

# **POLLARD** **banknote** limited

*June 30, 2020*

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

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2020**

August 12, 2020

*This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the three and six months ended June 30, 2020, is prepared as at August 12, 2020, 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, 2020, and the audited consolidated financial statements of Pollard for the year ended December 31, 2019, 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, purchase accounting amortization, unrealized foreign exchange gains and losses and certain non-recurring items including severance costs, acquisition costs and contingent consideration fair value adjustments. 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, 2020. 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. In addition, management believes Pollard is also the second largest bingo paper and pull-tab supplier to the charitable gaming industry in North America.

Pollard produces and provides a comprehensive line of instant tickets and lottery services including: licensed products, distribution, SureTrack<sup>®</sup> lottery management system, retail telephone selling (“tel-sell”), marketing, iLottery, interactive digital gaming, including mkodo’s world class game apps, PlayOn<sup>™</sup> loyalty program, retail management services, ScanACTIV<sup>™</sup>, lottery ticket dispensers and play stations and vending machines including charitable game systems marketed under the Diamond Game and Oasis trade names. 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’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 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 275 independent distributors with the majority of revenue generated from repeat business.

On February 3, 2020, Pollard completed the previously announced acquisition of mkodo Limited (“mkodo”). On December 6, 2019, Pollard signed a definitive agreement to purchase 100% of the share capital of mkodo for a purchase price of £7.8 million prior to standard working capital adjustments and potential future earn-out payments based on certain EBITDA targets. mkodo is a leading provider of digital apps and user interfaces for the lottery and gaming industry.

On February 6, 2020, Pollard entered into an agreement, approved by the courts, to acquire certain assets which were being sold under a bankruptcy process. The transaction was subject to certain closing conditions and closed on March 20, 2020. These assets had previously been used in the operation of a business producing pull-tab tickets for the lottery and charitable gaming business. The total purchase price, including estimated transportation, disassembly and reassembly, and related costs, was \$4.9 million.

## COVID-19

In March 2020, the World Health Organization declared a global pandemic known as COVID-19. The extent of the pandemic’s effect on Pollard’s operational and financial performance will depend on future developments, including the extent and duration of the pandemic, both of which are uncertain and difficult to predict. As a result, it is not currently possible to ascertain the overall financial impact on Pollard’s business. Our charitable and Diamond Game (“egaming”) businesses were negatively impacted with a large reduction in sales in the second quarter with the closure of many retail outlets. However, Pollard’s main lottery products and services have shown significant resilience, generating substantial cash flows from operating activities during the six months ended June 30, 2020. Pollard has significant cash

resources and unused credit facility available, which allows Pollard to support operations during the pandemic.

All Pollard facilities are now under some level of health state of emergency, or shelter-in-place order, restricting business activities, movement of people, size of groups and instituting mandatory quarantine for travelers. Wherever a shelter-in-place order or state of emergency has been declared, local and federal authorities have identified, under specific acts, which essential industries remain open and active until further notice. In all affected jurisdictions, Pollard is classified as an essential government supplier, which has allowed Pollard to continue to operate throughout the pandemic. As of the date of this MD&A, all Pollard production sites are operational and our supply chains have remained functional. Pollard is extremely dedicated to providing a safe workplace in all production facilities and is working to curb the spread of the virus through implementation of extensive safety measures at all locations, including daily temperature checks, extensive social distancing and mandated remote working for all employees capable of doing so.

### Product line breakdown of revenue

	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
Lottery <sup>(1)</sup> <sup>(2)</sup>	91.7%	75.5%	86.4%	76.1%
Charitable <sup>(3)</sup>	6.0%	15.3%	9.2%	15.0%
Gaming Systems <sup>(3)</sup>	2.3%	9.2%	4.4%	8.9%

(1) Includes Fastrak Retail (UK) Limited ("Fastrak") which was acquired on May 1, 2019.

(2) Includes mkodo Limited ("mkodo") which was acquired on February 3, 2020.

(3) Effective January 1, 2020, the Oasis egaming division was transferred from International Gamco (Charitable) to Diamond Game (Gaming Systems), comparative figures have been restated.

### Geographic breakdown of revenue

	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
United States	59%	59%	58%	61%
Canada	18%	19%	20%	20%
International	23%	22%	22%	19%

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, 2020.

**SELECTED FINANCIAL INFORMATION**

(millions of dollars, except per share information)

	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
Sales	\$91.5	\$97.1	\$193.8	\$194.7
Cost of sales	72.7	75.5	153.3	150.2
Gross profit	18.8	21.6	40.5	44.5
<i>Gross profit as a % of sales</i>	<i>20.5%</i>	<i>22.2%</i>	<i>20.9%</i>	<i>22.9%</i>
Administration expenses	9.5	10.5	19.7	19.2
<i>Administration expenses as a % of sales</i>	<i>10.4%</i>	<i>10.8%</i>	<i>10.2%</i>	<i>9.9%</i>
Selling expenses	3.4	4.1	7.1	7.6
<i>Selling expenses as a % of sales</i>	<i>3.7%</i>	<i>4.2%</i>	<i>3.7%</i>	<i>3.9%</i>
Other (income) expenses	(5.7)	0.7	(5.6)	0.9
<i>Other (income) expenses as a % of sales</i>	<i>(6.2%)</i>	<i>0.7%</i>	<i>(2.9%)</i>	<i>0.5%</i>
Unrealized foreign exchange (gain) loss	(1.8)	(1.2)	4.4	(3.0)
<i>Unrealized foreign exchange (gain) loss as a % of sales</i>	<i>(2.0%)</i>	<i>(1.2%)</i>	<i>2.3%</i>	<i>(1.5%)</i>
Net income	9.2	5.0	8.0	13.0
<i>Net income as a % of sales</i>	<i>10.1%</i>	<i>5.1%</i>	<i>4.1%</i>	<i>6.7%</i>
Adjusted EBITDA	19.8	13.6	35.8	30.0
<i>Adjusted EBITDA as a % of sales</i>	<i>21.6%</i>	<i>14.0%</i>	<i>18.5%</i>	<i>15.4%</i>
Net income per share (basic and diluted)	\$0.36	\$0.20	\$0.31	\$0.51

