

POLLARD **banknote** limited

December 31, 2013

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

FOR THE YEAR ENDED DECEMBER 31, 2013

March 5, 2014

This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the year ended December 31, 2013, is prepared as at March 5, 2014, and should be read in conjunction with the accompanying audited financial statements of Pollard and the notes therein as at December 31, 2013. Results are reported in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards ("GAAP" or "IFRS").

Forward-Looking Statements

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

Use of Non-GAAP Financial Measures

Reference to "Adjusted EBITDA" is to earnings before interest, income taxes, depreciation and amortization, unrealized foreign exchange gains and losses, mark-to-market gains and losses on foreign currency contracts and interest rate swaps, and certain non-recurring items including facility closing reserve, conversion expenses, warranty reserve accruals, settlement loss on pension curtailment and restructuring costs. Adjusted EBITDA is an important metric used by many investors to compare issuers on the basis of the ability to generate cash from operations and management believes that, in addition to net income, Adjusted EBITDA is a useful supplementary measure.

Adjusted EBITDA is a measure not recognized under GAAP and does not have a standardized meaning prescribed by GAAP. Therefore, this measure may not be comparable to similar measures presented by other entities. Investors are cautioned that Adjusted EBITDA should not be construed as an alternative to net income determined in accordance with GAAP as an indicator of Pollard's performance or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows.

Basis of Presentation

The results of operations in the following discussions encompass the consolidated results of Pollard for the year ended December 31, 2013. All figures are in millions except for per share amounts.

POLLARD BANKNOTE LIMITED

Overview

Pollard Banknote Limited ("Pollard") is one of the leading providers of products and services to the lottery and charitable gaming industries throughout the world. Management believes Pollard is the largest provider of instant-win scratch tickets ("instant tickets") based in Canada and the second largest producer of instant tickets in the world.

Pollard produces and provides a comprehensive line of instant tickets and lottery services including: licensed products, distribution, retail telephone selling ("tel-sell"), marketing, iLottery, interactive gaming, Social Instants™ and instant ticket vending machines. In addition, Pollard's charitable gaming product line includes pull-tab (or break-open) tickets, bingo paper, pull-tab vending machines and ancillary products such as pull-tab counting machines. Pollard also markets products to the commercial gaming and security sector including such items as promotional scratch and win tickets, transit tickets and parking passes.

Pollard's lottery products are sold extensively throughout Canada, the United States and the rest of the world, wherever applicable laws and regulations authorize their use. Pollard serves over 50 instant ticket lotteries including a number of the largest lotteries throughout the world. Charitable gaming products are mostly sold in the United States and Canada where permitted by gaming regulatory authorities. Pollard serves a highly diversified customer base in the charitable gaming market of over 250 independent distributors with the majority of revenue generated from repeat business.

Product line breakdown of revenue

	Year ended December 31, 2013	Year ended December 31, 2012
Instant Tickets	89%	89%
Charitable Gaming Products	10%	10%
Vending Machines	1%	1%

Geographic breakdown of revenue

	Year ended December 31, 2013	Year ended December 31, 2012
United States	53%	53%
Canada	22%	21%
International	25%	26%

The following financial information should be read in conjunction with the accompanying financial statements of Pollard and the notes therein as at and for the year ended December 31, 2013.

SELECTED FINANCIAL INFORMATION

(millions of dollars, except per share information)

	Year ended December 31, 2013	Year ended December 31, 2012 (Restated)	Year ended December 31, 2011 (Restated)	Year ended December 31, 2010 (Restated)
Sales	\$184.9	\$162.4	\$172.0	\$163.4
Cost of Sales	149.7	129.7	142.0	134.2
Gross Profit	35.2	32.7	30.0	29.2
<i>Gross Profit as a % of sales</i>	19.0%	20.1%	17.4%	17.9%
Administration Expenses	15.2	13.6	13.8	14.4
<i>Expenses as a % of sales</i>	8.2%	8.4%	8.0%	8.8%
Selling Expenses	6.8	6.1	6.3	6.0
<i>Expenses as a % of sales</i>	3.7%	3.8%	3.7%	3.7%
Net Income	5.4	6.5	3.1	1.8
<i>Net Income as a % of sales</i>	2.9%	4.0%	1.8%	1.1%
Adjusted EBITDA	22.7	19.9	22.5	18.2
<i>Adjusted EBITDA as a % of sales</i>	12.3%	12.3%	13.1%	11.1%
Adjusted EBITDA excluding gain on sale of property, plant and equipment and realized foreign exchange (loss) gain	21.8	20.2	17.8	17.3
<i>As a % of sales</i>	11.8%	12.4%	10.3%	10.6%
Earnings Per Share	\$0.23	\$0.28	\$0.13	\$0.08

See page 6 for restatement.

	December 31, 2013	December 31, 2012	December 31, 2011	December 31, 2010
Total Assets	\$133.4	\$127.0	\$121.6	\$126.3
Total Non-Current Liabilities	\$79.2	\$83.4	\$77.2	\$74.8

RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA

(millions of dollars)

	Year ended December 31, 2013	Year ended December 31, 2012 (Restated)	Year ended December 31, 2011 (Restated)	Year ended December 31, 2010 (Restated)
Net income	\$5.4	\$6.5	\$3.1	\$1.8
Adjustments:				
Amortization and depreciation	8.6	7.8	8.4	8.6
Interest	3.4	3.4	4.4	5.2
Unrealized foreign exchange (gain) loss	1.0	(0.1)	3.8	(1.2)
Mark-to-market (gain) loss on foreign currency contracts and interest rate swaps	0.4	-	-	(2.1)
Amortization of de-designated hedges	-	-	-	1.2
Conversion costs	-	-	-	0.7
Warranty reserve	-	-	-	0.9
Settlement loss on pension curtailment	-	-	0.7	-
Restructuring expense	-	-	0.5	1.2
Income taxes	3.9	2.3	1.6	1.9
Adjusted EBITDA	\$22.7	\$19.9	\$22.5	\$18.2
Gain on sale of property, plant and equipment	-	-	1.5	2.0
Realized foreign exchange (loss) gain	0.9	(0.3)	3.2	(1.1)
Adjusted EBITDA excluding gain on sale of property, plant and equipment and realized foreign exchange (loss) gain	\$21.8	\$20.2	\$17.8	\$17.3

See page 6 for restatement.

RESTATEMENT:

In June 2011, the International Accounting Standards Board ("IASB") published an amended version of International Accounting Standard ("IAS") 19 *Employee Benefits*. The amendments require actuarial gains and losses, renamed remeasurements, to be recognized immediately in other comprehensive income and past service cost must be recognized immediately in profit or loss. This amendment also requires that the expected return on plan assets recognized in profit or loss be calculated based on the rate used to discount the defined benefit obligation. IAS 19 is required for fiscal years beginning on or after January 1, 2013, with retrospective application.

As a result the reported results for the year ended December 31, 2012, have been restated and cost of sales increased \$0.19 million and deferred income taxes decreased by \$0.05 million. This was offset by corresponding defined pension plan remeasurement gain of \$0.14 million, net of \$0.05 million of related income taxes, both of which were recorded within other comprehensive income.

Results for the year ended December 31, 2011, have been restated and cost of sales increased \$0.08 million and deferred income taxes decreased by \$0.02 million. This was offset by corresponding defined pension plan remeasurement gain of \$0.06 million, net of \$0.02 million of related income taxes, both of which were recorded within other comprehensive income.

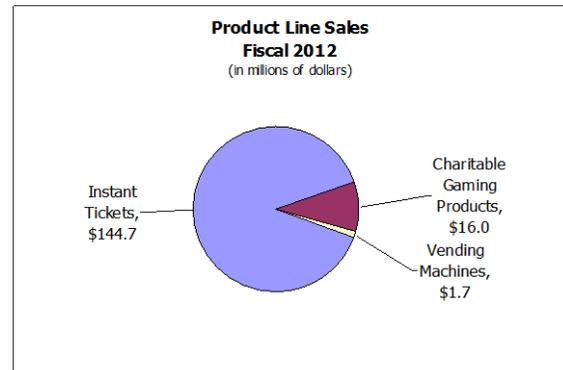
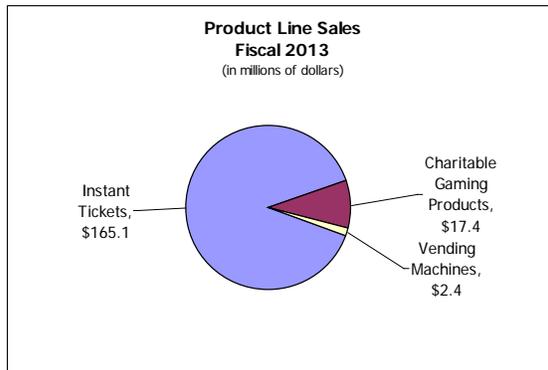
For the year ended December 31, 2010, the restatement was immaterial.

REVIEW OF OPERATIONS

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

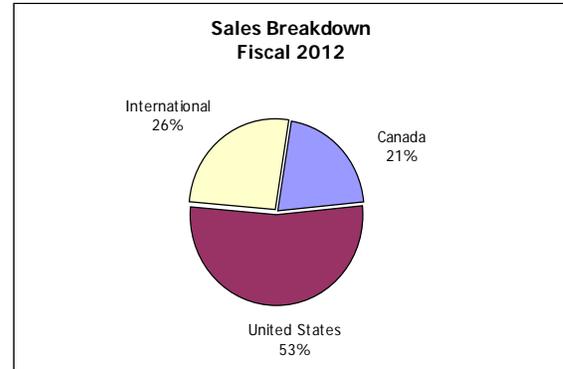
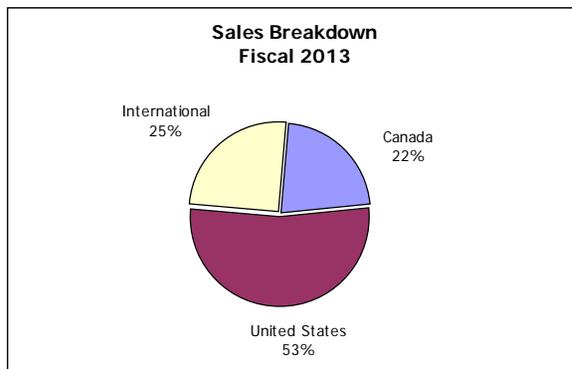
ANALYSIS OF RESULTS FOR THE YEAR ENDED DECEMBER 31, 2013

Sales



During the year ended December 31, 2013 ("Fiscal 2013" or "2013"), Pollard achieved sales of \$184.9 million, compared to \$162.4 million in the year ended December 31, 2012 ("Fiscal 2012" or "2012"). Factors impacting the \$22.5 million sales increase were:

Instant ticket sales volumes for Fiscal 2013 were significantly higher than Fiscal 2012 by 8.3% which increased sales by \$11.6 million. An increase in our ancillary instant ticket products and services, primarily licensed games, further increased sales by \$4.1 million. In addition, higher average selling prices compared to 2012 improved sales by \$1.3 million. Charitable Gaming average selling prices were slightly higher compared to 2012, increasing sales by \$0.2 million and greater volume further increased sales by \$0.8 million. An increase in the volume of machine sales raised sales \$0.6 million when compared to 2012.



During Fiscal 2013, Pollard generated approximately 64.9% (2012 – 66.9%) of its revenue in U.S. dollars including a portion of international sales which are priced in U.S. dollars. During Fiscal 2013 the actual U.S. dollar value was converted to Canadian dollars at \$1.028 compared to a rate of \$1.003 during Fiscal 2012. This 2.5% increase in the U.S. dollar value resulted in an approximate increase of \$2.9 million in revenue relative to Fiscal 2012. Also during Fiscal 2013, the Canadian dollar weakened against the Euro resulting in an approximate increase of \$1.0 million relative to Fiscal 2012.

Cost of sales and gross profit

Cost of sales was \$149.7 million in Fiscal 2013 compared to \$129.7 million in Fiscal 2012. Cost of sales was higher in Fiscal 2013 relative to Fiscal 2012 primarily as a result of increased sales volumes. In addition, higher exchange rates on U.S. dollar transactions in 2013 increased cost of sales approximately \$2.0 million when compared to Fiscal 2012.

Gross profit was \$35.2 million (19.0% of sales) in Fiscal 2013 compared to \$32.7 million (20.1% of sales) in Fiscal 2012. This absolute increase in gross profit dollars was due mainly to the higher instant ticket and licensed games sales volumes. The reduction in gross profit percentage occurred as a result of lower instant ticket production volumes relative to sales in Fiscal 2013, higher employee benefit costs, primarily pension expense, and increased machine costs.

Administration expenses

Administration expenses increased to \$15.2 million in Fiscal 2013 from \$13.6 million in Fiscal 2012 due primarily to increased compensation costs, including incentive accruals, as well as higher professional fees.

Selling expenses

Selling expenses increased to \$6.8 million in Fiscal 2013 from \$6.1 million in Fiscal 2012 primarily as a result of increased compensation expenses, including incentive accruals, to support new marketing opportunities including digital and iLottery initiatives.

Interest expense

Interest expense was \$3.4 million in Fiscal 2013 which was similar to \$3.4 million in Fiscal 2012.

