

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

*September 30, 2020*

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

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020**

November 9, 2020

*This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the three and nine months ended September 30, 2020, is prepared as at November 9, 2020, and should be read in conjunction with the accompanying unaudited condensed consolidated interim financial statements of Pollard and the notes therein as at September 30, 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 nine months ended September 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. As well Pollard, through its joint operation, is the leading iLottery operator in the North American lottery space.

Pollard produces and provides a comprehensive line of instant tickets and lottery services including: licensed products, distribution, SureTrack® lottery management system, retail telephone selling (“tel-sell”), marketing, iLottery, interactive digital gaming, including mkodo’s world class game apps, PlayOn™ loyalty program, retail management services, ScanACTIV™, 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 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 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. 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, these sales rebounded to pre-COVID levels in the third quarter. In addition, Pollard’s main lottery products and services have shown significant resilience throughout the pandemic, generating substantial cash flows from operating activities during the nine months ended September 30, 2020. 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. Pollard has significant cash resources and unused credit facility available, which we believe will allow Pollard to support its 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 facilities are operational and our supply chains have remained functional. Pollard is extremely dedicated to providing a safe workplace in all facilities and is working to curb the spread of the virus through implementation of extensive safety measures at all locations, including daily temperature checks and health screening, extensive social distancing, restriction of visitors and work from home policies for employees capable of doing so.

#### Product line breakdown of revenue

	Three months ended September 30, 2020	Three months ended September 30, 2019	Nine months ended September 30, 2020	Nine months ended September 30, 2019
Lottery <sup>(1)</sup> <sup>(2)</sup>	81.6%	80.2%	84.6%	77.5%
Charitable <sup>(3)</sup>	11.8%	13.0%	10.2%	14.3%
Gaming Systems <sup>(3)</sup>	6.6%	6.8%	5.2%	8.2%

(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 September 30, 2020	Three months ended September 30, 2019	Nine months ended September 30, 2020	Nine months ended September 30, 2019
United States	66%	63%	61%	61%
Canada	16%	18%	19%	20%
International	18%	19%	20%	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 nine months ended September 30, 2020.

**SELECTED FINANCIAL  
INFORMATION**

(millions of dollars, except per share information)

	Three months ended September 30, 2020	Three months ended September 30, 2019	Nine months ended September 30, 2020	Nine months ended September 30, 2019
Sales	\$116.7	\$103.2	\$310.4	\$297.8
Cost of sales	88.9	78.6	242.2	228.7
Gross profit	27.8	24.6	68.2	69.1
<i>Gross profit as a % of sales</i>	<i>23.8%</i>	<i>23.8%</i>	<i>22.0%</i>	<i>23.2%</i>
Administration expenses	10.3	10.5	30.0	29.7
<i>Administration expenses as a % of sales</i>	<i>8.8%</i>	<i>10.2%</i>	<i>9.7%</i>	<i>10.0%</i>
Selling expenses	3.8	4.2	10.9	11.8
<i>Selling expenses as a % of sales</i>	<i>3.3%</i>	<i>4.1%</i>	<i>3.5%</i>	<i>4.0%</i>
Other (income) expenses	(3.0)	0.8	(8.7)	1.8
<i>Other (income) expenses as a % of sales</i>	<i>(2.6%)</i>	<i>0.8%</i>	<i>(2.8%)</i>	<i>0.6%</i>
Unrealized foreign exchange (gain) loss	(2.8)	0.8	1.6	(2.3)
<i>Unrealized foreign exchange (gain) loss as a % of sales</i>	<i>(2.4%)</i>	<i>0.8%</i>	<i>0.5%</i>	<i>(0.8%)</i>
Net income	13.2	4.4	21.1	17.4
<i>Net income as a % of sales</i>	<i>11.3%</i>	<i>4.3%</i>	<i>6.8%</i>	<i>5.8%</i>
Adjusted EBITDA	24.5	16.1	60.3	46.0
<i>Adjusted EBITDA as a % of sales</i>	<i>21.0%</i>	<i>15.6%</i>	<i>19.4%</i>	<i>15.4%</i>
Net income per share (basic and diluted)	\$0.51	\$0.17	\$0.82	\$0.68
	September 30, 2020	December 31, 2019		
Total Assets	\$380.9	\$352.3		
Total Non-Current Liabilities	\$175.2	\$175.6		

**RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA**

(millions of dollars)

