POLLARD banknote limited

December 31, 2016

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

FOR THE YEAR ENDED DECEMBER 31, 2016

March 13, 2017

This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the year ended December 31, 2016, is prepared as at March 13, 2017, and should be read in conjunction with the accompanying audited financial statements of Pollard and the notes therein as at December 31, 2016. Results are reported in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards ("GAAP" or "IFRS").

Forward-Looking Statements

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

Use of Non-GAAP Financial Measures

Reference to "Adjusted EBITDA" is to earnings before interest, income taxes, depreciation and amortization, unrealized foreign exchange gains and losses, mark-to-market gains and losses on foreign currency contracts, and 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 consolidated results of Pollard for the year ended December 31, 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 the lottery and charitable gaming industries throughout the world. Management believes Pollard is the largest provider of instant-win scratch tickets ("instant tickets") based in Canada and the second largest producer of instant tickets in the world.

Pollard produces and provides a comprehensive line of instant tickets and lottery services including: licensed products, distribution, SureTrack® lottery management system, retail telephone selling ("tel-sell"), marketing, iLottery, digital products, 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

	Year ended December 31, 2016	Year ended December 31, 2015
Instant Tickets	89%	90%
Charitable Gaming Products	11%	10%

Geographic breakdown of revenue

	Year ended December 31, 2016	Year ended December 31, 2015
United States	54%	49%
Canada	20%	24%
International	26%	27%

The following financial information should be read in conjunction with the accompanying financial statements of Pollard and the notes therein as at and for the year ended December 31, 2016.

SELECTED FINANCIAL INFORMATION

(millions of dollars, except per share information)

	Year ended December 31, 2016	Year ended December 31, 2015	Year ended December 31, 2014	Year ended December 31, 2013
Sales	**$246.4**	$221.0	$194.5	$184.9
Cost of sales	**197.2**	176.7	153.4	149.7
Gross profit	**49.2**	44.3	41.1	35.2
Gross profit as a % of sales	***20.0%***	*20.0%*	*21.1%*	*19.0%*
Administration expenses	**20.9**	19.2	17.0	15.2
Expenses as a % of sales	***8.5%***	*8.7%*	*8.7%*	*8.2%*
Selling expenses	**8.0**	7.4	6.9	6.8
Expenses as a % of sales	***3.2%***	*3.3%*	*3.5%*	*3.7%*
Net income	**12.3**	7.5	8.7	5.4
Net income as a % of sales	***5.0%***	*3.4%*	*4.5%*	*2.9%*
Adjusted EBITDA	**29.7**	26.8	25.6	22.7
Adjusted EBITDA as a % of sales	***12.1%***	*12.1%*	*13.2%*	*12.3%*
Earnings per share (basic)	**$0.52**	$0.32	$0.37	$0.23
Earnings per share (diluted)	**$0.52**	$0.32	$0.37	$0.23

	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Total Assets	**$176.8**	$164.1	$149.3	$133.4
Total Non-Current Liabilities	**$94.4**	$96.3	$89.2	$79.2

RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA

(millions of dollars)

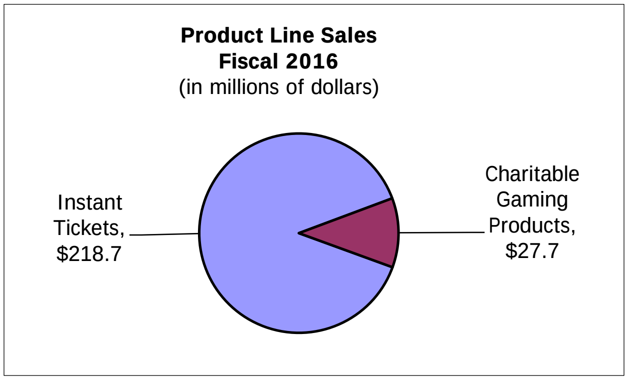
	Year ended December 31, 2016	Year ended December 31, 2015	Year ended December 31, 2014	Year ended December 31, 2013
Net income	**$12.3**	$7.5	$8.7	$5.4
Adjustments:				
Amortization and depreciation	**10.8**	8.4	7.9	8.6
Interest	**3.4**	2.9	2.9	3.4
Unrealized foreign exchange (gain) loss	**(1.6)**	3.8	1.7	1.0
Mark-to-market (gain) loss on foreign currency contracts	**-**	(0.5)	0.1	0.4
Start-up costs – Michigan iLottery	**-**	-	0.6	-
Income taxes	**4.8**	4.7	3.7	3.9
Adjusted EBITDA	**$29.7**	$26.8	$25.6	$22.7

