

POLLARD BANKNOTE REPORTS
2ND QUARTER FINANCIAL RESULTS

WINNIPEG, Manitoba, August 11, 2021 /CNW/ - Pollard Banknote Limited (TSX: PBL) ("Pollard") today released its financial results for the three and six months ended June 30, 2021, reporting strong quarterly results.

Results and Highlights for the Second Quarter ended June 30, 2021

- Sales reached \$113.4 million, up 24% from \$91.5 million achieved in the 2nd quarter last year, despite an \$11.1 million reduction due to exchange rates. Combined sales⁽¹⁾ in the quarter, including our share of our NeoPollard Interactive ("NPi") joint venture's sales, attained \$123.3 million, up 32% from \$93.7 million in 2020
- Income from operations attained \$12.1 million, compared to \$11.6 million the 2nd quarter last year and Adjusted EBITDA⁽¹⁾ reached \$22.6 million, compared to \$19.8 million in the same quarter in 2020. Last year's Adjusted EBITDA included significantly higher Canada Employee Wage Subsidy ("CEWS") of \$5.5 million compared to \$3.2 million in 2021
- Core instant ticket business remained strong, driven by continuing high sales of instant tickets at retail, particularly in North America, generating higher volume orders for Pollard
- Production volumes of instant tickets during the quarter achieved a near record level
- Combined iLottery sales⁽¹⁾ from our share of iLottery operations for Q2 increased to \$16.7 million from \$12.5 million in Q2 2020
- Robust charitable gaming revenue reflected strong consumer demand, exceeding pre-COVID-19 levels during the second quarter
- Diamond Game revenue in Ontario, its largest market, was negatively impacted by the closure of retail outlets that hosted our machines throughout the entirety of the second quarter. Subsequent to quarter end, COVID-19 restrictions were eased and the bingo halls containing our machines were reopened

(1) See Non-GAAP measures for explanation

"Pollard Banknote's second quarter results reflect the ongoing investment and growth in a number of our business lines and we are very pleased with the results," stated John Pollard, Co-Chief Executive Officer. "The lottery market continues to see very high levels of retail sales of instant tickets, particularly in the United States, maintaining the levels achieved during 2020 and early 2021 during the pandemic. In some jurisdictions retail sales are continuing to grow from the record levels achieved in 2020."

"This growth has helped us reach a near record quarterly level of instant ticket production volumes during the second quarter and although the timing of the recognition of some of the sales of this production can be delayed based on delivery timing and other factors, this strong trend underlies the strength of our key market. Indeed, we see this robust retail environment continuing going forward."

"iLottery attained a combined level of revenue among all of our iLottery operations of \$16.7 million, up over 30% from the same period last year. Our margin contribution from the second quarter was lower than the first quarter in 2021 and the second quarter of 2020 due to the fall off of play after the unusual double draw-based game jackpot runs in the first quarter for POWERBALL® and Mega Millions® and a shift to lower margin gaming verticals. In addition, there were higher player acquisition costs in some of our newer markets. However, this aspect of our business continues to be a very exciting opportunity for our lottery customers and Pollard."

"Towards the end of the first quarter most jurisdictions where our charitable gaming products are sold were fully reopened from COVID-19 restrictions and we saw very high consumer demand for our products. That trend continued throughout the second quarter with record order demand and revenue levels exceeding pre-pandemic levels, so much so that capacity limitations in production facilities have limited our ability to meet this increased demand. We are addressing these constraints by hiring additional staff and improving productivity, as we do not see any lowering in this demand level in the near future."

"Our Diamond Game business generated positive results as most jurisdictions where our machines are hosted were fully open as well, with limited negative impacts from COVID-19. The one major exception was the province of Ontario, which remained under COVID-19 restrictions requiring bingo halls to remain closed during the entire second quarter. Subsequent to quarter end, restrictions were eased and toward the end of July bingo and entertainment centers were allowed to open, allowing our machines to start generating revenue. Early signs of consumer play in Ontario are positive and we are hopeful of returning to levels of revenue experienced prior to COVID-19."

"Growing our portfolio of product lines to service lotteries in all areas is a cornerstone of our strategy," commented Doug Pollard, Co-Chief Executive Officer, "and has provided us with many opportunities to deepen our partnerships with key customers. Our Schafer and Fastrak retail merchandising operations continue to generate increased revenue as lotteries once again begin investing in their retail footprints coming out of the COVID-19

restrictions. Our ancillary product offerings including important products and services such as digital games, lottery management systems and loyalty systems continue to make important inroads in providing lotteries with the tools to expand, and connect with, their retail customers.”

