

# **POLLARD BANKNOTE LIMITED**

*June 30 - 2010*

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

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010**

August 4, 2010

*This management's discussion and analysis ("MD&A") of Pollard Banknote Limited ("Pollard") for the three and six months ended June 30, 2010, is prepared as at August 4, 2010, and should be read in conjunction with the accompanying unaudited interim financial statements of Pollard and the notes therein as at June 30, 2010, and the audited financial statements of the Pollard Banknote Income Fund (the "Fund") and Pollard Banknote Limited Partnership ("Pollard LP") for the year ended December 31, 2009, and the notes therein. Results are reported in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").*

*On May 14, 2010, the Fund and Pollard LP completed the conversion (the "Conversion") to a publically traded corporation. As there was no substantive change in ultimate ownership after the Conversion it was accounted for under the continuity of interests method. As a result, one consolidated financial statement, incorporating both the Fund and Pollard LP, has been prepared. Comparative figures have been restated to reflect the combined results of both entities.*

### **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 "EBITDA" is to earnings before interest, taxes, 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 conversion expenses and warranty reserve accruals. 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, EBITDA is a useful supplementary measure.

EBITDA is a measure not recognized under Canadian GAAP and does not have a standardized meaning prescribed by Canadian GAAP. Therefore, this measure may not be comparable to similar measures presented by other entities. Investors are cautioned that EBITDA should not be construed as an alternative to Net Income or Loss determined in accordance with Canadian 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 interim consolidated results of Pollard for the three and six months ended June 30, 2010. All figures are in millions except for per share amounts.

These consolidated financial statements reflect the entities conducting the business of manufacturing and selling lottery and gaming products of the Pollard group as a corporation subsequent to May 14, 2010 and as an income trust and limited partnership prior to the Conversion. All references to "common shares" collectively refer to Pollard's common shares on and subsequent to May 14, 2010 and Fund units and Class B and C limited partnership units prior to the Conversion. All references to "dividends" refer to dividends paid or payable to holders of Pollard common shares on and subsequent to May 14, 2010 and to distributions payable to Fund unitholders and Class B and C limited partnership unitholders prior to the Conversion. All references to "shareholders" refer collectively to holders of Pollard common shares on and subsequent to May 14, 2010 and to Fund unitholders and Class B and C limited partnership unitholders prior to the Conversion.

# POLLARD BANKNOTE LIMITED

## Overview

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

Pollard produces and provides a comprehensive line of instant tickets and lottery services including: licensed products, distribution, retail telephone selling ("tel-sell"), marketing 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 45 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 June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Instant Tickets	88.4%	87.0%	88.2%	86.6%
Charitable Gaming Products	10.7%	12.2%	10.9%	12.3%
Vending Machines	0.9%	0.8%	0.9%	1.1%

## Geographic breakdown of revenue

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
United States	60%	60%	56%	61%
Canada	19%	24%	24%	22%
International	21%	16%	20%	17%

## **Formation of the Corporation**

Pollard was incorporated under the laws of Canada on March 26, 2010, for purposes of implementing the Conversion of the organization from an income fund to a corporation.

## **Conversion to a Corporation**

On January 28, 2010, the Trustees of the Fund, in conjunction with the Board of Directors of Pollard Banknote GP Limited, General Partner of Pollard LP, approved in principle a plan to convert Pollard Banknote Income Fund into a publicly traded corporation. On April 6, 2010, the Ontario Supreme Court of Justice approved the preliminary plan of arrangement for the Conversion. On May 6, 2010, the Unitholders of the Fund voted in favour of the Conversion and on May 13, 2010, the Ontario Securities Commission approved the final plan of arrangement.

The Conversion utilized legislative tax-free conversion options and became effective May 14, 2010. Pursuant to the terms of the Conversion, holders of Fund units received, in exchange for each of their Fund units, one common share of Pollard. Pollard Equities Limited, the holder of the Class B and Class C limited partnership units (collectively, the "Exchangeable LP Units") of Pollard LP and the associated Special Voting Units, received, in exchange for each group of one Exchangeable LP Unit (together with the accompanying Special Voting Unit), one common share of Pollard.

As a result of the Conversion, Pollard became the 100% owner of both the Fund and Pollard LP, with Pollard LP continuing to operate the business of manufacturing and selling lottery and gaming products.

Pollard is expected to pay a dividend that will be in line with typical dividend payout ratios for publicly traded corporations. The Board of Directors declared an initial dividend for the two month period ending June 30, 2010 at \$0.02 per share. The dividend declared on August 4, 2010, for the period ending September 30, 2010, will reflect the full quarterly dividend of \$0.03 per share.

After conversion there was no substantive change in the ultimate ownership of Pollard. As a result, the Conversion will be accounted for under the continuity of interests method. One consolidated financial statement incorporating the results of both the Fund and Pollard LP will be prepared. Comparative figures will be restated reflecting the combined results of both entities. As the Canadian operations of Pollard are now taxable under the *Income Tax Act* (Canada), the difference between the tax values and the net book value of the Canadian assets and liabilities have been recorded as future tax assets and liabilities in the comparative figures.

The costs related to the Conversion of \$0.7 million have been expensed in the second quarter.

## **Kamloops Facility**

On February 28, 2010, Pollard permanently closed its Kamloops production facility with all related production being transferred to its other facilities. A one-time facility closing accrual of \$4.7 million was accrued in the fourth quarter of 2009, representing the estimated closing costs including employee severance. It is anticipated that the rationalization of facilities will result in significant reduced net annual operating costs, beginning in March 2010, of approximately \$4 million on an annual basis.

## Sale of Kamloops Property

On June 25, 2010, the building and land formally used in the Kamloops operation was sold to an affiliate of Equities for total proceeds of \$2.9 million resulting in a gain of \$1.8 million. The selling price was based on an appraised value determined through an independent appraisal. Under certain circumstances if the affiliate of Equities re-sells the property to a third party for a price higher than \$2.9 million, Pollard will receive additional proceeds up to a maximum of \$0.2 million.

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 six months ended June 30, 2010.

### RECONCILIATION OF NET INCOME (LOSS) TO EBITDA

(millions of dollars)

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Net Income (Loss)	(\$1.0)	\$9.1	\$0.8	\$7.2
Adjustments:				
Interest	1.3	1.0	2.7	2.0
Unrealized foreign exchange loss (gain)	0.4	(2.9)	(0.8)	(1.9)
Mark-to-market loss (gain) on foreign currency contracts and interest rate swaps	(0.5)	(5.9)	(1.8)	(4.1)
Amortization of de-designated hedges	0.5	-	0.9	-
Conversion costs	0.7	-	0.7	-
Warranty reserve	0.7	-	0.7	-
Income taxes	1.4	1.5	1.8	1.4
Amortization	2.0	2.2	4.2	4.3
EBITDA	\$5.5	\$5.0	\$9.2	\$8.9

**SELECTED FINANCIAL  
INFORMATION**

(millions of dollars)

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Sales	\$43.2	\$49.5	\$84.4	\$96.5
Cost of Sales	35.5	40.0	69.1	78.9
Gross Profit	7.7	9.5	15.3	17.6
<i>Gross Profit as a % of sales</i>	<i>17.8%</i>	<i>19.2%</i>	<i>18.1%</i>	<i>18.2%</i>
Selling and Administration Expenses	5.3	5.6	10.1	11.3
<i>Expenses as a % of sales</i>	<i>12.3%</i>	<i>11.3%</i>	<i>12.0%</i>	<i>11.7%</i>
Realized foreign exchange loss	0.2	1.9	0.8	2.5
<i>Loss as a % of sales</i>	<i>0.5%</i>	<i>3.8%</i>	<i>0.9%</i>	<i>2.6%</i>
Net Income (Loss)	(1.0)	9.1	0.8	7.2
<i>Net Income (Loss) as a % of sales</i>	<i>(2.3%)</i>	<i>18.4%</i>	<i>0.9%</i>	<i>7.5%</i>
EBITDA	5.5	5.0	9.2	8.9

