

POLLARD BANKNOTE LIMITED

September 30 - 2012

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

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012

November 6, 2012

This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the three and nine months ended September 30, 2012, is prepared as at November 6, 2012, and should be read in conjunction with the accompanying unaudited condensed consolidated interim financial statements of Pollard and the notes therein as at September 30, 2012 and the audited consolidated financial statements of Pollard for the year ended December 31, 2011 and the notes therein. Results are reported in Canadian dollars and have been prepared in accordance with International Financial Reporting Standards ("IFRS" or "GAAP").

Forward-Looking Statements

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

Use of Non-GAAP Financial Measures

Reference to "Adjusted EBITDA" is to earnings before interest, income taxes, amortization and depreciation, 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 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 unaudited condensed consolidated interim consolidated results of Pollard for the three and nine months ended September 30, 2012. 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, internet support, 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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Instant Tickets	90.3%	89.2%	89.1%	89.0%
Charitable Gaming Products	8.7%	9.9%	9.9%	9.9%
Vending Machines	1.0%	0.9%	1.0%	1.1%

Geographic breakdown of revenue

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
United States	49%	48%	54%	54%
Canada	22%	25%	20%	24%
International	29%	27%	26%	22%

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 three and nine months ended September 30, 2012.

SELECTED FINANCIAL INFORMATION

(millions of dollars, except per share information)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Sales	\$44.1	\$43.8	\$121.5	\$127.4
Cost of Sales	34.9	36.8	97.2	106.6
Gross Profit	9.2	7.0	24.3	20.8
<i>Gross Profit as a % of sales</i>	<i>20.9%</i>	<i>16.0%</i>	<i>20.0%</i>	<i>16.3%</i>
Administration Expenses	3.3	3.4	10.0	10.1
<i>Expenses as a % of sales</i>	<i>7.5%</i>	<i>7.8%</i>	<i>8.2%</i>	<i>7.9%</i>
Selling Expenses	1.4	1.5	4.6	4.5
<i>Expenses as a % of sales</i>	<i>3.2%</i>	<i>3.4%</i>	<i>3.8%</i>	<i>3.5%</i>
Realized foreign exchange loss (gain)	0.5	(1.2)	0.4	(3.2)
<i>Loss (gain) as a % of sales</i>	<i>0.1%</i>	<i>(2.7%)</i>	<i>0.03%</i>	<i>(2.5%)</i>
Net Income (Loss)	3.3	(1.2)	5.2	1.5
<i>Net Income (Loss) as a % of sales</i>	<i>7.5%</i>	<i>(2.7%)</i>	<i>4.3%</i>	<i>1.2%</i>
Adjusted EBITDA	5.9	5.9	14.5	17.5
<i>Adjusted EBITDA as a % of sales</i>	<i>13.4%</i>	<i>13.5%</i>	<i>11.9%</i>	<i>13.7%</i>
Adjusted EBITDA excluding gain on sale of property, plant and equipment and realized foreign exchange (loss) gain	6.4	4.7	14.9	12.8
<i>As a % of sales</i>	<i>14.5%</i>	<i>10.7%</i>	<i>12.2%</i>	<i>10.0%</i>
Earnings per share	\$0.14	(\$0.05)	\$0.22	\$0.06
	September 30, 2012	December 31, 2011		
Total Assets	\$124.7	\$121.6		
Total Non-Current Liabilities	\$77.8	\$77.2		

RECONCILIATION OF NET INCOME (LOSS) TO ADJUSTED EBITDA

(millions of dollars)

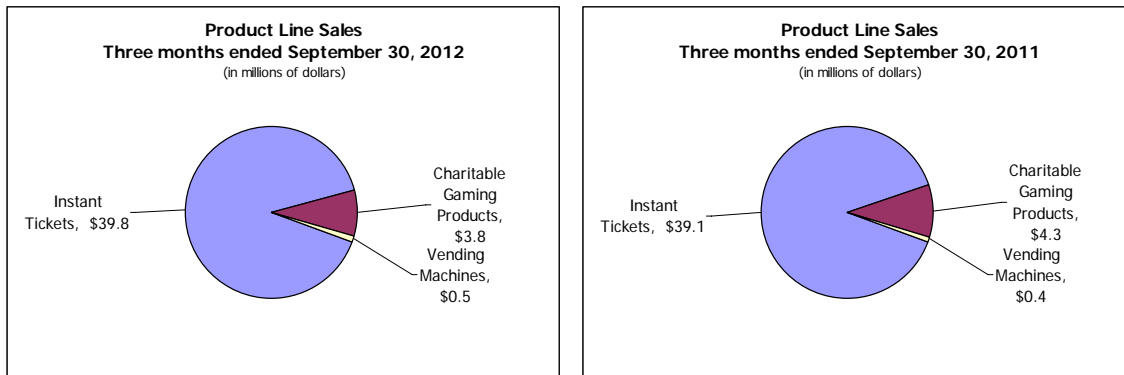
	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net Income (Loss)	\$3.3	(\$1.2)	\$5.2	\$1.5
Adjustments:				
Amortization and depreciation	1.9	2.1	5.6	6.4
Interest	0.8	1.1	2.5	3.5
Unrealized foreign exchange (gain) loss	(0.9)	2.5	(0.6)	3.8
Restructuring expense	-	0.5	-	0.5
Income taxes	0.8	0.9	1.8	1.8
Adjusted EBITDA	\$5.9	\$5.9	\$14.5	\$17.5
Gain on sale of property, plant and equipment	-	-	-	1.5
Realized foreign exchange (loss) gain	(0.5)	1.2	(0.4)	3.2
Adjusted EBITDA excluding gain on sale of property, plant and equipment and realized foreign exchange (loss) gain	\$6.4	\$4.7	\$14.9	\$12.8

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 THREE MONTHS ENDED SEPTEMBER 30, 2012

Sales



During the three months ended September 30, 2012, Pollard achieved sales of \$44.1 million, compared to \$43.8 million in the three months ended September 30, 2011. Factors impacting the \$0.3 million sales increase were:

Instant ticket volumes for the third quarter of 2012 were higher than the third quarter of 2011 by 1.7% which, combined with a change in our ancillary instant ticket products and services, increased sales by \$2.0 million. In addition, a decrease in average selling price compared to 2011 decreased sales by \$1.3 million. Charitable Gaming volume decreased slightly during the quarter reducing sales by \$0.3 million when compared to 2011 and average selling prices decreased in the quarter which reduced sales by \$0.2 million when compared to 2011.