“Our most recent acquisitions continue to perform well. Our Compliant electronic pull-tab operation is exceeding our performance expectations and is now fully integrated with our Diamond Game and charitable operations. Next Generation Lotteries continues to work with our lottery operations to integrate our business resources and invest in the product and services that will allow us to expand our support of lotteries around the world.”

“One of our business strengths is our high conversion rate of earnings into cashflow, which provides significant flexibility and opportunity to finance our investments from internally generated funds, and this trend continued during the second quarter of 2021. Our significant unused debt capacity and cash resources provides us the opportunity to continue to invest in our business, whether through acquisitions or investing in additional projects to expand capacity or develop additional products and services.”

“We are very pleased with the results of our second quarter and continue to be very excited about the great opportunities for our organization going forward,” concluded John Pollard. “We are extremely gratified by our team’s work as we expand our relationships with lotteries and charities around the world and invest in resources to help them succeed. The lottery and charitable gaming market is extremely healthy, and we believe this will allow our strategy of being their partner of choice to continue to be the foundation of our success.”

Use of Non-GAAP Financial Measures

Reference to “EBITDA” is to earnings before interest, income taxes, depreciation, amortization and purchase accounting amortization. Reference to “Adjusted EBITDA” is to EBITDA before unrealized foreign exchange gains and losses, and certain non-recurring items including severance costs, acquisition costs, litigation settlement 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.

Reference to “Combined sales” is to sales recognized under GAAP plus Pollard’s 50% proportionate share of NeoPollard Interactive LLC’s (“NPI”) sales, its iLottery joint venture operation. Reference to “Combined iLottery sales” is to sales recognized under GAAP for Pollard’s 50% proportionate share of its Michigan Lottery joint iLottery operation plus Pollard’s 50% proportionate share of NeoPollard Interactive LLC’s (“NPI”) sales, its iLottery joint venture operation.

EBITDA, Adjusted EBITDA, Combined sales and Combined iLottery sales are measures not recognized under GAAP and do not have a standardized meaning prescribed by GAAP. Therefore, these measures may not be comparable to similar measures presented by other entities. Investors are cautioned that EBITDA, Adjusted EBITDA, Combined sales and Combined iLottery sales should not be construed as alternatives to net income or sales as 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.

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.

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 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 and through its 50% joint venture, the largest supplier of iLottery solutions to the U.S. lottery market.

On December 30, 2020, Pollard signed and closed a definitive agreement to purchase 100% of the equity of Compliant Gaming, LLC ("Compliant") for a purchase price of \$19.0 million U.S. dollars (\$24.3 million) prior to standard working capital adjustments and potential future earn-out payments based on certain EBITDA targets. Compliant is a leading provider of electronic pull-tab gaming systems and products to the charitable gaming market.

On January 14, 2021, Pollard completed the acquisition of Next Generation Lotteries AS ("NGL"). On December 31, 2020, Pollard signed a definitive agreement to acquire 100% of the equity of NGL for a purchase price of €36.0 million (\$56.5 million), prior to standard working capital adjustments and certain deferred cash considerations, of which €32.0 million (\$50.2 million) was paid at the time of closing and the remaining €4.0 million (\$6.3 million) will be paid upon the achievement of certain gross margin targets in 2021. The

purchase price was funded from existing Pollard cash resources and availability under our existing senior credit facilities for approximately €27.4 million (\$43.0 million) and the issuance of treasury shares of Pollard for approximately €4.6 million (\$7.2 million).

On February 9, 2021, Pollard announced that it had entered into an agreement with a syndicate of underwriters to purchase, on a bought deal basis, 812,000 common shares of Pollard at a price of \$36.95 per share. Pollard also granted the underwriters an over-allotment option exercisable at any time up to 30 days following the closing of the offering, to purchase up to an additional 121,800 common shares. The offering, including the full over-allotment, closed on March 2, 2021. The total gross proceeds, prior to any commissions and offering expenses, from the sale of 933,800 common shares was approximately \$34.5 million. Pollard used the net proceeds to repay indebtedness under Pollard's credit facility incurred in the recent acquisitions of Compliant and NGL.