	Three months ended September 30, 2020	Three months ended September 30, 2019	Nine months ended September 30, 2020	Nine months ended September 30, 2019
Net income	\$13.2	\$4.4	\$21.1	\$17.4
Adjustments:				
Amortization and depreciation	8.3	7.1	23.7	20.1
Interest	1.0	1.7	3.9	4.8
Unrealized foreign exchange (gain) loss	(2.8)	0.8	1.6	(2.3)
Acquisition costs	0.5	0.2	1.3	0.6
Income taxes	4.3	1.9	8.7	5.4
Adjusted EBITDA	<u>\$24.5</u>	<u>\$16.1</u>	<u>\$60.3</u>	<u>\$46.0</u>
Lotteries and charitable gaming <sup>(1)</sup>	\$21.9	\$13.7	\$56.0	\$36.8
Diamond Game <sup>(1)</sup>	<u>2.6</u>	<u>2.4</u>	<u>4.3</u>	<u>9.2</u>
Adjusted EBITDA	<u><u>\$24.5</u></u>	<u><u>\$16.1</u></u>	<u><u>\$60.3</u></u>	<u><u>\$46.0</u></u>

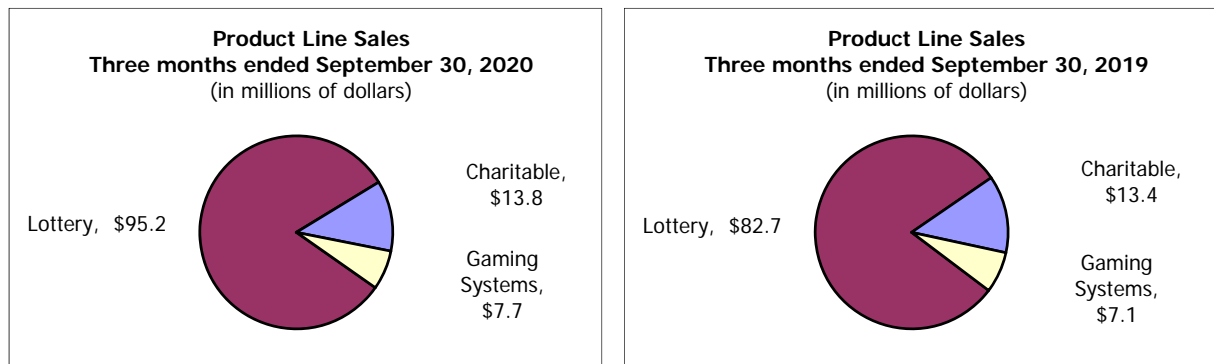
(1) Effective January 1, 2020, the Oasis egaming division was transferred from International Gamco (Charitable) to Diamond Game (Gaming Systems), comparative figures have been restated.

## 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 SEPTEMBER 30, 2020

#### Sales

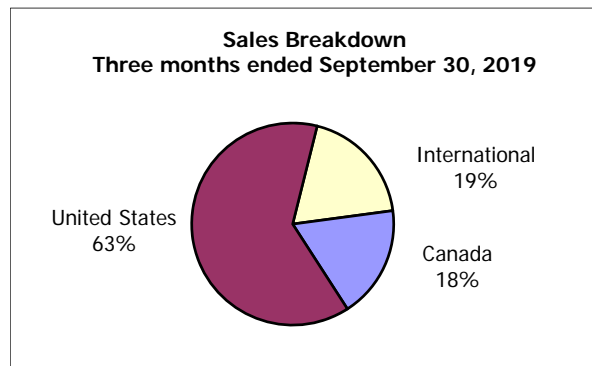
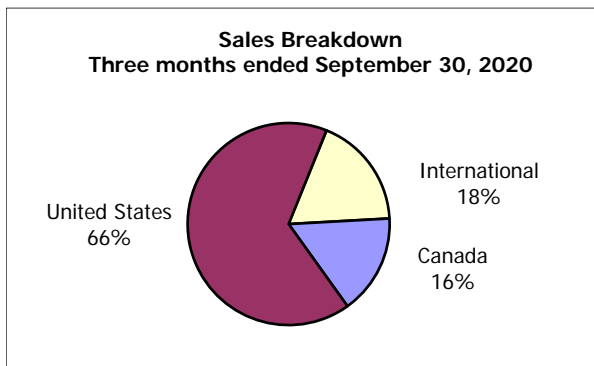


During the three months ended September 30, 2020, Pollard achieved sales of \$116.7 million, compared to \$103.2 million in the three months ended September 30, 2019. Factors impacting the \$13.5 million sales increase were:

An increase in the sales of ancillary lottery products and services increased revenue in the third quarter of 2020 by \$7.9 million as compared to the third quarter of 2019, primarily as a result of significantly higher iLottery sales. As well, increased sales of digital and loyalty products, including revenue from mkodo, and distribution services further contributed to the increase in ancillary sales. Partially offsetting these increases was a decrease in Schafer's and Fastrak's merchandising product sales in the third quarter of 2020.

