POLLARD
banknote limited

June 30, 2016

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

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016

August 10, 2016

This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the three and six months ended June 30, 2016, is prepared as at August 10, 2016, and should be read in conjunction with the accompanying unaudited condensed consolidated interim financial statements of Pollard and the notes therein as at June 30, 2016, and the audited consolidated financial statements of Pollard for the year ended December 31, 2015, 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, depreciation and amortization, unrealized foreign exchange gains and losses, mark-to-market gains and losses on foreign currency contracts, and certain non-recurring items including start-up 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 six months ended June 30, 2016. 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, SureTrack® lottery management system, retail telephone selling ("tel-sell"), marketing, iLottery, interactive gaming, Social Instants™, retail management services 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 60 instant ticket lotteries including a number of the largest lotteries throughout the world. Charitable gaming products are mostly sold in the United States and Canada where permitted by gaming regulatory authorities. Pollard serves a highly diversified customer base in the charitable gaming market of over 250 independent distributors with the majority of revenue generated from repeat business.

Product line breakdown of revenue

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Instant Tickets	87.6%	88.4%	88.3%	89.1%
Charitable Gaming Products	12.4%	11.6%	11.7%	10.9%

Geographic breakdown of revenue

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
United States	58%	58%	57%	53%
Canada	17%	20%	19%	21%
International	25%	22%	24%	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 six months ended June 30, 2016.

SELECTED FINANCIAL INFORMATION

(millions of dollars, except per share information)

	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Sales	$54.0	$51.4	$118.0	$105.9
Cost of sales	43.1	40.7	95.7	85.1
Gross profit	10.9	10.7	22.3	20.8
Gross profit as a % of sales	*20.2%*	*20.8%*	*18.9%*	*19.6%*
Administration expenses	5.1	4.3	10.4	8.5
Administration expenses as a % of sales	*9.4%*	*8.4%*	*8.8%*	*8.0%*
Selling expenses	1.8	1.6	3.7	3.4
Selling expenses as a % of sales	*3.3%*	*3.1%*	*3.1%*	*3.2%*
Net income	2.0	3.0	5.6	4.4
Net income as a % of sales	*3.7%*	*5.8%*	*4.7%*	*4.2%*
Adjusted EBITDA	6.0	6.3	12.8	13.0
Adjusted EBITDA as a % of sales	*11.1%*	*12.3%*	*10.8%*	*12.3%*
Adjusted EBITDA excluding realized foreign exchange (loss) gain	7.2	6.8	14.1	13.0
As a % of sales	*13.3%*	*13.2%*	*11.9%*	*12.3%*
Net income per share (basic and diluted)	$0.09	$0.13	$0.24	$0.18

	June 30, 2016	December 31, 2015
Total Assets	$170.1	$164.1
Total Non-Current Liabilities	$95.3	$96.3

RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA

(millions of dollars)

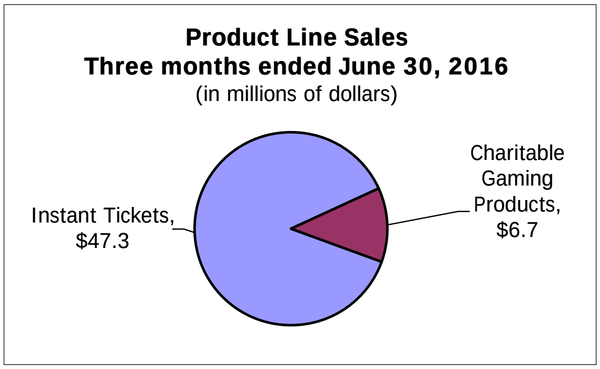
	Three months ended June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Net income	$2.0	$3.0	$5.6	$4.4
Adjustments:				
Amortization and depreciation	2.9	2.0	5.6	4.0
Interest	0.8	0.6	1.7	1.3
Mark-to-market gain on foreign currency contracts	-	(0.4)	-	(0.5)
Unrealized foreign exchange (gain) loss	(0.9)	(0.5)	(2.0)	1.2
Income taxes	1.2	1.6	1.9	2.6
Adjusted EBITDA	$6.0	$6.3	$12.8	$13.0
Realized foreign exchange loss	(1.2)	(0.5)	(1.3)	-
Adjusted EBITDA excluding realized foreign exchange loss	$7.2	$6.8	$14.1	$13.0