	June 30, 2010	December 31, 2009
Total Assets	\$140.5	\$154.3
Total Long Term Liabilities	\$78.2	\$76.5

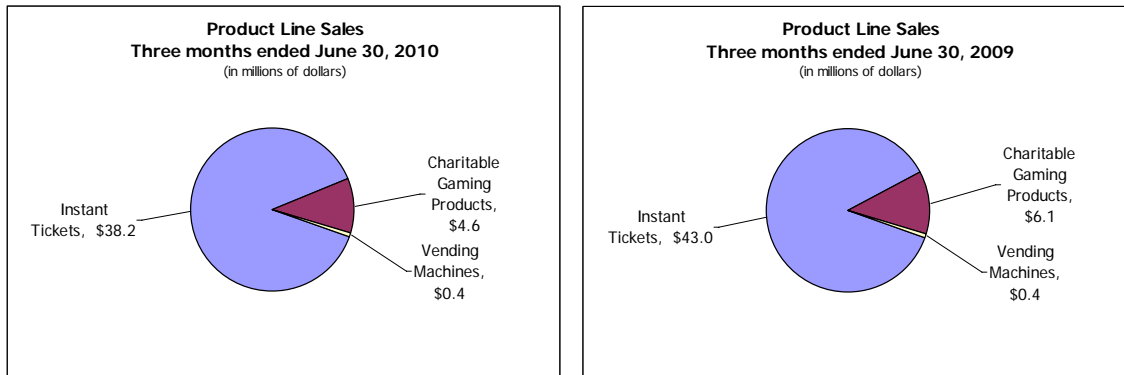
The selected financial and operating information has been derived from, and should be read in conjunction with, the consolidated financial statements of Pollard.

## 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 JUNE 30, 2010

### Sales



During the three months ended June 30, 2010, Pollard achieved sales of \$43.2 million, compared to \$49.5 million in the three months ended June 30, 2009. Factors impacting the \$6.3 million sales decrease were:

#### *Strengthening of the Canadian dollar*

During the three months ended June 30, 2010, Pollard generated approximately 76% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the second quarter of 2010 the actual U.S. dollar value was converted to Canadian dollars at \$1.04, compared to a rate of \$1.19 during the second quarter of 2009. This 13% decrease in the U.S. dollar value resulted in an approximate decrease of \$5.2 million in revenue relative to the second quarter of 2009. Also during the second quarter of 2010, the strengthening of the Canadian dollar against the Euro resulted in an approximate decrease of \$0.5 million in revenue relative to the second quarter of 2009.





## *Other*

Instant ticket volumes for the second quarter of 2010 were higher than the second quarter of 2009 which increased sales by \$2.8 million. This was offset by a decrease in average selling price compared to 2009 which reduced sales by \$3.4 million. Increased sales of related services such as our lottery management services generated an additional \$0.5 million in sales. Charitable Gaming volume decreased during the quarter reducing sales by \$0.5 million when compared to 2009.

### **Cost of sales and gross margin**

Cost of sales was \$35.5 million in the second quarter of 2010 compared to \$40.0 million in the second quarter of 2009. Lower exchange rates on U.S. dollar transactions in the second quarter of 2010 decreased cost of sales approximately \$2.7 million. In addition, cost of sales was lower due to lower costs associated with the mix of production and the initial impact of cost saving associated with the closure of the Kamloops facility.

Gross profit decreased from \$9.5 million (19.2% of sales) in the second quarter of 2009 to \$7.7 million (17.8% of sales) in the second quarter of 2010 due mainly to the increased volume of lower priced work during the quarter and the impact of the stronger Canadian dollar.

### **Selling and administration expenses**

Selling and administration expenses were \$5.3 million in the second quarter of 2010 which is lower than \$5.6 million in the second quarter of 2009 due to certain cost containment strategies and the initial impact of savings generated from the closure of the Kamloops facility.

### **Foreign exchange gain (loss)**

Foreign exchange loss was \$0.6 million in the second quarter of 2010 compared to a gain of \$1.0 million in the second quarter of 2009. Within the 2010 foreign exchange loss are unrealized losses of \$0.4 million, relating to a \$0.7 million foreign exchange loss on U.S. dollar denominated debt (caused by the weakening of the Canadian dollar between the balance sheets dates of March 31, 2010 and June 30, 2010) offset by unrealized net gains of \$0.3 million on U.S. dollar denominated receivables and payables, and \$0.2 million in realized losses on write-downs of U.S. dollar denominated receivables.

In the second quarter of 2009 the foreign exchange gain consisted of an unrealized gain of \$2.9 million relating to the foreign exchange on U.S. dollar denominated debt offset by \$1.0 million in realized losses relating to forward hedge contracts (caused by fixed exchange rates in the hedges being lower than the actual rates) and \$0.9 million in realized losses on write-downs of U.S. dollar denominated receivables.

### **Interest rate swaps**

A non-cash mark-to-market gain of \$0.5 million was recorded during the quarter ending June 30, 2010 on interest rate swap contracts no longer designated as hedges. In addition, amortization of \$0.5 of the previously recorded mark-to-market losses on these interest rate swaps, recorded as accumulated other comprehensive loss, was expensed in the second quarter of 2010.

### **Gain on sale of property, plant and equipment**

During the second quarter of 2010, Pollard disposed of a surplus building and land in Kamloops, British Columbia to an affiliate of Equities for total proceeds of \$2.9 million resulting in a gain of approximately \$1.8 million. The selling price was based appraised value as determined through an independent appraisal.

During the quarter ended June 30, 2009, Pollard disposed of a surplus building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of \$3.4 million resulting in a gain of \$1.7 million. The selling price was based on the current fair market value as determined through an independent appraisal.

### **EBITDA**

EBITDA was \$5.5 million in the second quarter of 2010 compared to \$5.0 million in the second quarter of 2009. The primary reasons for the increase in EBITDA were lower realized foreign exchange losses and lower selling and administration costs, partially offset by lower gross margin.

### **Amortization**

Amortization includes amortization of property and equipment and intangible assets and totaled \$2.0 million during the second quarter of 2010 which is similar to \$2.1 million during the second quarter of 2009.

### **Interest**

Interest expense increased from \$1.0 million in the second quarter of 2009 to \$1.3 million in the second quarter of 2010 due primarily to higher interest rates associated with the new syndicated credit facility completed on October 30, 2009.

### **Conversion costs**

Conversion expenses of \$0.7 million, primarily legal and accounting fees, were expensed in the second quarter of 2010 relating to conversion of Pollard to a publically traded corporation.

### **Warranty reserve**

A non-cash warranty reserve of \$0.7 million was accrued in the second quarter of 2010 relating to product produced in Fiscal 2009 for a specific customer as the originally delivered product no longer meets the contractual quality requirements.

### **Employee profit sharing**

Employee profit sharing costs decreased in the second quarter of 2010 to \$0.1 million as compared to \$0.6 million in the second quarter of 2009 due to reductions in income available for profit share. The mark-to-market gains on foreign currency contracts and interest rate swaps, as well as amortization of de-designated hedges, are excluded from the calculation of employee profit sharing.