Additionally, an increase in the instant ticket average selling price in the quarter compared to the third quarter of 2019 increased sales by \$3.5 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. In addition, a slight increase in instant ticket sales volume in the quarter further increased sales by \$0.2 million.

During the third quarter, the retail establishments where our charitable gaming products are sold and Diamond Game egaming machines are placed had reopened, after shutting down from mid-March through the end of the second quarter due to COVID-19. In the third quarter of 2020 higher Diamond Game revenue increased sales by \$0.6 million when compared to 2019. In addition, a higher average selling price for charitable games in 2020 increased sales by \$0.6 million. This was partially offset by a slight decrease in charitable gaming volumes which reduced sales by \$0.4 million from 2019.



During the three months ended September 30, 2020, Pollard generated approximately 73.9% (2019 – 71.7%) of its revenue in U.S. dollars including a portion of international sales which are priced in U.S. dollars. During the third quarter of 2020 the actual U.S. dollar value was converted to Canadian dollars at \$1.331, compared to a rate of \$1.320 during the third quarter of 2019. This 0.8% increase in the U.S. dollar value resulted in an approximate increase of \$0.7 million in revenue relative to the third quarter of 2019. In addition, during the quarter the value of the Canadian dollar weakened against the Euro resulting in an approximate increase of \$0.4 million in revenue relative to the third quarter of 2019.

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

Cost of sales was \$88.9 million in the third quarter of 2020 compared to \$78.6 million in the third quarter of 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, increased amortization and depreciation, and higher instant ticket manufacturing overheads further increased cost of sales in the third quarter of 2020.

Gross profit was \$27.8 million (23.8% of sales) in the third quarter of 2020 compared to \$24.6 million (23.8% of sales) in the third quarter of 2019. This increase in gross profit was primarily due to higher iLottery and licensed product sales in 2020, partially offset by lower gross profit from instant ticket, charitable gaming and Fastrak and Schafer merchandising product sales. Gross margin percentage was consistent with the third quarter of 2019, with higher margins from iLottery and licensed products sales being offset by lower margins as a result of increased manufacturing overhead costs and mix changes associated with the instant ticket production in the quarter.

### **Administration expenses**

Administration expenses decreased to \$10.3 million in the third quarter of 2020 from \$10.5 million in the third quarter of 2019. The decrease of \$0.2 million was a result of the reduction in travel and conference related costs due to COVID-19 and lower professional fees. Partially offsetting these decreases were higher acquisition costs of \$0.3 million and greater compensation and licensing expenses to support Pollard's growth strategies of developing innovative digital products. Additionally, the inclusion of mkodo further increased administration expenses in 2020.

### **Selling expenses**

Selling expenses decreased to \$3.8 million in the third quarter of 2020 from \$4.2 million in the third quarter of 2019 primarily due to the reduction in travel related costs due to COVID-19 and lower contract related costs. These decreases in selling expenses were partially offset by the additions of mkodo and higher compensation costs.



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

Other income increased to \$3.0 million in the third quarter of 2020 compared to \$0.8 million of other expenses in the third quarter of 2019. This increase of \$3.8 million was due to \$2.1 million of Canada Emergency Wage Subsidy ("CEWS") that was earned in the quarter and the increase in our share of income from our 50% owned iLottery joint venture, NeoPollard Interactive LLC ("NPI"), of \$2.0 million compared to the third quarter of 2019. These increases were partially offset by the reduction in the EBITDA support agreement in 2020, which expired on June 30, 2020.

### **Foreign exchange**

The net foreign exchange gain was \$1.8 million in the third quarter of 2020 compared to a net loss of \$1.1 million in the third quarter of 2019. The 2020 net foreign exchange gain of \$1.8 million consisted of a \$2.8 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, which was partially offset by an unrealized loss on U.S. dollar denominated cash and receivables. Partially offsetting the unrealized gain was a realized loss of \$1.0 million as a result of foreign currency denominated account receivables collected being converted into Canadian dollars at unfavorable foreign exchange rates.