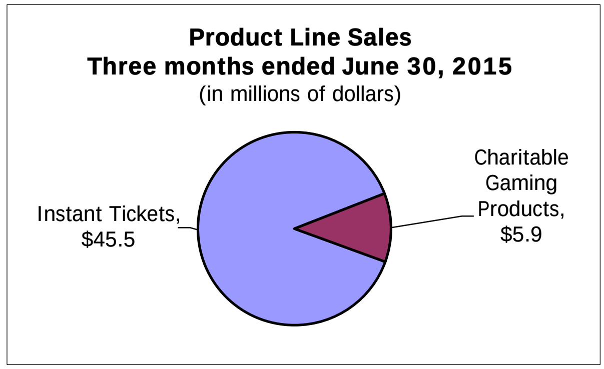
REVIEW OF OPERATIONS

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 JUNE 30, 2016

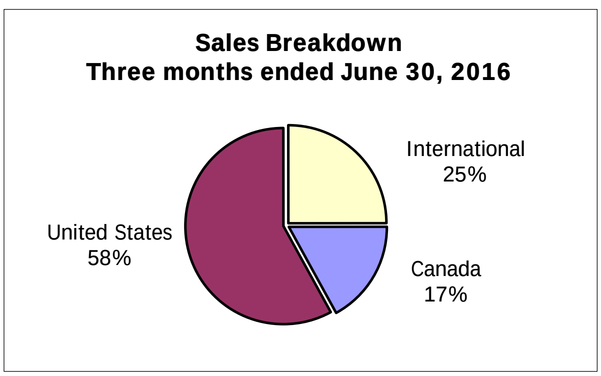
Sales

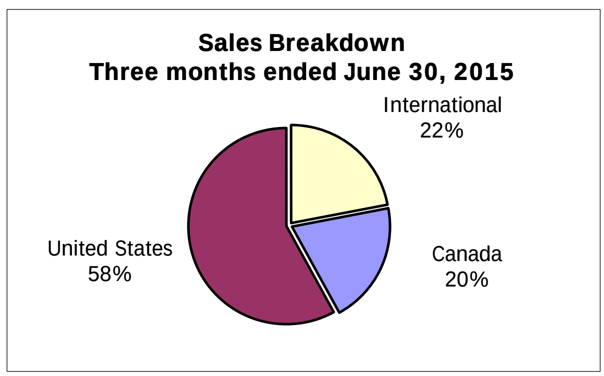




During the three months ended June 30, 2016, Pollard achieved sales of $54.0 million, compared to $51.4 million in the three months ended June 30, 2015. Factors impacting the $2.6 million sales increase were:

Instant ticket average selling price increased in the second quarter of 2016 compared to the prior year which increased sales by $3.4 million. Sales of ancillary instant ticket products and services increased in 2016, increasing sales by $0.8 million due primarily to increased sales from iLottery. An increase in the charitable gaming average selling price increased sales by $0.4 million when compared to the second quarter of 2015. Partially offsetting these increases, instant ticket sales volumes in the quarter decreased when compared to the second quarter of 2015 decreasing sales by $3.8 million due to a significant increase in volume of international customers' tickets produced in the second quarter in transit as at June 30, 2016.





During the three months ended June 30, 2016, Pollard generated approximately 69.0% (2015 – 68.5%) of its revenue in U.S. dollars including a portion of international sales which are priced in U.S. dollars. During the second quarter of 2016 the actual U.S. dollar value was converted to Canadian dollars at $1.288, compared to a rate of $1.238 during the second quarter of 2015. This 4.1% increase in the U.S. dollar value resulted in an approximate increase of $1.5 million in revenue relative to the second quarter of 2015. Also during the quarter, the value of the Euro strengthened against the Canadian dollar resulting in an approximate increase of $0.3 million in revenue relative to the second quarter of 2015.

Cost of sales and gross profit

Cost of sales was $43.1 million in the second quarter of 2016 compared to $40.7 million in the second quarter of 2015. Cost of sales were higher in the quarter relative to 2015 as a result of higher amortization, increased ancillary instant ticket products and services sales and higher exchange rates on U.S. dollar transactions.