## Income taxes

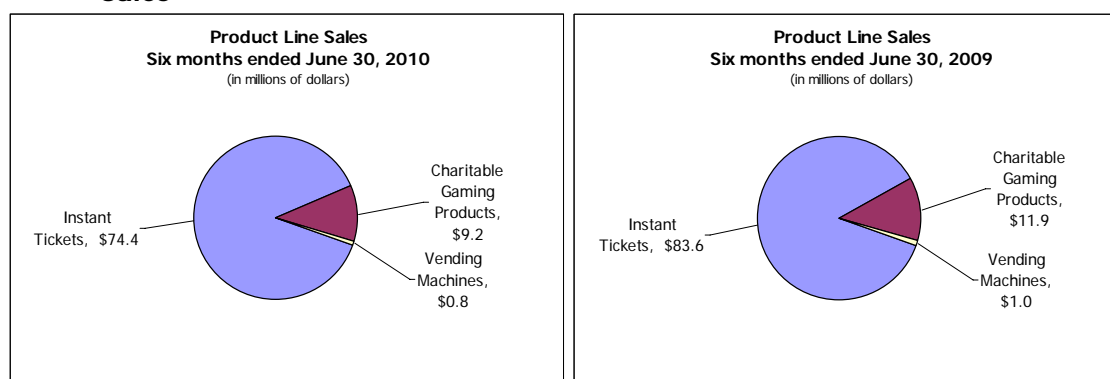
Income tax expense was \$1.4 million in the second quarter of 2010, similar to \$1.6 million in the second quarter of 2009. Income tax expense in both periods reflects that the Canadian operations of Pollard are now taxable.

## Net Income (Loss)

Net Loss was \$1.0 million in the second quarter of 2010 and in the second quarter of 2009 Net Income was \$9.1 million. The primary reasons for the decline were an elimination of the non-cash mark-to-market gain on foreign exchange currency contracts of \$5.9 million and a reduction in unrealized foreign exchange gains of \$3.3 million. Additional differences include a lower gross margin and non-recurring expenses related to conversion and warranty reserve costs.

## ANALYSIS OF RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2010

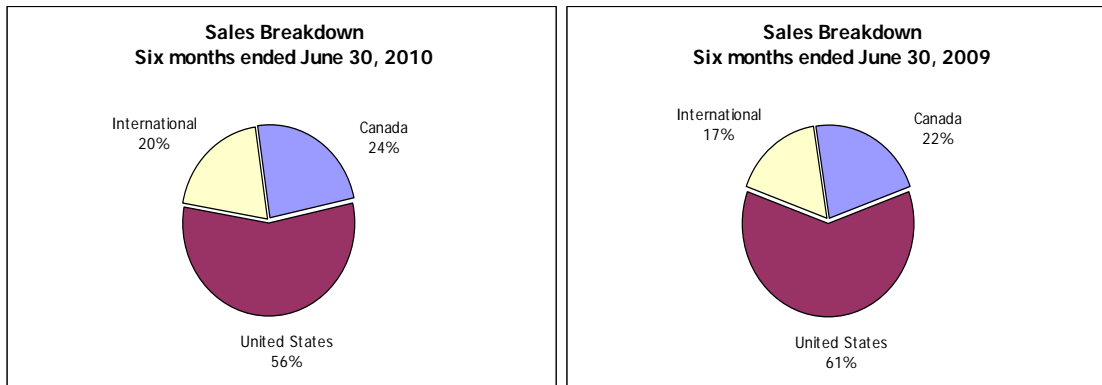
### Sales



During the six months ended June 30, 2010, Pollard achieved sales of \$84.4 million, compared to \$96.5 million in the six months ended June 30, 2009. Factors impacting the \$12.1 million sales decrease were:

### *Strengthening of the Canadian dollar*

During the six months ended June 30, 2010, Pollard generated approximately 71% of its revenue in U.S. dollars including a significant portion of international sales which are priced in U.S. dollars. During the first six months of 2010 the actual U.S. dollar value was converted to Canadian dollars at \$1.05, compared to a rate of \$1.22 during the first six months of 2009. This 14% decrease in the U.S. dollar value resulted in an approximate decrease of \$10.0 million in revenue relative to the first six months of 2009. In addition, during the six months ended June 30, 2010, the strengthening of the Canadian dollar against the Euro resulted in an approximate decrease of \$0.8 million in revenue relative to the first six months of 2009.



*Other*

Instant ticket volumes for the first six months of 2010 were higher increasing sales by \$5.2 million. A decrease in the average selling price of instant tickets reduced sales by \$5.3 million compared to the first half of 2009. Charitable Gaming Products volumes were lower than the first six months of 2009 reducing revenues by \$1.2 million.

**Cost of sales and gross margin**

Cost of sales was \$69.1 million in the six months ended June 30, 2010 compared to \$78.9 million in the first six months of 2009. Lower exchange rates on U.S. dollar transactions in 2010 decreased cost of sales approximately \$5.7 million. In addition, cost of sales were lower due to lower costs associated with the mix of production, lower costs of reproduction and the initial impact of cost savings associated with the closure of the Kamloops facility.

Gross profit decreased from \$17.6 million (18.2% of sales) in the first six months of 2009 to \$15.3 million (18.1% of sales) in the six months ended June 30, 2010, due to the impact of the strengthening Canadian dollar and a lower average selling price on instant ticket volumes.

**Selling and administration expenses**

Selling and administration expenses were \$10.1 million in the first six months of 2010 which is lower than \$11.3 million in the six months ended June 30, 2009, due to savings associated with the closure of the Kamloops facility and lower travel costs.

**Foreign exchange gain (loss)**

Within the 2010 foreign exchange gain (loss) is an unrealized gain of \$0.9 million, consisting of \$0.5 million gain on U.S. dollar denominated debt (caused by the strengthening of the Canadian dollar) and net gains of \$0.4 million on U.S. dollar denominated receivables and payables. Offsetting the unrealized gains was \$0.4 million in realized losses relating to forward hedge contracts (caused by a stronger Canadian dollar relative to fixed exchange rates in the hedges) and \$0.5 million in realized losses on write-downs of U.S. dollar denominated accounts receivable.

In the six months ended June 30, 2009, the foreign exchange loss of \$0.6 million consisted of an unrealized gain of \$1.9 million relating to the foreign exchange on U.S. dollar denominated debt offset by \$1.8 million in realized losses relating to forward hedge contracts (caused by fixed exchange rates in

the hedges being lower than the actual rates) and \$0.7 million in realized losses on write-downs of U.S. dollar denominated accounts receivable.

### **EBITDA**

EBITDA was \$9.2 million in the first six months of 2010 compared to \$8.9 million in the six months ended June 30, 2009. The primary reasons for the increase in EBITDA are lower realized foreign exchange losses, lower selling and administrative costs and lower profit share expense, partially offset by lower gross margin and other income.

### **Amortization**

Amortization includes amortization of property and equipment and intangible assets and totaled \$4.1 million during the six months ended June 30, 2010 which is similar to \$4.3 million during the first six months of 2009.

### **Interest**

Interest expense increased from \$2.0 million in the first six months of 2009 to \$2.7 million in the first six months 2010 due primarily to higher interest rates associated with the new syndicated credit facility completed on October 30, 2009.

### **Mark-to-market gain on foreign currency contracts**

A non-cash gain of \$0.8 million was recorded in the first six months of 2010, compared to a non-cash gain of \$4.1 million recognized in the first six months of 2009. On March 12, 2010, Pollard sold its remaining foreign currency contracts.

### **Interest rate swaps**

A non-cash mark-to-market gain of \$0.9 million was recorded during the first six months of 2010 on interest rate swap contracts no longer designated as hedges. In addition, amortization of \$0.8 of the previously recorded mark-to-market losses on these interest rate swaps, recorded as accumulated other comprehensive loss, was expensed in the first two quarters of 2010.

### **Gain on sale of property, plant and equipment**

During the first six months of 2010, Pollard disposed of a surplus building and land in Kamloops, British Columbia to an affiliate of Equities for total proceeds of \$2.9 million resulting in a gain of approximately \$1.8 million. The selling price was based on appraised value as determined through an independent appraisal.

During the six months ended June 30, 2009, Pollard disposed of a surplus building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of \$3.4 million resulting in a gain of \$1.7 million. The selling price was based on the current fair market value as determined through an independent appraisal.

### **Conversion costs**

Conversion expenses of \$0.7 million, primarily legal and accounting fees, were expensed in the second quarter of 2010 relating to conversion of Pollard to a publically traded corporation.