The 2019 net foreign exchange loss of \$1.1 million consisted of a \$0.8 million unrealized foreign exchange loss, comprised predominately of an unrealized loss on U.S. dollar denominated liabilities, due to the weakening of the Canadian dollar at the end of the quarter, which was partially offset by an unrealized gain on U.S. dollar denominated cash and receivables. Additionally, included in the net foreign exchange loss was a realized loss of \$0.3 million as a result of foreign currency denominated account receivables collected being converted into Canadian dollars at unfavorable foreign exchange rates.

### **Adjusted EBITDA**

Adjusted EBITDA increased to \$24.5 million in the third quarter of 2020 compared to \$16.1 million in the third quarter of 2019. The primary reasons for the \$8.4 million increase were the increase in gross profit of \$4.4 million (net of amortization and depreciation), the increase in other income of \$3.8 million, primarily due to the inclusion of \$2.1 million in CEWS support and the increase in our share of income from our 50% owned iLottery joint venture, NPI, of \$2.0 million, lower administration expenses (net of acquisition costs) of \$0.5 million and a decrease in selling expenses of \$0.4 million. These increases were partially offset by the increase in the realized foreign exchange loss of \$0.7 million.

### **Interest expense**

Interest expense decreased to \$1.0 million in the third quarter of 2020 from \$1.7 million in the third quarter of 2019 primarily as a result of the lower interest rates in 2020 and the decrease in long-term debt as compared to the third quarter of 2019.

### **Amortization and depreciation**

Amortization and depreciation, including amortization of intangible assets and depreciation of property and equipment, totaled \$8.3 million during the third quarter of 2020 which increased from \$7.1 million during the third quarter of 2019. The increase was primarily as a result of higher amortization on new intangible assets and the addition of mkodo, including the amortization and depreciation relating to the identifiable assets acquired, including intangible assets and property, plant and equipment.

## Income taxes

Income tax expense was \$4.3 million in the third quarter of 2020, an effective rate of 24.7%, 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 \$1.9 million in the third quarter of 2019, an effective rate of 30.5%, higher than our domestic rate of 27.0% due primarily to the impact of non-tax deductible expenses.

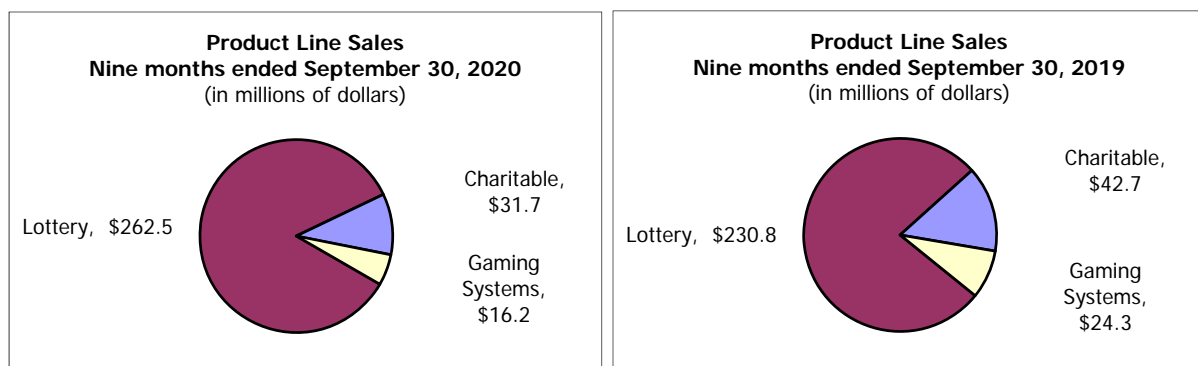
## Net income

Net income increased to \$13.2 million in the third quarter of 2020 from \$4.4 million in the third quarter of 2019. The primary reasons for the increase of \$8.8 million in net income were the increase in other income of \$3.8 million, primarily due to the inclusion of \$2.1 million in CEWS support and increased gain on equity investment of \$2.0 million, an increase in gross profit of \$3.2 million, an increase in the foreign exchange gain of \$2.9 million, a reduction in interest expense of \$0.7 million, a decrease in selling expenses of \$0.4 million and lower administration expenses of \$0.2 million. These increases to net income were partially offset by an increase in income taxes of \$2.4 million.

Net income per share (basic and diluted) increased to \$0.51 per share in the third quarter of 2020 from \$0.17 per share in the third quarter of 2019.