	June 30, 2020	December 31, 2019
Total Assets	\$390.8	\$352.3
Total Non-Current Liabilities	\$191.4	\$175.6

#### RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA

(millions of dollars)

	Three months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2020	Six months ended June 30, 2019
Net income	\$9.2	\$5.0	\$8.0	\$13.0
Adjustments:				
Amortization and depreciation	7.8	6.7	15.4	13.0
Interest	1.2	1.6	2.9	3.1
Unrealized foreign exchange (gain) loss	(1.8)	(1.2)	4.4	(3.0)
Acquisition costs	0.2	0.4	0.8	0.4
Income taxes	3.2	1.1	4.3	3.5
Adjusted EBITDA	<u>\$19.8</u>	<u>\$13.6</u>	<u>\$35.8</u>	<u>\$30.0</u>
Lotteries and charitable gaming <sup>(1)</sup>	\$20.2	\$10.0	\$34.1	\$23.2
Diamond Game <sup>(1)</sup>	<u>(0.4)</u>	<u>3.6</u>	<u>1.7</u>	<u>6.8</u>
Adjusted EBITDA	<u><u>\$19.8</u></u>	<u><u>\$13.6</u></u>	<u><u>\$35.8</u></u>	<u><u>\$30.0</u></u>

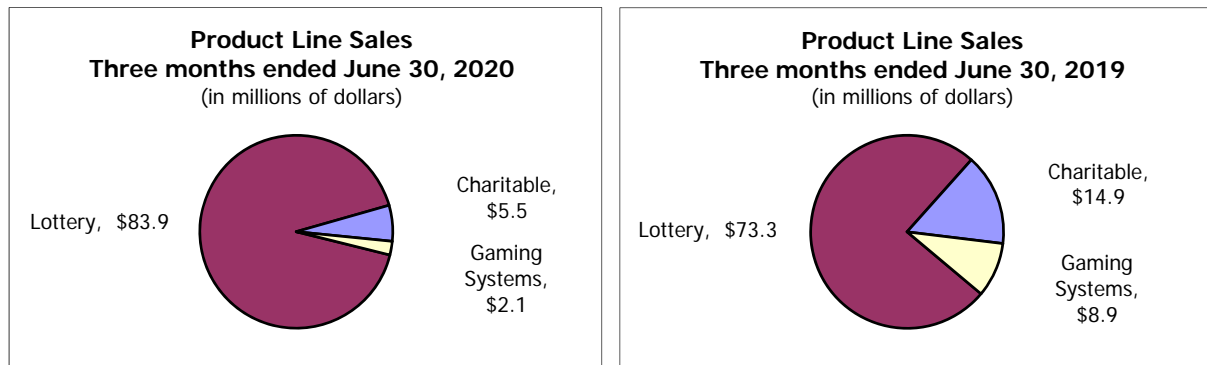
(1) Effective January 1, 2020, the Oasis egaming division was transferred from International Gamco (Charitable) to Diamond Game (Gaming Systems), comparative figures have been restated.

## 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, 2020

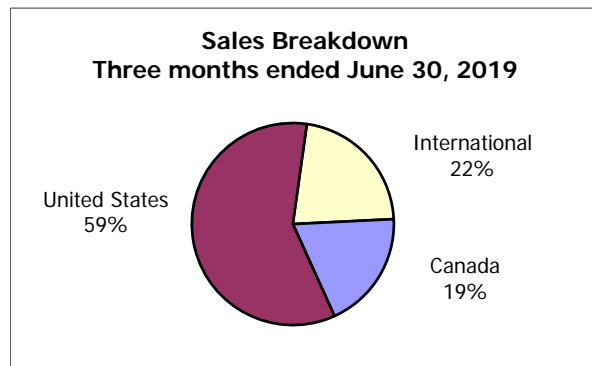
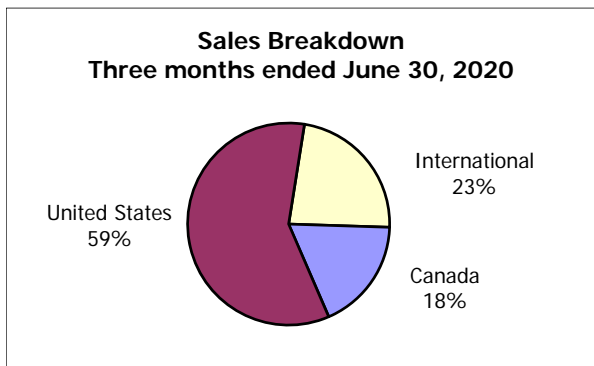
#### Sales