During the three months ended September 30, 2012, Pollard generated approximately 63.5% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the third quarter of 2012 the actual U.S. dollar value was converted to Canadian dollars at \$1.004, compared to a rate of \$0.982 during the third quarter of 2011. This 2.2% increase in the U.S. dollar value resulted in an approximate increase of \$0.6 million in revenue relative to the third quarter of 2011. Also during the third quarter of 2012, the Canadian dollar strengthened against the Euro resulting in an approximate decrease of \$0.5 million in revenue relative to the third quarter of 2011.

Cost of sales and gross margin

Cost of sales was \$34.9 million in the third quarter of 2012 compared to \$36.3 million in the third quarter of 2011. Cost of sales was lower in the quarter relative to 2011 as a result of the costs savings generated by our Change Initiative process, including improved manufacturing yields and labour efficiencies, partially offset by increased instant ticket volumes and higher exchange rates on U.S. dollar transactions in the third quarter.

Gross profit was \$9.2 million (20.9% of sales) in the third quarter of 2012 compared to \$7.5 million (17.1% of sales) in the third quarter of 2011. This increase is due mainly to the impact of costs savings generated by our Change Initiative process and increased instant ticket volumes, partially offset by reduced instant ticket average selling price.

Administration expenses

Administration expenses were \$3.3 million in the third quarter of 2012 which is similar to \$3.4 million in the third quarter of 2011.

Selling expenses

Selling expenses were \$1.4 million in the third quarter of 2012 which is similar to \$1.5 million in the third quarter of 2011.

Other (income) expenses – Restructuring expense

During the quarter ended September 30, 2011, Pollard incurred non-recurring costs related to the closure of our lottery management operations in Puerto Rico of \$0.5 million.

Finance costs and income

Under IFRS included in the income statement classification “finance costs” are interest, amortization of deferred financing costs and foreign exchange losses. Included in the income statement classification “finance income” are foreign exchange gains.

Interest expense

Interest expense decreased to \$0.8 million in the third quarter of 2012 from \$1.1 million in the third quarter of 2011 due primarily to the elimination of higher interest rates relating to certain interest rate

swaps which expired on August 31, 2011 and the reduced average amount of long-term debt over the quarter compared to 2011.

Foreign exchange gain and loss

The net foreign exchange gain was \$0.4 million in the third quarter of 2012 compared to a net loss of \$1.3 million in the third quarter of 2011. Within the 2012 foreign exchange gain is an unrealized foreign exchange gain of \$0.9 million, relating to a \$0.8 million unrealized foreign exchange gain on U.S. dollar denominated debt and a \$0.1 million unrealized gain on U.S. dollar denominated payables. The realized loss of \$0.5 million is comprised of realized losses on the decreased value of U.S. dollar denominated receivables.

Within the 2011 foreign exchange loss are unrealized losses of \$2.5 million relating to the unrealized foreign exchange loss on U.S. dollar denominated debt (caused by the reversal of previously recorded unrealized foreign exchange gains from the strengthening of the Canadian dollar which were realized upon repayment and the weakening of the value of the Canadian dollar versus the U.S. dollar toward the end of the third quarter). Within the foreign exchange loss is a realized gain of \$1.2 million, consisting of a \$1.1 million realized gain relating to payments made on U.S. dollar denominated debt and by \$0.1 million in realized gains on the increased value of U.S. dollar denominated receivables.

Adjusted EBITDA

Adjusted EBITDA was \$5.9 million in the third quarter of 2012 compared to \$5.9 million in the third quarter of 2011. The increase in gross margin of \$1.7 million in the third quarter of 2012 compared to the third quarter of 2011 was offset by lower realized foreign exchange gains (primarily relating to the repayment of U.S. dollar dominated debt in 2011) of \$1.7 million in the respective quarters.

Adjusted EBITDA excluding realized foreign exchange gains and losses was \$6.4 million in the third quarter of 2012, compared to \$4.7 million in the third quarter of 2011.

Income taxes

Income tax expense was \$0.8 million in the third quarter of 2012, an effective rate of 18.7%, as a result of permanent differences relating to the translation of the company's U.S. subsidiaries and differences relating to the foreign exchange impact of Canadian dollar dominated debt in the U.S. subsidiaries.

Income tax expense was \$0.9 million in the third quarter of 2011, an effective rate of (351.9%), as a result of permanent differences relating to the translation of the company's U.S. subsidiaries and differences relating to the foreign exchange impact of Canadian dollar dominated debt in the U.S. subsidiaries.

Amortization

Amortization includes amortization of property and equipment, deferred financing costs and intangible assets and totaled \$1.9 million during the third quarter of 2012 as compared to \$2.1 million during the third quarter of 2011, due primarily to lower amortization of intangible assets and property, plant and equipment.