Foreign exchange loss

The net foreign exchange loss was \$0.1 million in Fiscal 2013 compared to a net loss of \$0.2 million in Fiscal 2012. Within the 2013 net foreign exchange loss were realized foreign exchange gains of \$0.9 million comprised of \$1.0 million realized gain on the increased value of U.S. dollar denominated receivables and the conversion of U.S. dollars and Euros into Canadian dollars, partially offset by \$0.1 million of realized loss relating to payments made on U.S. dollar denominated payables. Offsetting the realized foreign exchange gains were unrealized foreign exchange losses of \$1.0 million comprised of an unrealized foreign exchange loss of \$0.9 million on U.S. dollar denominated debt and \$0.1 million unrealized foreign exchange loss on net U.S. denominated receivables and payables.

Within the 2012 net foreign exchange loss were realized foreign exchange losses of \$0.3 million comprised of \$0.5 million realized loss on the decreased value of U.S. dollar denominated receivables

and the conversion of U.S. dollars and Euros into Canadian dollars, partially offset by \$0.2 million of realized gain relating to payments made on U.S. dollar denominated debt. Partially offsetting the realized foreign exchange losses were unrealized foreign exchange gains of \$0.1 million comprised of an unrealized foreign exchange gain of \$0.4 million on U.S. dollar denominated debt, partially offset by \$0.3 million unrealized foreign exchange loss on U.S. denominated cash.

Adjusted EBITDA

Adjusted EBITDA was \$22.7 million in Fiscal 2013 compared to \$19.9 million in Fiscal 2012. The primary reasons for the increase in Adjusted EBITDA were the increase in gross profit (net of amortization and depreciation) of \$3.3 million and the higher realized foreign exchange gains of \$1.2 million. Partially offsetting these increases in Adjusted EBITDA were the increase in administration and selling expenses of \$1.6 million and \$0.7 million respectively.

Income taxes

Income tax expense was \$3.9 million in Fiscal 2013, an effective rate of 41.8%, due primarily to differences relating to the foreign exchange impact of Canadian dollar denominated debt in its U.S. subsidiaries. Pollard has capitalized its U.S. operations using intercompany Canadian dollar debt. The weakening of the Canadian dollar versus the U.S. dollar results in a future gain on debt repayment for U.S. tax purposes in the subsidiary, creating a deferred tax expense with no related income (as the gain is eliminated on consolidation). This increased the consolidated provision percentage by about 9%. Other permanent differences relating to the foreign exchange translation of property, plant and equipment increased the provision by approximately 3%.

Income tax expense was \$2.3 million in Fiscal 2012, an effective rate of 26.0%, consistent with the expected domestic tax rate.

Amortization and depreciation

Amortization and depreciation, including depreciation of property and equipment and the amortization of deferred financing costs and intangible assets, totaled \$8.6 million during Fiscal 2013 which increased from \$7.8 million during Fiscal 2012 due to increased depreciation of property, plant and equipment as well as additional amortization of development costs and license fees.

Net income

Net income was \$5.4 million in Fiscal 2013 compared to net income of \$6.5 million in Fiscal 2012. The primary reasons for the decrease were the increase in income tax expense of \$1.6 million, the increase in administration and selling expenses of \$1.6 million and \$0.7 million respectively and the \$0.4 million of non-cash mark-to-market loss on foreign currency contracts. Partially offsetting these reductions to net income were the increase in gross profit of \$2.5 million, a reduction in deferred financing costs of \$0.3 million and an increase in other income of \$0.3 million.

Earnings per share decreased to \$0.23 per share in Fiscal 2013 from \$0.28 in Fiscal 2012.

Liquidity and Capital Resources

Cash provided by operating activities

For the year ended December 31, 2013, cash flow provided by operating activities was \$12.3 million compared to \$9.5 million in Fiscal 2012. Changes in the non-cash component of working capital decreased cash flow from operations by \$4.1 million for Fiscal 2013 (due primarily to increases in accounts receivable and prepaids, partially offset by a decrease in inventory and an increase in accounts payable and accrued liabilities), compared to a decrease of \$5.1 million for Fiscal 2012 (due primarily to increases in accounts receivable and inventory, partially offset by an increase in accounts payable and accrued liabilities). Cash used for income taxes in Fiscal 2013 increased to \$1.2 million from \$0.7 million in Fiscal 2012, as well cash used regarding the pension liability increased to \$1.7 million in Fiscal 2013 from \$1.4 million in Fiscal 2012.

Cash used by investing activities

In the year ended December 31, 2013, cash used in investing activities was \$8.4 million compared to \$7.8 million in the year ended December 31, 2012. In Fiscal 2013 Pollard's capital expenditures were \$4.6 million, as well, Pollard also expended \$3.8 million on additions to intangible assets, primarily related to licensing fees and implementation costs, including capitalized internal costs, for ERP software.

In Fiscal 2012 Pollard's capital expenditures were \$6.5 million. As well, Pollard also expended \$0.4 million on its investment in associate and \$0.9 million on additions to intangible assets.

Cash used by financing activities

Cash used by financing activities was \$1.2 million in the year ended December 31, 2013, compared to cash used by financing activities of \$1.4 million in the year ended December 31, 2012. During Fiscal 2013 cash used by financing activities was comprised of \$2.8 million in dividends paid and \$0.2 million in deferred financing costs, which were partially offset by proceeds from long-term debt \$1.7 million.

In Fiscal 2012 cash used by financing activities was comprised of \$2.8 million in dividends paid and \$0.2 million in deferred financing costs, which were partially offset by proceeds from long-term debt \$1.6 million.

As at December 31, 2013, Pollard had unused committed credit facility of \$9.4 million. This amount is available to be used for future working capital requirements, contractual obligations, capital expenditures and dividends.

**ANALYSIS OF RESULTS FOR THE PERIOD OCTOBER 1, 2013 TO DECEMBER 31, 2013
FOURTH QUARTER OF 2013**

SELECTED FINANCIAL INFORMATION

(millions of dollars)

	Three months ended December 31, 2013	Three months ended December 31, 2012 (Restated)
	(unaudited)	(unaudited)
Sales	\$47.6	\$40.9
Cost of sales	38.4	32.6
Gross profit	9.2	8.3
Administration	4.2	3.5
Selling	1.7	1.6
Other (income) expense	(0.2)	0.1
Income from operations	3.5	3.1
Finance costs	1.6	1.3
Income before income taxes	1.9	1.8
Income taxes:		
Current	0.5	0.1
Future	0.5	0.4
Net income	\$0.9	\$1.3
Adjustments:		
Amortization and depreciation	2.7	2.2
Interest	0.8	0.9
Unrealized foreign exchange loss	0.5	0.5
Mark-to-market loss on foreign currency contracts	0.4	-
Income taxes	1.0	0.5
Adjusted EBITDA	\$6.3	\$5.4

See page 6 for restatement.

Sales

During the three months ended December 31, 2013, Pollard achieved sales of \$47.6 million, compared to \$40.9 million in the three months ended December 31, 2012. Factors impacting the \$6.7 million sales increase were:

Instant ticket sales volumes for the fourth quarter of 2013 were higher than the fourth quarter of 2012 by 5.7%, which combined with an increase in our ancillary instant ticket products and services, primarily licensed games and lottery management services, improved sales by \$3.1 million. In addition, an increase in average selling price of instant tickets compared to 2012 increased sales by \$1.3 million. Higher charitable gaming volumes for the quarter increased sales compared to 2012 by \$0.3 million. As well, machine volumes increased slightly in the fourth quarter of 2013 compared to final quarter of 2012, which increased sales by \$0.1 million.

During the three months ended December 31, 2013, Pollard generated approximately 59.8% (2012 – 65.0%) of its revenue in U.S. dollars including a portion of international sales which were priced in U.S. dollars. During the fourth quarter of 2013 the actual U.S. dollar value was converted to Canadian dollars at \$1.047, compared to the rate of \$0.997 during the fourth quarter of 2012. This 5.1% increase in the value of the U.S. dollar value resulted in an approximate increase of \$1.4 million in revenue relative to 2012. Also during the quarter, the value of the Canadian dollar weakened against the Euro, compared to the fourth quarter of 2012, resulting in an approximate increase of \$0.5 million in revenue.

Cost of sales and gross profit

Cost of sales was \$38.4 million in the fourth quarter of 2013 compared to \$32.6 million in the fourth quarter of 2012. Cost of sales was higher in the quarter relative to the fourth quarter of 2012 primarily as a result of increased sales volumes. In addition, higher exchange rates on U.S. dollar transactions in the fourth quarter of 2013 increased cost of sales approximately \$1.1 million when compared to fourth quarter of 2012.

Gross profit was \$9.2 million (19.3% of sales) in the fourth quarter of 2013 compared to \$8.3 million (20.3% of sales) in the fourth quarter of 2012. This absolute increase in gross profit dollars was due mainly to the higher instant ticket and licensed games sales volumes. The reduction in gross profit percentage occurred as a result of lower instant ticket production volumes relative to sales in fourth quarter of 2013 as compared to 2012, higher employee benefit costs, primarily pension expense, and increased machine costs.

Administration expenses

Administration expenses were \$4.2 million in the fourth quarter of 2013 which was higher compared to \$3.5 million in the fourth quarter of 2012 due primarily to increased compensation costs, including incentive accruals, as well as increased professional fees.

Selling expenses

Selling expense was \$1.7 million in the fourth quarter of 2013 which was similar to \$1.6 million in the fourth quarter of 2012.

Interest expense

Interest expense was \$0.8 million in the fourth quarter of 2013 which was similar to \$0.9 million in the fourth quarter of 2012.

Foreign exchange loss

The net foreign exchange loss was \$0.3 million in the fourth quarter of 2013 compared to a net loss of \$0.3 million in the fourth quarter of 2012. Within the 2013 fourth quarter net foreign exchange loss was an unrealized foreign exchange loss of \$0.5 million consisting of \$0.4 million relating to unrealized foreign exchange loss on U.S. dollar denominated debt and \$0.1 million relating to the unrealized foreign exchange loss on net U.S. dollar denominated receivables and payables. Partially offsetting the unrealized foreign exchange loss was a \$0.2 million realized foreign exchange gain on the increased value of U.S. and Euro denominated receivables.

Within the 2012 fourth quarter the net foreign exchange loss was an unrealized foreign exchange loss of \$0.5 million consisting of \$0.2 million relating to unrealized foreign exchange loss on U.S. dollar denominated debt and \$0.3 million relating to the unrealized foreign exchange loss on U.S. dollar denominated cash and receivables. Partially offsetting the unrealized foreign exchange loss was \$0.2 million realized foreign exchange gain on the increased value of Euro denominated receivables.

Adjusted EBITDA

Adjusted EBITDA was \$6.3 million in the fourth quarter of 2013 compared to \$5.4 million in the fourth quarter of 2012. The primary reasons for the increase in Adjusted EBITDA were the increase in gross profit (net of amortization and depreciation) of \$1.4 million and a \$0.3 million increase in other income, partially offset by higher administration expenses of \$0.7 million.

Income taxes

Income tax expense was \$1.0 million in the fourth quarter of 2013, an effective rate of 52.6%, due primarily to differences relating to the foreign exchange impact of Canadian dollar denominated debt in its U.S. subsidiaries. Pollard has capitalized its U.S. operations using intercompany Canadian dollar debt. The significant weakening of the Canadian dollar versus the U.S. dollar in the fourth quarter results in a future gain on debt repayment for U.S. tax purposes in the subsidiary, creating a deferred tax expense with no related income (as the gain is eliminated on consolidation). This increased the consolidated provision percentage by about 16%. Other increases were due to permanent differences relating to the translation of the company's U.S. subsidiaries.

Income tax expense was \$0.5 million in the fourth quarter of 2012, an effective rate of 27.8%, similar to the expected domestic tax rate.

Amortization and depreciation

Amortization and depreciation, including depreciation of property, plant and equipment and the amortization of deferred financing costs and intangible assets, totaled \$2.7 million during the fourth quarter of 2013 which increased from \$2.2 million during the fourth quarter of 2012 as a result of increased amortization of development costs and license fees in 2013.

Net income

Net income was \$0.9 million in the fourth quarter of 2013 compared to \$1.3 million in the fourth quarter of 2012. The primary reasons for the decrease were the increase in administration expenses of \$0.7 million, the increase in income tax expense of \$0.5 million and the \$0.4 million of non-cash mark-to-market loss on foreign currency contracts. Partially offsetting these reductions to net income were the increase in gross profit of \$0.9 million and an increase in other income of \$0.3 million.

Earnings per share decreased to \$0.04 per share in the fourth quarter of 2013 from \$0.06 in the fourth quarter of 2012.

Quarterly Information

(unaudited)

(millions of dollars)

	Q4 2013	Q3 2013	Q2 2013	Q1 2013	(Restated)			
					Q4 2012	Q3 2012	Q2 2012	Q1 2012
Sales	\$47.6	\$48.1	\$44.8	\$44.4	\$40.9	\$44.1	\$40.8	\$36.6
Adjusted EBITDA	6.3	6.3	4.9	5.2	5.4	5.8	5.3	3.4
Net income	0.9	2.6	1.0	0.9	1.3	3.3	1.0	0.9

See page 6 for restatement details.

Sales in Fiscal 2013 and in Q3 2012 were higher primarily due to increases in volumes.

Adjusted EBITDA in Q4 and Q3 2013 were higher due to higher gross profit achieved through higher sales volumes.