## ANALYSIS OF RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2020

### Sales

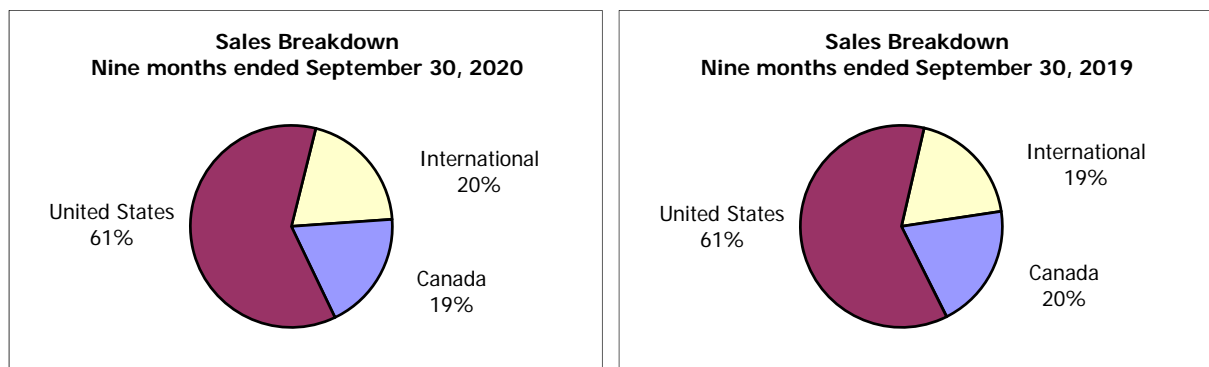


During the nine months ended September 30, 2020, Pollard achieved sales of \$310.4 million, compared to \$297.8 million in the nine months ended September 30, 2019. Factors impacting the \$12.6 million sales increase were:

Higher sales of ancillary lottery products and services increased revenue in the first nine months of 2020 by \$22.5 million compared to 2019. This increase was primarily due to the substantially higher revenues from iLottery and licensed products. As well, increased sales from digital and loyalty products, including revenue from mkodo, and distribution services further contributed to the increase in ancillary sales. Partially offsetting these increases was a decrease in Schafer's and Fastrak's merchandising product sales in 2020.

Charitable gaming sales volumes decreased by \$11.2 million in the nine 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 machines are located in similar establishments, and with their closure in response to COVID-19, Diamond Game sales decreased by \$8.3 million in 2020 compared to the first nine months of 2019. 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. With the reopening of these locations our charitable gaming and Diamond Game revenues returned to pre-COVID levels during the third quarter.

An increase in the instant ticket average selling price in the nine months ended September 30, 2020, compared to 2019 increased sales by \$6.2 million. In addition, a slight increase in instant ticket sales volume in 2020, as compared to the first nine months of 2019, further increased sales by \$0.9 million.



During the nine months ended September 30, 2020, Pollard generated approximately 71.7% (2019 – 72.1%) of its revenue in U.S. dollars including a portion of international sales which are priced in U.S. dollars. During the first nine months of 2020 the actual U.S. dollar value was converted to Canadian dollars at \$1.344, compared to a rate of \$1.332 the first nine months of 2019. This 1.0% increase in the U.S. dollar value resulted in an approximate increase of \$2.1 million in revenue relative to the first nine months of 2019. In addition, during the first nine months of 2020, the value of the Canadian dollar weakened against the Euro resulting in an approximate increase of \$0.4 million in revenue relative to the first nine months of 2019.

### Cost of sales and gross profit

Cost of sales was \$242.2 million in the nine months ended September 30, 2020, compared to \$228.7 million in the nine months ended September 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 nine months of 2020. These increases to cost of sales were partially offset by the reduction in charitable and Diamond Game sales due to reduced revenue, predominately in the second quarter, related to COVID-19 closures, as well as reduced merchandising product sales in 2020.

Gross profit decreased slightly to \$68.2 million (22.0% of sales) in the nine months ended September 30, 2020, from \$69.1 million (23.2% of sales) in the nine months ended September 30, 2019. This decrease in gross profit was primarily the result of the significant reduction in charitable and Diamond Game sales in the second quarter of 2020. In addition, a reduction in Fastrak and Schafer merchandising

product sales further reduced gross profit in the first nine months of 2020. These reductions were partially offset by a significant increase in iLottery, licensed products and, digital and loyalty sales. The lower gross profit percentage was due to the substantial reduction in charitable and Diamond Game sales, partially offset by increased iLottery and licensed product sales.

### **Administration expenses**

Administration expenses increased to \$30.0 million in the first nine months of 2020 from \$29.7 million in the first nine months of 2019. The increase of \$0.3 million was a result of higher acquisition costs of \$0.7 million and greater compensation and licensing expenses to support Pollard's growth strategies of developing innovative digital products. Additionally, the inclusion of mkodo further increased administration expenses. Partially offsetting these increases were the reduction in travel and conference related costs due to COVID-19 and lower professional fees.