### **Warranty reserve**

A non-cash warranty reserve of \$0.7 million was accrued in the second quarter of 2010 relating to product produced in Fiscal 2009 for a specific customer as the originally delivered product no longer meets the contractual quality requirements.

### **Employee profit sharing**

Employee profit sharing costs decreased to \$0.3 million in the first six months of 2010 compared to \$0.5 million for the first six months of 2009 due to a reduction in income available for profit share. The mark-to-market gains on foreign currency contracts and interest rate swaps, as well as amortization of de-designated hedges, are excluded from the calculation of employee profit sharing.

### **Income taxes**

Income tax expense was \$1.9 million in the first six months of 2010 compared to \$1.4 million in the first six months of 2009. The income tax expense is higher due to differences relating to the foreign exchange impact of Canadian dollar denominated debt in U.S. subsidiaries. Income tax expense in both periods reflects that the Canadian operations of Pollard are now taxable.

### **Net Income**

Net Income was \$0.8 million in the first six months of 2010 compared to \$7.2 million in the first six months of 2009. The primary reasons for the decline were an elimination of the non-cash mark-to-market gain on foreign exchange currency contracts of \$3.3 million and a reduction in unrealized foreign exchange gains of \$1.0 million. Additional differences include a lower gross margin, higher income taxes and non-recurring expenses related to conversion and warranty reserve costs.

## Quarterly Information

(unaudited)

(millions of dollars)

	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Sales	\$43.2	\$41.2	\$46.9	\$48.4	\$49.5	\$47.0	\$50.2	\$44.1
EBITDA	5.5	3.7	5.6	6.3	5.0	3.9	8.0	8.0
Net Income (Loss)	(1.0)	1.8	-	7.8	9.1	(1.9)	(5.9)	1.7

Fluctuations in Sales, EBITDA, and Net Income (Loss) will vary by quarter depending on the timing of contract awards, changes in customer budgets, ticket inventory levels, lottery retail sales and mark-to-market adjustments to financial instruments.

Sales in Q1 2010 and Q2 2010 were lower due to the strengthening of the Canadian dollar relative to the U.S. dollar and a decrease in average selling prices.

Sales in 2009 were higher due to the weaker Canadian dollar over the year relative to the U.S. dollar.

Net Loss in Q4 2009 was primarily due to the impact of the Kamloops facility closure accrual.

Net Income in Q2 2009 and Q3 2009 was higher primarily due to higher mark-to-market gains on foreign currency contracts. Q2 2009 and Q2 2010 include a gain on sale of property, plant and equipment.

Net Loss in Q1 2009 was incurred primarily due to lower levels of gross profit.

Net Income in Q3 2008 was lower and a Net Loss in Q4 2008 was incurred, primarily due to the non-cash mark-to-market loss on our foreign currency contracts.

## Liquidity and Capital Resources

### *Cash provided by operating activities*

For the three and six months ended June 30, 2010, cash flow provided by operating activities was \$1.0 million and \$0.7 million, compared to cash flow provided by operations of \$0.4 million and \$4.1 million, for the comparable periods in 2009.

Changes in the non-cash component of working capital provided a decrease in cash flow from operations of (\$0.2) million for the three months ended June 30, 2010, compared to a decrease of (\$1.2) million for the three months ended June 30, 2009. For the six months ended June 30, 2010, changes in the non-cash component of working capital provided a decrease in cash flow from

operations of (\$2.4) million compared to an increase of \$0.1 million during the comparable period in 2009. For the three months ended June 30, 2010, the decrease in non-cash working capital was primarily the result of a decrease in accounts payable, partially offset by decreased accounts receivable and inventory at the end of the quarter.

#### *Cash provided by investing activities*

In the three and six months ended June 30, 2010, cash provided by investing activities was \$2.5 million (net) and \$2.3 million (net). This is net of (\$0.4) million and (\$0.6) million capital expenditures. Cash provided by investing activities included \$2.9 million in proceeds from the sale of property, plant and equipment in the three and six months ended June 30, 2010.

#### *Cash provided by financing activities*

Cash used by financing activities was (\$0.8) million and (\$0.9) million in the three and six months ended June 30, 2010. Dividend payments were the primary use of cash in the three months ended June 30, 2010 and dividend payments partially offset by an increase in long-term debt were the main factors impacting cash in the six months ended June 30, 2010.

Cash provided by financing activities was \$14.9 million and \$9.3 million in the three and six months ended June 30, 2009. Cash was provided by a net increase in long-term debt of \$19.8 million when Pollard LP's credit facilities were renewed on June 30, 2009 and the demand operating facility was replaced by a committed facility. This was offset by dividends of (\$4.1) million and (\$9.7) million in the three and six months ended June 30, 2009.

As at June 30, 2010, Pollard had unused committed debt facility of \$12.6 million. This amount is available to be used for future working capital requirements, contractual obligations, capital expenditures and dividends.

### ***Productive Capacity***

Management has defined productive capacity as the level of operations necessary to maintain 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 EBITDA and cash flow. A number of factors impact the level of 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 increases in productive capacity due to acquisitions since August 5, 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, assembled workforce 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 future distributable cash. 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 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 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.

	June 30, 2010	December 31, 2009
Working Capital	\$29.9	\$25.9
Total Assets	\$140.5	\$154.3
Total Long Term Liabilities	\$78.2	\$76.5

### ***Credit Facilities***

Pollard's credit facility 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 \$25.8 million (US\$25.0 million) for its U.S. subsidiaries. Borrowings under these credit facilities bear interest at fixed and floating rates based on Canadian and U.S. prime bank rates, banker's acceptances or LIBOR. At June 30, 2010, the outstanding letters of credit were \$5.1 million and the remaining balance available for drawdown was \$12.6 million.

As at June 30, 2010, Pollard had entered into interest rate swap contracts to fix the interest rates on approximately 34% of the long-term debt for a period of two months and an additional 20% of the long-term debt for a period of 14 months. These interest rate swaps allow Pollard LP and one of its subsidiaries to receive interest at floating rates and pay interest at a fixed rate.

Under the terms and conditions of the credit facility agreement Pollard LP is required to maintain financial covenants including working capital ratios, debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratios and certain debt service coverage ratios. As at June 30, 2010 and August 4, 2010 Pollard is in compliance with all covenants.

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 August 4, 2010 and June 30, 2010, outstanding share data was as follows:

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

Prior to the Conversion, the total number of limited partnership units in Pollard LP was 23,543,158 and the total number of Fund units, including Special Voting Units, was 23,543,158.

### ***Contractual Obligations***

There have been no material changes to Pollard's contractual obligations since December 31, 2009, 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, 2009, 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 LP and Fund for the year ended December 31, 2009.

## Critical Accounting Policies and Estimates

The critical accounting policies and estimates are substantially unchanged from those identified in the MD&A for Pollard LP and Fund for the year ended December 31, 2009.

## International Financial Reporting Standards

In January 2006, the Accounting Standards Board of Canada (“AcSB”) announced that accounting standards in Canada are to converge with the International Financial Reporting Standards (“IFRS”). Canadian publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Pollard established a four part planning framework in 2008 to ensure an effective and efficient transition regarding the introduction of International Financial Reporting Standards (“IFRS”) in 2011:

	<b>Step</b>	<b>Timing</b>
1.	Scoping the Effort	(completed 2008)
2.	Enabling the Resources	(Q3 2008 - Q4 2010)
3.	Executing the Plan	(Q3 2009 - Q1 2011)
4.	Monitoring the Process	(2008 - 2011)

Step 1 has been completed. Steps 2, 3 and 4 are currently ongoing. All detailed execution steps continue to be consistent with the times identified in the planning framework.

### 1. Scoping the Effort

A project team was identified utilizing both internal resources and where necessary, external resources. Formal timelines were established and appropriate training was received by all team members including participation in a number of externally led in-depth programs, ongoing formal review of updates and regularly scheduled meetings to confirm ongoing status.