Adjusted EBITDA and net income in Q3 2012 were higher primarily due to higher gross profit achieved through higher sales volumes while obtaining cost efficiencies in cost of sales.

Sales in Q1 and Q2 2012 were lower primarily due to decreases in volumes and in average selling prices.

Productive Capacity

Management has defined productive capacity as the level of operations necessary to maintain a minimum Adjusted EBITDA of \$22.0 million on an annualized basis. Due to varying factors implicit in the nature of the lottery industry and the instant ticket market, productive capacity can best be measured through a financial output such as Adjusted EBITDA and cash flow. A number of factors impact the level of Adjusted EBITDA including physical plant capacity, machine capacity, nature of product and service offerings produced and mix of customers. Changes to productive capacity have occurred primarily through expenditures on fixed assets and improved processes and other internal improvement measures and the closure of the Kamloops facility in February 2010. Productive capacity is also impacted by changes in foreign exchange relationships. There have been no increases in productive capacity due to acquisitions since Pollard's initial public offering ("IPO") in August 2005.

Pollard's strategy with respect to productive capacity is to expend the required funds and resources to maintain the assets required to generate the targeted cash flow. In addition, dependent on certain market conditions and limitations on available funds, projects are incurred to increase cash inflow or decrease cash outflow. The nature of the lottery industry does not in itself lead to significant obsolescence risk with the operating assets. To grow productive capacity, ongoing investment in new technology, new fixed assets and new intangible assets is required. Pollard utilizes a number of individual strategies to maintain and grow productive capacity including a capital expenditure budget and a rigorous formal approval process, flexible individual customer management relationships and structured maintenance programs throughout all of the facilities.

An important component to managing and growing productive capacity is the management of certain intangible assets, including customer contracts and relationships, patents, computer software and goodwill. Certain of these assets are reflected in Pollard's financial statements due to the use of continuity of interest method of accounting during the transfer of the business at Pollard's IPO.

Management focuses on maintaining and growing the value of the customer relationship through winning contract renewals, pursuing and obtaining new contracts and assisting existing customers growing their instant ticket product lines. Regular commitment to research and development allows continual development of patents, software and additional technological assets that maintain and increase operating income and cash flow. Detailed cost benefit analysis is performed for any significant investment of funds or resources in order to minimize the associated risks that these assets will not be able to generate the expected level of cash flow. Where new opportunities are identified, such as a new marketing opportunity or a new machine or process able to reduce input costs, consideration is given to revise plans and take advantage of these prospects.

Certain risks are associated with projects aimed at increasing productive capacity, including increases in working capital, acquisition or development of intellectual property, development of additional products or services and purchases of fixed assets. If these investments fail to increase Adjusted EBITDA and cash flow, then productive capacity will ultimately decrease over time due to the consumption of these investment resources. The impact on productive capacity may also depend upon the completion and start up timing of certain investment projects.

Working Capital

Net non-cash working capital varies throughout the year based on the timing of individual sales transactions. The nature of the lottery industry is few individual customers who generally order large dollar value transactions. As such, the change in timing of a few individual orders can impact significantly the amount required to be invested in inventory or receivables at a particular period end. The high value, low volume of transactions results in some significant volatility in non-cash working capital, particularly during a period of rising volumes. Similarly, the timing of the completion of the sales cycle through collection can significantly impact non-cash working capital.

Instant tickets are produced specifically for individual clients resulting in a limited investment in finished goods inventory. Customers are predominantly government agencies, which result in regular payments. There are a limited number of individual customers, and therefore net investment in working capital is managed on an individual customer by customer basis, without the need for company wide benchmarks.

The overall impact of seasonality does not have a material impact on the carrying amounts in working capital.

As at December 31, 2013, Pollard's investment in non-cash working capital increased \$4.1 million compared to December 31, 2012 primarily as a result of increased investment in accounts receivables as a result of increased sales in the fourth quarter of 2013.

	December 31, 2013	December 31, 2012
Working Capital	\$33.3	\$27.2
Total Assets	\$133.4	\$127.0
Total Non-Current Liabilities	\$79.2	\$83.4

Credit Facility

Pollard's credit facility, which was renewed effective June 28, 2013, consists of one committed term bank loan facility. The committed term bank loan facility provides loans of up to \$74.0 million for its Canadian operations and up to US\$10.0 million for its U.S. subsidiaries. Borrowings under the credit facility bear interest at fixed and floating rates based on Canadian and U.S. prime bank rates, banker's acceptances or LIBOR. At December 31, 2013, the outstanding letters of guarantee were \$1.6 million and the remaining balance available for drawdown was \$9.4 million.

Under the terms and conditions of the credit facility agreement Pollard is required to maintain financial covenants including working capital ratios, debt to income before interest, income taxes, depreciation and amortization ("Adjusted EBITDA") ratios and certain debt service coverage ratios. As at December 31, 2013, and March 5, 2014, Pollard is in compliance with all covenants.

Under the credit facility, Pollard has agreed not to pay dividends in excess of the current quarterly amount of \$0.03 per share if the debt to Adjusted EBITDA ratio is above a certain level. As at December 31, 2013, Pollard's Adjusted EBITDA ratio is below the target level and as a result there are currently no restrictions on the amount of dividends.

Under the terms of the credit facility the amount of the facility will be reduced on a quarterly basis by an amount calculated as 50% of the prior quarter's Excess Cash Flow. Excess Cash Flow is defined as Adjusted EBITDA less scheduled principal indebtedness payments (if any), maintenance capital expenditures (to a maximum of \$3.5 million per year), pension deficit installments (to a maximum of \$2.0 million for Fiscal 2013 and \$2.7 million for Fiscal 2014), interest and cash income taxes paid. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. For the quarter ending December 31, 2013, the credit facility will be reduced by approximately \$2.1 million as of May 15, 2014.

Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard's operating subsidiaries. The credit facility can be prepaid without penalties. Under the terms of the agreement, the credit facility is committed for a one year period, renewable June 30, 2014 ("Facility Expiry Date"). If the credit facility is not renewed, the loans are repayable one year after the Facility Expiry Date. As such, the credit facility has effectively a two year term expiring June 30, 2015.

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 and dividends at existing business levels.

Outstanding Share Data

As at December 31, 2013 and March 5, 2014, outstanding share data was as follows:

Common shares	23,543,158
---------------	------------

Contractual Obligations

Pollard's subsidiaries rent premises and equipment under long-term operating leases. The following is a schedule by year of commitments and contractual obligations outstanding:

(millions of dollars)	Total	<1 Year	1-3 Years	4-5 Years	Thereafter
Long-term debt	\$73.3	-	\$73.3	-	-
Other non-current liabilities	\$0.2	-	\$0.2	-	-
Pension liability	\$2.8	-	-	-	\$2.8
Interest on long-term debt	\$3.8	\$2.5	\$1.3	-	-
Operating leases	\$20.8	\$3.4	\$6.3	\$5.6	\$5.5
Total	\$100.9	\$5.9	\$81.1	\$5.6	\$8.3

Pension Obligations

Pollard sponsors four non-contributory defined benefit pension plans, of which three are final pay plans and one is a flat benefit plan. As of December 31, 2013, the aggregate fair value of the assets of Pollard's defined benefit pension plans was \$32.5 million and the accrued benefit plan obligations were \$35.4 million. Pollard's total annual funding contribution for all pension plans in 2014 is expected to be approximately \$2.5 million, compared to \$4.7 million in 2013, so long as long-term expectations of fund performance for the defined benefit plans are met.

The reduction in expected funding requirements for 2014 as compared to 2013 is a result of the increase in discount rate being applied for 2014, the healthy returns on investments earned over the past two years and the previous additional solvency payments required for one of Pollard's Canadian pension plans. These factors will, we anticipate, eliminate the solvency payment requirements for 2014 and significantly reduced the pension deficit as at December 31, 2013 from the previous year-end balance.

Off-Balance Sheet Arrangements

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

Related Party Transactions

During the year, Pollard Equities Limited paid Pollard \$0.07 million (2012 – \$0.07 million) for accounting and administration fees.

During the year ended December 31, 2013, Pollard paid property rent of \$3.0 million (2012 - \$3.0 million) and \$0.2 million (2012 – \$0.2 million) in plane charter costs to affiliates of Equities.

During Fiscal 2011, Pollard sold a building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of \$3.5 million resulting in a gain of \$1.5 million. The selling price was based on the current fair market value as determined through an independent appraisal. Pollard subsequently leased the property back for a five year term (with an option to renew for an additional five year term) for an annual rent of \$0.3 million. During Fiscal 2010, Pollard sold the building and land formally used in the Kamloops operation to an affiliate of Equities for total proceeds of \$2.9 million resulting in a gain of \$2.0 million. The selling price was based on the current fair market value determined through an independent appraisal.

Pollard has leased a building in Council Bluffs, Iowa from an affiliate of Equities for a ten year term, ending December 31, 2018, with annual lease payments of US\$0.3 million.

A manufacturing facility in Winnipeg, Manitoba is leased from an affiliate of Equities for a 12 year 6 month period, ending March 31, 2021, at an annual base rate of approximately \$2.4 million.

At December 31, 2013, Pollard owes Equities and its affiliates \$0.7 million (2012 - \$1.4 million) for rent and other expenses.

Critical Accounting Policies and Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting period. Management of Pollard regularly reviews its estimates and assumptions based on historical experience and various other assumptions that it believes would result in reasonable estimates given the circumstances. Actual results could differ from those estimates under different assumptions. The following is a discussion of accounting policies which require significant management judgment and estimation.

Impairment of goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired of Pollard's U.S. subsidiaries and the excess purchase price over the underlying carrying amount of the portion of the net assets sold as at August 5, 2005, as part of the 26.7% of Pollard sold in conjunction with the IPO, and is not amortized. Goodwill is subject to an annual impairment review. This requires an estimation of the "value in use" or "fair value less costs to sell" of the cash-generating units ("CGUs") to which goodwill is allocated. Estimating a value in use requires Pollard to make an estimate of the expected future cash flows from the CGUs and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

Employee future benefits

Accounting for defined benefit plans requires Pollard to use actuarial assumptions. These assumptions include the discount rate and the rate of compensation increases. These assumptions depend on underlying factors such as economic conditions, government regulations, investment performance, employee demographics and mortality rates.

Income taxes

Pollard is required to evaluate the recoverability of deferred income tax assets. This requires an estimate of Pollard's ability to utilize the underlying future income tax deductions against future taxable income before they expire. In order to evaluate the recoverability of these deferred income tax assets, Pollard must estimate future taxable income.

Future Changes in Accounting Policies

In November 2009, the IASB issued IFRS 9 *Financial Instruments* ("IFRS 9 (2009)") and in October 2010, the IASB published amendments to IFRS 9 ("IFRS 9 (2010)"). In December 2011, the IASB issued an amendment to IFRS 9 to defer the mandatory effective date to annual periods beginning on or after January 1, 2015. IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classifications options in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities. In November 2013, a new general hedge accounting standard was issued, forming part of IFRS 9. It will more closely align with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirements to measure and recognize ineffectiveness, however it will allow more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more

judgment to assess the effectiveness of a hedging relationship. The effective date for IFRS 9 has not yet been determined. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In December 2011, the IASB issued an amendment to the application guidance in IAS 32 *Financial Instruments: Presentation* to clarify some of the requirements for offsetting financial assets and financial liabilities on the statement of financial position. The amendments do not change the current offsetting model in IAS 32 but instead clarify that the right of offset must not be contingent on a future event. It also must be legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amendments also clarify that for settlement mechanisms with features that both eliminate credit and liquidity risk and process receivables and payables in a single settlement process, are effectively equivalent to net settlement. The clarifications to the application guidance in IAS 32 are to be retrospectively applied, with an effective date for annual periods beginning on or after January 1, 2014. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

Industry Risks and Uncertainties

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

Dependence on Key Products

Instant lottery tickets and related services accounted for approximately 89% of Pollard's Fiscal 2013 revenues. Pollard's financial results and condition are substantially dependent on the continued success and growth in sales of this product and the profitability of such sales. Competitive efforts by other manufacturers of similar or substitute products, shifts in consumer preferences or the introduction and acceptance of alternative product offerings could have a material adverse effect on Pollard's business, financial condition, liquidity and results of operations.

Economic Uncertainty

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

Inability to Sustain Sales or EBITDA Margins

Pollard's income depends upon its ability to generate sales to customers and to sustain its EBITDA margins. These margins are dependent upon Pollard's ability to continue to profitably sell lottery tickets

and gaming products and to continue to provide products and services that make it the supplier of choice to its customers. If Pollard's costs of sales or operating costs increase, or other manufacturers of gaming products could compete more favourably with it, Pollard may not be able to sustain its level of sales or EBITDA margins.

Dependence on Major Customers

Pollard's 10 largest customers accounted for approximately 53% of its revenue during Fiscal 2013. Pollard's largest customer accounted for approximately 11% of Pollard's revenues during Fiscal 2013.

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

Exchange Rate Fluctuation

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

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

Additional Capital Requirements

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

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

Competition

The instant ticket and charitable gaming business is highly competitive, and Pollard faces competition from a number of domestic and foreign instant ticket manufacturers and other competitors. Pollard currently has two instant ticket competitors in North America: Scientific Games Corporation and Gtech Printing Corporation. Charitable gaming competitors include a number of manufacturers such as Arrow

International, Inc. and International Gamco, Inc. Internationally, there are a number of lottery instant ticket vendors which compete with Pollard including Scientific Games, Gtech, and the Eagle Press Group of Companies.

