $ 953 | $ 3,132 | $ 3,418 |

| Finance income: | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Foreign exchange gain | $ (515) | $ (447) | $ (515) | $ (648) |
| | $ (515) | $ (447) | $ (515) | $ (648) |

## 10. Income taxes:

### Income tax expense

| | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Current | $ 744 | $ 351 | $ 1,647 | $ 982 |
| Deferred | 125 | 418 | 1,191 | 781 |
| | $ 869 | $ 769 | $ 2,838 | $ 1,763 |

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

## 10. Income taxes (continued):

### Reconciliation of effective tax rate

| | | Three months ended September 30, 2013 | | | Three months ended September 30, 2012 |
|---|---|---|---|---|---|
| Net income for the period | | **$** | **2,623** | | $ | 3,348 |
| Total income taxes | | | **869** | | | 769 |
| Income before income taxes | | **$** | **3,492** | | $ | 4,117 |
| Income tax using Pollard's domestic tax rate | **26.3%** | **$** | **918** | 26.8% | $ | 1,103 |
| Withholding taxes and other non-deductable amounts | **(0.8%)** | | **(29)** | (0.2%) | | (7) |
| Effect of non-taxable items related to foreign exchange | **(0.6%)** | | **(20)** | (7.9%) | | (327) |
| | **24.9%** | **$** | **869** | 18.7% | $ | 769 |

| | | Nine months ended September 30, 2013 | | | Nine months ended September 30, 2012 |
|---|---|---|---|---|---|
| Net income for the period | | **$** | **4,586** | | $ | 5,192 |
| Total income taxes | | | **2,838** | | | 1,763 |
| Income before income taxes | | **$** | **7,424** | | $ | 6,955 |
| Income tax using Pollard's domestic tax rate | **26.3%** | **$** | **1,953** | 26.8% | $ | 1,864 |
| Withholding taxes and other non-deductable amounts | **0.3%** | | **21** | 0.1% | | 10 |
| Effect of non-taxable items related to foreign exchange | **11.6%** | | **864** | (1.6%) | | (111) |
| | **38.2%** | **$** | **2,838** | 25.3% | $ | 1,763 |

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

## 11. Supplementary cash flow information:

| | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|
| Change in non-cash operating working capital: | | |
| Accounts receivable | **$ (2,227)** | $ (798) |
| Inventories | **355** | (3,700) |
| Prepaid expenses and deposits | **(1,975)** | (617) |
| Accounts payable and accrued liabilities | **(33)** | (221) |
| | **$ (3,880)** | $ (5,336) |

## 12. 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 September 30, 2013, Pollard's Adjusted EBITDA ratio is below the target level and as a result there are currently no restrictions on the amount of dividends.

On August 7, 2013, a dividend of $0.03 per share was declared, payable on October 15, 2013, to the shareholders of record on September 30, 2013.

## 13. Related party transactions:

During the quarter ended September 30, 2013, Pollard paid property rent of $753 (2012 - $751) and $61 (2012 - $70) in plane charter costs to affiliates of Pollard Equities Limited ("Equities"). During the nine months ended September 30, 2013, Pollard paid property rent of $2,257 (2012 - $2,252) and $184 (2012 - $140) in plane charter costs to affiliates of Equities. During the quarter, Equities paid Pollard $18 (2012 - $18) for accounting and administration fees and $54 (2012 - $54) during the nine months ended September 30, 2013.

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.

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

## 13. Related party transactions (continued):

Key management personnel compensation comprised:

| | **Three months ended September 30, 2013** | Three months ended September 30, 2012 | **Nine months ended September 30, 2013** | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| Wages, salaries and benefits | **$ 572** | $ 551 | **$ 1,764** | $ 1,934 |
| Profit share | **3** | 4 | **7** | 7 |
| Expenses related to defined benefit plans | **89** | 54 | **267** | 161 |
| | **$ 664** | $ 609 | **$ 2,038** | $ 2,102 |

At September 30, 2013, included in accounts payable and accrued liabilities is an amount owing to Equities and its affiliates for rent and other expenses of $695 (December 31, 2012 - $1,449).

## 14. 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.

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

## 14. Financial risk management (continued):

*Credit risk*

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

| | **September 30, 2013** | December 31, 2012 |
|---|---|---|
| Current | **$ 16,922** | $ 13,003 |
| Past due for 1 to 60 days | **1,012** | 2,808 |
| Past due for more than 60 days | **932** | 499 |
| Less: Allowance for doubtful accounts | **(90)** | (9) |
| | **$ 18,776** | $ 16,301 |

*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 $75,000 for its Canadian operations and up to US$11,041 for its U.S. subsidiaries. At September 30, 2013, the unused balance available for drawdown was $11,235 (December 31, 2012 - $10,928).

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 portion of the credit facility. Pollard enters into contractual obligations in the normal course of business operations.

*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 weakening/strengthening 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 $23 for the third quarter of 2013 (2012 - $43) and approximately $58 for the nine months ended September 30, 2013 (2012 - $79).

## 14. Financial risk management (continued):

In addition, translation differences arise when foreign currency monetary assets and liabilities are translated at foreign exchange rates that change over time. At September 30, 2013, the amount of financial liabilities denominated in U.S. dollars exceeds the amount of financial assets denominated in U.S. dollars by approximately $5,196 (December 31, 2012 - $5,622). 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 income before income taxes of approximately $26 for the third quarter of 2013 (2012 - $38).

Pollard utilizes a number of strategies to mitigate its exposure to currency risk. 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.

In the second quarter of 2013, Pollard entered into foreign currency forward contracts to exchange US$1,000 each month for approximately $1,054 for 18 consecutive months from July 2013 to December 2014. In September 2013, Pollard sold its remaining open U.S. dollar forward contracts, realizing a gain of $298. As of September 30, 2013, Pollard has no U.S. dollar forward contracts.

In addition, Pollard has entered into foreign currency contracts to exchange Euros €500 each month for approximately $693 for 12 consecutive months from September 2013 to August 2014. The foreign currency contracts are recognized in the balance sheet and measured at fair value, which at September 30, 2013, was equal to the contract value and therefore no asset or liability was recorded.

A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the Euro would result in a decrease/increase in income before taxes of approximately $28 for the third quarter of 2013 (2012 - nil) and approximately $28 for the nine months ended September 30, 2013 (2012 - nil), due to the change in the value of the mark-to-market value of the foreign currency contracts.

*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 $92 for the three months ended September 30, 2013 (2012 - $89) and approximately $276 for the nine months ended September 30, 2013 (2012 - $267).