Net Income

Net Income was \$3.3 million in the third quarter of 2012 compared to a Net Loss of \$1.2 million in the third quarter of 2011. The primary reasons for the increase were an increase in gross profit of \$1.7 million, a decrease in interest expense of \$0.3 million, a decrease of \$0.2 million in selling and administrative expenses, an increase in foreign exchange gain of \$1.7 million and the reduction in restructuring expense of \$0.5 million.

Net income per share increased to \$0.14 per share in the third quarter of 2012 from a Net loss per share of \$0.05 in the third quarter of 2011.

ANALYSIS OF RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012

Sales



During the nine months ended September 30, 2012, Pollard achieved sales of \$121.5 million, compared to \$127.4 million in the nine months ended September 30, 2011. Factors impacting the \$5.9 million sales decrease were:

Instant ticket volumes for the first nine months of 2012 were consistent with the first nine months of 2011; however a reduction in our ancillary instant ticket products and services decreased sales by \$3.1 million. A decrease in the average selling price of instant tickets reduced sales by \$2.9 million compared to the first nine months of 2011. Charitable Gaming Products volumes were slightly lower than the first nine months of 2011 reducing revenues by \$0.7 million. A decrease in machine volumes in the first nine months of 2012 decreased sales by \$0.2 million when compared to 2011.



During the nine months ended September 30, 2012, Pollard generated approximately 67.5% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the first nine months of 2012 the actual U.S. dollar value was converted to Canadian dollars at \$1.005, compared to a rate of \$0.984 during the first nine months of 2011. This 2.1% increase in the U.S. dollar value resulted in an approximate increase of \$1.7 million in revenue relative to the first nine months of 2011. In addition, during the nine months ended September 30, 2012, the strengthening of the Canadian dollar against the Euro resulted in an approximate decrease of \$0.7 million in revenue relative to the first nine months of 2011.

Cost of sales and gross margin

Cost of sales was \$97.2 million in the nine months ended September 30, 2012, compared to \$106.1 million in the first nine months of 2011. Cost of sales was lower in 2012 relative to 2011 as a result of the costs savings generated by our Change Initiative process, including improved manufacturing yields and labour efficiencies, and a reduction in sales of ancillary instant ticket products, partially offset by higher exchange rates on U.S. dollar transactions in the first nine months of 2012 which increased cost of sales by approximately \$1.2 million.

Gross profit increased to \$24.3 million (20.0% of sales) in the first nine months of 2012 from \$21.3 million (16.7% of sales) in the nine months ended September 30, 2011. This increase is due mainly to the costs savings generated by our Change Initiative process, partially offset by reduced ancillary instant ticket volumes and average instant ticket selling price.

Administration expenses

Administration expenses were \$10.0 million in the first nine months of 2012 which is similar to \$10.1 million in the first nine months of 2011.

Selling expenses

Selling expenses were \$4.6 million in the first nine months of 2012 which is similar to \$4.5 million in the first nine months of 2011.

Other (income) expenses – Restructuring expense

During the nine months ended September 30, 2011, Pollard incurred non-recurring costs related to the closure of our lottery management operations in Puerto Rico of \$0.5 million.

Finance costs and income

Under IFRS included in the income statement classification “finance costs” are interest, amortization of deferred financing costs and foreign exchange losses. Included in the income statement classification “finance income” are foreign exchange gains.

Interest expense

Interest expense decreased to \$2.5 million in the first nine months of 2012 from \$3.5 million in the first nine months of 2011 due primarily to the elimination of higher interest rates relating to certain interest rate swaps which expired on August 31, 2011 and the reduced amount of long-term debt.

Foreign exchange gain and loss

The net foreign exchange gain was \$0.2 million in the first nine months of 2012 compared to a net loss of \$0.6 million in the first nine months of 2011. Within the 2012 net foreign exchange gain are unrealized gains of \$0.6 million, relating to unrealized foreign exchange gains on U.S. dollar denominated debt. Within the net foreign exchange gain is a realized loss of \$0.4 million consisting of \$0.6 million in realized losses 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 realized gains of \$0.2 million relating to payments made on U.S. dollar denominated debt.

Within the 2011 net foreign exchange loss are unrealized losses of \$3.8 million, relating to a \$4.0 million unrealized foreign exchange loss on U.S. dollar denominated debt (caused by the reversal of previously recorded unrealized foreign exchange gains from the strengthening of the Canadian dollar which were realized upon repayment and the weakening of the value of the Canadian dollar versus the U.S. dollar toward the end of the third quarter), partially offset by \$0.2 million unrealized gain on U.S. dollar denominated payables. Within the foreign exchange loss is a realized gain of \$3.2 million consisting of a \$3.4 million realized gain relating to payments made on U.S. dollar denominated debt, partially offset by \$0.2 million in realized losses on the decreased value of U.S. dollar denominated receivables and the conversion of U.S. dollars and Euros into Canadian dollars.

Gain on sale of property, plant and equipment

During the first nine months of 2011, Pollard sold a building and land in Winnipeg, Manitoba to an affiliate of Pollard Equities Limited 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.

Adjusted EBITDA

Adjusted EBITDA was \$14.5 million in the first nine months of 2012 compared to \$17.5 million in the first nine months of 2011. The primary reasons for the decrease in Adjusted EBITDA of \$3.0 million were the absence of a gain on sale of property, plant and equipment of \$1.5 million and lower realized foreign exchange gains (primarily relating to the repayment of U.S. dollar dominated debt in 2011) of \$3.6 million, partially offset by an increase in gross margin (net of amortization and depreciation) of \$2.2 million.

Adjusted EBITDA excluding the gain on sale of property, plant and equipment and realized foreign exchange gains and losses was \$14.9 million in the first nine months of 2012 compared to \$12.8 million in the first nine months of 2011.