Gross profit was $10.9 million (20.2% of sales) in the second quarter of 2016 compared to $10.7 million (20.8% of sales) in the second quarter of 2015. This increase in gross profit was primarily the result of the increase in ancillary instant ticket products and services sales and higher exchange rates on U.S. dollar transactions. The lower gross profit percentage was due to the instant ticket sales mix weighted to lower margin products and the impact of additional production costs related to the ramp up of the new press. Sequentially the second quarter gross profit percentage (20.2% of sales) was higher than the first quarter of 2016 gross margin percentage (17.8% of sales) due partially to improved manufacturing efficiencies.

Administration expenses

Administration expenses increased to $5.1 million in the second quarter of 2016 from $4.3 million in the second quarter of 2015 primarily as a result of higher professional fees, increased compensation expenses (which primarily related to expansion of lottery management systems and ancillary lottery product sales) and the increased Canadian dollar equivalent of U.S. dollar denominated expenses. Sequentially administration expenses have declined from $5.3 million in the first quarter of 2016 and $5.7 million in the fourth quarter of 2015 primarily due to lower professional fees. Pollard anticipates lower professional fees for the remainder of 2016.

Selling expenses

Selling expenses of $1.8 million in the second quarter of 2016 were similar to $1.6 million in the second quarter of 2015.

Interest expense

Interest expense increased to $0.8 million in the second quarter of 2016 from $0.6 million in the second quarter of 2015 primarily as a result of no longer capitalizing borrowing costs related to the new press project.

Foreign exchange loss

The net foreign exchange loss was $0.3 million in the second quarter of 2016 compared to a net loss of nil in the second quarter of 2015. The 2016 net foreign exchange loss was due to the strengthening of the Canadian dollar. Partially offsetting the realized foreign exchange loss of $1.2 million, relating to the decreased value on the collections of U.S. dollar denominated receivables, was the reversal of $0.9 million unrealized loss recognized in prior quarters.

Within the 2015 net foreign exchange loss was an unrealized foreign exchange gain of $0.5 million, predominately a result of unrealized gain on U.S. dollar denominated debt (caused by the strengthening of the value of the Canadian dollar versus the U.S. dollar) in addition to an unrealized gain on other U.S. dollar denominated accounts payable. Offsetting the unrealized gain was a realized foreign exchange loss of $0.5 million relating to the decreased value on the collections of U.S. dollar denominated receivables and a realized loss on the conversion of U.S. dollars and Euros into Canadian dollars.

Adjusted EBITDA

Adjusted EBITDA was $6.0 million in the second quarter of 2016 compared to $6.3 million in the second quarter of 2015. The primary reason for the decrease in Adjusted EBITDA of $0.3 million was the increase in administration expenses of $0.8 million and realized foreign exchange loss of $0.7 million. These decreases were partially offset by the increase in gross profit (net of amortization and depreciation) of $1.1 million.

Adjusted EBITDA excluding realized foreign exchange (loss) gain was $7.2 million in the second quarter of 2016 compared to $6.8 million in the second quarter of 2015.

Income taxes

Income tax expense was $1.2 million in the second quarter of 2016, an effective rate of 36.9%, which was higher than our expected effective rate of 27.0% due primarily to differences relating to the foreign exchange impact relating to permanent differences on the foreign exchange translation of property, plant and equipment and other net liabilities.

Income tax expense was $1.6 million in the second quarter of 2015, an effective rate of 35.7%, which was higher than our expected effective rate of 26.7% due primarily to differences relating to the foreign exchange impact of Canadian dollar denominated debt in its U.S. subsidiaries. Pollard has capitalized its U.S. operations using intercompany Canadian dollar debt. The overall weakening of the Canadian dollar versus the U.S. dollar results in a future gain on debt repayment for U.S. tax purposes in the subsidiary, creating a deferred tax expense with no related income (as the loss is eliminated on consolidation).

Amortization and depreciation

Amortization and depreciation, including amortization of deferred financing costs and intangible assets and depreciation of property and equipment, totaled $2.9 million during the second quarter of 2016 which increased from $2.0 million during the second quarter of 2015 primarily as a result of increased depreciation of property, plant and equipment due to the commissioning of the new press.