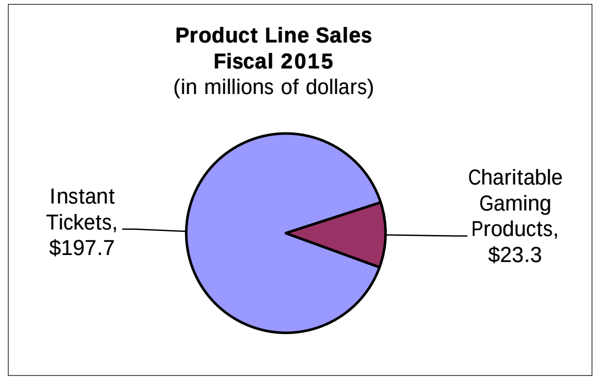
REVIEW OF OPERATIONS

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

ANALYSIS OF RESULTS FOR THE YEAR ENDED DECEMBER 31, 2016

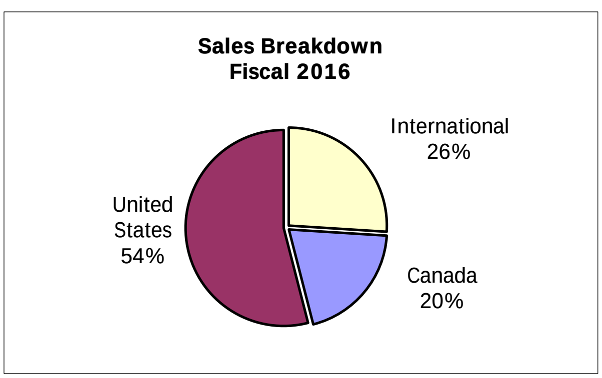
Sales

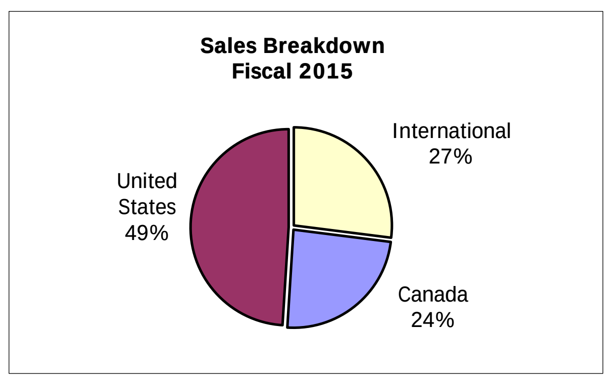




During the year ended December 31, 2016 (“Fiscal 2016” or “2016”), Pollard achieved sales of $246.4 million, compared to $221.0 million in the year ended December 31, 2015 (“Fiscal 2015” or “2015”). Factors impacting the $25.4 million sales increase were:

Higher instant ticket average selling prices for 2016 increased sales by $4.3 million compared to 2015, primarily as a result of greater proprietary product sales, while higher instant ticket volumes increased sales by $3.2 million. Improved sales of our ancillary lottery products and services further increased sales by $6.5 million from Fiscal 2015 due primarily to increased revenues from iLottery. Charitable gaming volumes were also higher than Fiscal 2015 increasing sales by $2.4 million, primarily as a result of greater vending machine sales, while the increase in average selling price increased sales of charitable gaming products by $0.8 million.





During Fiscal 2016, Pollard generated approximately 68.8% (2015 – 65.0%) of its revenue in U.S. dollars including a portion of international sales which are priced in U.S. dollars. During Fiscal 2016 the actual U.S. dollar value was converted to Canadian dollars at an average rate of $1.328 compared to an average rate of $1.269 during Fiscal 2015. This 4.7% increase in the U.S. dollar value resulted in an approximate increase of $7.6 million in revenue relative to Fiscal 2015. Also during Fiscal 2016, the Canadian dollar weakened against the Euro resulting in an approximate increase of $0.6 million in revenue relative to Fiscal 2015.

Cost of sales and gross profit

Cost of sales was $197.2 million in Fiscal 2016 compared to $176.7 million in Fiscal 2015. Cost of sales was higher in Fiscal 2016 relative to Fiscal 2015 as a result of an increase in instant ticket volumes, increased ancillary lottery products and services sales, higher exchange rates on U.S. dollar transactions in 2016, which increased cost of sales approximately $5.8 million, and higher amortization relating to our new press.

Gross profit was $49.2 million (20.0% of sales) in Fiscal 2016 compared to $44.3 million (20.0% of sales) in Fiscal 2015. This higher gross profit was due primarily to the increase in ancillary lottery products and services sales, increased average selling price of instant tickets and the positive impact from higher exchange rates on net U.S. dollar transactions.