Income taxes

Income tax expense was \$1.8 million in the first nine months of 2012, an effective rate of 25.3%, primarily as a result of permanent differences relating to the translation of the company's U.S. subsidiaries and differences relating to the foreign exchange impact of Canadian dollar dominated debt in the U.S. subsidiaries.

Income tax expense was \$1.8 million in the first nine months of 2011, an effective rate of 55.2%, primarily as a result of permanent differences relating to the translation of the company's U.S. subsidiaries and differences relating to the foreign exchange impact of Canadian dollar dominated debt in the U.S. subsidiaries.

Amortization

Amortization includes amortization of property and equipment, deferred financing costs and intangible assets and totaled \$5.6 million during the first nine months of 2012 compared to \$6.4 million during the first nine months of 2011, due primarily to lower amortization of intangible assets and property, plant and equipment.

Net Income

Net Income was \$5.2 million in the first nine months of 2012 compared to \$1.5 million in the first nine months of 2011. The primary reasons for the increase were the increase in gross profit of \$3.0 million, the absence of the restructuring expense of \$0.5 million, a decrease in interest expenses of \$1.0 million and an increase in foreign exchange gain of \$0.8 million partially offset by an absence of the \$1.5 million gain on sale of property, plant and equipment, and the loss on our Chinese joint venture of \$0.2 million.

Net income per share increased to \$0.22 per share in the nine months ending September 30, 2012, from \$0.06 in the first nine months of 2011.

Liquidity and Capital Resources

Cash provided by operating activities

For the nine months ended September 30, 2012, cash flow provided by operating activities was \$5.1 million compared to cash flow provided by operating activities of \$7.0 million for the first nine months of 2011. Changes in the non-cash component of working capital decreased cash flow from operations by \$5.3 million for the nine months ended September 30, 2012 (due primarily to increases in accounts receivable, inventories and prepaids), compared to a decrease of \$3.2 million for the nine months ended September 30, 2011 (due primarily to increases in accounts receivable and inventories and decrease in provisions, partially offset by an increase in accounts payable and accrued liabilities).

Cash provided by investing activities

In the nine months ended September 30, 2012, cash used by investing activities was \$4.6 million compared to cash provided of \$0.7 million in the first nine months of 2011. Capital expenditures of \$3.7 million were incurred in the nine months ended September 30, 2012, compared to \$2.6 million for the nine months ended September 30, 2011. Proceeds from the sale of property, plant and equipment were nil in the nine months ended September 30, 2012, as compared to \$3.5 in the comparable period of 2011. In addition, Pollard's investment in associate in the nine months ended September 30, 2012 was \$0.4 million.

Cash provided by financing activities

Cash provided by financing activities was \$0.2 million in the nine months ended September 30, 2012, compared to cash used of \$8.7 million in the nine months ended September 30, 2011. During the first nine months of 2012 proceeds from long-term debt of \$2.5 million were partially offset by dividends paid of \$2.1 million and an increase in deferred financing of \$0.2. Proceeds from long-term debt were used to finance increased investment in working capital and capital additions.

During the first nine months of 2011 cash used was comprised of repayments on long-term debt of \$6.5 million and dividends paid of \$2.1 million.

As at September 30, 2012, Pollard had unused committed debt facility of \$13.1 million. This amount is available to be used for future working capital requirements, contractual obligations, capital expenditures and dividends.

Quarterly Information

(unaudited)

(millions of dollars)

	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Sales	\$44.1	\$40.8	\$36.6	\$44.6	\$43.8	\$44.4	\$39.2	\$37.3	\$41.7	\$43.2	\$41.2
Adjusted EBITDA	5.9	5.2	3.4	5.2	5.9	7.7	3.8	4.1	4.6	5.8	3.7
Net Income (Loss)	3.3	1.0	0.9	1.7	(1.2)	1.7	0.9	(0.7)	1.5	(0.7)	1.7

Sales in Q3 2012 were higher primarily due to increases in 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 goods sold.

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

Sales in the final three quarters of 2011 were higher due to an increase in instant ticket volumes, offset partially by the strengthening of the Canadian dollar relative to the U.S. dollar.

Q2 2011 Adjusted EBITDA and Net Income include a gain on sale of property, plant and equipment of \$1.5 million and a realized foreign exchange gain of \$2.3 million on the repayment of U.S. dollar dominated debt.

Sales in Q1 2011 were lower primarily due to the strengthening of the Canadian dollar relative to the U.S. dollar and a decrease in average selling prices.

Q2 2010 Adjusted EBITDA and Net Loss include a gain on sale of property, plant and equipment of \$2.0 million.

Productive Capacity

Management has defined productive capacity as the level of operations necessary to maintain a minimum Adjusted EBITDA of \$20.0 million and the current cash flow target of \$13.4 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 since August 5, 2005, have occurred primarily through expenditures on fixed assets and improved processes and other internal improvement measures, offset by the impacts of changes in foreign exchange relationships, primarily the strengthening of the Canadian dollar relative to the U.S. dollar and the Euro, and the closure of the Kamloops facility in February 2010. There have been no acquisitions since August 5, 2005, and therefore no increases in productive capacity from acquisitions.

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 August 5, 2005.

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 the 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. These factors assist in a reasonably quick turnover in net working capital. 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, although production volumes are historically lower in the first quarter relative to the rest of the year.

Investment in non-cash working capital increased in the first nine months of Fiscal 2012 due primarily to an increase in inventories of \$3.5 million as a result of a significant increase in production volumes during the period.