### **Selling expenses**

Selling expenses decreased to \$10.9 million in the first nine months of 2020 from \$11.8 million in the first nine months of 2019 primarily due to the reduction in travel related costs due to COVID-19 and lower contract related costs. These decreases in selling expenses were partially offset by the additions of mkodo and higher compensation costs.

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

Other income increased to \$8.7 million in the first nine months of 2020 compared to \$1.8 million of other expenses in the nine months ended September 30, 2019. The increase of \$10.5 million was primarily due to \$7.6 million of CEWS earned and the decrease in our share of loss from our 50% owned iLottery joint venture, NPi, of \$3.2 million, compared to 2019. These increases were partially offset by the reduction in the EBITDA support agreement in 2020, which expired on June 30, 2020.

### **Foreign exchange**

The net foreign exchange loss was \$2.3 million in the first nine months of 2020 compared to net foreign exchange gain of \$1.8 million in the first nine months of 2019. The 2020 net foreign exchange loss of \$2.3 million consisted of a net unrealized foreign exchange loss of \$1.6 million, comprised predominately of an unrealized loss on U.S. denominated liabilities, due to the weakening of the Canadian dollar, which was partially offset by an unrealized gain on U.S. denominated receivables. Also included in the net foreign exchange loss was a \$0.7 million realized foreign exchange loss predominately a result of foreign currency denominated currencies and account receivables collected in the first nine months of 2020 being converted into Canadian dollars at unfavorable foreign exchange rates.

The 2019 net foreign exchange gain of \$1.8 million consisted of a net unrealized foreign exchange gain of \$2.3 million, comprised predominately of an unrealized gain on U.S. denominated liabilities, due to the strengthening of the Canadian dollar, which was partially offset by an unrealized loss on U.S. denominated receivables. Partially offsetting the unrealized gain was a \$0.5 million realized foreign exchange loss predominately a result of foreign currency denominated currencies and account receivables collected in the first nine months of 2019 being converted into Canadian dollars at unfavorable foreign exchange rates.

## **Adjusted EBITDA**

Adjusted EBITDA increased to \$60.3 million in the first nine months of 2020 compared to \$46.0 million in the first nine months of 2019. The primary reasons for the increase of \$14.3 million were the increase in other income of \$10.5 million, primarily due to the inclusion of \$7.6 million in CEWS support and reduced share of loss from our 50% owned iLottery joint venture, NPi, of \$3.2 million and an increase in gross profit (net of amortization and depreciation) of \$2.7 million. In addition, lower administration expenses (net of acquisition costs) of \$0.4 million and a decrease in selling expenses of \$0.9 million further increased Adjusted EBITDA. These increases to Adjusted EBITDA were partially offset by the increase in realized foreign exchange loss of \$0.2 million.

## **Interest expense**

Interest expense decreased to \$3.9 million in the first nine months of 2020 from \$4.8 million in the first nine 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 \$23.7 million during the first nine months of 2020 which increased from \$20.1 million during the first nine months of 2019. The increase was primarily as a result of higher depreciation and amortization on new property, plant and equipment and intangible assets, as well as the addition of mkodo, including the amortization and depreciation relating to the identifiable assets acquired, including intangible assets and property, plant and equipment.

## **Income taxes**

Income tax expense was \$8.7 million in the first nine months of 2020, an effective rate of 29.2%, higher than our domestic rate of 27.0% due primarily to the impact of non-deductible expenses and the effect of foreign exchange, which were partially offset by the impact of lower foreign tax rates.

Income tax expense was \$5.4 million in the first nine months of 2019, an effective rate of 23.7%, lower than our domestic rate of 27.0% due primarily to the impact of lower foreign tax rates and the effect of foreign exchange.

## **Net income**

Net income increased to \$21.1 million in the first nine months of 2020 from \$17.4 million in the first nine months of 2019. The reason for the increase in net income of \$3.7 million was the increase in other income of \$10.5 million, primarily due to the inclusion of \$7.6 million in CEWS support and reduced share of loss from our 50% owned iLottery joint venture, NPi, of \$3.2 million, the decrease in selling costs of \$0.9 million and the reduced interest expense of \$0.9 million. These increases were partially offset by the increase in the foreign exchange loss of \$4.1 million, the increase in income taxes of \$3.3 million, the decrease in gross profit of \$0.9 million and the increase in administration expenses of \$0.3 million.