Administration expenses

Administration expenses increased to $20.9 million in Fiscal 2016 from $19.2 million in Fiscal 2015 due primarily to higher professional fees, increased compensation expenses (which primarily related to expansion of our lottery management system and ancillary lottery product and services sales) including incentive accruals.

Selling expenses

Selling expenses increased to $8.0 million in Fiscal 2016 from $7.4 million in Fiscal 2015 due primarily to higher compensation expense in our charitable gaming division to support increased sales, higher contract support costs and the increased Canadian dollar equivalent of U.S. dollar denominated expenses.

Other income

Other income in Fiscal 2016 consisted of a $0.7 million loss on equity investment, which was fully offset by a $0.7 million miscellaneous gain, primarily consisting of a $0.5 million gain on the sale of an associate.

Interest expense

Interest expense increased to $3.4 million in Fiscal 2016 from $2.9 million in Fiscal 2015 primarily as a result of no longer capitalizing borrowing costs related to the new press project, which ended after the second quarter in 2015.

Foreign exchange gain

The net foreign exchange gain was $0.4 million in Fiscal 2016 compared to a net loss of $3.1 million in Fiscal 2015. The 2016 net foreign exchange gain consisted of a $1.6 million unrealized gain primarily a result of the decreased Canadian equivalent value of U.S. denominated accounts payable and long-term debt with the strengthening of the Canadian dollar relative to the U.S. dollar. This gain was partially offset by the realized foreign exchange loss of $1.2 million as a result of foreign currency denominated account receivables collected being converted into Canadian dollars at unfavorable foreign exchange rates.

The 2015 net foreign exchange loss consisted of a $3.8 million unrealized loss which was primarily a result of the increased Canadian equivalent value of U.S. denominated debt with the significant weakening of the Canadian dollar relative to the U.S. dollar. This loss was partially offset by the realized foreign exchange gain of $0.7 million as a result of foreign currency denominated account receivables collected being converted into Canadian dollars at favorable foreign exchange rates.

Amortization and depreciation

Amortization and depreciation, including depreciation of property and equipment and the amortization of deferred financing costs and intangible assets, totaled $10.8 million during Fiscal 2016 which increased from $8.4 million during Fiscal 2015 primarily as a result of increased depreciation of property, plant and equipment due to the commissioning of the new press in our Ypsilanti facility.

Adjusted EBITDA

Adjusted EBITDA was $29.7 million in Fiscal 2016 compared to $26.8 million in Fiscal 2015. The primary reason for the increase in Adjusted EBITDA of $2.9 million was the increase in gross profit of $7.3 million (net of amortization and depreciation). This increase was partially offset by higher administration expenses of $1.7 million, an increase in selling expenses of $0.6 million and the increase in realized foreign exchange loss of $1.9 million.

Income taxes

Income tax expense was $4.8 million in Fiscal 2016, an effective rate of 28.1%, which was similar to our expected effective rate of 27.0%.

Income tax expense was $4.7 million in Fiscal 2015, an effective rate of 38.8%, which was higher than our expected effective rate of 26.8% 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 consolidated provision percentage approximately 30%. Other permanent differences relating to the foreign exchange translation of property, plant and equipment decreased the provision by approximately 15%. Current income tax expense was in a recovery position due to accelerated tax depreciation on capital expenditures.

Net income

Net income was $12.3 million in Fiscal 2016 compared to net income of $7.5 million in Fiscal 2015. The primary reasons for the increase in net income were the increase gross profit of $4.9 million and the decrease in net foreign exchange loss of $3.5 million. Partially offsetting these increases in net income were the increase in administration expense of $1.7 million, the increase in selling expenses of $0.6 million, the increase in interest expense of $0.5 million and the decrease in the non-cash mark-to-market gain on foreign currency contracts of $0.5 million.

Earnings per share (basic and diluted) increased to $0.52 per share in Fiscal 2016 from $0.32 per share in Fiscal 2015.

Liquidity and Capital Resources

Cash provided by operating activities

For the year ended December 31, 2016, cash flow provided by operating activities was $11.7 million compared to $19.7 million in Fiscal 2015. Higher net income before income taxes after non-cash adjustments in Fiscal 2016 contributed to an increase in cash provided by operating activities compared to Fiscal 2015. Changes in the non-cash component of working capital decreased cash flow from operations by $16.9 million for Fiscal 2016 (due primarily to increases in accounts receivable and inventory, partially offset by an increase in accounts payable and accrued liabilities), compared to a decrease of $2.8 million for Fiscal 2015 (due primarily to increases in accounts receivable, prepaid expenses and income taxes receivable, and a decrease in accounts payable and accrued liabilities, partially offset by a decrease in inventory). The significant increase in the investment in accounts receivables in 2016 was a result of increased sales volumes.