### 2. Enabling the Resources

A review was undertaken of current accounting policies in comparison to the standards under IFRS. Differences were identified and documented, with those applicable to Pollard specifically reviewed to determine changes required and impact on current financial disclosure, systems and business activities.

### 3. Executing the Plan

Based on the differences identified in step #2, specific analysis was prepared identifying the preliminary recommended accounting policies (where choices are required) and analysis began to calculate the impact of on the opening transition balance sheet as at January 1, 2010. This analysis is planned to be completed in Q3 2010. A detailed seminar was held with the Audit Committee to review the preliminary recommendations relating to accounting policy choices and impact on other areas.

### 4. Monitoring the Process

Detailed quarterly updates have been prepared and presented to the Board of Directors and the Audit Committee of Pollard. Regular meetings are held to review the status of the transition plan and these will continue throughout 2010 and 2011.

The IFRS transition plan covers five main areas of Pollard's operations.

## **A Accounting Policies**

### 1. Future Accounting Policy Choices

Significant future accounting policy alternatives under IFRS have been reviewed. Recommendations, where choices are required, have been identified by management and approved in principle by the Audit Committee. Final approval is expected in the third quarter of 2010. Where differences exist with current Canadian GAAP analysis is being performed to quantify these differences.

### 2. Mandatory and Optional Exemptions

The balance sheet at the transition date of January 1, 2010 is projected to be completed and subject to review by the external auditors in the third quarter of 2010. IFRS #1 identifies certain voluntary and mandatory exemptions from adopting IFRS policies at transition date. Management has identified the optional exemptions to be utilized by Pollard and these have been approved in principle by the Audit Committee. Final approval is expected in the third quarter of 2010.

For a summary of Pollard's future accounting policies and optional exemptions under IFRS #1 please see the following chart on page 21.

### Preliminary Assessment

The impact on the opening balance sheet, including Shareholder's Equity, has not yet been determined and will be finalized upon final confirmation of the exemptions available under IFRS #1 and completion of the transitional balance sheet.

The future impact on the statements of operations and cash flow have not been determined, pending completion of the impact of revising amortization based on a detailed component approach for fixed assets. Currently management does not believe the impact will be materially different under IFRS compared to Canadian GAAP on a go forward basis.

## **B Internal Controls over Financial Reporting**

Upon finalization of the accounting policy choices on transition and for the future, any necessary changes will be implemented to the internal controls over financial reporting (“ICFR”) during the last two quarters of 2010. Appropriate review and testing of any new or changed controls will also occur during this time frame.

Based on our preliminary estimate of the impact of the new accounting standards not being significant, management does not expect impact on the ICFR to be significant and will focus on the key environment controls and management review and involvement to ensure the transition to IFRS is appropriately controlled.

## **C Disclosure Controls and Procedures**

Pollard will ensure its key stakeholders are informed about the anticipated effects of the IFRS transition including disclosure in our MD & A and we will provide quarterly updates throughout 2010 in our interim MD & A.

## **D Information Systems**

Our general ledger and financial reporting system is currently structured to allow for IFRS implementation without significant changes. The current fixed asset system allows for detailed component analysis to be tracked separately. No other major systems are expected to need significant changes.

## **E Business Activities**

A review of business related activities was undertaken during the scoping phase to identify issues that need to be addressed due to the transition to IFRS. The syndicated credit facility completed October 30, 2009, includes an allowance to reflect any potential impact based on IFRS adjustments. Other documents are being reviewed to determine any other required adjustments.

## **IFRS 1 – First-time Adoption of IFRSs and Future Accounting Policy Changes**

The initial adoption of IFRSs has required Pollard to review each of its accounting policies and determine whether or not a change is required or permitted under IFRSs and whether any amended policy is required to be applied on a retrospective or prospective basis. IFRS 1 generally requires retrospective application of the new policies but prospective application is required or permitted in some instances.

The below table is a high-level summary of the significant accounting policies of Pollard and the impact of adopting the new standard under IFRS 1. New standards under IFRS 1 that do not apply to Pollard have not been listed.

Accounting Policy	Policy change expected on transition to IFRSs	Is there an IFRS 1 exemption available?	Will the IFRS 1 exemption be applied?
<b>ELECTIVE EXEMPTIONS</b>			
Business Combinations	Yes	Yes	Yes
Fair Value or Revaluation as deemed Cost – Property, Plant and Equipment	No	Yes	No
Borrowing Costs	Yes	Yes	Yes
Employee Benefits – Actuarial Gains and Losses	Yes	Yes	Yes
Employee Benefit Plans – Defined Benefit Plans Disclosures	Yes	Yes	Yes
Cumulative Translation Differences	Yes	Yes	Yes

### **Business Combinations**

IFRS 3 will be applied prospectively in the opening IRFS statement of financial position and prior business combinations will not be restated due to Pollard choosing to apply the IFRS 1 exemption for business combinations prior to January 1, 2010. As required by the prospective application requirements relating to IFRS 3, Pollard will test its goodwill for impairment in accordance with IFRS at the date of transition.

### **Property, Plant and Equipment**

Under the requirements of IAS 16, the company will continue to account for all property, plant and equipment (“PP&E”) under the cost model. There are options available under the new standard to account for PP&E on a fair market value basis.

Under IFRS 1 there is an exemption available whereby an organization can elect at its opening transitional balance sheet to revalue some or all of its PP&E on a fair market value basis rather than cost. Pollard will not be electing this exemption.

International Accounting Standard (“IAS”) 16 also requires that assets be depreciated at the significant parts level. Pollard is currently finalizing its categorization and recalculating the impact of restating depreciation on this basis. This restatement will be applied both retrospectively (ie an adjustment to retained earnings and PP&E at the transitional opening balance sheet) as well as prospectively. Management does not believe any adjustments arising from this depreciation change will be material.

### **Borrowing Costs**

Under IAS 27 companies are required to capitalize borrowing costs directly attributable to acquisitions or construction activities under certain circumstances. Historically Pollard has not capitalized borrowing

costs and after adoption of IFRS will be required to prospectively capitalize borrowing costs for qualifying assets. Pollard will elect the IFRS 1 exemption and not retrospectively restate our financials to reflect the capitalization of borrowing costs.

### **Employee Benefits – Actuarial Gains and Losses**

Under adoption of IFRS 1 companies have the choice to recognize all cumulative unrecognized Actuarial Gains and Losses (“AGL”) at the date of transition. Pollard will be electing this exemption and will be recognizing retrospectively the cumulative unrecognized AGL in retained earnings at time of transition.

Companies also currently have the option to account for prospective AGL’s using a variety of methods including full recognition in income or recognizing over a period of time utilizing the corridor method. Pollard will continue to use the corridor method, which recognizes AGL’s into income over a period of time only if the absolute amount exceeds a certain level relative to the assets and liabilities of the pension plan. Under Canadian GAAP Pollard currently also follows the corridor method.

### **Employee Benefit Plans – Defined Benefit Plans Disclosures**

Under IFRS 1 a company can elect not to provide the extensive historical disclosures required under IAS 19. Pollard will elect the exemption to exclude the extensive disclosure on transition.

### **Cumulative Translation Differences**

Under IFRS 1 a first-time adopter can elect not to restate and recalculate the Cumulative Translation Differences (“CTA”) in accordance with the new standard. If an adopter uses this exemption the CTA difference is deemed to be zero at the transition date. Pollard will elect to utilize this exemption and the CTA related to translations differences will be deemed to be zero.

### **Related Party Transactions**

Pollard has not entered into any significant transactions with related parties during the six months ended June 30, 2010, which are not disclosed in the unaudited interim financial statements.

### **Industry Risks and Uncertainties**

The risk factors affecting Pollard remain substantially unchanged from those identified in the MD&A for Pollard LP and Fund for the year ended December 31, 2009.