	September 30, 2012	December 31, 2011
Working Capital	\$28.3	\$23.2
Total Assets	\$124.7	\$121.6
Total Non-Current Liabilities	\$77.8	\$77.2

Credit Facility

Pollard's credit facility, which was renewed effective June 29, 2012, consists of one committed term bank loan facility. The committed term bank loan facility provides loans of up to \$70.0 million for its Canadian operations and up to US\$17.6 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 September 30, 2012, the outstanding letters of guarantee were \$2.4 million and the remaining balance available for drawdown was \$13.1 million.

Under the terms and conditions of the credit facility agreement Pollard is required to maintain certain financial covenants including working capital ratios, debt to income before interest, income taxes, amortization and depreciation ("Adjusted EBITDA") ratios and certain debt service coverage ratios. As at September 30, 2012 and November 6, 2012, Pollard is in compliance with all 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), interest and cash income taxes paid. For the quarters ending June 30, 2012, through to and including December 31, 2012, Excess Cash Flow can be reduced up to an aggregate of \$2.0 million of actual costs related to a specific capital expenditure. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. For the quarter ending September 30, 2012, the credit facility will be reduced by approximately \$2.3 million as of November 29, 2012. As of September 30, 2012, Pollard has unused credit facility available of \$13.1 million (December 31, 2011 - \$17.7 million).

Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard and its operating subsidiaries. The credit facility can be prepaid without penalties. Under the terms of the agreement effective June 29, 2012, the credit facility is committed for a one year period, renewable June 30, 2013 ("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, 2014.

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 September 30, 2012 and November 6, 2012, outstanding share data was as follows:

Common shares	23,543,158
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Contractual Obligations

There have been no material changes to Pollard's contractual obligations since December 31, 2011, that are outside the normal course of business.

Off-Balance Sheet Arrangements

There have been no material changes to Pollard's off-balance sheet arrangements since December 31, 2011, that are outside the normal course of business.

Financial Instruments

The financial instruments of Pollard remain substantially unchanged from those identified in the MD&A for Pollard for the year ended December 31, 2011.

Critical Accounting Policies and Estimates

The preparation of the financial statements in conformity with Canadian 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, expected rate of return on plan assets 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.

Related Party Transactions

Pollard has not entered into any significant transactions with related parties during the nine months ended September 30, 2012, which are not disclosed in the unaudited condensed consolidated interim financial statements.

Industry Risks and Uncertainties

The risk factors affecting Pollard remain substantially unchanged from those identified in the MD&A for Pollard for the year ended December 31, 2011.

Outlook

We continue to see strong growth in the lottery market, particularly within the instant ticket and related products and services areas. Independent tracking agencies report significant retail dollar sales growth year over year and this growth is expected to continue through the end of 2012 and the first months of 2013. Many lotteries have recently announced record fiscal sales with instant tickets being a prime driver of this growth in North America as well as lottery organizations throughout the world.

Our volumes in the third quarter were similar to the higher levels achieved in the second quarter of 2012. Our order book continues to show similarly high or higher volumes for the remainder of 2012 and early 2013. Based on additional contract awards during this past quarter, we expect our 2013 volumes to exceed those obtained in 2012. We will continue to selectively bid on key contract opportunities as they become available.

A number of jurisdictions have been reviewing alternative strategies to maximize the return generated by their lottery operations, many of which involve increased participation by the private sector including Pollard. We will continue to monitor developments in this area and where financially and strategically appropriate will actively participate in these opportunities.

Our formal Change Initiative process continues to be our main internal vehicle to refine and improve our operations. Improvements in efficiency, waste reduction and productivity throughout all of our operations have been achieved and will continue to be a major influence over the course of the next year.

The charitable gaming market (pull-tabs and bingo paper) remains steady and we continue to focus on improving operational efficiency to maintain and improve margins.

During the third quarter our Chinese joint venture initiated operation of our first installed validation and distribution system for a Chinese provincial lottery. In the future we will be looking to expand this operation to additional provincial lotteries throughout the country.

The value of the Canadian dollar relative to the U.S. dollar continues to be an important factor in our operations. During the quarter the Canadian dollar strengthened about 3%. A significant portion of our revenue is denominated in U.S. dollars and despite being partially offset by U.S. dollar expenditures, we continue to have net financial exposure to the U.S. dollar. In addition we do have some exposure to the Euro due to a number of European lotteries in our client roster. We expect both of these exposures to continue and will manage them through the use of a number of mitigation strategies.

Capital expenditures over the next two quarters will be slightly higher than recent years due to the completion of some increased press capacity improvements, expected to be completed by the first quarter of 2013.

Pollard Banknote believes that its credit facilities 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.

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") for the interim period regarding the design of the disclosure controls and procedures. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the design of the disclosure controls and procedures as defined in Multilateral Instrument 52-109 will provide 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 of the internal controls over financial reporting. Pollard's management, with the participation of the Certifying Officers of Pollard, has concluded that the design of the internal controls over financial reporting as defined in Multilateral Instrument 52-109 will provide reasonable assurance of achieving the financial reporting objectives.

No changes were made in Pollard's internal control over financial reporting during the three and nine months ended September 30, 2012, that have materially affected, or are reasonably likely to materially affect, Pollard's internal control over financial reporting.

Additional Information

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

Additional information relating to Pollard, including the Audited Consolidated Financial Statements and the Annual Information Form of Pollard for the year ended December 31, 2011, is available on SEDAR at www.sedar.com.

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Condensed Consolidated Interim Financial Statements of

**POLLARD BANKNOTE
LIMITED**

(unaudited)

Nine months ended September 30, 2012

These condensed consolidated interim financial statements have not been audited or reviewed by the Company's independent external auditors, KPMG LLP.