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

Licensing and Regulatory Requirements

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

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

Income and Other Taxes

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

Intellectual Property

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

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

Interest Rates

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

Future Acquisition and Integration Risks

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

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

Financial Instruments

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

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

management controls and utilizes the annual risk assessment process as the basis for the annual audit plan.

Risk Exposure

Currency risk

Pollard sells a significant portion of its products and services to customers in the United States and to international customers where sales are denominated in U.S. dollars. In addition, a significant portion of its cost inputs are denominated in U.S. dollars. Pollard also generates revenue in currencies other than Canadian and U.S. dollars, primarily in Euros.

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

Interest rate risk

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

Credit risk

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

Liquidity risk

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

Risk Management

Currency risk

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

A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian and U.S. dollar would decrease/increase the income before income taxes due to changes in operating cashflow by approximately \$0.07 million for year ended December 31, 2013 (2012 - \$0.09 million). A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian and Euro would decrease/increase the income before income taxes due to changes in operating cashflow by approximately \$0.06 million for year ended December 31, 2013 (2012 - \$0.05 million).

Two manufacturing facilities are located in the U.S. and a significant amount of cost inputs for all production facilities are denominated in U.S. dollars, offsetting a large portion of the U.S. dollar revenue in a natural hedge.

In addition, Pollard has entered into foreign currency contracts to exchange US\$1.0 million each month for approximately \$1.065 million for 18 consecutive months from December 2013 to May 2015. Pollard has also entered into foreign currency contracts to exchange Euros €0.5 million each month for

approximately \$0.7 million for 12 consecutive months from September 2013 to August 2014. At December 31, 2013, the remaining open foreign currency contracts have been recognized at fair value in the statement of financial position as a \$0.4 million liability.

A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the U.S. dollar would result in a decrease/increase in net income before income taxes of approximately \$0.9 million for the year ended December 31, 2013, due to the change in value of the mark-to-market value of the U.S. foreign currency contracts. In addition, a 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the Euro would result in a decrease/increase in net income before income taxes of approximately \$0.02 million for the year ended December 31, 2013, due to the change in value of the mark-to-market value of the Euro foreign currency contracts.

As at December 31, 2013, the amount of financial liabilities denominated in U.S. dollars exceeds the amount of financial assets denominated in U.S. dollars by approximately \$3.4 million. A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the U.S. dollar would result in a decrease/increase in net income before income taxes of approximately \$0.02 million.

Interest rate risk

A 50 basis point decrease/increase in interest rates would result in an increase/decrease in income before income taxes of \$0.4 million for the year ended December 31, 2013.

Credit risk

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

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

Liquidity risk

Pollard's approach is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. Pollard maintains a committed credit facility including up to \$74.0 million for its Canadian operations and up to US\$10.0 million for its U.S. subsidiaries. At December 31, 2013, the unused balance available for drawdown was \$9.4 million.

The 2014 requirements for capital expenditures, working capital and dividends are expected to be financed from cash flow provided by operating activities and unused credit facility. Pollard enters into contractual obligations in the normal course of business operations.

Outlook

The lottery industry overall, and in particular the instant ticket product line, continues to have a very positive outlook. Retail sales growth continues to be very strong across many jurisdictions and this trend is expected to carry on. Governments are looking for ways to increase and maximize the money they generate for their good causes. As lotteries look for more ways to increase returns, this creates opportunities for suppliers like Pollard to provide solutions to those needs. Unique and proprietary instant tickets, better marketing strategies, extensive retail support, internet support and promotional ideas are examples of ways lotteries are looking to their suppliers to add value to the instant ticket product line and these opportunities will increase in the future.

In terms of new opportunities, the recent development of selling lottery products on the internet is potentially significant. Prior to 2013, a few lotteries had begun sales via this distribution method and the number of lotteries initiating internet sales is expected to grow in 2014 and beyond. With the recent award of the Michigan Lottery iLottery contract to us, Pollard is well positioned to capitalize on these opportunities. While internet distribution is an exciting new opportunity, in the near term the strong growth in the traditional paper based instant tickets will continue to drive the success of the business.

We are projecting slightly higher volumes for 2014 based on our current expectations of customer order requirements and ongoing growth in retail sales. We are also anticipating higher sales in ancillary product areas including licensed games and in particular greater sales in our digital product line including individual game apps and other internet support. While still small in absolute terms, the digital area is a rapidly growing opportunity for Pollard. Sales of our premium and proprietary products are continuing to maintain the strong growth achieved in 2013. These premium products generate a positive impact on average selling prices and margins and this will continue in 2014.

Our contract portfolio reflects the success of a number of key new contract wins and important extensions over the course of 2013. The weakening of the Canadian dollar during 2013 and the early part of 2014 in addition to generating higher returns from our net cashflow, also allows us to be more competitive in our bidding. Ongoing Canadian dollar weakness would have a positive impact on our operating results in 2014. We have no material customer contracts that come due in 2014 (when extensions are considered) and will continue to aggressively pursue requests for proposals and other opportunities within the lottery industry as they come up for bid.

Our manufacturing operations are continuing on our Change Initiative plan to improve our efficiencies and lower our per-unit costs. 2014 will focus on a number of key areas, including improved finishing practices and new integrated information systems.

Charitable gaming generated strong results again in 2013 and we have identified some incremental geographic areas and ancillary product lines that should result in an opportunity to grow the top line in a market where overall sales remain challenged. In addition, select investments in newer technology during 2014 will allow our ongoing cost improvement initiative to continue.

Budgeted capital expenditures for 2014 are expected to be similar to the levels of expenditures incurred in 2013.

Pollard believes our ongoing cash flow from operations and our current bank facility capacity will be sufficient to allow it to meet ongoing requirements for investment in capital expenditures, working capital and dividends at existing business levels.

Disclosure Controls and Procedures

Under Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings," issuers are required to document the conclusions of the Chief Executive Officer and Chief Financial Officer (the "Certifying Officers") regarding the design and effectiveness of the disclosure controls and procedures. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the disclosure controls and procedures as defined in Multilateral Instrument 52-109 are designed appropriately and are effective at providing reasonable assurance of achieving the disclosure objectives.

Internal Controls over Financial Reporting

Under Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings," issuers are required to document the conclusions of the Certifying Officers regarding the design and effectiveness of the internal controls over financial reporting. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the internal controls over financial reporting as defined in Multilateral Instrument 52-109 are designed appropriately and are effective at providing reasonable assurance of achieving the financial reporting objectives.

No changes were made in Pollard's internal control over financial reporting during the year ended December 31, 2013, that have materially affected, or are reasonably likely to materially affect, Pollard's internal control over financial reporting.

Additional Information

Shares of Pollard Banknote Limited are traded on the Toronto Stock Exchange under the symbol PBL.

Additional information relating to Pollard, including the Audited Consolidated Financial Statements and the Annual Information Form for the year ended December 31, 2013, is available on SEDAR at www.sedar.com.

Pollard Banknote Limited
1499 Buffalo Place
Winnipeg, Manitoba R3T 1L7
(204) 474-2323
www.Pollardbanknote.com

Consolidated Financial Statements of

**POLLARD BANKNOTE
LIMITED**

Years ended December 31, 2013 and 2012



Management's Report

The accompanying consolidated financial statements and all the information contained in the annual report of Pollard Banknote Limited ("Pollard") are the responsibility of management and have been approved by the Board of Directors of Pollard. Financial and operating data elsewhere in the annual report is consistent with the information contained in the financial statements. The financial statements and all other information have been prepared by management in accordance with Canadian generally accepted accounting principles. The financial statements include some amounts and assumptions based on management's best estimates which have been derived with careful judgment.

In fulfilling its responsibilities, management of Pollard has developed and maintains a system of internal accounting controls. These controls are designed to ensure that the financial records are reliable for preparing the financial statements. The Board of Directors of Pollard carries out its responsibility for the financial statements through the Audit Committee. The Audit Committee reviews Pollard's annual consolidated financial statements and recommends their approval by the Board of Directors. The auditors have full access to the Audit Committee with and without management present.

The consolidated financial statements have been audited by KPMG LLP Chartered Accountants, whose opinion is contained in this annual report.

"John Pollard"

JOHN POLLARD
Co-Chief Executive Officer

"Robert Rose"

ROBERT ROSE
Chief Financial Officer

March 5, 2014



KPMG LLP
Chartered Accountants
Suite 2000 – One Lombard Place
Winnipeg MB R3B 0X3
Canada

Telephone (204) 957-1770
Fax (204) 957-0808
Internet www.kpmg.ca

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Pollard Banknote Limited

We have audited the accompanying consolidated financial statements of Pollard Banknote Limited and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2013 and 2012 and the consolidated statements of income, comprehensive income, changes in equity, and cash flows for the two years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Pollard Banknote Limited and its subsidiaries as at December 31, 2013 and 2012 and its financial performance and its cash flows for the two years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

March 5, 2014

Winnipeg, Canada

Pollard Banknote Limited
Consolidated Statements of Financial Position
(In thousands of Canadian dollars)

	December 31, 2013	December 31, 2012
Assets		
Current assets		
Cash	\$ 7,774	\$ 4,982
Accounts receivable	22,779	16,301
Inventories (note 6)	21,281	21,726
Prepaid expenses and deposits	2,012	1,760
Total current assets	53,846	44,769
Non-current assets		
Property, plant and equipment (note 7)	28,918	30,113
Equity investment (note 8)	167	204
Goodwill (note 9)	36,111	35,703
Intangible assets (note 10)	13,532	11,840
Deferred income taxes (note 11)	801	4,324
Total non-current assets	79,529	82,184
Total assets	\$ 133,375	\$ 126,953

	December 31, 2013	December 31, 2012
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 18,074	\$ 16,174
Dividends payable	706	706
Income taxes payable	1,795	700
Total current liabilities	20,575	17,580
Non-current liabilities		
Long-term debt (note 12)	73,345	70,485
Other non-current liabilities	205	195
Foreign currency contracts (note 24)	412	-
Pension liability (note 13)	2,824	9,902
Deferred income taxes (note 11)	2,374	2,781
Total non-current liabilities	79,160	83,363
Shareholders' equity		
Share capital (note 14)	73,209	73,209
Reserves	219	(826)
Deficit	(39,788)	(46,373)
Total shareholders' equity	33,640	26,010
Commitments and contingencies (note 15)		
Total liabilities and shareholders' equity	\$ 133,375	\$ 126,953

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"D.C. Crewson" Director

"John Pollard" Director

Pollard Banknote Limited
Consolidated Statements of Income
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31

	2013	2012 (Restated)
Sales	\$ 184,937	\$ 162,427
Cost of sales	149,745	129,766
Gross profit	35,192	32,661
Administration	15,241	13,590
Selling	6,763	6,124
Other (income) expense (note 16)	(356)	40
Income from operations	13,544	12,907
Finance costs (note 17)	4,697	4,751
Finance income (note 17)	(516)	(648)
Income before income taxes	9,363	8,804
Income taxes (note 11)		
Current	2,193	1,078
Deferred	1,722	1,211
	3,915	2,289
Net income	\$ 5,448	\$ 6,515
Basic and diluted net income per share	\$ 0.23	\$ 0.28
Weighted average number of shares outstanding	23,543,158	23,543,158

See accompanying notes to consolidated financial statements, note 3 for restatement.

Pollard Banknote Limited
Consolidated Statements of Comprehensive Income
(In thousands of Canadian dollars)

Years ended December 31

	2013	2012 (Restated)
Net income	\$ 5,448	\$ 6,515
Other comprehensive income (loss)		
Items that are or may be reclassified to profit and loss		
Foreign currency translation differences – foreign operations	1,045	(500)
Items that will never be reclassified to profit and loss		
Defined benefit plans remeasurements, net of income tax (reduction) of \$1,517 and (\$1,745) (note 11 & note 13)	3,962	(4,841)
Other comprehensive income (loss) – net of income tax	5,007	(5,341)
Comprehensive income	\$ 10,455	\$ 1,174

See accompanying notes to consolidated financial statements, note 3 for restatement.

Pollard Banknote Limited
Consolidated Statements of Changes in Equity
(In thousands of Canadian dollars)

Year ended December 31, 2013

	Attributable to equity holders of Pollard Banknote Limited			
	Share capital	Translation reserve	Deficit	Total equity
Balance at January 1, 2013	\$ 73,209	(826)	(46,373)	26,010
Net income	-	-	5,448	5,448
Other comprehensive income				
Foreign currency translation differences – foreign operations	-	1,045	-	1,045
Defined benefit plans remeasurements, net of income tax of \$1,517	-	-	3,962	3,962
Total other comprehensive income	\$ -	1,045	3,962	5,007
Total comprehensive income	\$ -	1,045	9,410	10,455
Dividends to owners of Pollard Banknote Limited	-	-	(2,825)	(2,825)
Balance at December 31, 2013	\$ 73,209	219	(39,788)	33,640

Year ended December 31, 2012

	Attributable to equity holders of Pollard Banknote Limited			
	Share capital	Translation reserve	Deficit	Total equity
Balance at January 1, 2012	\$ 73,209	(326)	(45,222)	27,661
Net income (Restated note 3)	-	-	6,515	6,515
Other comprehensive income (loss)				
Foreign currency translation differences – foreign operations	-	(500)	-	(500)
Defined benefit plans remeasurements, net of income tax reduction of (\$1,745) (Restated note 3)	-	-	(4,841)	(4,841)
Total other comprehensive loss (Restated note 3)	\$ -	(500)	(4,841)	(5,341)
Total comprehensive income (loss)	\$ -	(500)	1,674	1,174
Dividends to owners of Pollard Banknote Limited	-	-	(2,825)	(2,825)
Balance at December 31, 2012	\$ 73,209	(826)	(46,373)	26,010

See accompanying notes to consolidated financial statements, note 3 for restatement.