The selected financial and operating information has been derived from, and should be read in conjunction with, the unaudited condensed consolidated interim financial statements of Pollard as at and for the three and six months ended June 30, 2021. These financial statements have been prepared in accordance with the International Financial Accounting Standards ("IFRS" or "GAAP").

HIGHLIGHTS	Three months ended <u>June 30, 2021</u>	Three months ended <u>June 30, 2020</u>
Sales	\$ 113.4 million	\$ 91.5 million
Gross Profit	\$ 22.6 million	\$ 18.8 million
<i>Gross Profit % of sales</i>	<i>19.9%</i>	<i>20.5%</i>
Administration expenses	\$ 11.1 million	\$ 9.5 million
Selling expenses	\$ 3.9 million	\$ 3.4 million
(Gain) loss on NPi equity investment	(\$ 2.5 million)	\$ 0.3 million
Other income	(\$ 2.0 million)	(\$ 6.0 million)
Unrealized foreign exchange gain	(\$ 1.6 million)	(\$ 1.8 million)
Net income	\$ 7.7 million	\$ 9.2 million
Net income per share (basic and diluted)	\$ 0.29	\$ 0.36
Adjusted EBITDA:		
Lotteries and charitable gaming	\$ 18.5 million	\$ 20.2 million
Diamond Game and Compliant	4.1 million	(0.4 million)
Total adjusted EBITDA	<u>\$ 22.6 million</u>	<u>\$ 19.8 million</u>
	Six months ended <u>June 30, 2021</u>	Six months ended <u>June 30, 2020</u>
Sales	\$ 225.6 million	\$ 193.8 million
Gross Profit	\$ 47.1 million	\$ 40.5 million
<i>Gross Profit % of sales</i>	<i>20.9 %</i>	<i>20.9%</i>
Administration expenses	\$ 23.1 million	\$ 19.7 million
Selling expenses	\$ 7.5 million	\$ 7.1 million
(Gain) loss on NPi equity investment	(\$ 6.5 million)	\$ 0.8 million
Other income	(\$ 1.4 million)	(\$ 6.4 million)
Unrealized foreign exchange loss (gain)	(\$ 2.5 million)	\$ 4.4 million
Net income	\$ 15.1 million	\$ 8.0 million
Net income per share (basic and diluted)	\$ 0.56	\$ 0.31
Adjusted EBITDA:		
Lotteries and charitable gaming	\$ 38.3 million	\$ 34.1 million
Diamond Game and Compliant	7.6 million	1.7 million
Total adjusted EBITDA	<u>\$ 45.9 million</u>	<u>\$ 35.8 million</u>

SELECTED FINANCIAL INFORMATION

(millions of dollars)	Three months ended June 30, 2021 (unaudited)	Three months ended June 30, 2020 (unaudited)	Six months ended June 30, 2021 (unaudited)	Six months ended June 30, 2020 (unaudited)
Sales	\$113.4	\$91.5	\$225.6	\$193.8
Cost of sales	90.8	72.7	178.5	153.3
Gross profit	22.6	18.8	47.1	40.5
Administration expenses	11.1	9.5	23.1	19.7
Selling expenses	3.9	3.4	7.5	7.1
(Gain) loss on NPI equity investment	(2.5)	0.3	(6.5)	0.8
Other income	(2.0)	(6.0)	(1.4)	(6.4)
Income from operations	12.1	11.6	24.4	19.3
Foreign exchange (gain) loss	(0.7)	(2.0)	(0.2)	4.1
Interest expense	1.1	1.2	2.2	2.9
Income before income taxes	11.7	12.4	22.4	12.3
Income taxes:				
Current	4.8	1.9	9.1	4.0
Deferred (reduction)	(0.8)	1.3	(1.8)	0.3
Net income	\$7.7	\$9.2	\$15.1	\$8.0
Adjustments:				
Amortization and depreciation	9.9	7.8	19.2	15.4
Interest	1.1	1.2	2.2	2.9
Income taxes	4.0	3.2	7.3	4.3
EBITDA	\$22.7	\$21.4	\$43.8	\$30.6
Unrealized foreign exchange (gain) loss	(1.6)	(1.8)	(2.5)	4.4
Acquisition costs	0.4	0.2	1.0	0.8
Contingent consideration adjustment	1.1	0.0	1.1	0.0
Litigation settlement cost	0.0	0.0	2.5	0.0
Adjusted EBITDA	\$22.6	\$19.8	\$45.9	\$35.8