Net income

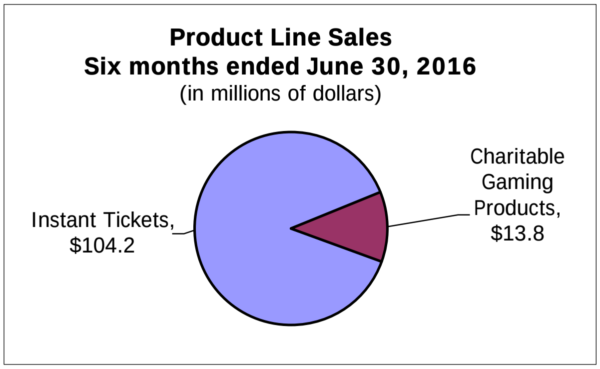
Net income decreased to $2.0 million in the second quarter of 2016 from $3.0 million in the second quarter of 2015. The primary reasons for the decrease of $1.0 million in net income were the increase in administration expenses of $0.8 million, the reduction in the gain on the non-cash mark-to-market adjustment on foreign currency contracts of $0.4 million and the increase in foreign exchange loss of

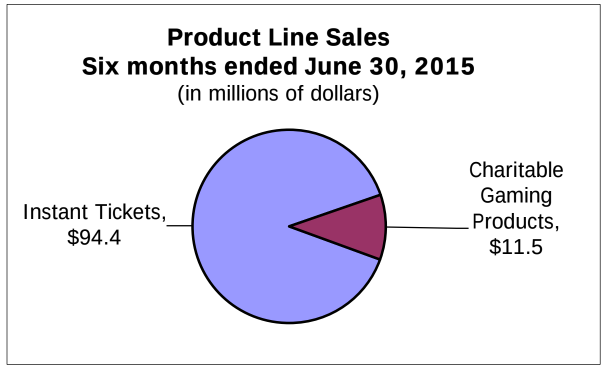
$0.3 million. These decreases were partially offset by the $0.3 million increase in other income and the reduction in income tax expense of $0.4 million.

Net income per share (basic and diluted) decreased to $0.09 per share in the second quarter of 2016 from $0.13 per share in the second quarter of 2015.

ANALYSIS OF RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2016

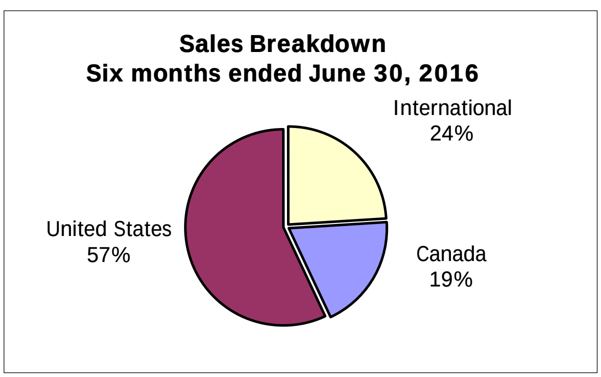
Sales

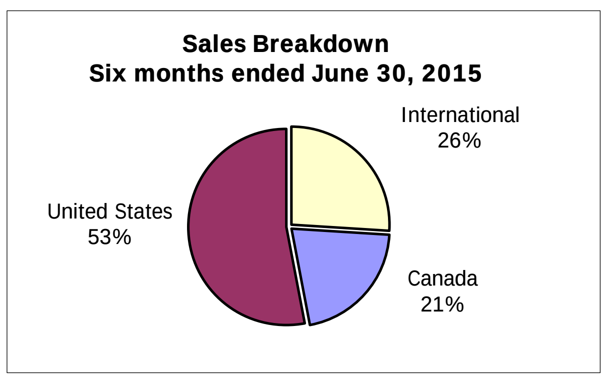




During the six months ended June 30, 2016, Pollard achieved sales of $118.0 million, compared to $105.9 million in the six months ended June 30, 2015. Factors impacting the $12.1 million sales increase were:

Higher instant ticket average selling price increased sales by $4.3 million in the first six months of 2016 compared to the first six months of 2015. Higher sales of our ancillary instant ticket products and services increased sales by $3.9 million from the first half of 2015. Charitable gaming products volumes were higher in the first six months of 2016 which increased sales by $0.7 million. An increase in the charitable gaming average selling price increased sales by $0.4 million when compared to the first half of 2015. Partially offsetting these increases, lower instant ticket sales volumes decreased sales by $4.8 million when compared to 2015 due to a significant increase in volume of international customers' tickets produced in the second quarter in transit as at June 30, 2016.