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

	September 30,		December 31,
	2012		2011
Assets			
Current assets			
Cash	\$ 5,380	\$	5,059
Accounts receivable	16,245		15,514
Inventories (note 5)	20,893		17,361
Prepaid expenses and deposits	2,397		2,020
Total current assets	44,915		39,954
Non-current assets			
Property, plant and equipment	28,888		29,219
Equity investment (note 6)	261		-
Goodwill	35,752		35,902
Intangible assets	11,792		12,294
Deferred income taxes	3,119		4,253
Total non-current assets	79,812		81,668
Total assets	\$ 124,727	\$	121,622
Liabilities and Shareholders' Equity			
Current liabilities			
Accounts payable and accrued liabilities	\$ 15,303	\$	15,654
Provisions	10		21
Dividends payable	706		706
Income taxes payable	617		338
Total current liabilities	16,636		16,719
Non-current liabilities			
Long-term debt (note 7)	71,062		69,077
Other long-term liabilities	148		210
Pension liability	3,671		4,742
Deferred income taxes	2,879		3,213
Total non-current liabilities	77,760		77,242
Shareholders' equity			
Share capital	73,209		73,209
Reserves	(729)		(326)
Deficit	(42,149)		(45,222)
Total shareholders' equity	30,331		27,661
Total liabilities and shareholders' equity	\$ 124,727	\$	121,622

See accompanying notes to condensed consolidated interim financial statements.

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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Sales	\$ 44,113	\$ 43,814	\$ 121,494	\$ 127,449
Cost of sales	34,878	36,333	97,202	106,131
Gross profit	9,235	7,481	24,292	21,318
Administration	3,259	3,385	10,048	10,107
Selling	1,448	1,467	4,567	4,530
Gain on sale of property, plant and equipment	-	(10)	-	(1,479)
Other (income) expense (note 8)	(95)	404	(48)	348
Income from operations	4,623	2,235	9,725	7,812
Finance costs (note 9)	953	2,505	3,418	5,259
Finance income (note 9)	(447)	-	(648)	(749)
Income (loss) before income taxes	4,117	(270)	6,955	3,302
Income taxes (note 10)	769	950	1,763	1,822
Net income (loss)	\$ 3,348	\$ (1,220)	\$ 5,192	\$ 1,480
Basic and diluted net income (loss) per share	\$ 0.14	\$ (0.05)	\$ 0.22	\$ 0.06
Weighted average number of shares outstanding	23,543,158	23,543,158	23,543,158	23,543,158

See accompanying notes to condensed consolidated interim financial statements.

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

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net income (loss)	\$ 3,348	\$ (1,220)	\$ 5,192	\$ 1,480
Other comprehensive income (loss)				
Foreign currency translation differences – foreign operations	(414)	1,061	(403)	663
Unrealized gain on derivatives designated as cash flow hedges, net of income tax of \$40 and \$116	-	142	-	258
Other comprehensive income (loss) – net of income tax	(414)	1,203	(403)	921
Comprehensive income (loss)	\$ 2,934	\$ (17)	\$ 4,789	\$ 2,401

See accompanying notes to condensed consolidated interim financial statements.

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

For the nine months ended September 30, 2012

		Attributable to equity holders of Pollard Banknote Limited				Total equity
		Share capital	Translation reserve	Hedging reserve	Retained deficit	
Balance at January 1, 2012	\$	73,209	(326)	-	(45,222)	27,661
Net income		-	-	-	5,192	5,192
Other comprehensive loss						
Foreign currency translation differences – foreign operations		-	(403)	-	-	(403)
Total other comprehensive loss	\$	-	(403)	-	-	(403)
Total comprehensive income (loss)	\$	-	(403)	-	5,192	4,789
Dividends to owners of Pollard Banknote Limited (note 12)		-	-	-	(2,119)	(2,119)
Balance at September 30, 2012	\$	73,209	(729)	-	(42,149)	30,331

For the nine months ended September 30, 2011

		Attributable to equity holders of Pollard Banknote Limited				Total equity
		Share capital	Translation reserve	Hedging reserve	Retained deficit	
Balance at January 1, 2011	\$	73,209	(661)	(258)	(41,411)	30,879
Net income		-	-	-	1,480	1,480
Other comprehensive income						
Foreign currency translation differences – foreign operations		-	663	-	-	663
Unrealized loss on derivatives designated as cash flow hedges, net of income tax of \$116		-	-	258	-	258
Total other comprehensive income	\$	-	663	258	-	921
Total comprehensive income	\$	-	663	258	1,480	2,401
Dividends to owners of Pollard Banknote Limited		-	-	-	(2,119)	(2,119)
Balance at September 30, 2011	\$	73,209	2	-	(42,050)	31,161

See accompanying notes to condensed consolidated interim financial statements.

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

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Cash increase (decrease)		
Operating activities		
Net income	\$ 5,192	\$ 1,480
Adjustments		
Income taxes	1,763	1,822
Amortization and depreciation	5,655	6,377
Interest expense	2,510	3,475
Unrealized foreign exchange (gain) loss	(596)	3,810
Loss on equity investment	147	-
Gain on sale of property, plant and equipment	-	(1,479)
Interest paid	(2,519)	(2,786)
Income tax paid	(714)	(944)
Change in pension liability	(1,052)	(1,531)
Change in non-cash operating working capital (note 11)	(5,336)	(3,226)
	5,050	6,998
Investing activities		
Additions to property, plant and equipment	(3,717)	(2,581)
Proceeds from sale of property, plant and equipment	-	3,483
Investment in associate (note 6)	(408)	-
Additions to intangible assets	(492)	(202)
	(4,617)	700
Financing activities		
Proceeds from (repayments of) long-term debt	2,485	(6,518)
Change in other long-term liabilities	(57)	(13)
Additions to deferred financing charges	(157)	(3)
Dividends paid	(2,119)	(2,119)
	152	(8,653)
Foreign exchange gain (loss) on cash held in foreign currency	(264)	99
Change in cash position	321	(856)
Cash position, beginning of period	5,059	5,405
Cash position, end of period	\$ 5,380	\$ 4,549

See accompanying notes to condensed consolidated interim financial statements.