During the three months ended June 30, 2020, Pollard achieved sales of \$91.5 million, compared to \$97.1 million in the three months ended June 30, 2019. Factors impacting the \$5.6 million sales decrease were:

Charitable gaming sales volumes decreased by \$9.4 million in the second quarter of 2020. Our charitable gaming products are sold at retail through various bars, veteran organizations and bingo halls, which were closed in the middle of March in response to the onset of the COVID-19 virus. Additionally, Diamond Game's machines are located in similar establishments and with their closure in response to COVID-19 Diamond's sales decreased by \$6.9 million in the quarter compared to 2019. Additionally, the slightly lower average selling price of charitable games in 2020 further decreased sales by \$0.1 million. Many U.S. jurisdictions began to reopen these retail locations towards the end of the second quarter, however, for the majority of the three months ended June 30, 2020, our charitable gaming and egaming machine revenue was severely limited. By the end of July, continued reopenings have resulted in overall charitable gaming and egaming revenues approaching levels achieved pre-COVID-19.

An increase in the instant ticket average selling price in the quarter compared to the second quarter of 2019 increased sales by \$6.9 million. This increase was a result of the sales mix in the quarter, including higher sales of Pollard's proprietary Scratch FX<sup>®</sup> product. Higher sales of ancillary lottery products and services increased revenue in the second quarter of 2020 by \$3.3 million. This increase was primarily from the substantially higher revenues from iLottery, as well as increased sales of licensed product, digital and loyalty products, including revenue from mkodo, and distribution services which further contributed to the increase in sales. Partially offsetting these was a decrease in Schafer's and Fastrak's merchandising product sales in the second quarter of 2020. Also, a slight decrease in instant ticket sales volume in the quarter reduced sales by \$1.9 million.



During the three months ended June 30, 2020, Pollard generated approximately 72.5% (2019 – 71.6%) 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 2020 the actual U.S. dollar value was converted to Canadian dollars at \$1.393, compared to a rate of \$1.343 during the second quarter of 2019. This 3.7% increase in the U.S. dollar value resulted in an approximate increase of \$2.4 million in revenue relative to the second quarter of 2019. During the quarter the value of the Canadian dollar weakened against the Euro resulting in an approximate increase of \$0.1 million in revenue relative to the second quarter of 2019.

### **Cost of sales and gross profit**

Cost of sales was \$72.7 million in the second quarter of 2020 compared to \$75.5 million in the second quarter of 2019. Cost of sales was lower in the quarter as a result of the significant reduction in charitable and Diamond Game sales due to venue closures related to COVID-19, as well as reduced merchandising product sales in 2020. These decreases were partially offset by higher ancillary instant ticket product sales, including the addition of mkodo. In addition, higher exchange rates on U.S. dollar denominated transactions and increased amortization and depreciation further offset the decrease in cost of sales.

Gross profit was \$18.8 million (20.5% of sales) in the second quarter of 2020 compared to \$21.6 million (22.2% of sales) in the second quarter of 2019. This decrease in gross profit was primarily the result of the significant reduction in charitable and Diamond Game's sales in the quarter. These reductions were partially offset by the significant increase in iLottery, digital and loyalty sales. The lower gross profit percentage was due to the substantial reduction in charitable and Diamond Game's sales, partially offset by increased iLottery sales and higher sales of Pollard's proprietary Scratch FX<sup>®</sup> product.

### **Administration expenses**

Administration expenses decreased to \$9.5 million in the second quarter of 2020 from \$10.5 million in the second quarter of 2019. The decrease of \$1.0 million was primarily due to the reduction in travel and conference related costs due to cost containment strategies implemented in response to COVID-19, lower professional fees and a \$0.2 million reduction in acquisition costs. These reductions in administration expenses were partially offset by the addition of mkodo, as well as higher compensation and licensing expenses to support Pollard's growth strategies of developing innovative digital products.



### **Selling expenses**

Selling expenses decreased to \$3.4 million in the second quarter of 2020 from \$4.1 million in the second quarter of 2019 primarily due to the reduction in travel related costs due to cost containment strategies implemented in response to COVID-19, partially offset by the addition of mkodo.

### **Other (income) expenses**

Other income increased to \$5.7 million in the second quarter of 2020 compared to the \$0.7 million other expenses in the second quarter of 2019. The increase of \$6.4 million was primarily due to \$5.5 million of Canada Emergency Wage Subsidy ("CEWS") earned in the quarter. In addition, the loss on equity investment in the quarter decreased by \$0.8 million in comparison to 2019.

### **Foreign exchange**

The net foreign exchange gain was \$2.0 million in the second quarter of 2020 compared to a net gain of \$1.4 million in the second quarter of 2019. The 2020 net foreign exchange gain of \$2.0 million resulted in part from a \$1.8 million unrealized foreign exchange gain, comprised predominately of an unrealized gain on U.S. dollar denominated accounts payable and long-term debt due to the strengthening of the Canadian dollar. This unrealized gain was partially offset by an unrealized loss on U.S. dollar denominated accounts receivable. In addition, a \$0.2 million realized foreign exchange gain as a result of foreign currency denominated accounts receivable collected being converted into Canadian dollars at favorable foreign exchange rates increased the net foreign exchange gain.

The 2019 net foreign exchange gain of \$1.4 million resulted from a \$1.2 million unrealized foreign exchange gain, comprised predominately of an unrealized gain on U.S. dollar denominated liabilities, due to the strengthening of the Canadian dollar at the end of the quarter. This gain was partially offset by an unrealized loss on U.S. dollar denominated accounts receivable. In addition a \$0.2 million realized foreign exchange gain as a result of foreign currency denominated accounts receivable collected being converted into Canadian dollars at favorable foreign exchange rates increased the net foreign exchange gain.