Pollard Banknote Limited
Consolidated Statements of Cash Flows
(In thousands of Canadian dollars)

Years ended December 31

	2013	2012 (Restated)
Cash increase (decrease)		
Operating activities		
Net income	\$ 5,448	\$ 6,515
Adjustments		
Income taxes	3,915	2,289
Amortization and depreciation	8,580	7,850
Interest expense	3,349	3,382
Unrealized foreign exchange (gain) loss	993	(129)
Loss on equity investment	37	204
Mark-to-market loss on foreign currency contracts	412	-
Interest paid	(3,392)	(3,350)
Income tax paid	(1,176)	(726)
Change in pension liability	(1,736)	(1,392)
Change in non-cash operating working capital (note 19)	(4,110)	(5,138)
	12,320	9,505
Investing activities		
Additions to property, plant and equipment	(4,604)	(6,511)
Equity investment (note 8)	-	(408)
Additions to intangible assets	(3,766)	(888)
	(8,370)	(7,807)
Financing activities		
Proceeds from long-term debt	1,787	1,623
Change in other non-current liabilities	(6)	(7)
Additions to deferred financing charges	(180)	(201)
Dividends paid	(2,825)	(2,825)
	(1,224)	(1,410)
Foreign exchange gain (loss) on cash held in foreign currency	66	(365)
Change in cash position	2,792	(77)
Cash position, beginning of year	4,982	5,059
Cash position, end of year	\$ 7,774	\$ 4,982

See accompanying notes to consolidated financial statements, note 3 for restatement.

Pollard Banknote Limited
Notes to Consolidated Financial Statements
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

1. Reporting entity:

Pollard Banknote Limited ("Pollard") was incorporated under the laws of Canada on March 26, 2010.

The consolidated financial statements of Pollard as at and for the year ended December 31, 2013, comprise Pollard and its subsidiaries. Pollard is primarily involved in the manufacture, development and sale of lottery and gaming products.

The overall impact of seasonality does not have a significant impact on the operations of Pollard.

2. Basis of preparation:

(a) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

On March 5, 2014, Pollard's Board of Directors approved these consolidated financial statements.

(b) Basis of preparation:

These consolidated financial statements have been prepared on a historical cost basis, except for the following material items in the statement of financial position:

- Derivative financial instruments are measured at fair value;
- The pension liability is recognized as the net total of the fair value of plan assets less the present value of the defined benefit obligation.

These statements are presented in Canadian dollars, Pollard's functional currency, and all values are rounded to the nearest thousand (except share and per share amounts) unless otherwise indicated.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

2. Basis of preparation (continued):

(c) Use of estimates and judgments:

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Information about judgments, assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next period are as follows:

Impairment of goodwill:

Pollard determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the "value in use" or "fair value less costs to sell" of the cash-generating units ("CGUs") to which goodwill is allocated. Estimating a value in use requires Pollard to make an estimate of the expected future cash flows from the CGUs and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Further details are provided in Note 9.

Employee future benefits:

Accounting for defined benefit plans requires Pollard to use actuarial assumptions. These assumptions include the discount rate and the rate of compensation increases. These assumptions depend on underlying factors such as economic conditions, government regulations, investment performance, employee demographics and mortality rates. See Note 13 for further information.

Income taxes:

Pollard is required to evaluate the recoverability of deferred income tax assets. This requires an estimate of Pollard's ability to utilize the underlying future income tax deductions against future taxable income before they expire. In order to evaluate the recoverability of these deferred income tax assets, Pollard must estimate future taxable income. Further details are provided in Note 11.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

3. Changes in accounting policies:

Except for the changes below, Pollard has consistently applied the accounting policies set out in Note 4 to all periods presented in these consolidated financial statements. Except as noted, the following new standards and amendments did not have a material impact on the consolidated financial statements.

Restatement:

In June 2011, the International Accounting Standards Board ("IASB") published an amended version of International Accounting Standard ("IAS") 19 *Employee Benefits*. The amendments require actuarial gains and losses, renamed remeasurements, to be recognized immediately in other comprehensive income and past service cost must be recognized immediately in profit or loss. This amendment also requires that the expected return on plan assets recognized in profit or loss be calculated based on the rate used to discount the defined benefit obligation. IAS 19 is required for fiscal years beginning on or after January 1, 2013, with retrospective application.

As a result the reported results for the year ended December 31, 2012, have been restated and cost of sales increased \$190 and deferred income taxes decreased by \$50. This was offset by corresponding defined pension plan remeasurement gain of \$140, net of \$50 of related income taxes, both of which were recorded within other comprehensive income. The additional disclosures required with the amendment have been provided in Note 13.

The retroactive restatement has had no impact on Pollard's Consolidated Statement of Financial Position as at December 31, 2011, and therefore has not been presented.

Other changes in accounting policies:

In May 2011, the IASB issued the following group of new standards and amendments to existing standards relating to consolidations and joint ventures. Each of these new standards is effective for fiscal years beginning on or after January 1, 2013.

- IFRS 10 *Consolidated Financial Statements* replaces the guidance on control and consolidation in IAS 27 *Consolidated and Separate Financial Statements* and Standing Interpretations Committee ("SIC") 12 *Consolidation – Special Purpose Entities*. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

3. Changes accounting policies (continued):

- IFRS 11 *Joint Arrangements* replaces IAS 31 *Interests in Joint Ventures*. IFRS 11 reduces the types of joint arrangements to two: joint ventures and joint operations. IFRS 11 requires the use of equity accounting for interests in joint ventures, eliminating the existing policy choice of proportionate consolidation for jointly controlled entities under IAS 31. Entities that participate in joint operations will recognize their share of the assets, liabilities, revenue and expenses of the joint operation.
- IFRS 12 *Disclosure of Interests in Other Entities* replaces the disclosure requirements currently found in IAS 28 *Investments in Associates*.
- IAS 27 has been amended and renamed *Separate Financial Statements* and deals solely with separate financial statements and the guidance for which remains unchanged.
- IAS 28 has been amended to include joint ventures in its scope and to address changes in IFRS 10 through 12 as explained above.

In May 2011, the IASB published IFRS 13 *Fair Value Measurements* which replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance, with enhanced disclosure requirements for information about fair value measurements. IFRS 13 is required for fiscal years beginning on or after January 1, 2013. Prospective application is required.

In June 2011, the IASB published amendments to IAS 1 *Financial Statement Presentation*. The amendments require items presented in other comprehensive income to be separated into two groups, based on whether or not they may be recycled to the statement of income later. The amendments are effective for fiscal years beginning on or after July 1, 2012.

In December 2011, the IASB published amendments to IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Offsetting Financial Assets and Liabilities*. These amendments are to be applied retrospectively. The amendments to IAS 32 provide clarification on the application of rules to offset financial assets and liabilities. These amendments are effective for fiscal years beginning on or after January 1, 2014. The amendments to IFRS 7 contain new disclosure requirements for financial assets and liabilities that are offset. These amendments are effective for fiscal years beginning on or after January 1, 2013.

4. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

(a) Principles of consolidation:

These consolidated financial statements include the accounts of Pollard and all its subsidiaries. Subsidiaries are entities which are under Pollard's control, where control is defined as the power to govern financial and operating policies of an entity so as to obtain benefits from its activities. Pollard holds 100% of the voting rights in, and therefore controls, its subsidiaries.

All inter-company balances and transactions, and any unrealized income and expenses arising from inter-company transactions, have been eliminated.

(b) Revenue recognition:

Revenue is recognized when persuasive evidence of an arrangement exists, significant risks and benefits of ownership are transferred, the sales price to the customer is fixed or is determined and collection of the resulting receivable is reasonably assured. The significant risks of ownership and benefits of ownership are normally transferred in accordance with the shipping terms agreed to with the customer. Volume rebates are accrued and recorded as a reduction to sales based on historical experience and management's expectations regarding sales volume. Revenues relating to license and royalty sales and lottery management services are recognized pursuant to the terms of the applicable contracts.

(c) Leases:

One of Pollard's subsidiaries has leasing operations which consist principally of the leasing of Pull-Tab Vending Machines ("PTVM") with various private establishments. These leases are classified as finance leases. The PTVM leases have terms of three years. The net investment in these leases consists of the present value of the future minimum lease payments. Interest income is recognized in other income based on a pattern reflecting a constant periodic return on the net investment in the finance lease.

(d) Inventories:

Raw materials, work-in-process and finished goods are valued at the lower of cost and net realizable value. The cost of raw material inventory is based on its weighted average cost and includes all costs incurred to acquire the materials. In addition to the direct costs of conversion, the cost of work-in-process and finished goods, which Pollard manufactures, also includes an appropriate share of production overheads based on normal operating capacity.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

(e) Goodwill:

Goodwill is comprised of the excess sale price over the underlying carrying amount of the net assets sold as at August 5, 2005, as part of the 26.7% of Pollard Holdings Limited Partnership ("Pollard LP") sold in conjunction with the Initial Public Offering ("IPO") and the excess purchase price over the underlying carrying amount of the net assets acquired of Pollard's U.S. subsidiaries. Goodwill is not amortized but is subject to an annual impairment review to ensure its recoverable value remains greater than, or equal to, book value.

(f) Intangible assets:

Deferred development:

Development expenditures are recognized as an intangible asset only if Pollard can demonstrate that the development costs can be measured reliably, the product is technically and commercially feasible, future economic benefits are probable and Pollard has sufficient resources to complete development and to use or sell the asset. The expenditures capitalized include the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use and borrowing costs incurred in respect of qualifying assets. Other development expenditures are expensed as incurred.

Capitalized development expenditures are measured at cost less accumulated amortization and accumulated impairment losses.

Computer software and licenses:

Computer software consists of the cost of acquiring and implementing these systems. Cost of implementation include third party costs as well as direct labour and related overhead costs attributable to the asset. Minimum license fees incurred in connection with our licensing agreements for our use of third-party brands are capitalized and amortized over the estimated life of the asset.

Capitalized computer software costs and licenses are measured at cost less accumulated amortization and accumulated impairment losses.

Other intangible assets:

Intangible assets that are acquired by Pollard and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

Intangible assets are amortized, on a straight-line basis, over their useful lives as follows:

Asset	Rate
Customer assets	16 years
Patents	20 years
Computer software and licenses	5 to 7 years or term of license
Deferred development	2 to 7 years

Amortization methods, useful lives and residual value are reviewed each annual reporting date and adjusted prospectively if appropriate.

(g) Property, plant and equipment:

Property, plant and equipment ("PP&E") are stated at cost less investment tax credits, accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour and related fringes, other costs directly attributable to bringing the assets to working condition for their intended use and borrowing costs incurred in respect to qualifying assets. Major spare parts are treated as PP&E when they have a useful life greater than a year. Once major spare parts are put in service, they are transferred into equipment and amortized accordingly.

An item of PP&E is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. The gain or loss on disposal of an item of PP&E is determined by comparing the proceeds from disposal with the carrying value of the PP&E and is recognized in the statement of income on a net basis.

The cost of each component of an item of PP&E is depreciated over its estimated useful life on a straight-line basis. Land is not depreciated. The estimated useful lives for the current and comparative periods are as follows:

Asset	Rate
Buildings	10 to 30 years
Leasehold improvements	Term of lease
Equipment	2 to 11 years
Furniture, fixtures and computers	3 to 9 years

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

Depreciation methods, useful lives and residual values are reviewed each annual reporting date and adjusted prospectively if appropriate.

The carrying value of property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

(h) Investment in associate:

Pollard accounts for its investment in associate using the equity method of accounting as it has significant influence, but not control. Significant influence is presumed to exist when Pollard holds between 20 and 50 percent of the voting power of another entity. The consolidated financial statements include Pollard's share of the income and expenses and equity movements of the entity accounted for under the equity method of accounting, which are recorded on a three month delayed basis.

(i) Financial instruments:

Non-derivative financial assets

Pollard initially recognizes loans and receivables on the date that they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which Pollard becomes a party to the contractual provisions of the instrument. Pollard derecognizes a financial asset when the contractual rights to the cash flows from the asset expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, Pollard has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. Pollard classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity financial assets, loans and receivables and available-for-sale financial assets.

i) Financial assets at fair value through profit or loss

A financial asset is classified as financial assets at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Attributable transaction costs are recognized in net income as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in net income. Pollard has no non-derivative financial assets classified as financial assets at fair value through profit or loss.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

ii) Held-to-maturity financial assets

If Pollard has the positive intent and ability to hold debt securities to maturity, then such financial assets are classified as held-to-maturity. Held-to-maturity financial assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses. Pollard has no financial assets classified as held-to-maturity.

iii) Loans and receivables

Loans and receivables are financial assets with fixed or determined payments that are not quoted in the active market. Such assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses, and the net gain or loss is included in finance income. Pollard has classified cash and accounts receivable as loans and receivables.

iv) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the previous categories. Subsequent to initial recognition, available-for-sale financial assets are measured at fair value and changes therein, other than impairment losses and foreign exchange differences, are recognized in other comprehensive income and are presented in the fair value reserve in equity. When an investment is derecognized, the gain or loss accumulated in equity is reclassified to net income. Pollard has no financial assets classified as available-for-sale.