Cash used for interest payments increased to $3.3 million in 2016 as compared to $2.8 million in 2015. As well, cash used for pension plan contributions increased to $3.1 million in 2016 as compared to $2.9 million in 2015. Cash received for income taxes recovered was $0.7 million in 2016 compared to $3.1 million of income taxes paid in 2015. Income taxes were recovered as a result of tax loss carrybacks generated from accelerated depreciation on U.S. based equipment.

Cash used for investing activities

In the year ended December 31, 2016, cash used for investing activities was $6.4 million compared to $16.5 million in the year ended December 31, 2015. In Fiscal 2016, capital expenditures were $5.0 million. Pollard expended $0.8 million on its investment in its iLottery joint venture and $1.1 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 Fiscal 2015, capital expenditures were $15.4 million, with $12.0 million in expenditures relating to the new press project including various auxiliary equipment. Pollard expended $0.4 million on its investment in its iLottery joint venture and $0.7 million on additions to intangible assets, net of investment tax credits. These intangible additions primarily related to implementation costs, including capitalized internal costs, for ERP software.

Cash used for financing activities

Cash used for financing activities was $5.4 million in the year ended December 31, 2016, compared to cash used for financing activities of $2.3 million in the year ended December 31, 2015.

During Fiscal 2016, cash was used to repay $1.8 million of long-term debt, $0.7 million of subordinated debt, $0.2 million of financing costs and dividends paid of $2.8 million.

During Fiscal 2015 proceeds from long-term debt of $1.0 million were offset by $0.4 million of financing costs and dividends paid of $2.8 million.

As at December 31, 2016, Pollard had unused committed credit facility of $18.9 million. This amount is available to be used for future working capital requirements, contractual obligations, capital expenditures and dividends.

ANALYSIS OF RESULTS FOR THE PERIOD OCTOBER 1, 2016 TO DECEMBER 31, 2016
FOURTH QUARTER OF 2016

SELECTED FINANCIAL INFORMATION

(millions of dollars)

	Three months ended December 31, 2016	Three months ended December 31, 2015
	(unaudited)	(unaudited)
Sales	$65.7	$57.2
Cost of sales	51.5	45.6
Gross profit	14.2	11.6
Administration	4.9	5.7
Selling	2.2	2.0
Other expense	0.3	0.1
Income from operations	6.8	3.8
Finance costs	1.2	1.8
Income before income taxes	5.6	2.0
Income taxes:		
Current (recovery)	1.2	(4.5)
Future	0.6	5.3
	1.8	0.8
Net income	$3.8	$1.2
Adjustments:		
Amortization and depreciation	2.3	2.4
Interest	0.8	0.8
Unrealized foreign exchange loss	0.4	1.1
Income taxes	1.8	0.8
Adjusted EBITDA	$9.1	$6.3

Sales

During the three months ended December 31, 2016, Pollard achieved sales of $65.7 million, compared to $57.2 million in the three months ended December 31, 2015. Factors impacting the $8.5 million sales increase were:

Instant ticket sales volumes for the fourth quarter of 2016 were higher than the fourth quarter of 2015 by 14.1%, which increased sales by $6.7 million, due to higher volumes from existing customers. In addition, an increase in our ancillary instant ticket products and services volumes, primarily sales from iLottery, increased sales by $1.1 million. Higher volumes of charitable game sales added $1.5 million in sales compared to the fourth quarter of 2015, primarily as a result of higher vending machine sales. Partially offsetting these increases in sales was a slight decrease in average selling price of instant tickets compared to 2015 which reduced sales by $0.6 million.

During the three months ended December 31, 2016, Pollard generated approximately 68.2% (2015 – 62.0%) of its revenue in U.S. dollars including a portion of international sales which were priced in U.S. dollars. During the fourth quarter of 2016 the actual U.S. dollar value was converted to Canadian dollars at an average rate of $1.332, compared to an average rate of $1.336 during the fourth quarter of 2015. This 0.3% decrease in the value of the U.S. dollar resulted in an approximate decrease of $0.1 million in revenue relative to 2015. Also during the fourth quarter of 2016, the Canadian dollar strengthened against the Euro resulting in an approximate decrease of $0.1 million in revenue relative to 2015.

Cost of sales and gross profit

Cost of sales was $51.5 million in the fourth quarter of 2016 compared to $45.6 million in the fourth quarter of 2015. Cost of sales was higher in the quarter relative to the fourth quarter of 2015 as a result of an increase in instant ticket volumes and higher ancillary instant ticket products and services volumes.