### **Adjusted EBITDA**

Adjusted EBITDA increased to \$19.8 million in the second quarter of 2020 compared to \$13.6 million in the second quarter of 2019. The primary reasons for the \$6.2 million increase were the increase in other income of \$6.4 million, primarily due to the inclusion of \$5.5 million in CEWS support, lower administration expenses (net of acquisition costs) of \$0.8 million and a decrease in selling expenses of \$0.7 million. These increases to Adjusted EBITDA were partially offset by the decrease in gross profit (net of amortization and depreciation) of \$1.7 million, primarily due to the reduction in charitable gaming and egaming sales caused by the impact of COVID-19, partially offset by higher iLottery revenues.

### **Interest expense**

Interest expense decreased to \$1.2 million in the second quarter of 2020 from \$1.6 million in the second quarter of 2019 primarily as a result of the lower interest rates in 2020, partially offset by the increase in long-term debt.

## Amortization and depreciation

Amortization and depreciation, including amortization of intangible assets and depreciation of property and equipment, totaled \$7.8 million during the second quarter of 2020 which increased from \$6.7 million during the second quarter of 2019. The increase was primarily as a result the addition of mkodo, including the amortization and depreciation relating to the identifiable assets acquired, including intangible assets and property, plant and equipment, and higher depreciation and amortization on new equipment and intangible assets.

## Income taxes

Income tax expense was \$3.2 million in the second quarter of 2020, an effective rate of 25.4%, lower than our domestic rate of 27.0% due primarily to the effect of foreign exchange and lower tax rates in foreign jurisdictions.

Income tax expense was \$1.1 million in the second quarter of 2019, an effective rate of 17.3%, lower than our domestic rate of 27.0% due primarily to the impact of lower tax rates in foreign jurisdictions and the effect of foreign exchange.

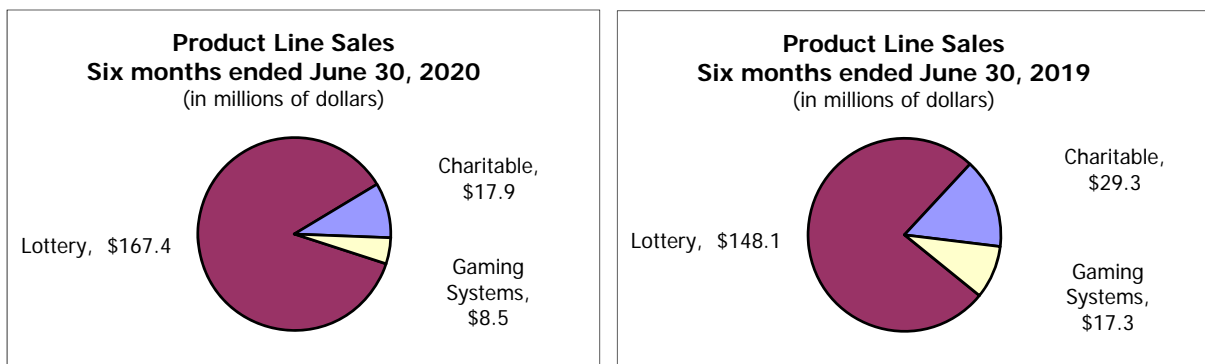
## Net income

Net income increased to \$9.2 million in the second quarter of 2020 from \$5.0 million earned in the second quarter of 2019. The primary increases in net income were the increase in other income of \$6.4 million, primarily due to the inclusion of \$5.5 million in CEWS support, lower administration expenses of \$1.0 million, a decrease in selling expenses of \$0.7 million, a reduction in interest expense of \$0.4 million and an increase in the foreign exchange gain of \$0.6 million. These increases to net income were partially offset by the decrease in gross profit of \$2.8 million, primarily due to the reduction in charitable gaming and egaming sales due to the impact of COVID-19, partially offset by higher iLottery revenues, and an increase in income taxes of \$2.1 million.

Net income per share (basic and diluted) increased to \$0.36 per share in the second quarter of 2020 from \$0.20 per share in the second quarter of 2019.

## ANALYSIS OF RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2020

### Sales

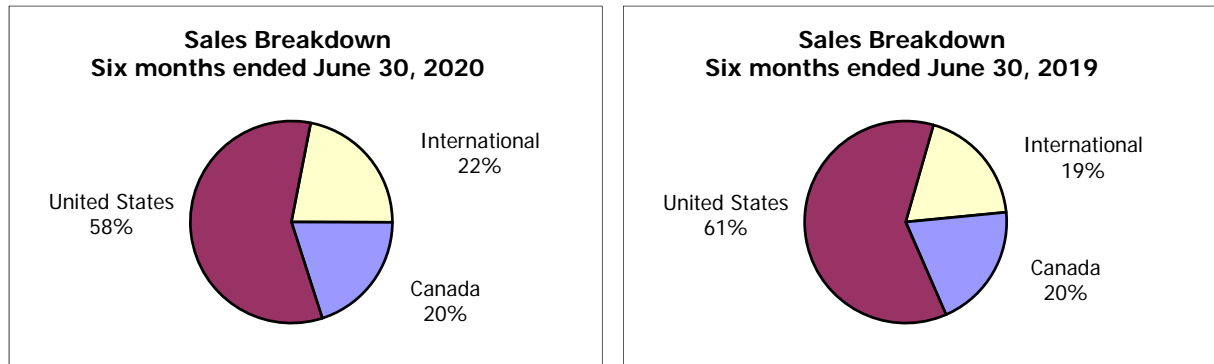


During the six months ended June 30, 2020, Pollard achieved sales of \$193.8 million, compared to \$194.7 million in the six months ended June 30, 2019. Factors impacting the \$0.9 million sales decrease were:

Charitable gaming sales volumes decreased by \$10.9 million in the six months ended 2020. Our charitable gaming products are sold at retail through various bars, veteran organizations and bingo halls, which were closed in the middle of March in response to the onset of the COVID-19 virus. Additionally, Diamond Game's machines are located in similar establishments and with their closure in response to COVID-19 Diamond Game's sales decreased by \$8.8 million in 2020 compared to the first six months of 2019. Additionally, the lower average selling price of charitable games in 2020 further decreased sales by \$0.7 million. Many U.S. jurisdictions began to reopen these retail locations towards the end of the second quarter, however, for the majority of the three months ended June 30, 2020, our charitable gaming and egaming machine revenue was severely limited. By the end of July continued reopenings have resulted in overall charitable gaming and egaming revenues approaching levels achieved pre-COVID-19.

Higher sales of ancillary lottery products and services increased revenue in the first six months of 2020 by \$14.7 million compared to 2019. This increase was primarily due to the substantially higher revenues from iLottery and licensed products, as well as increased sales from digital and loyalty products, including revenue from mkodo, and distribution services. Partially offsetting these increases was a decrease in Schafer's and Fastrak's merchandising product sales in 2020.

An increase in the instant ticket average selling price in the six months ended June 30, 2020, compared to 2019 increased sales by \$2.7 million. In addition, a slight increase in instant ticket sales volume in 2020, as compared to the first six months of 2019, further increased sales by \$0.7 million.



During the six months ended June 30, 2020, Pollard generated approximately 70.4% (2019 – 72.3%) 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 2020 the actual U.S. dollar value was converted to Canadian dollars at \$1.353, compared to a rate of \$1.338 the first six months of 2019. This 1.1% increase in the U.S. dollar value resulted in an approximate increase of \$1.4 million in revenue relative to the first six months of 2019.

### Cost of sales and gross profit

Cost of sales was \$153.3 million in the six months ended June 30, 2020, compared to \$150.2 million in the six months ended June 30, 2019. Cost of sales was higher as a result of higher ancillary instant ticket product sales, including the addition of mkodo in 2020. As well, higher exchange rates on U.S. dollar denominated transactions and increased amortization and depreciation further increased cost of sales in the first six months of 2020. These increases to cost of sales were partially offset by the reduction in

charitable and Diamond Game sales due to venue closures related to COVID-19, as well as reduced merchandising product sales in 2020.

Gross profit decreased to \$40.5 million (20.9% of sales) in the six months ended June 30, 2020, from \$44.5 million (22.9% of sales) in the six months ended June 30, 2019. This decrease in gross profit was primarily the result of the significant reduction in charitable and Diamond Game's sales in 2020. These reductions were partially offset by a significant increase in iLottery and, digital and loyalty sales. The lower gross profit percentage was due to the substantial reduction in charitable and Diamond Game's sales, partially offset by increased iLottery and license product sales.

### **Administration expenses**

Administration expenses increased to \$19.7 million in the first six months of 2020 from \$19.2 million in the first six months of 2019. The increase of \$0.5 million was a result of higher acquisition costs of \$0.4 million and greater compensation and licensing expenses to support Pollard's growth strategies of developing innovative digital products. Additionally, the inclusion of Fastrak and mkodo further increased administration expenses. Partially offsetting these increases were the reduction in travel and conference related costs due to cost containment strategies implemented in response to COVID-19 and lower professional fees.

### **Selling expenses**

Selling expenses decreased to \$7.1 million in the first six months of 2020 from \$7.6 million in the first six months of 2019 primarily due to the reduction in travel related costs due to cost containment strategies implemented in response to COVID-19, partially offset by the additions of mkodo and Fastrak, and higher compensation costs.

### **Other (income) expenses**

Other income increased to \$5.6 million in the first six months of 2020 compared to \$0.9 million other expenses in the first six months of 2019. This increase of \$6.5 million was primarily due to \$5.5 million of CEWS earned in the first six months of 2020. In addition, the loss on equity investment in the quarter decreased by \$1.2 million in comparison to 2019.

### **Foreign exchange**

The net foreign exchange loss was \$4.1 million in the first six months of 2020 compared to a net foreign exchange gain of \$2.8 million in the first six months of 2019. The 2020 net foreign exchange loss of \$4.1 million resulted from a net unrealized foreign exchange loss of \$4.4 million, comprised predominately of an unrealized loss on U.S. dollar denominated accounts payable and long-term debt due to the weakening of the Canadian dollar. Partially offsetting the unrealized loss was a \$0.3 million realized foreign exchange gain as a result of foreign currency denominated accounts receivable collected being converted into Canadian dollars at favorable foreign exchange rates.