Non-derivative financial liabilities

All non-derivative financial liabilities are classified as other financial liabilities and are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method and the net gain or loss is included in finance costs.

Pollard classifies accounts payable and accrued liabilities, dividends payable, long-term debt and other non-current liabilities as other financial liabilities.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

Share Capital

Common stock is classified as equity. Incremental costs directly attributable to the issue of common stock are recognized as a deduction from equity, net of any tax effects.

Derivatives and hedge accounting

Pollard may use certain derivative financial instruments to manage risks of fluctuation in interest rates and foreign exchange rates. On initial designation of the derivative as the hedging instrument, Pollard formally documents the relationship between the hedging instrument and the hedging item, including the risk management objectives and strategy in undertaking the hedge transaction and the hedged risk, together with the methods that will be used to assess the effectiveness of the hedging relationship. Pollard makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, of whether the hedging instruments are expected to be "highly effective" in offsetting the change in the fair value or cash flows of the respective hedged items attributable to the hedged risk, and whether the actual results of each hedge are within a range of 80 – 125 percent.

Derivatives are recognized initially at fair value and attributable transaction costs are recognized in net income as incurred. Subsequent to initial recognition, derivatives are measured at fair value and changes are accounted for as follows:

i) Cash flow hedges

When a derivative financial instrument is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognized asset or liability, the effective portion of changes in the fair value of the derivative is recognized in other comprehensive income and presented in the hedging reserve in equity. Any ineffective portion of changes in fair value of the derivative is recognized immediately in net income. If the hedging instrument no longer meets the criteria for hedge accounting, then hedge accounting is discontinued prospectively. This results in the amortization of the respective derivative's cumulative changes in fair value in the hedging reserve, over the remaining term of the derivative. Any adjustments to fair value after discontinuing hedge accounting are recognized immediately in net income as finance income or loss.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

ii) Other non-trading derivatives

When a derivative financial instrument is not designated in a hedge relationship that qualifies for hedge accounting, all changes in its fair value are recognized immediately in net income as finance income or loss.

(j) Translation of foreign currencies:

The functional currency for each of Pollard's subsidiaries is the currency of the primary economic environment in which the entity operates. Transactions in foreign currencies are translated to the respective functional currencies of each entity within the consolidated group using the exchange rates in effect at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rates prevailing at the end of the reporting period. Non-monetary items measured at historical cost in a foreign currency are translated to the functional currency using the exchange rate prevalent at the date of acquisition. Non-monetary items denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate prevalent at the date that the fair value was determined. Foreign currency differences arising from translation are recognized in net income, except for exchange differences arising on the translation of financial instruments qualifying as a cash flow hedge, which are recognized directly in other comprehensive income ("OCI").

The results and financial position of entities within the consolidated group that have a functional currency different from the presentation currency are translated into Canadian dollars as follows: assets and liabilities are translated at the exchange rate prevailing at the end of the reporting period; income and expenses are translated at the average rate for the reporting period; all resulting exchange differences are recognized in other comprehensive income. On disposal of a foreign operation, the deferred cumulative amount recognized in OCI relating to that particular foreign operation is recognized in net income.

(k) Employee future benefits:

Defined contribution plans

Pollard's U.S. subsidiaries maintain two defined contribution plans in the United States. The obligation to contribute to these plans is recognized as an employee benefit expense as incurred.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

Defined benefit plans

Pollard maintains four non-contributory defined benefit pension plans in Canada and the United States, three being final pay plans and one being a flat benefit plan. None of the plans have indexation features.

The costs of Pollard's defined benefit plans are recognized over the period in which employees render service to Pollard in return for the benefits. The defined benefit obligations associated with the plans are actuarially determined using the projected unit credit method pro-rated on service and management's best estimate of salary escalation and retirement ages of employees. The present value of the defined benefit obligations are determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that have maturity terms approximating the maturity terms of the related obligation and that are denominated in the currency in which the benefits will be paid. The expected return on pension plan assets is calculated utilizing the discount rate used to measure the defined benefit obligation at the beginning of the annual period.

Past service costs are recognized as an expense on a straight line basis over the average period until the benefits becomes vested. If the benefits have vested, past service costs are recognized in net income immediately.

Remeasurements that arise in calculating the present value of the defined benefit obligation and the fair value of plan assets are recognized immediately in other comprehensive income.

Pollard's pension asset is limited to the total of any unrecognized past services costs and the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to Pollard's plans. An economic benefit is available to Pollard if it is realizable during the life of the plan, or on settlement of the plan liabilities.

(l) Income taxes:

Current income tax and deferred income tax are recognized in the statement of income except to the extent that the tax relates to items recognized directly in equity or in other comprehensive income. Current income tax is the expected tax payable or receivable on the taxable income or loss for the period and any adjustment to tax payable in respect to previous years. Current income tax expense includes withholding taxes.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

Deferred income tax is recorded to reflect the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities and their tax basis. Deferred income tax assets and liabilities are determined based on the enacted or substantively enacted tax rates, which are expected to be in effect when the underlying items of income and expense are expected to be realized.

Deferred income tax is not recognized for: temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future, taxable temporary differences arising on the initial recognition of goodwill or temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss.

Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment, except if it relates to an item previously recognized in equity, in which case the adjustment is made to equity.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax liabilities and assets, and they are levied by the same taxation authority on the same taxable entity, or on different tax entities which intend to settle their current income tax assets and liabilities on a net basis.

(m) Provisions:

Provisions are recognized when Pollard has a present legal or constructive obligation as a result of a past event that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

(n) Impairment:

Financial assets

Financial assets classified as loans and receivables, held-to-maturity and available-for-sale are assessed at each reporting period date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. Evidence of impairment may include default or delinquency by a debtor, indications that a debtor will enter bankruptcy or economic conditions that correlate with defaults. Pollard has neither available-for-sale or held-to-maturity instruments.

For loans and receivables, Pollard first assesses whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If Pollard determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assess them for impairment. Individually assessed assets with an impairment loss are not included in the collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial assets original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the statement of income. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment is increased or reduced by adjusting the allowance account, through the statement of income.

Non-financial assets

The carrying amount of Pollard's non-financial assets, other than inventories and deferred income tax assets, are reviewed at each reporting date to determine whether there is an indication that an asset may be impaired. If any such indication exists, or when the annual impairment testing for an asset is required, Pollard estimates the asset's recoverable amount. For goodwill the recoverable amount is estimated as of December 31 each year. An impairment loss is recognized if the carrying amount of an asset or its related CGU exceeds its estimated recoverable amount.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

4. Significant accounting policies (continued):

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of cash inflows of other assets or CGUs.

Impairment losses are recognized in net income. Impairment losses recognized in respect to CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other asset in the CGU on a pro rata basis. An impairment loss in respect to goodwill is not reversed. In respect to other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss can only be reversed to the extent that the asset's carrying value that would have been determined, net of amortization, if no impairment had been recognized.

(o) Finance costs and finance income:

Finance costs comprise interest expense on borrowings, amortization of deferred financing costs, mark-to-market losses on foreign exchange contracts and net foreign exchange losses.

Borrowing costs that are not directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are expensed in the period incurred using the effective interest method.

Finance income comprises mark-to-market gains on foreign exchange contracts and net foreign exchange gains.

5. Future accounting standards:

In November 2009, the IASB issued IFRS 9 *Financial Instruments* ("IFRS 9 (2009)") and in October 2010, the IASB published amendments to IFRS 9 ("IFRS 9 (2010)"). In December 2011, the IASB issued an amendment to IFRS 9 to defer the mandatory effective date to annual periods beginning on or after January 1, 2015. IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classifications options in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities. In November 2013, a new general hedge accounting standard was issued, forming part of IFRS 9. It will more closely align with risk management. This new standard does not fundamentally change the types of

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

5. Future accounting standards (continued):

hedging relationships or the requirements to measure and recognize ineffectiveness, however it will allow more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. The effective date for IFRS 9 has not yet been determined. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In December 2011, the IASB issued an amendment to the application guidance in IAS 32 *Financial Instruments: Presentation* to clarify some of the requirements for offsetting financial assets and financial liabilities on the statement of financial position. The amendments do not change the current offsetting model in IAS 32 but instead clarify that the right of offset must not be contingent on a future event. It also must be legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amendments also clarify that for settlement mechanisms with features that both eliminate credit and liquidity risk and process receivables and payables in a single settlement process, are effectively equivalent to net settlement. The clarifications to the application guidance in IAS 32 are to be retrospectively applied, with an effective date for annual periods beginning on or after January 1, 2014. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

6. Inventories:

	December 31, 2013	December 31, 2012
Raw materials	\$ 7,345	\$ 5,713
Work-in-process	883	843
Finished goods	13,053	15,170
	<u>\$ 21,281</u>	<u>\$ 21,726</u>

During 2013 Pollard recorded inventory write-downs of \$425 representing an increase in the obsolescence reserves and reversals of previous write-downs of \$73 due to changes in foreign exchange rates.

During 2012 Pollard recorded reversals of previous inventory write-downs of \$24 representing a decrease in the obsolescence reserves and write-downs of \$27 due to changes in foreign exchange rates.

The cost of sales reflects the costs of inventory including direct material, direct labour and manufacturing overheads.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

7. Property, plant and equipment:

Cost	Land	Buildings	Leasehold improvements	Equipment	Spare parts	Furniture, fixture and computers	Total
Balance at January 1, 2012	\$ 803	9,091	1,722	110,868	-	3,948	126,432
Additions/reclassifications	-	88	145	5,280	980	18	6,511
Disposals	-	-	(31)	(152)	-	(57)	(240)
Effect of movements in exchange rates	-	-	(22)	(134)	-	-	(156)
Balance at December 31, 2012	\$ 803	9,179	1,814	115,862	980	3,909	132,547
Additions/reclassifications	-	79	102	4,373	3	47	4,604
Effect of movements in exchange rates	-	-	46	280	-	-	326
Balance at December 31, 2013	\$ 803	9,258	1,962	120,515	983	3,956	137,477

Accumulated depreciation	Land	Buildings	Leasehold improvements	Equipment	Spare parts	Furniture, fixture and computers	Total
Balance at January 1, 2012	\$ -	3,283	878	90,112	-	2,940	97,213
Depreciation for the year	-	320	135	4,956	-	191	5,602
Disposals/reclassifications	-	-	(31)	(152)	-	(57)	(240)
Effect of movements in exchange rates	-	-	(24)	(117)	-	-	(141)
Balance at December 31, 2012	\$ -	3,603	958	94,799	-	3,074	102,434
Depreciation for the year	-	312	143	5,182	-	188	5,825
Effect of movements in exchange rates	-	-	46	254	-	-	300
Balance at December 31, 2013	\$ -	3,915	1,147	100,235	-	3,262	108,559

Carrying amounts	Land	Buildings	Leasehold improvements	Equipment	Spare parts	Furniture, fixture and computers	Total
At December 31, 2012	\$ 803	5,576	856	21,063	980	835	30,113
At December 31, 2013	\$ 803	5,343	815	20,280	983	694	28,918

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

8. Equity investment:

	December 31, 2013		December 31, 2012	
Balance – beginning of year	\$	204	\$	-
Initial investment		-		408
Equity loss		(37)		(204)
Balance – end of year	\$	167	\$	204

Pollard has entered into an agreement with Palm Commerce Information and Technology (China) Co., Ltd. for the establishment of Shenzhen Palm Commerce & Pollard Banknote Technology Co., Ltd.. As per the agreement, Pollard completed its capital investment of US\$400, representing 40% of the registered capital of the corporation, in January 2012. The entity was established to provide distribution and validation systems to provincial lottery operations in China.

9. Goodwill:

Goodwill is comprised of \$30,620 (2012- \$30,620), representing the excess purchase price over the underlying carrying amount of the net assets sold, as at August 5, 2005, as a result of the 26.7% of Pollard LP sold as part of Pollard Banknote Income Fund's IPO with the remaining \$5,491 (2012- \$5,083) from Pollard's purchase of its U.S. subsidiaries. Goodwill has been allocated to CGUs for impairment testing in this manner, as described in the table below.

	December 31, 2013		December 31, 2012	
Lottery	\$	30,620	\$	30,620
Charitable games		5,491		5,083
	\$	36,111	\$	35,703

During 2013 the value of goodwill increased \$408 (2012 – decreased \$199) as a result of changes in foreign exchange rates.

For both the Lottery and Charitable games CGUs the recoverable amounts have been determined based on a value in use calculation using cash flow projections from financial forecasts approved by senior management. These forecasts cover a period of five years and reflect an estimate of a terminal value. Included in these forecasts is an assumption of a 3% growth rate which was based on historical trend and expected future performance.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

9. Goodwill (continued):

The calculation of value in use for the CGUs described above are most sensitive to the following key assumptions on which management has based its cash flow projections to undertake impairment testing of goodwill:

- Revenue and related gross profit
- Foreign exchange rates
- Discount rates
- Growth rates

Revenue and related gross profit

Projected cash flows from revenue assumes the continuation of recent historical trends adjusted for expected new contract wins, anticipated contract renewal pricing pressures and the expected impact of sales initiatives in conjunction with certain production efficiencies that are being developed or are expected to be developed.