Gross profit was $14.2 million (21.6% of sales) in the fourth quarter of 2016 compared to $11.6 million (20.3% of sales) in the fourth quarter of 2015. This increase in gross profit dollars was due to the higher instant ticket sales volumes and higher ancillary instant ticket products and services volumes. The increase in gross profit percentage was due to a favorable instant ticket sales mix.

Administration expenses

Administration expenses were $4.9 million in the fourth quarter of 2016 which was lower compared to $5.7 million in the fourth quarter of 2015 primarily as a result of lower professional fees, including a settlement generating a recovery of previous legal expenses.

Selling expenses

Selling expenses increased to $2.2 million in the fourth quarter of 2016 from $2.0 million in the fourth quarter of 2015 primarily as a result of an increase in contract support costs.

Other expense

Other expense of $0.3 million in the fourth quarter of 2016 consisted of $0.4 million loss on equity investment, which was partially offset by a $0.1 million miscellaneous gain.

Interest expense

Interest expense of $0.8 million in the fourth quarter of 2016 was similar to $0.8 million in the fourth quarter of 2015.

Foreign exchange loss

The net foreign exchange loss was $0.3 million in the fourth quarter of 2016 compared to a net loss of $0.9 million in the fourth quarter of 2015. The 2016 net foreign exchange loss consisted of a $0.4 million unrealized loss which was primarily a result of the increased Canadian equivalent value of U.S. denominated debt with the weakening of the Canadian dollar relative to the U.S. dollar. This loss was partially offset by the realized foreign exchange gain of $0.1 million, as a result of foreign currency denominated account receivables collected being converted into Canadian dollars at favorable foreign exchange rates.

The 2015 net foreign exchange loss consisted of a $1.1 million unrealized loss which was primarily a result of the increased Canadian equivalent value of U.S. denominated debt with the weakening of the Canadian dollar relative to the U.S. dollar. This loss was partially offset by the realized foreign exchange gain of $0.2 million, as a result of foreign currency denominated account receivables collected being converted into Canadian dollars at favorable foreign exchange rates.

Amortization and depreciation

Amortization and depreciation, including depreciation of property, plant and equipment and the amortization of deferred financing costs and intangible assets, totaled $2.3 million during the fourth quarter of 2016 which was similar to $2.4 million during the fourth quarter of 2015.

Adjusted EBITDA

Adjusted EBITDA was $9.1 million in the fourth quarter of 2016 compared to $6.3 million in the fourth quarter of 2015. The primary reasons for the increase in Adjusted EBITDA were the increase in gross profit (net of amortization and depreciation) of $2.6 million and the decrease in administration expenses of $0.8 million, partially offset by higher selling expenses of $0.2 million and an increase in other expenses of $0.2 million.

Income taxes

Income tax expense was $1.8 million in the fourth quarter of 2016, an effective rate of 32.5% which was higher 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 significant weakening of the Canadian dollar versus the U.S. dollar in the fourth quarter 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 consolidated provision percentage by about 8%. Other permanent differences relating to the foreign exchange translation of property, plant and equipment decreased the provision by approximately 4%.

Income tax expense was $0.8 million in the fourth quarter of 2015, an effective rate of 37.8% which was higher than our expected effective rate of 26.8% 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 significant weakening of the Canadian dollar versus the U.S. dollar in the fourth quarter 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 consolidated provision percentage by about 31%. Other permanent differences relating to the foreign exchange translation of property, plant and equipment decreased the provision by approximately 21%. Current income tax expense was in a recovery position due to accelerated tax depreciation on capital expenditures.

Net income

Net income was $3.8 million in the fourth quarter of 2016 compared to $1.2 million in the fourth quarter of 2015. The primary reasons for the increase in net income were the higher gross profit of $2.6 million, the decrease in administration expenses of $0.8 million and the decrease in net foreign exchange loss of $0.6 million. Partially offsetting these increases were the increase in income taxes of $1.0 million, the increase in selling expenses of $0.2 million and higher other expenses of $0.2 million.

Earnings per share (basic and diluted) increased to $0.16 per share in the fourth quarter of 2016 from $0.05 per share in the fourth quarter of 2015.

Quarterly Information

(unaudited)
(millions of dollars)

	Q4 2016	Q3 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Sales	$65.7	$62.7	$54.0	$64.0	$57.2	$57.9	$51.4	$54.5
Adjusted EBITDA	9.1	7.8	6.0	6.8	6.3	7.5	6.3	6.7
Net income	3.8	2.8	2.1	3.6	1.2	1.9	3.0	1.4

Q4 2016 sales and adjusted EBITDA were higher due to increased sales volumes and favorable sales mix.