### **Outlook**

The outlook for retail sales of instant lottery tickets is for moderate growth over the next few quarters. Indications within the overall lottery industry appear that there are some signs of increasing growth reflecting the overall improvement in retail sales as the world economy shows signs of improvement. In addition, increased expansion of instant tickets, particularly outside of North America, has generated higher retail sales growth. We anticipate our own instant ticket volumes to also reflect a slow but steady growth when compared to last year. We also expect the mix of product for the remainder of 2010 to reflect a great percentage of higher value products.

We have no major contracts coming due in 2010 when extensions are considered. During the quarter we announced that Pollard has been named as the new primary instant ticket supplier to the Minnesota Lottery. Production under this contract will be expected to begin in the third quarter of 2010.

The Canadian dollar remained strong relative to the U.S. dollar during the quarter. We manage our currency exposure risk to the U.S. dollar through our natural hedges including sourcing purchase inputs in U.S. currency, utilizing U.S. dollar denominated debt to hedge balance sheet exposure and efficiently using our U.S. based production facilities. A strong Canadian dollar does place negative pressure on our operating margins. In addition, we generate a small portion of our revenue in Euros. Over the last few quarters the Euro has weakened significantly relative to the Canadian dollar. As we have no natural hedges denominated in Euros any weakening in the Euro relative to the Canadian dollar will have a negative impact on our operating margins.

We will see improvements in our cost structure over the second half of 2010 due to the closing of the Kamloops facility. In addition we have undertaken a number of initiatives internally to improve our cost structure and efficiencies and we believe this focus will allow for additional cost savings over the next few quarters.

Pollard's conversion from an income trust to a publicly traded corporation was completed during the second quarter. After the Conversion, effective May 14, the Canadian operations of Pollard will now be subject to regular rates of corporate taxation on their taxable income.

Licensed product volume was lower than normal in the second quarter, a trend which started in the first quarter of 2010. Historically licensed product volumes were greater in the last half of the year, reflecting the run-up to the holiday season, and we believe this trend will continue in 2010 although unlikely to achieve the same overall margin levels of last year.

Our balance sheet is beginning to see the impact of our changes made to improve our cash flow including controlled capital expenditures and our new dividend policy. There are a number of business factors that will impact our cash resources in the near term including the continued payments of the Kamloops severance amounts and investments required in non-cash working capital for new client commitments such as the recently awarded primary contract for the Minnesota Lottery.

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") 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 six months ended June 30, 2010, 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 LP and Fund for the year ended December 31, 2009, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

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Consolidated Financial Statements of

**POLLARD BANKNOTE  
LIMITED**

(unaudited)

Six months ended June 30, 2010

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

## Pollard Banknote Limited

### Consolidated Balance Sheets

(In thousands of dollars)

(unaudited)

	June 30, 2010	December 31, 2009
<b>Assets</b>		
Current assets:		
Cash	\$ 5,846	\$ 3,706
Accounts receivable	17,604	16,361
Loan to Pollard Equities Limited (note 4)	2,157	12,572
Inventories (note 5)	17,590	20,259
Prepaid expenses and deposits	5,332	4,113
Net investment in leases due within one year	173	262
Future income taxes	1,751	2,529
	<b>50,453</b>	<b>59,802</b>
Property, plant and equipment	35,703	39,085
Net investment in leases	129	194
Goodwill (note 6)	32,366	32,316
Intangible assets (note 7)	18,414	19,326
Future income taxes	3,387	3,605
	<b>\$ 140,452</b>	<b>\$ 154,328</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 17,834	\$ 19,516
Dividends payable	471	298
Dividends payable to Pollard Equities Limited (note 4)	2,157	13,392
Income taxes payable	45	655
	<b>20,507</b>	<b>33,861</b>
Long-term debt	77,270	75,651
Other long-term liabilities	883	827
Foreign currency contracts	-	834
Interest rate swap contracts	652	1,423
Future income taxes	5,358	5,336
Shareholders' equity:		
Share capital (note 10)	73,209	73,209
Deficit	(34,874)	(33,405)
Accumulated other comprehensive loss (note 11)	(2,553)	(3,408)
	<b>35,782</b>	<b>36,396</b>
	<b>\$ 140,452</b>	<b>\$ 154,328</b>

See accompanying notes to consolidated financial statements.

**Pollard Banknote Limited**  
**Consolidated Statements of Income (Loss)**  
*(In thousands of dollars)*  
*(unaudited)*

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Sales	\$ 43,151	\$ 49,493	\$ 84,397	\$ 96,540
Cost of sales	<b>35,451</b>	40,053	<b>69,053</b>	78,947
	<b>7,700</b>	9,440	<b>15,344</b>	17,593
Expenses (income):				
Selling and administration	5,319	5,622	10,136	11,285
Interest	1,342	1,038	2,684	2,042
Foreign exchange loss (gain)	626	(979)	9	603
Amortization of intangibles	488	472	971	942
Mark-to-market gain on foreign currency contracts	-	(5,878)	(834)	(4,110)
Mark-to-market gain on interest rate swap contracts	(475)	-	(935)	-
Amortization of de-designated hedges	463	-	918	-
Gain on sale of property, plant and equipment (note 12)	(1,820)	(1,751)	(1,823)	(1,751)
Conversion costs (note 1)	673	-	673	-
Warranty reserve	700	-	700	-
Other income	(60)	(254)	(86)	(483)
	<b>7,256</b>	(1,730)	<b>12,413</b>	8,528
Income before the undernoted	444	11,170	2,931	9,065
Employee profit sharing	66	550	284	511
Income before income taxes	378	10,620	2,647	8,554
Income taxes:				
Current	402	640	777	1,122
Future	982	841	1,044	207
	<b>1,384</b>	1,481	<b>1,821</b>	1,329
Net income (loss)	\$ (1,006)	\$ 9,139	\$ 826	\$ 7,225
Basic and diluted income (loss) per share	\$ (0.04)	\$ 0.39	\$ 0.04	\$ 0.31
Weighted average number of shares outstanding	<b>23,543,158</b>	23,543,158	<b>23,543,158</b>	23,543,158

See accompanying notes to consolidated financial statements.

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

	<b>Three months ended June 30, 2010</b>	Three months ended June 30, 2009	<b>Six months ended June 30, 2010</b>	Six months ended June 30, 2009
Net income (loss)	<b>\$ (1,006)</b>	\$ 9,139	<b>\$ 826</b>	\$ 7,225
Other comprehensive income (loss):				
Unrealized (loss) gain on translation of self-sustaining foreign operations	<b>596</b>	(1,504)	<b>134</b>	(967)
Unrealized gain (loss) on derivatives designated as cash flow hedges, net of income tax of (\$11) and (\$45) (2009 – \$66 and \$115)	<b>(19)</b>	48	<b>(79)</b>	233
Amortization of de-designated hedges, net of income tax of \$58 and \$118	<b>405</b>	-	<b>800</b>	-
Other comprehensive income (loss) – net of income tax	<b>982</b>	(1,456)	<b>855</b>	(734)
Comprehensive income (loss)	<b>\$ (24)</b>	\$ 7,683	<b>\$ 1,681</b>	\$ 6,491

**Pollard Banknote Limited**  
**Consolidated Statements of Deficit**  
*(In thousands of dollars)*  
*(unaudited)*

	<b>Six months ended June 30, 2010</b>	Six months ended June 30, 2009
Balance, beginning of period	<b>\$ (33,405)</b>	\$ (32,026)
Net income for the period	<b>826</b>	6,527
Dividends declared	<b>(2,295)</b>	(9,696)
Balance, end of period	<b>\$ (34,874)</b>	\$ (35,195)

See accompanying notes to consolidated financial statements.