The 2019 net foreign exchange gain of \$2.8 million resulted in part from a net unrealized foreign exchange gain of \$3.0 million, comprised predominately of an unrealized gain on U.S. denominated liabilities, due to the strengthening of the Canadian dollar at the end of the quarter. This gain was partially offset by an unrealized loss on U.S. dollar denominated accounts receivable. Partially offsetting the unrealized gain was a \$0.2 million realized foreign exchange loss as a result of foreign currency

denominated accounts receivable collected being converted into Canadian dollars at unfavorable foreign exchange rates.

### **Adjusted EBITDA**

Adjusted EBITDA increased to \$35.8 million in the first six months of 2020 compared to \$30.0 million in the first six months of 2019. The primary reasons for the increase of \$5.8 million were the increase in other income of \$6.5 million, primarily due to the inclusion of \$5.5 million in CEWS support, a decrease in selling expenses of \$0.5 million and an increase in realized foreign exchange gain of \$0.5 million. These increases to Adjusted EBITDA were partially offset by the decrease in gross profit (net of amortization and depreciation) of \$1.6 million, primarily due to the reduction of charitable gaming and egaming sales caused by the impact of COVID-19, partially offset by higher iLottery revenues.

### **Interest expense**

Interest expense decreased to \$2.9 million in the first six months of 2020 from \$3.1 million in the first six months of 2019 primarily as a result of the lower interest rates in 2020, partially offset by the increase in long-term debt.

### **Amortization and depreciation**

Amortization and depreciation, including amortization of intangible assets and depreciation of property and equipment, totaled \$15.4 million during the first six months of 2020 which increased from \$13.0 million during the first six months of 2019. The increase was primarily as a result of the additions of mkodo and Fastrak, including the amortization and depreciation relating to the identifiable assets acquired, including intangible assets and property, plant and equipment, and higher depreciation and amortization on new equipment and intangible assets.

### **Income taxes**

Income tax expense was \$4.3 million in the first six months of 2020, an effective rate of 35.5%, which was higher than our domestic rate of 27.0% due primarily to the effect of foreign exchange and non-deductible expenses.

Income tax expense was \$3.5 million in the first six months of 2019, an effective rate of 21.1%, which was lower than our domestic rate of 27.0% due primarily to the impact of lower tax rates in foreign jurisdictions and the effect of foreign exchange.

### **Net income**

Net income decreased to \$8.0 million in the first six months of 2020 from \$13.0 million in the first six months of 2019 primarily as a result of the increase in foreign exchange loss of \$6.9 million, a decrease in gross profit of \$4.0 million, due to the reduction in charitable gaming and egaming sales caused by the impact of COVID-19, partially offset by higher iLottery revenues, the increase in income tax expense of \$1.8 million and higher administration expenses of \$0.5 million. These decreases in net income were partially offset by the increase in other income of \$6.5 million, primarily due to the inclusion of \$5.5 million in CEWS support, the decrease in selling costs of \$0.5 million and the reduced interest expense of \$0.2 million.

Net income per share (basic and diluted) decreased to \$0.31 per share in the six months ending June 30, 2020, as compared to \$0.51 per share in the six months ending June 30, 2019.

## **Liquidity and Capital Resources**

### *Cash provided by operating activities*

For the six months ended June 30, 2020, cash flow provided by operating activities was \$37.6 million compared to cash flow provided by operating activities of \$3.3 million for the first six months of 2019.

The primary reason for the increase in cash flow provided by operations was a significant decrease in our investment in working capital. For the six months ended June 30, 2020, decreases in non-cash working capital provided \$4.2 million compared to increases in 2019 which used \$22.4 million in cash, a \$26.2 million difference.

For the six months ended June 30, 2020, changes in the non-cash working capital increased cash flow from operations due primarily to a decrease in accounts receivable and prepaid expenses and deposits, as well as an increase in accounts payable and accrued liabilities. These reductions in non-cash working capital were partially offset by an increase in inventory. For the first six months of 2019, changes in the non-cash working capital decreased cash flow from operations due primarily to an increase in accounts receivable and a decrease in accounts payable and accrued liabilities, partially offset by a decrease in inventory. The higher investment in accounts receivable reflects the increasing sales volume from increased orders levels building throughout the first six months of 2019.

Net income before income taxes after non-cash adjustments in the first half of 2019 contributed \$39.7 million to the cash provided by operating activities compared to \$34.8 million in the first half of 2019. Cash used for interest was \$2.7 million in 2020, similar to \$2.7 million in 2019. Cash used for pension plan contributions decreased to \$3.3 million in 2020 as compared to \$3.4 million in 2019. Cash used for income tax payments decreased to \$0.3 million in 2020 from \$3.0 million in 2019.

### *Cash used for investing activities*

In the six months ended June 30, 2020, cash used for investing activities was \$31.6 million compared to cash used of \$22.0 million in the first half of 2019. In the six months ended June 30, 2020, Pollard used \$17.4 million, net of cash acquired and debt assumed, to purchase mkodo. In addition, Pollard expended \$5.3 million on capital expenditures, \$4.9 million to purchase certain charitable gaming assets, \$0.7 million on its investment in its iLottery joint venture and \$3.2 million on additions to intangible assets.

In the six months ended June 30, 2019, Pollard used \$8.5 million, net of cash acquired, to purchase Fastrak. In addition, Pollard expended \$7.3 million in capital expenditures, \$2.2 million on its investment in its iLottery joint venture and \$4.0 million on additions to intangible assets.

### *Cash used for financing activities*

Cash used for financing activities was \$2.0 million in the six months ended June 30, 2020, compared to cash provided by financing activities of \$8.7 million in the six months ended June 30, 2019.