Net income per share (basic and diluted) increased to \$0.82 per share in the nine months ending September 30, 2020, from \$0.68 in the nine months ending September 30, 2019.

## Liquidity and Capital Resources

### *Cash provided by operating activities*

For the nine months ended September 30, 2020, cash flow provided by operating activities was \$58.2 million compared to cash flow provided by operating activities of \$16.3 million for the first nine 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 nine months ended September 30, 2020, decreases in non-cash working capital provided \$6.6 million compared to increases in 2019 which used \$24.5 million in cash, a \$31.1 million difference.

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

Net income before income taxes after non-cash adjustments in the first nine months of 2020 contributed \$64.9 million to the cash provided by operating activities compared to \$53.2 million in first nine months of 2019. Cash used for interest decreased to \$3.8 million in 2020 as compared to \$4.3 million in 2019. Cash used for pension plan contributions increased to \$5.6 million in 2020 as compared to \$5.4 million in 2019. Cash used for income tax payments increased to \$4.0 million in 2020 from \$2.7 million in 2019.

### *Cash used for investing activities*

In the nine months ended September 30, 2020, cash used for investing activities was \$36.9 million compared to cash used of \$30.9 million in the first nine months of 2019. In the nine months ended September 30, 2020, Pollard used \$17.4 million, net of cash acquired and debt assumed, to purchase mkodo. In addition, Pollard expended \$9.9 million on capital expenditures, \$4.9 million to purchase certain charitable gaming assets and \$4.8 million on additions to intangible assets.

In the nine months ended September 30, 2019, Pollard used \$8.5 million, net of cash acquired, to purchase Fastrak. In addition, Pollard expended \$12.7 million in capital expenditures, \$3.3 million on its investment in its iLottery joint venture and \$6.4 million on additions to intangible assets.

### *Cash provided by financing activities*

Cash used by financing activities was \$17.9 million in the nine months ended September 30, 2020, compared to cash provided by financing activities of \$10.1 million in the nine months ended September 30, 2019.

During the first nine months of 2020 Pollard used cash to repay \$11.0 million of long-term debt and pay \$3.8 million of lease principal payments and \$3.1 million of dividends.

During the first nine months of 2019 Pollard received net proceeds from long-term debt of \$17.0 million. This receipt of cash was partially offset by \$3.8 million of lease principal payments and \$2.8 million of dividends.

As at September 30, 2020, Pollard had unused credit facility of \$90.0 million, in addition to \$11.3 million in available cash resources. These amounts, in addition to cash flow provided by operating activities, are available to be used for future working capital requirements, contractual obligations, capital expenditures, dividends and to assist in financing future acquisitions.

### Quarterly Information

(unaudited)

(millions of dollars)

	Q3 2020	Q2 2020	Q1 2020	Q4 2019	Q3 2019	Q2 2019	Q1 2019	Q4 2018	Q3 2018
Sales	\$116.7	\$91.5	\$102.2	\$100.0	\$103.2	\$97.1	\$97.6	\$70.2	\$94.5
Adjusted EBITDA	24.5	19.8	16.0	14.2	16.1	13.6	16.3	7.5	14.2
Net income (loss)	13.2	9.2	(1.3)	4.6	4.4	5.0	8.0	(1.9)	7.2

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

Sales, Adjusted EBITDA and net income were higher in the third quarter of 2020 as a result of higher ancillary sales, including iLottery.

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 third 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 September 30, 2020, Pollard's investment in non-cash working capital decreased \$6.6 million compared to December 31, 2019, primarily as a result of increase in accounts payable and accrued liabilities and a decrease in prepaid expenses and deposits. These reductions in non-cash working capital were partially offset by an increased investment in inventories.

	September 30, 2020	December 31, 2019
Working Capital	\$75.0	\$79.2
Total Assets	\$380.9	\$352.3
Total Non-Current Liabilities	\$175.2	\$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 September 30, 2020, the outstanding letters of guarantee were \$0.7 million. The remaining balance available for drawdown under the credit facility was \$90.0 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 September 30, 2020, 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 September 30, 2020, the outstanding letters of credit drawn on this facility were \$10.9 million.

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

As at September 30, 2020 and November 9, 2020, outstanding share data was as follows:

Common shares	25,635,658
---------------	------------

### ***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 September 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.