Foreign exchange rates

A significant portion of revenue is denominated in U.S. dollars and Euros, partially offset by a U.S. dollar denominated costs. In addition, certain financial assets and liabilities are denominated in U.S. currency. Projected cash flows assume an estimated exchange rate between Canadian dollars to U.S. dollars and Euros based on expected exchange rates during the forecast period.

Discount rates

Discount rates were calculated based on the estimated cost of equity capital and debt capital considering data and factors relevant to the economy, the industry and the CGUs. These costs were then weighted in terms of a typical industry capital structure to arrive at an estimated weighted average cost of capital. The after-tax discount rates applied to the cash flow projections for the CGUs described above were as follows:

Lottery	10.0%
Charitable games	11.0%

Growth rates

Growth rates are based on estimated sustainable long-term growth rates of the CGUs.

Management believes that any reasonable possible change in any of the key assumptions on which the cash generating unit's recoverable amounts are based would not cause the unit's carrying amounts to exceed its recoverable amount.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

10. Intangible assets:

Cost		Customer assets	Patents	Deferred development	Computer software and licenses	Total
Balance at January 1, 2012	\$	18,645	4,818	731	229	24,423
Additions		-	137	178	128	443
Additions – internally developed		-	-	250	195	445
Balance at December 31, 2012	\$	18,645	4,955	1,159	552	25,311
Additions		-	58	140	3,388	3,586
Additions – internally developed		-	-	99	81	180
Balance at December 31, 2013	\$	18,645	5,013	1,398	4,021	29,077

Accumulated amortization		Customer assets	Patents	Deferred development	Computer software and licenses	Total
Balance at January 1, 2012	\$	7,471	4,259	170	229	12,129
Amortization for the year		1,165	45	132	-	1,342
Balance at December 31, 2012	\$	8,636	4,304	302	229	13,471
Amortization for the year		1,165	57	316	536	2,074
Balance at December 31, 2013	\$	9,801	4,361	618	765	15,545

Carrying amounts		Customer assets	Patents	Deferred development	Computer software and licenses	Total
At December 31, 2012	\$	10,009	651	857	323	11,840
At December 31, 2013	\$	8,844	652	780	3,256	13,532

Customer assets, \$3,874 of patents and \$229 of computer software were recognized as a result of the excess purchase price over the underlying carrying amount of the intangible assets acquired as at August 5, 2005, as part of the 26.7% of Pollard LP sold in conjunction with the IPO. As at December 31, 2011, computer software and licenses, and patents recognized at IPO were fully amortized. Customer assets will continue to be amortized until fiscal 2021.

Amortization of intangible assets in 2013 of \$2,074 (2012 – \$1,342), was included in cost of sales.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

11. Income taxes:

Income tax expense

	2013	2012 (Restated)
Current income tax expense	\$ 2,193	\$ 1,078
Deferred income tax expense	1,722	1,211
Total income tax expense	\$ 3,915	\$ 2,289

See note 3 for restatement.

Income tax recognized in other comprehensive income (loss)

	Amount before tax	Tax expense	2013 Amount net of tax	Amount before tax	Tax benefit	2012 Amount net of tax (Restated)
Defined benefit plans remeasurement loss	\$ 5,479	(1,517)	3,962	\$ (6,586)	1,745	(4,841)
	\$ 5,479	(1,517)	3,962	\$ (6,766)	1,745	(4,841)

Reconciliation of effective tax rate

	2013	2013	2012	2012 (Restated)
Net income for the year		\$ 5,448		\$ 6,515
Total income tax expense		3,915		2,289
Income before income taxes		\$ 9,363		\$ 8,804
Income tax using Pollard's domestic tax rate	26.3%	2,463	26.3%	2,315
Withholding taxes and other items	1.8%	168	(0.1%)	(12)
Effect of non-taxable items related to foreign exchange	13.7%	1,284	(0.2%)	(14)
	41.8%	\$ 3,915	26.0%	\$ 2,289

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

11. Income taxes (continued):

Deferred income tax assets and liabilities

Recognized deferred income tax assets and liabilities

Deferred income tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2013	2012	2013	2012	2013	2012
Property, plant and equipment	\$ 89	78	\$ (1,038)	(1,035)	\$ (949)	(957)
Intangible assets	974	1,134	(4,184)	(4,219)	(3,210)	(3,085)
Inventories	209	134	-	-	209	134
Employee benefits	2,891	4,184	(1,913)	(1,352)	978	2,832
Unrealized foreign exchange (gains) and losses	1,332	1,864	(424)	(700)	908	1,164
Unused tax losses	301	1,266	-	-	301	1,266
Other	190	189	-	-	190	189
Tax assets (liabilities)	\$ 5,986	8,849	\$ (7,559)	(7,306)	\$ (1,573)	1,543

Movement in temporary differences during the year

	Balance January 1, 2012	Recognized in profit or loss	Recognized in other comprehensive income (Restated)	Balance December 31, 2012	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2013
Property, plant and equipment	\$ (1,505)	548	-	(957)	8	-	(949)
Intangible assets	(2,977)	(108)	-	(3,085)	(125)	-	(3,210)
Inventories	157	(23)	-	134	75	-	209
Employee benefits	1,470	(383)	1,745	2,832	(337)	(1,517)	978
Unrealized foreign exchange (gains) and losses	915	249	-	1,164	(256)	-	908
Unused tax losses	2,914	(1,648)	-	1,266	(965)	-	301
Other	66	123	-	189	1	-	190
Tax assets (liabilities)	\$ 1,040	(1,242)	1,745	1,543	(1,599)	(1,517)	(1,573)

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

11. Income taxes (continued):

Recognized in the consolidated statements of financial position as follows:

	December 31, 2013	December 31, 2012
Deferred income tax - asset	\$ 801	\$ 4,324
Deferred income tax - liability	(2,374)	(2,781)
	\$ (1,573)	\$ 1,543

Recognized in the consolidated statements of income as follows:

	2013	2012 (Restated)
Deferred income tax expense	\$ (1,722)	\$ (1,211)
Finance income	123	(31)
	\$ (1,599)	\$ (1,242)

Amounts included in finance income relate to unrealized foreign exchange.

12. Long-term debt:

	December 31, 2013	December 31, 2012
Credit facility, interest of 2.9% to 5.0%, payable monthly, maturing 2015	\$ 73,523	\$ 70,815
Deferred financing charges, net of amortization	(178)	(330)
	\$ 73,345	\$ 70,485

Included in the total credit facility balance is a U.S. dollar loan balance of US\$13,600 (2012 – US\$13,597).

Effective June 28, 2013, Pollard's subsidiaries Pollard Holdings Limited Partnership and Pollard Holdings, Inc. renewed their credit facility. The credit facility provides loans of up to \$73,961 for its Canadian operations and up to US\$10,000 for its U.S. subsidiaries. Borrowings under the credit facility bear interest at fixed and floating rates based on Canadian and U.S. prime bank rates,

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

12. Long-term debt (continued):

banker's acceptances or LIBOR. At December 31, 2013, the outstanding letters of guarantee drawn under the credit facility were \$1,632 (2012 - \$3,248).

Under the terms and conditions of the credit facility agreement Pollard is required to maintain certain financial covenants including working capital ratios, debt to income before interest, income taxes, amortization and depreciation ("Adjusted EBITDA") ratios and certain debt service coverage ratios. As at December 31, 2013, Pollard is in compliance with all financial covenants.

Under the terms of the credit facility the amount of the facility will be reduced on a quarterly basis by an amount calculated as 50% of the prior quarter's Excess Cash Flow. Excess Cash Flow is defined as Adjusted EBITDA less scheduled principal indebtedness payments (if any), maintenance capital expenditures (to a maximum of \$3,500 per year), pension deficit installments (to a maximum of \$2,000 for fiscal 2013 and \$2,700 for fiscal 2014), interest and cash income taxes paid. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. For the quarter ending December 31, 2013, the credit facility will be reduced by approximately \$2,136 as of May 15, 2014. As of December 31, 2013, Pollard has unused credit facility available of \$9,425 (2012 - \$10,928).

Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard's operating subsidiaries. The credit facility can be prepaid without penalties. Under the terms of the agreement effective June 28, 2013, the credit facility is committed for a one year period, renewable June 30, 2014 ("Facility Expiry Date"). If the credit facility is not renewed, the loans are repayable one year after the Facility Expiry Date. As such, the credit facility has effectively a two year term expiring June 30, 2015.

13. Pension liability:

	December 31, 2013	December 31, 2012
Fair value of benefit plan assets	\$ 32,528	\$ 24,195
Present value of benefit plan obligations	(35,352)	(34,097)
Net pension liability	\$ (2,824)	\$ (9,902)

Pollard sponsors non-contributory defined benefit plans providing pension benefits to its employees. Pollard has four pension plans of which three are final pay plans and one is a flat benefit plan. None of the plans have indexation features. The measurement date for all the plans is December 31. The two plans of the U.S. subsidiaries require valuations annually with the last valuations being as of January 1, 2013. One of the Canadian plans of Pollard currently requires valuation every year with the last valuation as of December 31, 2012. Pollard's other Canadian plan's last valuation was as of

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

13. Pension liability (continued):

January 1, 2013. Pollard's U.S. subsidiaries also maintain two defined contribution plans. The pension expense for these defined contribution plans is the annual funding contribution by the subsidiaries.

Pollard expects to contribute approximately \$2.5 million to its defined benefit plans in 2014.

The benefit plan assets are held in trust and are invested as follows:

	December 31, 2013	December 31, 2012
Equities	64.0%	59.4%
Bonds	35.5%	35.2%
Cash and cash equivalents	0.5%	5.4%
	100.0%	100.0%

Information about Pollard's defined benefit plans, in aggregate, is as follows:

	2013	2012
<i>Benefit plan assets</i>		
Fair value, beginning of year	\$ 24,195	\$ 20,214
Expected return on plan assets	1,175	1,325
Employer contributions	4,742	3,237
Benefits paid	(649)	(1,039)
Remeasurement gains	2,835	558
Other	230	(100)
Fair value, end of year	\$ 32,528	\$ 24,195
<i>Accrued benefit plan obligations</i>		
Balance, beginning of year	\$ 34,097	\$ 24,956
Current service cost	2,665	1,653
Interest cost	1,539	1,340
Benefits paid	(649)	(1,039)
Remeasurement (gains) losses	(2,643)	7,334
Other	343	(147)
Balance, end of year	\$ 35,352	\$ 34,097
Net pension liability	\$ (2,824)	\$ (9,902)

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

13. Pension liability (continued):

The total net cost for Pollard's defined benefit and defined contribution pension plans recognized in cost of sales is as follows:

	2013	2012 (Restated)
<i>Net defined benefit plans cost</i>		
Current service cost	\$ 2,665	\$ 1,653
Interest on plan obligations	1,539	1,340
Actual return on plan assets	(4,010)	(1,883)
Difference between expected return and actual return on plan assets	3,150	834
Net defined benefit plans cost	3,344	1,944
Defined contribution plans cost	179	169
Net pension plans cost	\$ 3,523	\$ 2,113

See note 3 for restatement.

Actuarial assumptions

The principal actuarial assumptions used in measuring at the reporting date are as follows:

	2013	2012
Discount rate	5.0% to 5.2%	4.1% to 4.5%
Rate of compensation increase	0% to 3.0%	0% to 3.0%

Assumptions regarding future mortality have been based on published statistics and mortality tables. As of December 31, 2013, Pollard used 90% of the UP94 Generational mortality table for its Canadian subsidiary's pension plans and the 2013 PPA static tables for its U.S. subsidiary's pension plans.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

13. Pension liability (continued):

Sensitivity analysis

Reasonably possible changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts show below:

	Increase		Decrease	
Discount rate (1% movement)	\$	(6,397)	\$	8,450
Rate of compensation increase (1% movement)	\$	1,042	\$	(941)
Future mortality (one year)	\$	697	\$	(704)

Remeasurements

	2013		2012 (Restated)	
Remeasurement gains arising on plan assets	\$	(2,835)	\$	(558)

Remeasurement (gains) losses arising on plan liabilities from:

Demographic assumptions	\$	778	\$	538
Financial assumptions		(4,209)		6,156
Experience adjustments		788		640
Remeasurement (gains) losses arising on plan liabilities	\$	(2,643)	\$	7,334

Remeasurements recognized in other comprehensive income

	2013		2012 (Restated)	
Amount accumulated in deficit, beginning of year	\$	(10,375)	\$	(5,534)
Recognized during the year		3,962		(4,841)
Amount accumulated in deficit, end of year	\$	(6,413)	\$	(10,375)

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

14. Share capital:

	December 31, 2013	December 31, 2012
Authorized		
Unlimited common shares		
Unlimited preferred shares		
Issued		
23,543,158 common shares	\$ 73,209	\$ 73,209
	\$ 73,209	\$ 73,209

Ownership restrictions:

The holders of the common shares are entitled to one vote in respect to each common share held, subject to the Board of Directors ability to take constraint actions when a person, or group of persons acting in concert acquires, agrees to acquire, holds, beneficially owns or controls, either directly or indirectly, a number of shares equal to or in excess of 5% of the common shares (on a non-diluted basis) issued and outstanding ("Ownership Threshold"). The Board of Directors, in its sole discretion, can take the following constraint actions:

- place a stop transfer on all or any of the common shares believed to be in excess of the Ownership Threshold;
- suspend all voting and/or dividend rights on all or any of common share held believed to be in excess of the Ownership Threshold;
- apply to a court seeking an injunction to prevent a person from acquiring, holding, owning, controlling and/or directing, directly or indirectly, common shares in excess of the Ownership Threshold; and/or
- make application to the relevant securities commission to effect a cease trading order or such similar restriction, until the person no longer controls common shares equal to or in excess of the Ownership Threshold.