During the first half of 2020 cash was used to pay \$2.5 million of lease principal payments and \$2.1 million of dividends. These payments were partially offset by cash received from long-term debt of \$2.6 million.

During the first half of 2019 Pollard received net proceeds from long-term debt of \$13.1 million. This receipt of cash was partially offset by \$2.5 million of lease principal payments and \$1.8 million of dividends.

As at June 30, 2020, Pollard had unused credit facility of \$74.4 million and an available accordion feature of \$35.0 million, in addition to \$11.7 million in cash resources. This total available liquidity of \$121.1 million, coupled with our strong operating cash flow, provides Pollard with significant available resources in light of the ongoing uncertainty related to COVID-19. Our strong balance sheet and ongoing cash flow will generate significant resources to continue to invest in future working capital and capital expenditures, meet our contractual obligations and assist in future acquisitions, while at the same time providing a significant safety net to account for negative impacts of the pandemic.

### Quarterly Information

(unaudited)

(millions of dollars)

	Q2 2020	Q1 2020	Q4 2019	Q3 2019	Q2 2019	Q1 2019	Q4 2018	Q3 2018	Q2 2018
Sales	\$91.5	\$102.3	\$100.0	\$103.2	\$97.1	\$97.6	\$70.2	\$94.5	\$86.8
Adjusted EBITDA	19.8	16.0	14.2	16.0	13.6	16.4	7.5	14.2	14.1
Net income (loss)	9.2	(1.2)	4.6	4.4	5.0	8.0	(1.9)	7.2	5.0

Effective January 1, 2019, Adjusted EBITDA increased as a result of the implementation of IFRS 16 *Leases*.

Sales were lower in the second quarter of 2020 as a result of reduced charitable and Diamond Game's sales due to the impact of COVID-19 shutdowns.

Net loss for the first quarter of 2020 included a \$6.2 million unrealized foreign exchange loss due to the significant weakening of the Canadian dollar.

The trend of increased sales, Adjusted EBITDA and net income, starting the second quarter of 2018, with the exceptions of the second quarter of 2020 and the fourth quarter of 2018, was primarily as a result of higher instant ticket volumes and the acquisitions made during this timeframe.

The significant decrease in instant ticket volumes in the fourth quarter of 2018 reduced sales, Adjusted EBITDA and net income. Net income was further reduced by the large unrealized foreign exchange loss in the quarter.

### ***Working Capital***

Net non-cash working capital varies significantly 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 significantly impact the amount required to be invested in inventory or receivables at a particular period end. The high value, low volume nature 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 mitigates collection risk. 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.

Seasonality does not have a material impact on the carrying amounts in working capital.

As at June 30, 2020, Pollard's investment in non-cash working capital decreased \$4.2 million compared to December 31, 2019, primarily as a result of decreased investment in accounts receivable and prepaid expenses and deposits, and an increase accounts payable and accrued liabilities, partially offset by a increase in inventories.

	June 30, 2020	December 31, 2019
Working Capital	\$77.5	\$79.2
Total Assets	\$390.8	\$352.3
Total Non-Current Liabilities	\$191.4	\$175.6

### ***Credit Facility***

Pollard's credit facility was renewed effective December 31, 2019. The credit facility provides loans of up to \$190.0 million for its Canadian operations and US\$14.0 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 \$190.0 million Canadian equivalent. The credit facility also includes an accordion feature which can increase the facility by \$35.0 million. 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, 2020, the outstanding letters of guarantee were \$2.1 million. The remaining balance available for drawdown under the credit facility was \$74.4 million.

Under the terms and conditions of the credit facility agreement Pollard is required to maintain certain financial covenants including debt to income before interest, income taxes, amortization and depreciation, and certain other items ("Adjusted EBITDA") ratios and certain debt service coverage ratios. As at June 30, Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard. Under the terms of the agreement the facility is committed for a three-year period, renewable December 31, 2022. Principal payments are not required until maturity. The facility can be prepaid without penalties.



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

### ***Economic Development Canada (“EDC”) Facility***

Effective February 28, 2020, Pollard entered into an agreement with EDC to provide a €15 million facility whereby Pollard can issue qualifying letters of credit against the EDC facility. This facility is guaranteed by a general indemnity from Pollard. As of June 30, 2020, the outstanding letters of credit drawn on this facility were \$9.2 million.

### ***Outstanding Share Data***

As at June 30, 2020 and August 12, 2020, outstanding share data was as follows:

Common shares	25,635,658
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### ***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. As at June 30, 2020, the total share options issued and outstanding were 377,500.

### **Contractual Obligations**

There have been no material changes to Pollard’s contractual obligations since December 31, 2019, 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, 2019, 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, 2019.

### **Critical Accounting Policies and Estimates**

Except as noted in the unaudited condensed consolidated financial statements for the six months ended June 30, 2020, the critical accounting policies and estimates of Pollard remain substantially unchanged from those identified in Pollard’s consolidated financial statements for the year ended December 31, 2019.

## **Related Party Transactions**

Pollard has not entered into any significant transactions with related parties during the six months ended June 30, 2020, which are not disclosed in the unaudited condensed consolidated interim financial statements.

## **Industry Risks and Uncertainties**

Except as discussed previously regarding the current COVID-19 pandemic, the risk factors affecting Pollard remain substantially unchanged from those identified in the MD&A for Pollard for the year ended December 31, 2019.