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

1. Reporting entity:

Pollard Banknote Limited ("Pollard"), formerly 7510101 Canada Limited, was incorporated under the laws of Canada on March 26, 2010.

The condensed consolidated interim financial statements of Pollard as at and for the nine months ended September 30, 2012, comprise Pollard, Pollard's subsidiaries and its interest in an associate. Pollard is primarily involved in the manufacture and sale of lottery and gaming products.

Pollard's consolidated financial statements as at and for the year ended December 31, 2011, are available at www.sedar.com.

The overall impact of seasonality does not have a significant impact on the operations of Pollard, although instant ticket volumes are historically lower in the first quarter relative to the rest of the year.

2. Basis of preparation:

(a) Statement of compliance:

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standards ("IAS") 34 *Interim Financial Reporting* and do not include all of the information required for full annual consolidated financial statements.

On November 6, 2012, Pollard's Board of Directors approved these condensed consolidated interim financial statements.

(b) Use of estimates and judgments:

The preparation of condensed consolidated interim financial statements 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.

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying Pollard's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended December 31, 2011.

3. Significant accounting policies:

Except for the addition of the accounting policy described below, these condensed consolidated interim financial statements follow the same significant accounting policies as described and used in

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

3. Significant accounting policies (continued):

Pollard's consolidated financial statements for the year ended December 31, 2011 and should be read in conjunction with those reports.

(a) Investment in associate:

Pollard accounts for its investments in entities where it has significant influence, but not control, using the equity method of accounting. 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 entities accounted for under the equity method of accounting, which are recorded on a three month delayed basis.

4. Future accounting standards:

In November 2009, the International Accounting Standards Board ("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. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

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. Pollard is currently assessing the impact of the new standards and amendments on its consolidated financial statements.

- 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.
- 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.

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

4. Future accounting standards (continued):

- 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. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

In June 2011, the IASB published an amended version of IAS 19 *Employee Benefits*. The amendments require actuarial gains and losses 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. Additional disclosures are also required. IAS 19 is required for fiscal years beginning on or after January 1, 2013. Pollard is currently assessing the impact of the new standard on its consolidated financial statements.

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. Pollard is currently assessing the impact of the amendments on its consolidated financial statements.

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. Pollard is currently assessing the impact of the amendments on its consolidated financial statements.

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

5. Inventories:

	September 30, 2012	December 31, 2011
Raw materials	\$ 5,141	\$ 5,275
Work-in-process	750	689
Finished goods	15,002	11,397
	\$ 20,893	\$ 17,361

During the third quarter of 2012, Pollard recorded inventory write-downs of \$30 due to changes in foreign exchange rates. During the nine months ended September 30, 2012, Pollard recorded inventory write-downs of \$53 representing an increase in the obsolescence reserves, and a reversal of previous write-downs of \$2 due to changes in foreign exchange rates.

During the third quarter of 2011, Pollard recorded inventory write-downs of \$52 representing an increase in the obsolescence reserves, and reversals of previous write-downs of \$154 due to changes in foreign exchange rates. During the nine months ended September 30, 2011, Pollard recorded inventory write-downs of \$145 representing an increase in the obsolescence reserves, and reversal of previous write-downs of \$195 due to changes in foreign exchange rates.

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

6. Equity investment:

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Balance – beginning of period	\$ -	\$ -
Initial investment	408	-
Equity loss	(147)	-
Balance – end of period	\$ 261	\$ -

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. In July 2012, the entity successfully completed its first system installation with its initial provincial lottery customer.

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

7. Long-term debt:

	September 30, 2012	December 31, 2011
Credit facility, interest of 3.22% to 4.75% payable monthly, maturing 2014	\$ 71,494	\$ 69,769
Deferred financing charges, net of amortization	(432)	(692)
	\$ 71,062	\$ 69,077

Included in the total credit facility balance is a U.S. dollar loan balance of US\$15,196 (December 31, 2011 – US\$14,480).

Effective June 29, 2012, Pollard's subsidiaries Pollard Holdings Limited Partnership and Pollard Holdings, Inc. renewed their credit facility. The credit facility provides loans of up to \$70,000 for its Canadian operations and up to US\$17,573 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 September 30, 2012, the outstanding letters of guarantee drawn under the credit facility were \$2,406 (December 31, 2011 - \$2,163).

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 September 30, 2012, 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), interest and cash income taxes paid. For the quarters ending June 30, 2012, to and including December 31, 2012, Excess Cash Flow can be reduced up to an aggregate of \$2,000 of actual costs related to a specific capital expenditure. The reduction in the available facility is not required when the debt to Adjusted EBITDA ratio reaches certain target levels. For the quarter ending September 30, 2012, the credit facility will be reduced by approximately \$2,261 as of November 29, 2012. As of September 30, 2012, Pollard has unused credit facility available of \$13,146 (December 31, 2011 - \$17,659).

Pollard's credit facility is secured by a first security interest in all of the present and after acquired property of Pollard and its operating subsidiaries. The credit facility can be prepaid without penalties. Under the terms of the agreement effective June 29, 2012, the credit facility is committed for a one year period, renewable June 30, 2013 ("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, 2014.