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 December 31, 2016, Pollard's investment in non-cash working capital increased $16.9 million compared to December 31, 2015, primarily as a result of an increased investments in accounts receivables and inventories, which were partially offset by an increase in accounts payable and accrued liabilities. Increased sales volumes, particularity in the fourth quarter, resulted in the large increase in accounts receivable.

	December 31, 2016	December 31, 2015
Working Capital	$49.5	$39.1
Total Assets	$176.8	$164.1
Total Non-Current Liabilities	$94.4	$96.3

Credit Facility

Pollard's credit facility was renewed effective June 24, 2016. 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 $75.0 million 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 December 31, 2016, the outstanding letters of guarantee were $1.2 million. The remaining balance available for drawdown under the credit facility was $18.9 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 December 31, 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 Debt

On April 2, 2014, Pollard 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.

Quarterly principal payments on the subordinated loan facility commenced the quarter following June 30, 2016. Interest on the subordinated debt 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 December 31, 2016 and March 13, 2017, 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.

On September 7, 2016, the Board of Directors approved the award of 25,000 options to purchase common shares of Pollard for a key management member. The options were granted on October 3, 2016, 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 September 30, 2016.

Subsequent to year end, on March 13, 2017, the Board of Directors approved the award of 125,000 options to purchase common shares of Pollard for key management personnel. The options will be granted on March 16, 2017, and have a seven year term, vesting 25% per year over the first four years. The exercise price of the options will be equal to the closing price of the common shares on March 15, 2017.

Contractual Obligations

Pollard rents premises and equipment under long-term operating leases. The following is a schedule by year of commitments and contractual obligations outstanding, including related interest payments:

(millions of dollars)	Total	<1 Year	2-3 Years	4-5 Years	Thereafter
Long-term debt	$74.7	$2.3	$72.4	-	-
Subordinated debt	$7.3	$1.8	$3.3	$2.2	-
Pension liability	$13.5	$1.3	$2.6	$2.6	$7.0
Operating leases	$22.7	$4.9	$7.9	$5.8	$4.1
Total	$118.2	$10.3	$86.2	$10.6	$11.1

Pension Obligations

Pollard sponsors four non-contributory defined benefit pension plans, of which three are final pay plans and one is a flat benefit plan. As of December 31, 2016, the aggregate fair value of the assets of Pollard's defined benefit pension plans was $44.4 million and the accrued benefit plan obligations were $57.9 million. Pollard's total annual funding contribution for all pension plans in 2017 is expected to be approximately $4.1 million, compared to $2.6 million in 2016, including estimated solvency payments.

One of Pollard's Canadian pension plans will be subject to a solvency valuation as of December 31, 2016. We anticipate the valuation will result in a deficit due the low current levels of the mandated interest rate used to discount the future liabilities. We estimate the valuation will generate an estimated deficit of approximately $13.0 million. As a result Pollard will be subject to additional special pension plan payments beginning in 2017 of approximately $1.3 million per year through to 2026. These additional solvency payments do not impact pension expense and therefore will not affect our net income or EBITDA. Pollard was subject to additional solvency payments from 2011 to 2013, when Pollard was required to make additional pension contributions of approximately $2.0 million per year. These additional pension solvency payments will be funded from operating cash flows.

Off-Balance Sheet Arrangements

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

Related Party Transactions

During the year ended December 31, 2016, Pollard paid property rent of $3.1 million (2015 - $3.1 million) and $0.4 million (2015 - $0.3 million) in plane charter costs to affiliates of Equities. In addition, Pollard paid Equities $0.6 million (2015 - $0.6 million) of interest on Pollard's subordinated debt.

During the year ended December 31, 2016, Equities paid Pollard $0.07 million (2015 - $0.07 million) for accounting and administration fees.

During the year ended December 31, 2016, Pollard reimbursed operating costs and paid software royalties of $1.8 million (2015 - $0.5 million) to its iLottery partner which are recorded in cost of sales and $0.6 million (2015 - $0.1 million) of development costs.

At December 31, 2016, Pollard owes Equities and its affiliates $0.9 million (2015 - $0.8 million) for rent, interest and other expenses. Also included in accounts payable and accrued liabilities is a net amount owing to Pollard's iLottery partner of $0.8 million (2015 - $1.1 million) for reimbursement of operating costs and capital expenditures, and its share of operating profits.

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 test. 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.