## **Outlook**

After an initial decline in March and April, the lottery industry impressively rebounded, with many lottery organizations generating record sales of instant tickets at retail during June, July and August to date. Higher retail sales do not immediately translate into higher revenue for Pollard as our production schedule is usually 2-3 months in advance of the lottery's retail launch schedule. However, ongoing elevated retail sales over extended periods of time will lead to greater volumes of tickets ordered and greater revenue for manufacturers like Pollard.

Our third quarter has traditionally been a busy quarter for our instant ticket product line as we produce games for the holiday season and this timing, combined with strong industry retail sales, will provide positive dynamics for our production schedule going forward. Our Ypsilanti facility is returning to full capacity by starting up production on our second printing press, which was temporarily idled during the pandemic.

As noted previously our iLottery operations experienced a doubling of sales during the pandemic and these higher revenue levels have continued into the third quarter. Interest from the lottery industry, particularly in North America, for internet distribution of lottery products is very high. On July 1, 2020, our existing iLottery operation for the Virginia Lottery transitioned from just providing a subscription service for draw based games to a complete suite of iLottery products including einstants and individual draw based games. To date, results have exceeded expectations. It was also recently announced that the Alberta Gaming, Liquor and Cannabis Commission has awarded a contract to our NeoPollard Interactive joint venture to provide a complete iGaming solution to the province of Alberta, anticipated to go live in the third quarter.

Sales of our charitable gaming products, pull-tabs and bingo paper were significantly affected by COVID-19. Our revenue was effectively reduced to nil mid-March. Beginning in May, and increasingly in June, most jurisdictions began reopening their economies, including most of the retail outlets that sell our charitable gaming products to consumers. By the end of the second quarter sales of our paper-based products were returning to our pre-COVID levels.

Similarly, locations hosting our Diamond Game and Oasis branded egaming machines began reopening in May and by the end of the second quarter the majority of our machines were generating revenue. The remainder of our machines, primarily machines located in Ontario, are expected to be in operation by mid-third quarter. Our experience so far has seen the level of consumer play at individual machines meet or exceed levels seen pre-COVID. While recognizing that the COVID-19 situation is fluid, the return of our charitable gaming and egaming businesses approaching pre-COVID levels, as early as the beginning of the third quarter, is a very positive development.

Our balance sheet and overall cash flow remained very strong throughout the second quarter and, as a result, Pollard has greater available liquidity currently than compared to the end of the first quarter. At June 30, 2020, our current cash resources and undrawn senior debt facility, including our accordion feature, provided approximately \$121 million in available financial liquidity. During the pandemic our robust lottery operations generated significant operating cash flow which included effective management of working capital. As our charitable gaming and egaming revenues return to pre-COVID levels in the third quarter, our cash flow will continue to be strong and position us well to invest in our business.

During the second quarter we qualified for the Canada Emergency Wage Subsidy program. This program has been extended to December 31, 2020, with revised qualification criteria. It is still to be determined to what extent, if any, Pollard will qualify under these new guidelines, however, we do not anticipate qualifying for any further material amounts.

COVID-19 continues to generate unprecedented uncertainty for all organizations including Pollard. Our lottery operations have demonstrated impressive resilience throughout this challenging period and with the significant reopening of the charitable gaming and egaming retail outlets, our overall business expectations remain very positive. However, some jurisdictions have, or are actively considering, rolling back reopening protocols, including closing retail outlets that sell our charitable gaming products. Such additional closures or roll back of reopenings could have a significant negative impact on our financial results through a reduction of charitable gaming and egaming sales. Similarly, although we are not currently aware of any jurisdictions contemplating these actions, any reduction or limitation in retail outlets selling lottery products, and specifically impacting the sale of instant tickets, could also have a material effect on our financial results.

We have been and continue to be very proactive in ensuring the safety and health of our 2,000 team members throughout all of our operations. Extensive protocols based on local and national health directives are in place including daily temperature screenings, extensive social distancing conventions and mandatory remote working for all employees who are capable. We are currently implementing a multi-phase workplace safety plan in all our locations to recognize the ongoing risks of COVID-19, focusing on the safety of our employees while continuing to meet the needs of our customers. We want to express our extreme gratitude to all of our staff who have demonstrated such dedication and shown remarkable ability to help us adapt to new work protocols during these difficult and complicated times.

An important piece of our strategic plan is the addition of critical assets through appropriate acquisitions. We continue to actively research opportunities and will pursue strategic business combinations that support our vision of being the partner of choice to the lottery and charitable gaming community.

Our confidence in the resilience of the lottery and charitable gaming industries has been confirmed during these last few months with significant retail sales growth in instant tickets and iLottery operations, and a strong recovery of sales of charitable gaming products upon reopening of retail outlets. The short and long-term fundamentals of lottery and charitable gaming are extremely positive as evidenced by the financial results generated during the pandemic. Our strong financial position and robust cash flow have uniquely positioned Pollard to continue to capitalize on opportunities and grow our business.

## **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.

Pollard has limited its design of disclosure controls and procedures to exclude controls, policies and procedures of mkodo, as it was acquired not more than 365 days before the end of the financial period to which this MD&A relates.

### **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.

Pollard has limited its design of ICFR to exclude controls, policies and procedures of mkodo, as it was acquired not more than 365 days before the end of the financial period to which this MD&A relates.

No changes were made in Pollard's internal control over financial reporting during the three and six months ended June 30, 2020, 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, 2019, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

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