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

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Cash increase (decrease):				
Operating activities:				
Net income (loss)	\$ (1,006)	\$ 9,139	\$ 826	\$ 7,225
Items not involving cash:				
Amortization	2,030	2,127	4,135	4,273
Gain on sale of property, plant and equipment	(1,820)	(1,751)	(1,823)	(1,751)
Unrealized foreign exchange (gain) loss	392	(2,924)	(861)	(1,879)
Future income tax	982	841	1,044	207
Mark-to-market gain on foreign currency contracts	-	(5,878)	(834)	(4,110)
Mark-to-market gain on interest rate swaps	(475)	-	(934)	-
Amortization of de-designated hedges	405	-	860	-
Warranty reserve	700	-	700	-
Change in non-cash operating working capital	(184)	(1,177)	(2,454)	140
	<b>1,024</b>	<b>377</b>	<b>659</b>	<b>4,105</b>
Investing activities:				
Additions to property, plant and equipment	(431)	(747)	(662)	(1,832)
Proceeds from sale of property, plant and equipment	2,876	3,414	2,881	3,414
Change in net investment in leases	72	241	156	462
Change in intangible assets	(55)	(15)	(59)	(15)
	<b>2,462</b>	<b>2,893</b>	<b>2,316</b>	<b>2,029</b>
Financing activities:				
Change in long-term debt	(152)	19,877	2,261	19,835
Change in other long-term liabilities	104	(111)	62	(111)
Change in deferred financing charges	(294)	-	(296)	-
Change in loan to Pollard Equities Limited	(345)	(3,554)	10,415	8,747
Change in dividends payable	408	(199)	173	(199)
Change in dividends payable to Pollard Equities Limited	172	3,006	(11,235)	(9,295)
Dividends	(706)	(4,102)	(2,294)	(9,696)
	<b>(813)</b>	<b>14,917</b>	<b>(914)</b>	<b>9,281</b>
Foreign exchange (loss) gain on cash/bank indebtedness held in foreign currency	50	(33)	79	(404)
Change in cash position	<b>2,723</b>	<b>18,154</b>	<b>2,140</b>	<b>15,011</b>
Cash position (bank indebtedness), beginning of period	<b>3,123</b>	<b>(16,249)</b>	<b>3,706</b>	<b>(13,106)</b>
Cash position, end of period	<b>\$ 5,846</b>	<b>\$ 1,905</b>	<b>\$ 5,846</b>	<b>\$ 1,905</b>

See accompanying notes to consolidated financial statements.

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**

*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

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**1. Description of the Corporation:**

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

On May 14, 2010, the operations of Pollard Banknote Income Fund (the "Fund") and its main operating affiliate Pollard Holdings Limited Partnership ("Pollard LP") converted, by way of a Plan of Arrangement (the "Conversion"), to a corporation, 7510101 Canada Limited, which was subsequently renamed Pollard Banknote Limited. Prior to the Conversion the Fund indirectly owned, through the Pollard Banknote Trust ("Trust"), approximately 26.7 percent of Pollard LP and the remaining approximately 73.3 percent was owned by Pollard Equities Limited ("Equities"). Pursuant to the terms of the Conversion, holders of Fund units received, in exchange for each of their Fund units, one common share of Pollard. Equities, the holder of the Class B and Class C limited partnership units (collectively, the "Exchangeable LP Units") of Pollard LP and the associated Special Voting Units, received, in exchange for each group of one Exchangeable LP Unit (together with the accompanying Special Voting Units) one common share of Pollard.

As a result of the Conversion, Pollard became the 100% owner of both the Fund and Pollard LP, with Pollard LP continuing to operate the business.

The Conversion was accounted for as a continuity of interests method since there was no change of control. These consolidated financial statements incorporate the results of both the Fund and Pollard LP with the comparative figures having been restated to reflect the combined results of both entities. As the Canadian operations of Pollard are now taxable under the *Income Tax Act* (Canada), the difference between the tax values and the net book value of the Canadian assets and liabilities have been recorded as future tax assets and liabilities in the comparative figures.

These consolidated financial statements reflect the entities conducting the business of manufacturing and selling lottery and gaming products of the Pollard group as a corporation subsequent to May 14, 2010 and as an income trust and limited partnership prior to the conversion. All references to "common shares" collectively refer to Pollard's common shares on and subsequent to May 14, 2010 and Fund units and Class B and C limited partnership units prior to the Conversion. All references to "dividends" refer to dividends paid or payable to holders of Pollard common shares on and subsequent to May 14, 2010 and to distributions payable to Fund unitholders and Class B and C limited partnership unitholders prior to the Conversion. All references to "shareholders" refer collectively to holders of Pollard common shares on and subsequent to May 14, 2010 and to Fund unitholders and Class B and C limited partnership unitholders prior to the Conversion.

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

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**2. Basis of presentation:**

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Accordingly, certain information and footnote disclosure normally included in annual financial statements prepared in accordance with Canadian GAAP have been omitted or condensed. In the opinion of management, all adjustments considered necessary for fair presentation have been included in these financial statements.

These unaudited interim consolidated financial statements follow the same significant accounting policies as described and used in the consolidated financial statements of the Fund and Pollard LP for the year ended December 31, 2009 and should be read in conjunction with those reports.

These unaudited consolidated financial statements include the accounts of Pollard and the following 100 percent owned subsidiaries:

- Pollard Holdings Limited Partnership.
- Pollard Banknote GP Limited
- Pollard (U.S.) Ltd.
- Pollard Banknote Limited Partnership
- Pollard Holdings, Inc.
- Pollard Investments Limited
- Pollard Banknote Income Fund
- Pollard Banknote Trust.
- Pollard (Canada), Inc.
- PBL of Puerto Rico, Inc.
- Pollard Games, Inc.
- Nacako Sdn Bhd

All inter-company transactions have been eliminated.

Certain prior period amounts have been reclassified to conform to the current period's presentation.

**3. Future accounting standards:**

In January, 2006 the Accounting Standards Board of Canada ("AcSB") announced that accounting standards in Canada are to converge with the International Financial Reporting Standards ("IFRS"). Canadian publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Pollard is currently assessing the impact of these new standards on its consolidated financial statements.

In January, 2009, the CICA issued Section 1582, *Business Combinations*, replacing Section 1581, *Business Combinations*. This new section establishes standards for the measurement of



**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

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**3. Future accounting standards (continued):**

a business combination and the recognition and measurement of assets acquired and liabilities assumed. In addition, Section 1601, *Consolidated Financial Statements* was issued and replaced Section 1600, *Consolidated Financial Statements*. This new section establishes standards for the preparation of consolidated financial statements.

Pollard is required to apply Section 1582 prospectively to business combinations for which the acquisition date is on or after January 1, 2011. Section 1582 is the Canadian equivalent to International Financial Reporting Standard IFRS 3, *Business Combinations*. Pollard is also required to apply Section 1601 for fiscal years beginning on or after January 1, 2011. Section 1601 is equivalent to a portion of International Financial Reporting Standard IAS 27, *Consolidated and Separate Financial Statements*.

Pollard does not expect Sections 1582 and 1601 to have a material impact on its consolidated financial statements.

**4. Loan to Pollard Equities Limited and dividends payable to Pollard Equities Limited:**

Pollard Equities Limited has exercised its right to receive its entitlement to monthly cash dividends, prior to the Conversion, by way of a loan. The loan to Pollard Equities Limited and the dividends payable to Pollard Equities Limited will be settled subsequent to December 31, 2010. For purposes of financial presentation, the loan receivable from and related dividends payable to Pollard Equities Limited have been presented separately as there is no legal right of offset against each of these balances.

**5. Inventories:**

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	<b>June 30, 2010</b>	December 31, 2009
Raw materials	\$ 5,396	\$ 5,593
Work-in-process	907	753
Finished goods	11,287	13,913
	<b>\$ 17,590</b>	<b>\$ 20,259</b>

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During the second quarter of 2010, Pollard recorded reversals of previous write-downs of \$15 due to changes in foreign exchange rates. During the six months ended June 30, 2010, Pollard recorded inventory write-downs of \$19, representing an increase in the obsolescence reserves, and write-downs of \$1 due to changes in foreign exchange rates.