During the six months ended June 30, 2016, Pollard generated approximately 70.0% (2015 – 68.2%) of its revenue in U.S. dollars including a portion of international sales which are priced in U.S. dollars. During the first six months of 2016 the actual U.S. dollar value was converted to Canadian dollars at $1.339, compared to a rate of $1.226 during the first six months of 2015. This 9.2% increase in the U.S. dollar value resulted in an approximate increase of $7.0 million in revenue relative to the six months ended June 30, 2015. Also during the first half of 2016, the value of the Euro strengthened against the Canadian dollar resulting in an approximate increase of $0.6 million in revenue relative to the first half of 2015.

Cost of sales and gross profit

Cost of sales was $95.7 million in the six months ended June 30, 2016, compared to $85.1 million in the six months ended June 30, 2015. Cost of sales was higher in the first half of 2016 relative to 2015 as a result of higher amortization, increased ancillary instant ticket products and services sales and higher exchange rates on U.S. dollar transactions.

Gross profit increased to $22.3 million (18.9% of sales) in the six months ended June 30, 2016, from $20.8 million (19.6% of sales) in the six months ended June 30, 2015. This increase in gross profit was primarily the result of the increase in ancillary instant ticket products and services sales and higher exchange rates on U.S. dollar transactions. The lower gross profit percentage was due to the instant ticket sales mix weighted to lower margin products and the impact of additional production costs related to the ramp up of the new press.

Administration expenses

Administration expenses increased to $10.4 million in the first six months of 2016 from $8.5 million in the first six months of 2015 due primarily to higher professional fees, increased compensation expenses (which primarily related to expansion of lottery management systems and ancillary lottery product sales) and the increased Canadian dollar equivalent of U.S. dollar denominated expenses. Sequentially administration expenses have declined from $10.7 million in the final six months of 2015 primarily due to lower professional fees. Pollard anticipates lower professional fees for the remainder of 2016.

Selling expenses

Selling expenses increased to $3.7 million in the first six months of 2016 from $3.4 million in the first six months of 2015 due primarily to the increased Canadian dollar equivalent of U.S. dollar denominated expenses and higher compensation expense in our charitable gaming division to support increased sales.

Interest expense

Interest expense increased to $1.7 million in the first six months of 2016 from $1.3 million in the first six months of 2015 primarily as a result of no longer capitalizing borrowing costs related to the new press project.

Foreign exchange (gain) loss

The net foreign exchange gain was $0.7 million in the first six months of 2016 compared to a net loss of $1.2 million in the first half of 2015. The 2016 foreign exchange gain resulted from unrealized foreign exchange gain of $2.0 million, comprised predominately of an unrealized gain on U.S. dollar denominated debt (caused by the strengthening of the value of the Canadian dollar versus the U.S. dollar) in addition to an unrealized gain on other U.S. dollar denominated accounts payable. The unrealized gain was partially offset by a realized loss of $1.3 million, relating to the decreased value on the collections of U.S. dollar denominated receivables.

The 2015 foreign exchange loss resulted from unrealized foreign exchange losses of $1.2 million, comprised predominately of an unrealized loss on U.S. dollar denominated debt (caused by the weakening of the value of the Canadian dollar versus the U.S. dollar) in addition to an unrealized loss on other U.S. dollar denominated accounts payable.

Adjusted EBITDA

Adjusted EBITDA was $12.8 million in the first six months of 2016 compared to $13.0 million in the first six months of 2015. The primary reason for the decrease in Adjusted EBITDA of $0.2 million was the increase in administration expenses of $1.9 million and realized foreign exchange loss of $1.3 million. These decreases were offset by the increase in gross profit (net of amortization and depreciation) of $3.1 million.

Adjusted EBITDA excluding realized foreign exchange (loss) gain was $14.1 million in the first six months of 2016 compared to $13.0 million in the first six months of 2015.