	June 30, 2021	December 31, 2020
Total Assets	\$459.5	\$404.6
Total Non-Current Liabilities	\$171.2	\$191.3

Results of Operations – Three months ended June 30, 2021

During the three months ended June 30, 2021, Pollard achieved sales of \$113.4 million, compared to \$91.5 million in the three months ended June 30, 2020. Factors impacting the \$21.9 million sales increase were:

- Since the end of the first quarter of 2021, most retail establishments where our charitable gaming products are sold and Diamond Game eGaming machines are placed have remained open, and sales of pull-tab tickets have reached record highs. The increase in charitable gaming volumes increased sales by \$11.4 million in the second quarter of 2021, as compared to the second quarter of 2020 when most retail establishments were closed for periods of time in response to the onset of COVID-19. Diamond Game revenue increased \$8.0 million as compared to 2020 as a result of the acquisition of Compliant and having significantly more retail establishments open in 2021 compared to the retail shutdowns experienced in 2020. In addition, the higher average selling price of charitable games in 2021 further increased sales by \$0.2 million.
- Higher sales of ancillary lottery products and services increased revenue in the second quarter of 2021 by \$12.5 million. This increase was primarily from increased sales of licensed products, as well as an increase in retail merchandising product sales. The addition of NGL and increased sales of digital and loyalty products further increased ancillary lottery sales in the quarter. As well, higher instant ticket sales volumes increased sales by a further \$6.3 million in the second quarter of 2021. Partially offsetting these increases was a lower instant ticket average selling price, due primarily to the customer sales mix and slightly lower proprietary product sales in the quarter, which reduced sales by \$2.6 million as compared to the second quarter of 2020.
- Lower sales from Michigan iLottery decreased revenue in the second quarter of 2021 by \$2.7 million as compared to 2020, when Michigan iLottery sales reached record quarterly levels at the start of the pandemic.
- During the three months ended June 30, 2021, Pollard generated approximately 69.3% (2020 – 72.5%) of its revenue in U.S. dollars including a portion of international sales which are priced in U.S. dollars. During the second quarter of 2021 the actual U.S. dollar value was converted to Canadian dollars at \$1.226, compared to a rate of \$1.393 during the second quarter of 2020. This 12.0% decrease in the U.S. dollar value resulted in an approximate decrease of \$10.7 million in revenue relative to the second quarter of 2020. During the quarter the value of the Canadian dollar strengthened against the Euro resulting in an approximate decrease of \$0.5 million in revenue relative to the second quarter of 2020.

Cost of sales was \$90.8 million in the second quarter of 2021 compared to \$72.7 million in the second quarter of 2020. The increase of \$18.1 million was primarily a result of the

substantial increase in charitable gaming sales volumes as compared to the second quarter of 2020, and the addition of NGL and Compliant. Higher sales of ancillary lottery products and services further added to the increase in cost of sales in 2021. Partially offsetting these increases were lower exchange rates on U.S. dollar denominated expenses in the second quarter of 2021 which decreased cost of sales.

Gross profit was \$22.6 million (19.9% of sales) in the second quarter of 2021 compared to \$18.8 million (20.5% of sales) in the second quarter of 2020. This increase in gross profit of \$3.8 million was primarily the result of the significant increase in the quarter in charitable and Diamond Game sales, including the addition of Compliant. These increases were partially offset by the decrease in gross profit from lower Michigan iLottery sales. The lower gross profit percentage was due to the reduction in Michigan iLottery sales and the inclusion of NGL having a negative impact on our overall margin percentage.

Administration expenses increased to \$11.1 million in the second quarter of 2021 from \$9.5 million in the second quarter of 2020. The increase of \$1.6 million was primarily a result of the additions of NGL and Compliant, in addition to increased compensation expenses to support Pollard's growth strategies and higher acquisition costs. Partially offsetting these increases was a reduction in professional fees in 2021.

Selling expenses increased to \$3.9 million in the second quarter of 2021 from \$3.4 million in the second quarter of 2020 primarily due to increased compensation costs and the addition of NGL.

Pollard's share of income from its 50% owned iLottery joint venture, NeoPollard Interactive LLC ("NPI"), increased to \$2.5 million in the second quarter of 2021 from a loss of \$0.3 in the second quarter of 2020. This \$2.8 million increase was primarily due to the increase in revenue in 2021, as compared to 2020. Contracts held by NPI experienced significant organic growth, in addition to the added sales increase from the Virginia Lottery operation which added e-Instants on July 1, 2020. As well, NPI's contract with Alberta Gaming, Liquor & Cannabis ("AGLC"), went live with a select product launch on September 30, 2020.