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

**6. Goodwill:**

During the second quarter of 2010 the value of goodwill increased \$596 as a result of changes in foreign exchange rates (2009 – decrease \$549). During the six months ended June 30, 2010, the value of goodwill increased \$134 as a result of changes in foreign exchange rates (2009 – decrease \$349).

**7. Intangible assets:**

June 30, 2010	Cost	Accumulated amortization	Net book value
Customer assets	\$ 18,645	\$ 5,718	\$ 12,927
Patents	4,716	3,379	1,337
Assembled workforce	3,736	-	3,736
Computer software	229	223	6
Deferred development costs	434	26	408
	\$ 27,760	\$ 9,346	\$ 18,414

December 31, 2009	Cost	Accumulated amortization	Net book value
Customer assets	\$ 18,645	\$ 5,139	\$ 13,506
Patents	4,714	3,040	1,674
Assembled workforce	3,736	-	3,736
Computer software	229	195	34
Deferred development costs	376	-	376
	\$ 27,681	\$ 8,375	\$ 19,326

Amortization of intangible assets in the second quarter of 2010 was \$488 (2009 - \$472) and for the six months ended June 30, 2010 was \$971 (2009 - \$942).

Intangible assets includes the excess purchase price over the underlying carrying amount of the net assets acquired as at August 5, 2005 as part of the 26.7% of Pollard LP sold in conjunction with the Initial Public Offering.

**8. 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.

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

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**8. Financial instruments (continued):**

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

The fair value of the investment in leases approximate the carrying value as the interest rates implicit in the leases approximate rates for similar type instruments.

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 long-term 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.

The fair value of the interest rate swap contracts is based on the amount at which they could be settled using current interest rates.

Certain financial instruments recorded at fair value on the balance sheet 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 June 30, 2010, the cash recorded at fair value is classified as level one and interest rate swap contracts recorded at fair value in the consolidated balance sheet are classified as level two, of the fair value hierarchy.

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

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**9. 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.

*Credit risk*

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

	<b>June 30, 2010</b>	December 31, 2009
Current	\$ 14,563	\$ 12,693
Past due for 1 to 60 days	2,740	3,019
Past due for more than 60 days	510	825
Less: Allowance for doubtful accounts	(209)	(176)
	<b>\$ 17,604</b>	<b>\$ 16,361</b>

*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 committed credit facilities including up to \$70,000 for its Canadian operations and up to \$25,750 (US\$25,000) for its U.S. subsidiaries. At June 30, 2010, the unused balance available for drawdown was \$12,636.

*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

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

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**9. Financial risk management (continued):**

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.

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 \$45 for the three months ended June 30, 2010 and \$90 for the six months ended June 30, 2010.

In addition, translation differences arise when foreign currency monetary assets and liabilities are translated at foreign exchange rates that change over time. As at June 30, 2010, the amount of financial liabilities denominated in U.S. dollars exceeds the amount of financial assets denominated in U.S. dollars by approximately \$12,269. 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 \$61.

*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. As at June 30, 2010, Pollard had entered into interest rate swap contracts to fix the interest rates on approximately 34% of the long-term debt for a period of two months and an additional 20% of the long-term debt for a period of 14 months. These interest rate swaps allow Pollard LP and one of its subsidiaries to receive interest at floating rates and pay interest at a fixed rate.

A 50 basis point decrease/increase in interest rates would result in an increase/decrease in income before income taxes of \$45 for the three months ended June 30, 2010 and \$90 for the six months ended June 30, 2010.

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

**10. Capital stock:**

	<b>June 30, 2010</b>	December 31, 2009
Authorized:		
Unlimited common shares		
Unlimited preferred shares		
Issued:		
23,543,158 common shares	<b>\$ 73,209</b>	\$ 73,209
	<b>\$ 73,209</b>	\$ 73,209

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.

*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 other comprehensive loss. The Board of Directors regularly monitors the levels of debt, equity and dividends.

Pollard monitors capital on the basis of funded debt to EBITDA, working capital ratio and debt service coverage. Pollard has externally imposed capital requirements as determined through its bank credit facility. As at June 30, 2010, Pollard is in compliance with all financial covenants.

On January 28, 2010, Pollard LP changed its dividend policy. Dividends of \$0.01 per share were declared for the month of February, payable March 15, 2010.

Following the Conversion, Pollard initiated a dividend rate of \$0.03 per share per quarter. The dividend declared on May 5, 2010, to shareholders on record on June 30, 2010, for payment July 15, 2010, was \$0.02 per share relating to the months of May and June. Prior to the Conversion, a dividend of \$0.01 per share was paid on May 14, 2010 for the month of April.

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

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

**11. Accumulated other comprehensive loss:**

	<b>Three months ended June 30, 2010</b>	Three months ended June 30, 2009	<b>Six months ended June 30, 2010</b>	Six months ended June 30, 2009
Translation of financial statements of self-sustaining foreign operations:				
Balance, beginning of period	\$ (2,650)	\$ 677	\$ (2,188)	\$ 140
Unrealized gain (loss) on translation of financial statements of self-sustaining foreign operations	<b>596</b>	(1,504)	<b>134</b>	(967)
Balance, end of period	<b>(2,054)</b>	(827)	<b>(2,054)</b>	(827)
Derivatives designated as cash flow hedges:				
Balance, beginning of period	<b>(885)</b>	(2,351)	<b>(1,220)</b>	(2,536)
Unrealized gain (loss) on derivatives designated as cash flow hedges, net of income tax (reduction) of (\$11) and (\$45) (2009 - \$66 and \$115)	<b>(19)</b>	48	<b>(79)</b>	233
Amortization of de-designated hedges, net of income tax of \$58 and \$118	<b>405</b>	-	<b>800</b>	-
Balance, end of period	<b>(499)</b>	(2,303)	<b>(499)</b>	(2,303)
Total accumulated other comprehensive loss	<b>\$ (2,553)</b>	\$ (3,130)	<b>\$ (2,553)</b>	\$ (3,130)

**12. Related party transactions:**

During the quarter Pollard disposed of a building and land in Kamloops, British Columbia to an affiliate of Equities for total proceeds of \$2,900 resulting in a gain of \$1,838. The selling price was based on appraised value as determined through an independent appraisal. Under certain circumstances if the affiliate of Equities re-sells the property to a third party for a price higher than \$2,900, Pollard will receive additional proceeds up to a maximum of \$200.

During the second quarter Pollard paid rent of \$674 (2009 - \$403) to affiliates of Equities and \$1,343 (2009 - \$810) during the six months ended June 30, 2010. During the second quarter, Equities paid Pollard \$18 (2009 - \$18) for accounting and administrative fees and \$36 (2009 - \$36) during the six months ended June 30, 2010.

**Pollard Banknote Limited**  
**Notes to Consolidated Financial Statements**  
**Six months ended June 30, 2010**  
*(In thousands of dollars, except for share amounts)*  
*(unaudited)*

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**12. Related party transactions (continued):**

At June 30, 2010, included in accounts payable and accrued liabilities is an amount owing to Equities and its affiliates of \$704. At June 30, 2009, included in accounts payable and accrued liabilities is an amount recoverable from Equities and its affiliates of \$552.

During the quarter ended June 30, 2009, Pollard disposed of a surplus building and land in Winnipeg, Manitoba to an affiliate of Equities for total proceeds of \$3,400 resulting in a gain of \$1,737. The selling price was based on the current fair market value as determined through an independent appraisal.

**13. Facility closing:**

On November 5, 2009, Pollard announced the closing of its Kamloops production facility effective February 28, 2010. In 2009 a facility closing reserve of \$4,746 was incurred primarily representing employee severance and related fringe costs. The cash outlays related to the facility closing accrual will be expended, starting March 1, 2010, over a period of approximately two years, consistent with the terms of their salary and benefit continuance based on their individual weeks of severance.