In addition, if a Gaming Regulatory Authority has determined that ownership by a holder of common shares is inconsistent with its declared policies, the Board of Directors is entitled to take constraint action against such shareholder. Any person who controls common shares equal to or in excess of the Ownership Threshold, may be required to file an application, be investigated and have suitability as a shareholder determined by a Gaming Regulatory Authority, if such Gaming Regulatory Authority has reason to believe such ownership would otherwise be inconsistent with its declared policies. The shareholder must pay all the costs of the investigation incurred by any such Gaming Regulatory Authority.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

14. Share capital (continued):

Capital management:

Pollard's objectives in managing capital are to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Pollard also strives to maintain an optimal capital structure to reduce the overall cost of capital.

In the management of capital, Pollard includes long-term debt, share capital and deficit, but excludes reserves. The Board of Directors regularly monitors the levels of debt, equity and dividends.

Pollard monitors capital on the basis of funded debt to Adjusted EBITDA, working capital ratio and debt service coverage. Pollard has externally imposed capital requirements as determined through its bank credit facility. As at December 31, 2013, Pollard is in compliance with all financial covenants.

Dividends:

Dividends are paid on the common shares within 15 days of the end of each quarter and are fully discretionary, as determined by the Board of Directors of Pollard, subject to restrictions imposed under its credit facility. Under the credit facility, Pollard has agreed not to pay dividends in excess of the current quarterly amount of \$0.03 per share if the debt to Adjusted EBITDA ratio is above a certain level. As at December 31, 2013, Pollard's Adjusted EBITDA ratio is below the target level and as a result there are currently no restrictions on the amount of dividends.

On November 6, 2013, a dividend of \$0.03 per share was declared, payable on January 15, 2014, to the shareholders of record on December 31, 2013.

There were no other changes in Pollard's approach to capital management during the current period.

Share purchase compensation:

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.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

14. Share capital (continued):

On March 5, 2014, the Board of Directors approved their intention to award 100,000 options to purchase common shares of Pollard for a select group of key management personnel. The options will be granted on March 10, 2014, and will have a seven year term, vesting 25% per year over the first four years. The exercise price of the options will be equal to the closing price of the common shares on March 7, 2014. The fair market value of these options will be determined on the date of grant.

15. Commitments and contingencies:

Certain Pollard subsidiaries rent premises and equipment under long-term operating leases. The following is a schedule by fiscal year of rental payment commitments under operating leases outstanding:

2014	\$	3,428
2015		3,241
2016		3,018
2017		2,843
2018		2,728
Thereafter		5,470

Pollard's subsidiaries are contingently liable for outstanding letters of guarantee in the amount of \$1,632 at December 31, 2013 (2012 - \$3,248). These letters of guarantee are part of Pollard's credit facility and are secured as disclosed in Note 12.

During 2011 Pollard entered into a sale leaseback with an affiliate of Pollard Equities Limited ("Equities") for land and building in Winnipeg, Manitoba (Equities owns approximately 73.5% of Pollard's outstanding shares). The property was sold for \$3,473 and leased back for five years (with an option to renew for an additional five year term) at an annual lease rate of approximately \$313. The sale value was determined through independent appraisal. See Note 20 for further description.

During 2008 Pollard entered into a sale leaseback with an affiliate of Equities for land and building in Council Bluffs, Iowa. The property was sold for \$4,081 and leased back for ten years at an annual lease rate of approximately US\$260. The sale value was determined through independent appraisal. Also in 2008 Pollard entered into a lease with an affiliate of Equities for a manufacturing facility in Winnipeg, Manitoba. The lease was for a 12 year 6 month period, ending March 31, 2021, at an annual base rate of approximately \$2,424.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

15. Commitments and contingencies (continued):

Pollard is involved in litigation and claims associated with operations, the aggregate amounts of which are not determinable. While it is not possible to estimate the outcome of the proceedings, management is of the opinion that any resulting settlements would not materially affect the financial position of Pollard. Should a loss occur on resolution of these claims, such loss would be accounted for as a charge to income in the period in which the settlement occurs.

Pollard has agreed to indemnify Pollard's current and former directors and officers from and against liability and costs in respect of any action or suit against them in connection with the execution of their duties of office, subject to certain usual limitations. No claims with respect to such occurrences have been made and, as such, no amount has been recorded in these financial statements with respect to these indemnifications.

16. Other (income) expense:

	2013		2012	
Loss on equity investment (note 8)	\$	37	\$	204
Other income		(393)		(164)
	\$	(356)	\$	40

17. Finance costs and finance income:

Finance costs	2013		2012	
Foreign exchange loss	\$	604	\$	806
Interest		3,349		3,382
Mark-to-market loss on foreign currency contracts (note 24)		412		-
Amortization of deferred financing costs		332		563
	\$	4,697	\$	4,751

Finance income	2013		2012	
Foreign exchange gain	\$	(516)	\$	(648)
	\$	(516)	\$	(648)

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

18. Personnel expenses:

	2013		2012 (Restated)	
Wages and salaries	\$	58,131	\$	54,554
Benefits and government payroll remittances		8,834		8,514
Profit share		1,217		1,107
Expenses related to defined contribution plans		179		169
Expenses related to defined benefit plans		3,344		1,944
	\$	71,705	\$	66,288

See note 3 for restatement.

19. Supplementary cash flow information:

	2013		2012	
Change in non-cash operating working capital:				
Accounts receivable	\$	(5,946)	\$	(1,096)
Inventories		946		(4,589)
Prepaid expenses and deposits		(542)		(116)
Accounts payable and accrued liabilities		1,432		663
	\$	(4,110)	\$	(5,138)

20. Related party transactions:

During the year ended December 31, 2013, Pollard paid property rent of \$3,012 (2012 - \$3,002) and \$212 (2012 - \$245) in plane charter costs to affiliates of Equities. During the year, Equities paid Pollard \$72 (2012 - \$72) for accounting and administration fees.

Key management personnel are those having authority and responsibility for planning, directing and controlling the activities of the company. The Board of Directors and the Executive Committee are considered key management personnel.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

20. Related party transactions (continued):

Key management personnel compensation comprised:

	2013	2012 (Restated)
Wages, salaries and benefits	\$ 2,311	\$ 2,427
Profit share	10	9
Expenses related to defined benefit plans	355	239
	\$ 2,676	\$ 2,675

See note 3 for restatement.

At December 31, 2013, included in accounts payable and accrued liabilities is an amount owing to Equities and its affiliates for rent and other expenses of \$690 (2012 - \$1,449).

During the second quarter of fiscal 2011, Pollard disposed of a building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of \$3,473 resulting in a gain of \$1,469. The selling price was based on the current fair market value as determined through an independent appraisal. Pollard subsequently leased the property back for a five year term (with an option to renew for an additional five year term) for annual rent of \$313.

Significant subsidiaries:	Country of establishment	Percent Ownership Interest	
		December 31, 2013	December 31, 2012
Pollard Holdings Limited Partnership	Canada	100	100
Pollard Banknote Limited Partnership	Canada	100	100
Pollard Holdings, Inc.	U.S.	100	100
Pollard (U.S.) Ltd.	U.S.	100	100
Pollard Games, Inc.	U.S.	100	100

21. Sales to major customers:

For the year ended December 31, 2013, sales to one customer amounted to approximately 11 percent of consolidated sales (2012 - 10 percent).

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

22. Segmented information:

Pollard's operations consist of one reporting segment principally in the manufacturing, development and sale of lottery and charitable gaming products. Geographic distribution of sales, property, plant and equipment and goodwill are as follows:

	2013		2012	
Sales:				
Canada	\$	40,938	\$	33,431
U.S.		97,018		86,503
Other		46,981		42,493
	\$	184,937	\$	162,427
		December 31, 2013		December 31, 2012
Property, plant and equipment and goodwill:				
Canada	\$	49,841	\$	50,497
U.S.		15,188		15,319
	\$	65,029	\$	65,816

23. Financial instruments:

The fair value of a financial instrument is the estimated amount that Pollard would receive or pay to terminate the instrument agreement at the reporting date. The following methods and assumptions were used to estimate the fair value of each type of financial instrument by reference to various market value data and other valuation techniques as appropriate.

The fair values of accounts receivable, accounts payable and accrued liabilities and dividends payable approximate their carrying values given their short-term maturities.

The fair value of the long-term debt approximates the carrying value due to the variable interest rate of the debt.

The fair value of the other non-current liabilities approximates the carrying value based on the expected settlement amount of these liabilities.

The fair value of foreign currency forward contracts is estimated utilizing market forward rates of exchange.

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

23. Financial instruments (continued):

Certain financial instruments recorded at fair value on the statements of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on the quoted prices observed in active markets for identical assets or liabilities

Level 2 - valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market data by correlation or other means

Level 3 - valuation techniques with significant unobservable market inputs

A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

As at December 31, 2013, the cash recorded at fair value is classified as level one and the foreign currency forward contracts recorded at fair value are classified as level two of the fair value hierarchy.

24. Financial risk management:

Pollard has exposure to the following risks from its use of financial instruments:

Credit risk
Liquidity risk
Currency risk
Interest rate risk

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

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

24. Financial risk management (continued):

Credit risk

The following table outlines the details of the aging of Pollard's receivables and the related allowance for doubtful accounts:

	December 31, 2013	December 31, 2012
Current	\$ 17,274	\$ 13,003
Past due for 1 to 60 days	4,876	2,808
Past due for more than 60 days	641	499
Less: Allowance for doubtful accounts	(12)	(9)
	<u>\$ 22,779</u>	<u>\$ 16,301</u>

Liquidity risk

Liquidity risk is the risk that Pollard will not be able to meet its financial obligations as they fall due. Pollard's approach is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. In addition, Pollard maintains a committed credit facility including up to \$73,961 for its Canadian operations and up to US\$10,000 for its U.S. subsidiaries. At December 31, 2013, the unused balance available for drawdown was \$9,425 (2012 - \$10,928).

The 2014 requirements for capital expenditures, working capital and dividends are expected to be financed from cash flow provided by operating activities and the unused credit facility. Pollard enters into contractual obligations in the normal course of business operations.

Currency risk

Pollard sells a significant portion of its products and services to customers in the United States and to some international customers where sales are denominated in U.S. dollars. In addition, a significant portion of its cost inputs are denominated in U.S. dollars. Pollard also generates revenue in currencies other than the Canadian and U.S. dollar, primarily in Euros.

A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian and U.S. dollar would decrease/increase the income before income taxes due to changes in operating cashflow by approximately \$70 for year ended December 31, 2013 (2012 - \$87). A 50 basis point strengthening/weakening in the foreign exchange rate between the Canadian dollar and Euro would decrease/increase the income before income taxes due to changes in operating cashflow by approximately \$59 for year ended December 31, 2013 (2012 - \$52).

Pollard Banknote Limited
Notes to Consolidated Financial Statements (continued)
(In thousands of Canadian dollars, except for share amounts)

Years ended December 31, 2013 and 2012

24. Financial risk management (continued):

In addition, translation differences arise when foreign currency monetary assets and liabilities are translated at foreign exchange rates that change over time. As at December 31, 2013, the amount of financial liabilities denominated in U.S. dollars exceeds the amount of financial assets denominated in U.S. dollars by approximately \$3,433 (2012 - \$5,622). A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the U.S. dollar would result in a decrease/increase in net income of approximately \$17 for the year ended December 31, 2013 (2012 - \$28).

Pollard utilizes a number of strategies to mitigate its exposure to currency risk. Two manufacturing facilities are located in the U.S. and a significant amount of cost inputs for all production facilities are denominated in U.S. dollars, offsetting a large portion of the U.S. dollar revenue in a natural hedge.

In addition, Pollard has entered into foreign currency contracts to exchange US\$1,000 each month for approximately \$1,065 for 18 consecutive months from December 2013 to May 2015. Pollard has also entered into foreign currency contracts to exchange Euros €500 each month for approximately \$693 for 12 consecutive months from September 2013 to August 2014. At December 31, 2013, the remaining open foreign currency contracts have been recognized at fair value in the statement of financial position as a \$412 liability.

A 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the U.S. dollar would result in a decrease/increase in net income of approximately \$85 for the year ended December 31, 2013, due to the change in value of the mark-to-market value of the U.S. foreign exchange contracts. In addition, a 50 basis point weakening/strengthening in the value of the Canadian dollar relative to the Euro would result in a decrease/increase in net income of approximately \$20 for the year ended December 31, 2013, due to the change in value of the mark-to-market value of the Euro foreign exchange contracts.

Interest rate risk

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

A 50 basis point decrease/increase in interest rates would result in an increase/decrease in income before income taxes of approximately \$368 for the year ended December 31, 2013 (2012 - \$354).