Income taxes

Income tax expense was $1.9 million in the first six months of 2016, an effective rate of 24.7%, which was lower than our expected effective rate of 27.0% due primarily to differences relating to the foreign exchange impact of Canadian dollar denominated debt in its U.S. subsidiaries. Pollard has capitalized its U.S. operations using intercompany Canadian dollar debt. The strengthening of the Canadian dollar versus the U.S. dollar results in a future loss on debt repayment for U.S. tax purposes in the subsidiary, creating a deferred tax recovery with no related income (as the loss is eliminated on consolidation). This decreased the effective tax rate by about 13 percentage points. Other differences relating to permanent differences on the foreign exchange translation of property, plant and equipment, and other net liabilities increased the effective tax rate by approximately 10 percentage points on a net basis.

Income tax expense was $2.6 million in the first six months of 2015, an effective rate of 37.7%, which was higher than our expected effective rate of 26.7% due primarily to differences relating to the foreign exchange impact of Canadian dollar denominated debt in its U.S. subsidiaries. Pollard has capitalized its U.S. operations using intercompany Canadian dollar debt. The weakening of the Canadian dollar versus the U.S. dollar results in a future gain on debt repayment for U.S. tax purposes in the subsidiary, creating a deferred tax expense with no related income (as the gain is eliminated on consolidation). This increased the effective tax rate by about 16 percentage points. Other differences relating to permanent differences on the foreign exchange translation of property, plant and equipment, and other net liabilities decreased the effective tax rate by approximately 4 percentage points on a net basis.

Amortization and depreciation

Amortization and depreciation, including amortization of deferred financing costs and intangible assets and depreciation of property and equipment, totaled $5.6 million during the first six months of 2016 which increased from $4.0 million during the first six months of 2015 primarily as a result of increased depreciation of property, plant and equipment due to the commissioning of the new press.

Net income

Net income increased to $5.6 million in the first six months of 2016 from $4.4 million in the first six months of 2015. The primary reasons for the increase were the $1.5 million increase in gross profit, the $1.9 million increase in foreign exchange gains and the decrease in income tax expense of $0.7 million.

These increases were partially offset by higher administration expenses of $1.9 million, higher selling expenses of $0.3 million and increased interest expense of $0.4 million, as well as the reduction in the gain on the non-cash mark-to-market adjustment on foreign currency contracts of $0.5 million.

Net income per share (basic and diluted) increased to $0.24 per share in the six months ending June 30, 2016, as compared to $0.18 per share in the six months ending June 30, 2015.

Liquidity and Capital Resources

Cash provided by operating activities

For the six months ended June 30, 2016, cash flow provided by operating activities was $4.6 million compared to cash flow provided by operating activities of $10.5 million for the first six months of 2015. For the six months ended June 30, 2016, changes in the non-cash component of working capital decreased cash by $5.5 million. The decrease was due primarily to the increased investment in accounts receivables and inventories, partially offset by increased accounts payable and accrued liabilities. For the six months ended June 30, 2015, changes in the non-cash component of working capital increased cash by $0.9 million. The increase was due primarily to the decrease in inventories, partially offset by increased accounts receivables and prepaids.

Cash used for interest increased to $1.6 million in 2016 as compared to $1.4 million in 2015. Cash used for pension plan contributions increased to $1.5 million in 2016 as compared to $1.1 million in 2015. Cash used for income tax payments decreased to $1.3 million in 2016 from $2.8 million in 2015. Taxable income in Canada increased in 2014 due to improved operating results. Pollard was not required to make installments during 2014, therefore the income taxes due for 2014 were payable at the end of February 2015.

Cash used for investing activities

In the six months ended June 30, 2016, cash used for investing activities was $3.0 million compared to cash used of $9.4 million in the first half of 2015. In the six months ended June 30, 2016, capital expenditures were $2.3 million. In addition, Pollard expended $0.6 million on its investment in its iLottery joint venture and $0.5 million on additions to intangible assets. These intangible additions primarily related to implementation costs, including capitalized internal costs, for ERP software. Proceeds from the sale of Pollard's investment in associate provided cash of $0.5 million.