### **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 nine months ended September 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 nine months ended September 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

Sales of instant lottery tickets at retail locations grew significantly starting in early May 2020 and have continued to sell at higher levels right through to and including October. Despite economies in the United States and around the world opening up during the third quarter, providing greater alternative outlets for discretionary consumer expenditures, lotteries, and in particular instant tickets, continue to sell at a much higher level than ever before. We have experienced increased order levels, starting in the third quarter, and expect our production volume levels to remain high while strong retail sales continue.

During the third quarter our financial results were boosted by particularly strong sales of our licensed games products, including sales of Pac-Man®. These sales tend to be lumpy and we do not anticipate any large sales of licensed game products in the fourth quarter.

Based on our anticipated revenue, we do not anticipate qualifying for any additional subsidies under the Canada Emergency Wage Subsidy program during the fourth quarter. We will recognize in income approximately \$185,000 which was deferred from the third quarter relating to inventory product produced in the third quarter recognized as revenue in the fourth quarter.

Sales generated through iLottery operations continued to be strong through the third quarter and we believe growth of sales through this distribution method will continue to be important for lotteries. Our iLottery operation for the Virginia Lottery transitioned from just providing a subscription service for draw-based games to a suite of iLottery products, including einstants and individual draw-based games, on July 1, 2020, and we believe these sales will continue to grow as more players register to play.

Also, on September 30, 2020, our fifth iLottery operation went live with the initiation of the Alberta Gaming, Liquor and Cannabis Commission iLottery contract. Early results are very positive and we are seeing significant interest from other lotteries to develop new iLottery operations.

The market for our charitable gaming products (pull-tabs, bingo paper and vending machines) has returned to pre-COVID-19 levels as the majority of the jurisdictions in which we distribute products opened during the third quarter and remain open. Strong consumer demand for these products has been experienced at most individual sites and we are optimistic that these positive demand trends will continue.

Similarly, jurisdictions for our Diamond Game egaming machine market were mostly opened in the third quarter. While some sites have restricted the number of machines in use at each individual location, overall consumer demand has remained strong such that overall levels of revenue are at, or exceeding, pre-COVID-19 levels. Subsequent to the end of the third quarter, certain jurisdictions have reimplemented shutdowns of some of their retail locations that sell our gaming products due to COVID-19, and increased shutdowns of additional retail locations could have a negative impact on our charitable gaming and Diamond Game revenue.

The impact of the COVID-19 pandemic on our lives and our businesses has been significant. Our product lines and business units have shown strong resilience over the last two quarters and our financial results in most areas have been very strong. Our charitable gaming product lines have responded with positive

trends and mostly returned to pre-COVID-19 levels of revenue or in fact higher. However, there remains great uncertainty regarding the current status of COVID-19 and concerns about the growing infection rate in many countries. These increasing rates of infection have caused many jurisdictions to consider or actively reintroduce expanded restrictions, shutdowns and closures of their economies, and legislate further restrictions on their constituents. We are unable at this time to quantify the impact on Pollard's financial results should ongoing restrictions or closures expand to more parts of the economy for extended periods of time, however, there could be significant negative impacts on Pollard should these occur.

We remain extremely focused on ensuring a safe and healthy environment for all of our staff as our top priority. Through our formal pandemic planning team, we meet regularly and ensure the most up to date guidance from local health authorities are followed or exceeded in all instances. Extensive remote work from home policies are in place at all our facilities, detailed temperature and health screenings are utilized daily, restricted access to our sites for non-Pollard staff are enforced, mandatory mask wearing and enforced social distancing through rearranged work places are paramount to our COVID-19 response.

We have had very strong cash flow this year resulting in Pollard's liquidity position being very robust, which continued to improve during the third quarter. As at September 30, 2020, our current cash resources and undrawn senior debt facility, including our accordion feature, provided approximately \$136 million in available financial liquidity. This provides a significant source of capital available to invest in organic growth, including critical capital assets for our existing business, and help us finance future acquisitions. Expanding our product portfolio and growing our product offerings to the lottery and charitable gaming market is key to our strategic vision and we continue to actively review external opportunities to add to our portfolio.

Strong trends across our business units remained evident during the third quarter and we believe those trends will continue going forward both in the short term and over the longer term. Our strong balance sheet and increasing cashflow positions Pollard very well for ongoing future success. We are very confident in the strength of our businesses and our ability to weather any uncertainty that COVID-19 may bring and believe the future of our business is very positive.

### **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 nine months ended September 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).

Pollard Banknote Limited  
140 Otter Street  
Winnipeg, Manitoba R3T 0M8  
(204) 474-2323  
[www.Pollardbanknote.com](http://www.Pollardbanknote.com)