Future Changes in Accounting Policies

In July 2014, the International Accounting Standards Board ("IASB") issued International Financial Reporting Standards ("IFRS") 9 *Financial Instruments* ("IFRS 9"), which replaces the existing guidance in IAS 39 *Financial Instruments: Recognition and Measurement.* IFRS 9 includes revised guidance on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets and new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is required for fiscal years beginning on or after January 1, 2018. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*. The new standard specifies the steps and timing for recognizing revenue, as well as requiring more informative, relevant disclosures. IFRS 15 supersedes IAS 11 *Construction Contracts* and IAS 18 *Revenue*. IFRS 15 is required for fiscal years beginning on or after January 1, 2018 with early adoption available. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In September 2014, the IASB issued amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (2011). The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. These amendments were to be effective for fiscal years beginning on or after January 1, 2016, with early adoption available; however, in December 2015 the IASB decided to defer the effective date for these amendments indefinitely. Pollard is currently assessing the impact of the amendments on its consolidated financial statements.

In January 2016, the IASB issued IFRS 16 *Leases* which replaces IAS 17 *Leases*. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The new standard is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply IFRS 15 *Revenue from Contracts with Customers* at or before the date of initial adoption of IFRS 16. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In January 2016, the IASB issued amendments to IAS 7 *Statement of Cash Flows*. The amendments were issued to improve information provided to users of financial statements about an entity's changes in liabilities arising from financing activities. These amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. Pollard does not expect these amendments to have a material impact on its consolidated financial statements.

In January 2016, the IASB issued amendments to IAS 12 *Income Taxes*. The amendments were regarding the recognition of deferred tax assets for unrealized losses relating to debt instruments measured at fair value. These amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. Pollard does not expect these amendments to have a material impact on its consolidated financial statements.

In June 2016, the IASB issued amendments to IAS 2 *Share-Based Payments.* The amendments clarify how to account for certain types of share-based payment transactions. These amendments are effective for annual periods beginning on or after January 1, 2018. Retrospective or earlier application is permitted under certain conditions. Pollard is currently assessing the impact of the amendments on its consolidated financial statements.

In December 2016, the IASB issued IFRIC Interpretation 22 *Foreign Currency Transactions and Advance Consideration.* The interpretation clarifies the date of the transaction for the purposes of determining the exchange rate to use on initial recognition of the related asset, expense or income is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. The interpretation is effective for annual periods beginning on or after January 1, 2018. Retrospective or earlier application is permitted under certain conditions. Pollard is currently assessing the impact of the amendments on its consolidated financial statements.

Industry Risks and Uncertainties

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

Dependence on Key Products

Instant lottery tickets and related services accounted for approximately 89% of Pollard's Fiscal 2016 revenues. Pollard's financial results and condition are substantially dependent on the continued success and growth in sales of this product and the profitability of such sales. Competitive efforts by other manufacturers of similar or substitute products, shifts in consumer preferences or the introduction and acceptance of alternative product offerings could have a material adverse effect on Pollard's business, financial condition, liquidity and results of operations.

Economic Uncertainty

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

Inability to Sustain Sales or EBITDA Margins

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

Dependence on Major Customers

Pollard's 10 largest customers accounted for approximately 54% of its revenue during Fiscal 2016. Pollard's largest customer accounted for approximately 17% of Pollard's revenues during Fiscal 2016.

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

Exchange Rate Fluctuation

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

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

Additional Capital Requirements

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

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

Competition

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

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

Licensing and Regulatory Requirements

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

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

Income and Other Taxes

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

Intellectual Property

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

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

Interest Rates

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

Future Acquisition and Integration Risks

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

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

Financial Instruments

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

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

Risk Exposure

<u>Currency risk</u>

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 revenue in currencies other than Canadian and U.S. dollars, primarily in Euros.

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

<u>Interest rate risk</u>

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

Credit risk

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

Liquidity risk

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

Risk Management

Currency risk

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

A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian and U.S. dollar would decrease/increase the income before income taxes due to changes in operating cashflow by approximately $0.06 million for year ended December 31, 2016 (2015 - $0.05 million). A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian dollar and Euro would decrease/increase the income before income taxes due to changes in operating cashflow by approximately $0.06 million for year ended December 31, 2016 (2015 - $0.05 million).

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.

As at December 31, 2016, the amount of financial liabilities denominated in U.S. dollars exceeded the amount of financial assets denominated in U.S. dollars by approximately $1.6 million ($2015 - $4.1 million). A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the U.S. dollar would result in a decrease/increase in income before income taxes of approximately $0.01 million (2015 - $0.02 million).

Pollard also uses financial hedges, including foreign currency contracts, to help manage foreign currency risk. At December 31, 2016, Pollard had no outstanding foreign currency contracts.

Interest rate risk

A 50 basis point decrease/increase in interest rates would result in an increase/decrease in income before income taxes of $0.4 million for the year ended December 31, 2016 (2015 - $0.4 million).