Other income decreased to \$2.0 million in the second quarter of 2021 compared to \$6.0 million in the second quarter of 2020. This decrease of \$4.0 million was primarily due to the reduction in Canada emergency wage subsidy ("CEWS") recognized in the second quarter of 2021 as compared to 2020, of \$2.3 million. In addition, the contingent consideration accrual adjustment, as part of our Compliant acquisition, further decreased other income by \$1.1 million. Also, the elimination of the EBITDA support agreement, which expired on June 30, 2020, further decreased other income by \$0.5 million in 2021.

The net foreign exchange gain was \$0.7 million in the second quarter of 2021 compared to a net gain of \$2.0 million in the second quarter of 2020. The 2021 net foreign exchange gain of \$0.7 million resulted in part from a \$1.6 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. Partially offsetting this unrealized gain was a \$0.9 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.

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.

Adjusted EBITDA increased to \$22.6 million in the second quarter of 2021 compared to \$19.8 million in the second quarter of 2020. The primary reasons for the \$2.8 million increase were the increase in gross profit (net of amortization and depreciation) of \$5.9 million, primarily from increased charitable gaming and Diamond Game sales, and the increase in our share of income from our joint venture, NPi, of \$2.8 million in the second quarter of 2021. Partially offsetting these increases were the decrease in other income (net of contingent consideration) of \$2.9 million, higher administration expenses (net of acquisition costs) of \$1.4 million, an increase in realized foreign exchange loss of \$1.1 million and an increase in selling expenses of \$0.5 million.

Interest expense decreased to \$1.1 million in the second quarter of 2021 from \$1.2 million in the second quarter of 2020 primarily as a result of lower interest rates and a decrease in long-term debt.

Amortization and depreciation, including amortization of intangible assets and depreciation of property and equipment, totaled \$9.9 million during the second quarter of 2021 which increased from \$7.8 million during the second quarter of 2020. The increase of \$2.1 million was primarily as a result of the addition of Compliant and NGL, including the amortization and depreciation relating to the identifiable assets acquired, including intangible assets and property, plant and equipment.

Income tax expense was \$4.0 million in the second quarter of 2021, an effective rate of 34.2%, higher than our domestic rate of 27.0% due primarily to the tax effect of unrecognized non-capital losses and non-deductible expenses. Partially offsetting these increases in effective rate were the lower federal income tax rates in the United States.

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.

Net income decreased to \$7.7 million in the second quarter of 2021 from \$9.2 million earned in the second quarter of 2020. The primary reasons for the decrease in net income of \$1.5 million were the decrease in other income of \$4.0 million, higher administration expenses of \$1.6 million, an increase in selling expenses of \$0.5 million, a decrease in the net foreign exchange gain of \$1.3 million and an increase in income taxes of \$0.8 million. These decreases to net income were partially offset by the increase in gross profit of \$3.8 million and the increase in our share of income from our joint venture, NPi, of \$2.8 million.

Net income per share (basic and diluted) decreased to \$0.29 per share in the second quarter of 2021 from \$0.36 per share in the second quarter of 2020.

Results of Operations – Six months ended June 30, 2021

During the six months ended June 30, 2021, Pollard achieved sales of \$225.6 million, compared to \$193.8 million in the six months ended June 30, 2020. Factors impacting the \$31.8 million sales increase were:

- For the majority of the first half of 2021, most retail establishments where our charitable gaming products are sold and Diamond Game eGaming machines are placed have remained open, and sales of pull-tab tickets have reached record highs. The increase in charitable gaming volumes increased sales by \$13.3 million in the first half of 2021, as compared to 2020 when many retail establishments were closed for periods of time in response to the onset of COVID-19. Diamond Game revenue increased \$9.8 million as compared to 2020 as a result of the acquisition of Compliant and having more retail establishments open in 2021. In addition, the higher average selling price of charitable games in 2021 further increased sales by \$0.6 million.
- Higher sales of ancillary lottery products and services increased revenue by \$9.4 million in the first half of 2021. This increase was primarily as a result of the addition of NGL and increased sales of digital and loyalty products in 2021. In addition, an increase in retail merchandising product sales also contributed to the increase in ancillary lottery product sales. Higher instant ticket sales volumes increased sales by \$7.2 million in 2021 and an increase in the instant ticket average selling further increased sales by \$3.6 million as compared to the first half of 2020, primarily due to a positive customer sales mix.
- Higher sales from Michigan iLottery increased revenue in the first half of 2021 by \$1.0 million, excluding the negative impact of foreign exchange rates of \$1.3 million, as compared to 2020, when Michigan iLottery sales were lower in the first quarter of 2020 prior to the dramatic increase at the start of the pandemic in the second quarter 2020.
- During the six months ended June 30, 2021, Pollard generated approximately 69.7% (2020 – 70.4%) 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 2021 the actual U.S. dollar value was converted to Canadian dollars at \$1.249, compared to a rate of \$1.353 the first six months of 2020. This 7.7% decrease in the U.S. dollar value resulted in an approximate decrease of \$13.1 million in revenue relative to the first six months of 2020.

Cost of sales was \$178.5 million in the six months ended June 30, 2021, compared to \$153.3 million in the six months ended June 30, 2020. This increase of \$25.2 million was primarily a result of the substantial increase in charitable gaming sales volumes, as compared to the second quarter of 2020, and the addition NGL and Compliant. In addition, the higher sales of instant tickets and ancillary lottery products and services further added to the increase in cost of sales in 2021. Partially offsetting these increases were lower exchange rates on U.S. dollar denominated expenses in 2021 which decreased cost of sales.

Gross profit increased to \$47.1 million (20.9% of sales) in the six months ended June 30, 2021, from \$40.5 million (20.9% of sales) in the six months ended June 30, 2020. This increase in gross profit of \$6.6 million was primarily the result of the significant increase in charitable and Diamond Game sales, including the addition of Compliant, in the first half of 2021. In addition, the favourable increases in instant ticket volumes and pricing further added to the increase in gross profit in 2021. These increases were partially offset by the decrease in Michigan iLottery gross profit, lower margin from license product sales and the addition of NGL. The gross profit percentage achieved in 2021 was consistent with the gross profit percentage in 2020.

Administration expenses increased to \$23.1 million in the first six months of 2021 from \$19.7 million in the first six months of 2020. The increase of \$3.4 million was primarily a result of the additions of NGL and Compliant, in addition to increased compensation, including higher incentive costs, to support Pollard's growth strategies. Partially offsetting these increases was a reduction in professional fees in 2021.

Selling expenses increased to \$7.5 million in the first six months of 2021 from \$7.1 million in the first six months of 2020 primarily due to the increased compensation costs and the addition of NGL. These increases were partially offset by the reduction in travel related costs due to COVID-19.

Pollard's share of income from NPi increased to \$6.5 million in the first six months of 2021 from a loss of \$0.8 million in 2020. This \$7.3 million increase was primarily due to the increase in revenue in 2021. Contracts held by NPi experienced significant organic growth, in addition to the added sales increase from the Virginia Lottery operation which added e-Instants on July 1, 2020. As well, NPi's contract with AGLC went live with a select product launch on September 30, 2020. Additionally, the unusual simultaneous significant jackpot runs for POWERBALL® and Mega Millions® which were won in the latter half of January 2021, further added significantly to the increase in sales in the first half of 2021 as compared to 2020.

Other income decreased to \$1.4 million in the first six months of 2021 compared to \$6.4 million in 2020. This decrease of \$5.0 million was due, in part, to Pollard entering into an agreement for a one-time payment of \$2.5 million to settle all aspects of certain litigation regarding a patent dispute relating to our instant ticket production. Further reducing other income in 2021 were the elimination of the EBITDA support agreement of \$1.0 million, which expired on June 30, 2020, the contingent consideration accrual adjustment, as part of our Compliant acquisition, which decreased other income by \$1.1 million and the \$0.3 million reduction in CEWS recognized in the first half of 2021 as compared to 2020.

The net foreign exchange gain was \$0.2 million in the first six months of 2021 compared to a net foreign exchange loss of \$4.1 million in the first six months of 2020. The 2021 net foreign exchange gain of \$0.2 million resulted from a net unrealized foreign exchange gain of \$2.5 million, 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. Partially offsetting the unrealized gain was a \$2.3 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.

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.