In the six months ended June 30, 2015, capital expenditures were $9.1 million, including $7.9 million in payments relating to the new printing press. As well Pollard expended $0.3 million on additions to intangible assets, primarily related to implementation costs, including capitalized internal costs, for ERP software.

Cash used for financing activities

Cash used for financing activities was $0.1 million in the six months ended June 30, 2016, compared to cash provided by financing activities of $0.2 million in the six months ended June 30, 2015.

During the first half of 2016 cash proceeds from long-term debt of $1.6 million were offset by $0.1 million of financing costs and dividends paid of $1.4 million.

During the first half of 2015 cash proceeds from long-term debt of $1.9 million were offset by $0.3 million of financing costs and dividends paid of $1.4 million.

As at June 30, 2016, Pollard had unused credit facility of $15.6 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)

	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015	Q4 2014	Q3 2014	Q2 2014
Sales	$54.0	$64.0	$57.2	$57.9	$51.5	$54.4	$43.2	$53.5	$47.1
Adjusted EBITDA	6.0	6.8	6.3	7.5	6.3	6.7	5.6	7.3	6.4
Net Income	2.0	3.6	1.2	1.9	3.0	1.4	2.2	1.7	3.7

Q2 2016 sales were lower due to reduced instant ticket volumes due to a significant increase in volume of international customers' tickets produced in the second quarter in transit as at June 30, 2016.

Productive Capacity

Management has defined the current productive capacity, factoring in the new press becoming fully operational, as the level of operations necessary to maintain a minimum Adjusted EBITDA of $30.0 to $35.0 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 significant impact on our Adjusted EBITDA capacity will be the timing of the ramp up of our new press and how quickly increased volumes will be attained through the relatively long sales cycle of the lottery industry. 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. Changes to productive capacity have occurred primarily through expenditures on fixed assets and improved processes and other internal improvement measures. Productive capacity is also impacted by changes in foreign exchange relationships. 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 and other investments. 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. 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.

As at June 30, 2016, Pollard's investment in non-cash working capital increased $5.5 million compared to December 31, 2015 primarily as a result of increased investment in accounts receivables and inventory partially offset by an increase in accounts payable and accrued liabilities.

	June 30, 2016	December 31, 2015
Working Capital	$43.4	$39.1
Total Assets	$170.1	$164.1
Total Non-Current Liabilities	$95.3	$96.3

Credit Facility

Pollard's credit facility was renewed effective June 24, 2016. As part of the renewal, the outstanding balance of the term facility was repaid. The credit facility provides loans of up to $75.0 million for its Canadian operations and US$12.0 million for its U.S. subsidiaries. The borrowings for the Canadian operations can be denominated in Canadian or U.S. dollars, to a maximum of $75,000 Canadian equivalent. 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 June 30, 2016, the outstanding letters of guarantee were $1.2 million. The remaining balance available for drawdown under the credit facility was $15.6 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 June 30, 2016, Pollard is in compliance with all financial covenants.

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 facility can be prepaid without penalties. Under the terms of the agreement effective June 24, 2016, the facility was committed for a two year period, renewable June 24, 2018.

Pollard believes that its credit facility, subordinated loan from Pollard Equities Limited 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.

Subordinated Loan

On April 2, 2014, Pollard's former subsidiary, Pollard Holdings Limited Partnership, entered into a loan agreement with Pollard Equities Limited ("Equities") for a subordinated term loan facility with a seven year term in the amount of $6.8 million. Equities owns approximately 73.5% of Pollard's outstanding shares. Effective January 1 2015, Pollard Banknote Limited assumed the subordinated debt on completion of the amalgamation of the Canadian entities.

Quarterly principal payments on the subordinated loan facility commenced the month following the repayment in full of the additional secured term facility, which occurred June 30, 2016. Interest on the subordinated term loan facility commenced with the first draw at a rate of 9%. The loan is fully subordinated to the secured credit facility.

Outstanding Share Data

As at June 30, 2016 and August 10, 2016, outstanding share data was as follows:

Common shares	23,543,158

Share Options

Under the Pollard Banknote Limited Stock Option Plan the Board of Directors has the authority to grant options to purchase common shares to eligible persons and to determine the applicable terms. The aggregate maximum number of common shares available for issuance from Pollard's treasury under the Option Plan is 2,354,315 common shares.