Credit risk

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

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

Liquidity risk

Pollard's approach is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. Pollard maintains a committed credit facility including up to $75.0 million for its Canadian operations and up to US$12.0 million for its U.S. subsidiaries. At December 31, 2016, the unused balance available for drawdown was $18.9 million (2015 - $17.6 million).

The 2017 requirements for capital expenditures, working capital and dividends are expected to be financed from cash flow provided by operating activities and unused credit facility. Pollard enters into contractual obligations in the normal course of business operations.

Outlook

The lottery industry continues to grow in a number of areas, particularly relating to instant tickets and ancillary services. Lotteries are looking to grow the amount of funds they can raise for good causes by meeting consumer demand for gaming products. This includes refreshing their core products in addition to expanding into alternative channels such as digital products. Retail consumer demand for instant tickets remains very robust and we believe this underlying product strength will continue.

The outlook for our instant ticket volumes in 2017 remains positive and we expect it to grow, due to overall growth in the market, higher underlying retail sales in our existing customer base and strategically increasing our market share utilizing additional available capacity generated through our recent investments in new capacity. As is the nature of our business, quarter to quarter variations in our volumes will continue, as timing of orders and the variability of the mix of our work over short term periods will impact our quarterly results. Historically our product mix during the first half of the year involves fewer higher value-added proprietary products and we expect this trend to continue. The timing of revenue recognition can also be impacted between quarters based on the timing of receipt of the product by our customers.

Our additional press capacity in Ypsilanti continues to produce increasing volumes of high quality product, evidenced in both the fourth quarter of 2016 and the first quarter of 2017. Our efficiencies and related cost structure are improving and we are confident that as our experience grows we will be able to continue to lower our cost platform. Improvement will be incremental and continue throughout 2017 with focus on such critical areas as reduced spoilage, improved set up time, lower machine costs and more efficient labour costs.

Our contract portfolio remains very strong, with the renewal of a number of key contracts occurring in 2016. In January 2017 we were awarded a new three year contract (with five one-year renewal options available) to provide instant tickets to the Michigan lottery, an important and long served customer of Pollard. We do not have any significant contracts coming due in 2017 when renewal options are considered, while a number of lottery contracts where we do not provide significant product are up for bid this upcoming year. We will bid strategically to enhance our product mix and grow our market share while at the same time focusing on growth of our profit margins.

Lotteries are increasing their focus on ancillary services such as: developing player loyalty programs to improve engagement with lottery consumers; expanding digital options for extending interactions with players and providing greater entertainment value; improving the efficiency of their product distribution to ensure products are easily accessible to players; refreshing their retail point of sale programs; and investigating the appropriate internet and iLottery strategy for each respective jurisdiction. These trends will continue to progress and provide additional opportunities for Pollard to expand our business within the lottery market.

iLottery business remains an important initiative within the lottery industry, particularly in the North American market. Lotteries are taking a cautious approach to expanding in this area and, although we do not anticipate many new opportunities to open up in the short term, there are several jurisdictions currently investigating taking this step in the near term. We continue to monitor developments and assist the industry in realizing the potential of working through this channel. Our Michigan iLottery operation continues to be the industry leader and adds significantly to the Michigan Lottery's contribution to its good causes. Our second iLottery contract with the Virginia Lottery began operation in the fall of 2016 and while available only for subscriptions for draw based games, it demonstrates another successful iLottery implementation.

The market for charitable games products (bingo paper and pull-tabs) remains stable and our American Games operation continues to be an important contributor to our financial success. Our focus will be on incrementally building market share through growth of specific product initiatives such as pull-tabs for specific events and the lottery market.

We continue to review strategic initiatives to increase our expertise to serve the market as lotteries expand their products and services. This includes looking at strategic acquisitions to both add to our core competencies and develop additional areas of expertise. Our strong organic cash flow allows us the flexibility to pursue opportunities to grow our organization while maintaining a sound financial foundation.

The nature of the international focus of our business results in a net positive exposure to U.S. dollar cash flows. Changes in the foreign exchange relationship between the Canadian and U.S. dollar can impact the short term financial results including the operating cash flow and creation of gains and/or losses in monetary assets and liabilities on the balance sheet. We maintain a significant array of internal hedges to offset our net exposure to the U.S. dollar and do not anticipate utilizing any financial hedges in the near future. We also maintain a net exposure to the Euro, major fluctuations in this currency will also impact our financial results.

Our budgeted capital expenditures for 2017 should remain at similar levels as experienced in 2016, with no major projects anticipated. Assuming no additional significant investments in non-cash working capital, strong positive operating cash flow is expected going forward.

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

No changes were made in Pollard’s internal control over financial reporting during the year ended December 31, 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 for the year ended December 31, 2016, is available on SEDAR at www.sedar.com.

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