Adjusted EBITDA increased to \$45.9 million in the first six months of 2021 compared to \$35.8 million in the first six months of 2020. The primary reasons for the increase of \$10.1 million were the increase in gross profit (net of amortization and depreciation) of \$10.4 million, primarily from increased charitable gaming and Diamond Game sales, and the increase in our share of income from our joint venture, NPi, of \$7.3 million in the first half of 2021. Partially offsetting these increases were the higher administration expenses (net of acquisition costs) of \$3.2 million, an increase in realized foreign exchange loss of \$2.6 million, the decrease in other income (net of contingent consideration and legal settlement) of \$1.4 million and an increase in selling expenses of \$0.4 million.

Interest expense decreased to \$2.2 million in the first six months of 2021 from \$2.9 million in the first six months of 2020 primarily as a result lower interest rates and a decrease in long-term debt.

Amortization and depreciation, including amortization of intangible assets and depreciation of property and equipment, totaled \$19.2 million during the first six months of 2021 which increased from \$15.4 million during the first six months of 2020. The increase of \$3.8 million was primarily as a result of the addition of Compliant and NGL, including the amortization and depreciation relating to the identifiable assets acquired, including intangible assets and property, plant and equipment.

Income tax expense was \$7.3 million in the first six months of 2021, an effective rate of 32.4%, which was higher than our domestic rate of 27.0% due primarily to the tax effect of unrecognized non-capital losses and non-deductible expenses. Partially offsetting these increases in effective rate were the lower federal income tax rates in the United States.

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.

Net income increased to \$15.1 million in the first six months of 2021 from \$8.0 million in the first six months of 2020. The primary reasons for the increase of \$7.1 million were the increase in gross profit of \$6.6 million, the increase in our share of income from our joint venture, NPi, of \$7.3 million, the increase in net foreign exchange gain of \$4.3 million and the decrease in interest expense of \$0.7 million. Partially offsetting these increases were the decrease in other income of \$5.0 million, the higher administration expenses of \$3.4 million, an increase in selling expenses of \$0.4 million and an increase in income tax expense of \$3.0 million.

Net income per share (basic and diluted) increased to \$0.56 per share in the six months ending June 30, 2021, as compared to \$0.31 per share in the six months ending June 30, 2020.

iLottery

Pollard and its iLottery partner, Neogames S.A. ("Neogames"), provide iLottery services to the North American Lottery market. In 2013, Pollard was awarded an iLottery contract from the Michigan Lottery. As a result, Pollard entered into a contract with Neogames to provide its technology in return for a 50% financial interest in the operation. Under IFRS, Pollard recognizes its 50% share in the Michigan Lottery contract in its consolidated statements of income in sales and cost of sales.

In 2014 Pollard, in conjunction with Neogames, established NeoPollard Interactive LLC ("NPi"). All iLottery related customer contracts, excluding the Michigan Lottery iLottery contract, have been awarded to NPi. Under IFRS, Pollard accounts for its investment in its joint venture, NPi, as an equity investment. Under the equity method of accounting, Pollard recognizes its share of the income and expenses of NPi separately as (gain) loss on equity investment.

**SELECT ILOTTERY RELATED
FINANCIAL INFORMATION**

(millions of dollars)

	Q2 2021	Q1 2021	Q4 2020	Q3 2020	Q2 2020	Q1 2020
Sales – Pollard’s share						
Michigan iLottery	\$6.8	\$8.4	\$8.6	\$9.5	\$10.3	\$5.1
NPi	9.9	9.9	6.1	3.1	2.2	1.2
Combined iLottery sales	<u>\$16.7</u>	<u>\$18.3</u>	<u>\$14.7</u>	<u>\$12.6</u>	<u>\$12.5</u>	<u>\$6.3</u>
Income (loss) before income taxes – Pollard’s share						
Michigan iLottery	\$2.8	\$4.0	\$4.5	\$5.4	\$6.5	\$2.1
NPi	2.5	4.0	1.6	0.8	(0.3)	(0.5)
Combined income before income taxes – Pollard’s share	<u>\$5.3</u>	<u>\$8.0</u>	<u>\$6.1</u>	<u>\$6.2</u>	<u>\$6.2</u>	<u>\$1.6</u>

Beginning in the second quarter of 2020, with the onset of COVID-19, revenues from Pollard’s contract with the Michigan Lottery increased substantially. Contracts held by NPi also experienced significant organic growth, in addition to the sales increase from the Virginia Lottery operation which added e-Instants on July 1, 2020. As well, NPi’s contract with Alberta Gaming, Liquor & Cannabis (“AGLC”), went live with a limited product launch on September 30, 2020. The substantial jackpots for POWERBALL® and Mega Millions® awarded in the latter half of January 2021 further increased sales significantly in the fourth quarter of 2020 and the first quarter of 2021.