On March 5, 2014, the Board of Directors approved the award of 100,000 options to purchase common shares of Pollard for certain key management personnel. The options were granted on March 10, 2014, and have a seven year term, vesting 25% per year over the first four years. The exercise price of the options was equal to the closing price of the common shares on March 7, 2014.

Contractual Obligations

There have been no material changes to Pollard's contractual obligations since December 31, 2015, that are outside the normal course of business, other than noted below.

Off-Balance Sheet Arrangements

There have been no material changes to Pollard's off-balance sheet arrangements since December 31, 2015, that are outside the normal course of business.

Financial Instruments

The financial instruments of Pollard remain substantially unchanged from those identified in the MD&A for Pollard for the year ended December 31, 2015.

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 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 six months ended June 30, 2016, 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, 2015.

Outlook

Lotteries continue to look to grow their revenue and maximize their net proceeds for distribution to various good causes, and this presents opportunities for suppliers like Pollard to likewise increase their role in supporting these initiatives. The lottery market continues to grow and, in particular, the instant ticket and related services product lines remains a key driver of lotteries' success and we expect this trend to continue. Greater instant ticket product variety at retail continues to generate solid growth in retail sales.

Lotteries are increasingly looking to new methods to support and strengthen this growth, including utilizing more active social media, enriched consumer engagement and better retail methodology to lay the foundation for more ticket sales. Pollard is aggressively marketing these ancillary products and services including second chance draws, free-to-play downloadable internet games, VIP clubs and enhanced retail management. These additional services expand our revenue base and, as importantly, increase the sales of the actual instant tickets.

Our Michigan iLottery operation continues to grow and is the cornerstone in our overall on-line gaming strategy. With our second iLottery contract on pace to go live later in 2016, we are actively marketing the benefits of a successful, integrated iLottery strategy to lotteries throughout North America. As noted before, the lottery industry remains cautious as it relates to on-line gaming and we do not anticipate a dramatic change in the number of iLottery opportunities in the short term.

Our manufacturing platform, and specifically our new press, continues to improve its productivity and efficiency. This progress will continue throughout 2016 and into 2017 as the complexity of the technology, depth of training required and the intricacy of the instant ticket product itself dictates a significant learning curve. We are confident this positive trend will continue and result in a very efficient manufacturing platform capable of producing higher volumes of product.

We do not anticipate any material changes to our contract portfolio throughout 2016. Historically our third and fourth quarter have generated slightly higher selling prices due to increased production of specialty products in anticipation of the yearend holiday season. These products generally carry slightly higher prices due to the greater value proposition they provide our lottery customers and we would expect that to continue this year. Actual timing of the related revenue recognition is dependent on such factors as the actual receipt of shipment.

As we saw in the second quarter, fluctuations in the relationship between the Canadian dollar and the U.S. dollar can impact the short term financial results. We continue to have a net exposure to the U.S. dollar and some exposure to the Euro, and depending on the timing of cash inflows and outflows, coupled with changes in the actual exchange rates, cash flow, EBITDA and net income can all be impacted. We continue to utilize a number of internal and natural hedges to help lessen or mitigate the variability of the fluctuations, however the effectiveness of these policies can be limited. We do not anticipate implementing any financial hedges in the near future.

Although small in absolute terms, our charitable gaming business, operating as American Games, continues to exceed expectations and should improve on last year's revenue and profits. Higher sales in pull-tabs and vending machines have led the way and, despite a relatively flat overall market, we anticipate maintaining these positive results.

Our anticipated capital expenditures for the remainder of 2016 should continue to be low and, barring any unusual investments in non-cash working capital, strong positive cash flow should be generated going forward. We are also actively looking at strategic alliances to augment and expand our expertise as it relates to our core lottery customer base. Whether through joint venture, partnerships or outright acquisitions we are very open to adding the appropriate resources to Pollard in order to remain the partner of choice for successful lotteries worldwide.

Disclosure Controls and Procedures

Under National 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 National Instrument 52-109 will provide reasonable assurance of achieving the disclosure objectives.

Internal Controls over Financial Reporting

Under National 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. Management used the Internal Control – Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013) as the control framework in designing its 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 National 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 six months ended June 30, 2016, 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, 2015, is available on SEDAR at www.sedar.com.

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