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

8. Other (income) expense:

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Loss on equity investment (note 6)	\$ 38	\$ -	\$ 147	\$ -
Restructuring expense	-	486	-	486
Other	(133)	(82)	(195)	(138)
	\$ (95)	\$ 404	\$ (48)	\$ 348

During the quarter ended September 30, 2011, the Government of Puerto Rico issued a final ruling determining our operations were no longer legal under current legislation. As a result the operations commenced winding up resulting in a restructuring expense of \$486 reflecting the write off of assets associated with the operations and the accrual of related severance.

9. Finance costs and finance income:

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Finance costs:				
Foreign exchange loss	\$ -	\$ 1,265	\$ 490	\$ 1,366
Interest	811	1,100	2,510	3,475
Amortization of deferred financing costs	142	140	418	418
	\$ 953	\$ 2,505	\$ 3,418	\$ 5,259

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Finance income:				
Foreign exchange gain	\$ (447)	\$ -	\$ (648)	\$ (749)
	\$ (447)	\$ -	\$ (648)	\$ (749)

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

10. Income taxes:

Income tax expense

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Current	\$ 351	\$ 327	\$ 982	\$ 917
Deferred	418	623	781	905
	\$ 769	\$ 950	\$ 1,763	\$ 1,822

Reconciliation of effective tax rate

	Three months ended September 30, 2012	Three months ended September 30, 2011
Net income (loss) for the period	\$ 3,348	\$ (1,220)
Total income taxes	769	950
Income before income taxes	\$ 4,117	\$ (270)
Income tax using Pollard's domestic tax rate	26.8% \$ 1,103	28.3% \$ (76)
Withholding taxes and other non-deductible amounts	(0.2%) (7)	(28.3%) 76
Effect of non-taxable items related to foreign exchange	(7.9%) (327)	(351.9%) 950
	18.7% \$ 769	(351.9%) \$ 950

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

10. Income taxes (continued):

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net income for the period	\$ 5,192	\$ 1,480
Total income taxes	1,763	1,822
Income before income taxes	\$ 6,955	\$ 3,302
Income tax using Pollard's domestic tax rate	26.8% \$ 1,864	28.3% \$ 935
Withholding taxes and other non-deductible amounts	0.1% 10	5.2% 172
Effect of non-taxable items related to foreign exchange	(1.6%) (111)	21.7% 715
	25.3% \$ 1,763	55.2% \$ 1,822

11. Supplementary cash flow information:

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Change in non-cash operating working capital:		
Accounts receivable	\$ (798)	\$ (968)
Inventories	(3,700)	(1,957)
Prepaid expenses and deposits	(617)	(50)
Accounts payable and accrued liabilities	(210)	580
Provisions	(11)	(831)
	\$ (5,336)	\$ (3,226)

12. 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 September 30, 2012, Pollard's Adjusted EBITDA ratio is above the target level and as a result Pollard is currently subject to the dividend restriction.

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

12. Dividends (continued):

On August 9, 2012, a dividend of \$0.03 per share was declared, payable on October 15, 2012, to the shareholders of record on September 30, 2012.

13. Related party transactions:

During the quarter ended September 30, 2012, Pollard paid property rent of \$751 (2011 - \$749) and \$70 (2011 - nil) in plane charter costs to affiliates of Pollard Equities Limited ("Equities"). During the nine months ended September 30, 2011, Pollard paid property rent of \$2,252 (2011 - \$2,092) and \$140 (2011 - nil) in plane charter costs to affiliates of Equities. During the quarter, Equities paid Pollard \$18 (2011 - \$18) for accounting and administration fees and \$54 (2011 - \$54) during the nine months ended September 30, 2012.

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.

Key management personnel compensation comprised:

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Wages, salaries and benefits	\$ 551	\$ 623	\$ 1,934	\$ 1,993
Profit share	4	-	7	4
Expenses related to defined benefit plans	54	54	161	161
	\$ 609	\$ 677	\$ 2,102	\$ 2,158

At September 30, 2012, included in accounts payable and accrued liabilities is an amount owing to Equities and its affiliates for rent and other expenses of \$1,161 (December 31, 2011 - \$1,209).

14. 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 Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

14. Financial risk management (continued):

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.

Credit risk

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

	September 30, 2012	December 31, 2011
Current	\$ 12,531	\$ 11,174
Past due for 1 to 60 days	3,628	3,818
Past due for more than 60 days	120	671
Less: Allowance for doubtful accounts	(34)	(149)
	\$ 16,245	\$ 15,514

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 \$70,000 for its Canadian operations and up to US\$17,573 for its U.S. subsidiaries. At September 30, 2012, the unused balance available for drawdown was \$13,146 (December 31, 2011 - \$17,659).

The 2012 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 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 a small amount of revenue in currencies other than the Canadian and U.S. dollar, primarily in Euros.

Pollard Banknote Limited

Notes to Condensed Consolidated Interim Financial Statements (continued)

(In thousands of Canadian dollars, except for share amounts)

(unaudited)

14. Financial risk management (continued):

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 \$30 for the third quarter of 2012 (2011 - \$30) and approximately \$90 for the nine months ended September 30, 2012 (2011 - \$120).

In addition, translation differences arise when foreign currency monetary assets and liabilities are translated at foreign exchange rates that change over time. At September 30, 2012, the amount of financial liabilities denominated in U.S. dollars exceeds the amount of financial assets denominated in U.S. dollars by approximately \$7,646 (December 31, 2011 - \$6,182). 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 \$38 for the third quarter of 2012 (2011 - \$50) and approximately \$114 for the nine months ended September 30, 2012 (2011 - \$150).

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 \$89 for the three months ended September 30, 2012 (2011 - \$91) and approximately \$267 for the nine months ended September 30, 2012 (2011 - \$273).