Sales declined in the second quarter of 2021, in our combined iLottery operations, due to the reduction in draw-based games sales after the jackpot runs that significantly impacted the previous two quarters. Also, the lower exchange rate on U.S. dollar denominated sales, further significantly reduced sales in the second quarter of 2021. Income before income taxes from Michigan iLottery declined in the second quarter 2021, directly as a result of the decrease in sales, while income in NPi decreased as a result of revenue moving to other new lower margin gaming verticals and the added player acquisition and development costs in these new verticals.

Outlook

Robust retail sales of instant tickets in the United States continued throughout the second quarter and we anticipate no change in this trend in the immediate future. During 2020 many U.S. based lotteries experienced significant growth at the retail sales level on average in the 20-30% range relative to the same periods in 2019. During the first six months of this year lotteries have been able to maintain these high sales levels achieved in 2020, and in some jurisdictions even generate single digit growth in addition to the high growth realized last year. Sales growth outside of North America has continued to be mixed, and we anticipate continuing to produce higher levels of North American based work while strategically monitoring our international customer portfolio. As discussed previously, some of the lotteries' retail growth is generated from higher price points and other factors which don't necessarily translate into the same growth rate at the manufacturing level. However, this does allow us to offer greater value-added products like our Scratch FX[®] and other options which provide opportunities to generate higher average selling prices and margins for Pollard.

Traditionally the third quarter tends to be slightly busier for our instant ticket production and involves more high-value option-based products in preparation for the holiday retail selling season in the fall, and we anticipate that to still be the case in 2021.

iLottery is an important opportunity for lotteries to expand their revenue and increase their player base, and we continue to see significant interest throughout the market, particularly involving lotteries in the United States. As noted, the development of iLottery in new jurisdictions is a slow process involving many stakeholders and requiring government authorization which varies extensively from state to state and country to country. Our joint venture, NeoPollard Interactive, continues to be the market leader in the United States and we are working with a number of potential customers to expand the iLottery footprint. Second quarter results within our iLottery operations reflect a number of factors including the reduction in sales from the high levels achieved in the first quarter due to the draw-based games jackpot runs and additional acquisition and development costs associated with introducing new gaming verticals. We remain very confident that this product line will continue to grow significantly over the long term.

As we have seen very recently, COVID-19 continues to be an issue in our world and something that businesses, including Pollard, must always factor in our risk management process. Our second quarter financial results were still impacted negatively in some areas by the pandemic. While the start of the third quarter environment appears to show most of the direct issues associated with COVID-19 being mitigated in our business, we remain very wary of setbacks resulting in additional negative repercussions through further retail shutdowns, problems in our supply chains or other impacts that may negatively affect our financial results. We continue to focus on a healthy and safe environment for our team including a number of programs offering encouragement for all employees to be vaccinated.

Our charitable gaming markets have shown record levels of demand during the past number of months and this shows no sign of lessening in the immediate future. Despite a challenging environment for hiring, we will continue to focus on expanding our production capabilities and investing in both the people and technological resources to efficiently meet this opportunity. With the gradual reopening of the bingo and entertainment centers in Ontario in late July, our only remaining closed jurisdiction hosting Diamond Game machines is now open, and we have so far seen strong initial consumer uptake in that market, similar to what we have seen with our other customers. We are hopeful this trend will continue.

Our cashflow and available liquidity remains very strong and provides us with available resources to invest in our existing businesses organically as well as continue to review strategic opportunities to grow through acquisitions.

We remain extremely positive in the many opportunities in the medium and long term across the broad spectrum of our customers. Both the lottery and charitable sectors are showing significant strength from the ultimate consumer demand for our products and services, and in many areas we are seeing orders levels and related revenue well above what was being achieved prior to COVID-19. iLottery continues to be an exciting growth opportunity for lotteries in the future and we will remain actively engaged with the development of this market. Our strategy of being the partner of choice by addressing as many of the critical needs as possible for lotteries and charities around the world has been the foundation of our success and will continue to drive our growth in the future.

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