

## Pollard Banknote (TSE:PBL)

Consumer Discretionary – Commercial Services

### Betting Big on Scratch and Win

Aug 1, 2018

*Pollard Banknote (Pollard) is the second largest supplier of instant lottery tickets in the world, serving over 60 lottery and charitable gaming organizations worldwide. Pollard is headquartered in Winnipeg, Manitoba with manufacturing facilities located across Canada, the United States, and Europe.*

#### Thesis

Instant ticket lottery sales have been the fastest growing segment of the lottery industry for the past decade, with sales growing 67% worldwide between 2006 and 2016 and 7.4% in the U.S. in 2017. We believe that this trend will continue and will be driven by increasing government reliance on lottery revenues. Jurisdictions that do not support lotteries will move to adopt them while jurisdictions that already support lotteries will look for ways to maximize revenue generation. This means new customers for Pollard and increased demand from existing customers. In particular, we believe that demand will be highest for products that target the 18 to 35 year-old demographic as this group traditionally spends the least on lottery purchases and is central to the industry's continued growth. With products like the Social Instants™ app, which integrates the social media and instant ticket experiences, Pollard Banknote has shown an ability to meet this demand. As such, we believe Pollard is poised for success and increased profitability in the coming years.

#### Valuation

Based on a discounted cash flow and comparable companies analysis we determined a price target of \$18.00, which represents a downside of 13.0%. Although the economics of the lottery industry and Pollard's penchant for innovation give plenty of reasons to be optimistic about the company's future, we believe Pollard is fairly valued by the market and are initiating a Hold rating.

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#### Equity Research Canada

<b>Price Target</b>	<b>CAD\$ 18.00</b>
<b>Rating</b>	Hold
<b>Share Price (July 30 Close)</b>	CAD\$ 20.70
<b>Total Return</b>	-13.0%

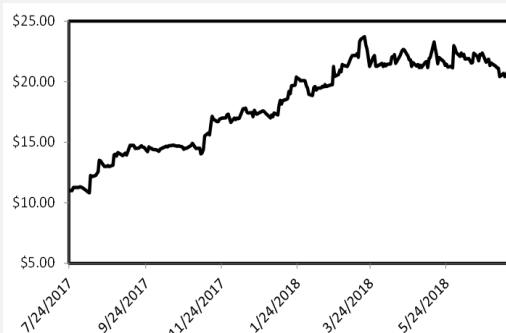
#### Key Statistics

<b>52 Week H/L</b>	\$24.09/\$9.78
<b>Market Capitalization</b>	\$530.2M
<b>Average Daily Trading Volume</b>	12,600
<b>Net Debt</b>	\$68.7M
<b>Enterprise Value</b>	\$598.9M
<b>Net Debt/EBITDA</b>	1.71x
<b>Diluted Shares Outstanding</b>	25.2M
<b>Free Float</b>	32.22%
<b>Dividend Yield</b>	0.58%

#### WestPeak's Forecast

	<u>2018E</u>	<u>2019E</u>	<u>2020E</u>
<b>Revenue</b>	\$333M	\$359M	\$388M
<b>EBITDA</b>	\$53M	\$57M	\$62M
<b>Net Income</b>	\$22.1M	\$26.3M	\$30.7M
<b>EPS</b>	\$0.88	\$1.05	\$1.22
<b>P/E</b>	24.1x	20.3x	17.3x
<b>EV/EBITDA</b>	8.9x	8.3x	7.6x

#### 1-Year Price Performance



## Business Overview

### Business Summary



Source: [Winnipeg Free Press](#)

Pollard Banknote's primary source of revenue is the design and manufacture of instant lottery tickets on behalf of lottery and charitable gaming organizations around the world. Pollard Banknote also provides a variety of lottery management services to lottery organizations which include, but are not limited to: market research, strategic planning, game development, graphic design, warehousing, and distribution services. Pollard Banknote is headquartered in Winnipeg, Manitoba, and has printing facilities in Canada, the United States, and Europe. Pollard Banknote has been at the forefront of recent innovations in the lottery industry, developing technologies like Scratch FX®, Fusion®, play Play3D™, and more. These technologies aim to increase the value of instant ticket gaming for Pollard's clients by attracting players with vibrant,

elaborate designs and multiple modes of play. Pollard has also been active in pursuing social media integration with its instant tickets. For instance, Pollard's patent pending Quick Link™ technology allows players to scan QR codes on their tickets which share their gaming experiences on social media via the Social Instants™ app. By doing so, players are rewarded with second chance draws and exclusive prizes. Pollard Banknote also offers lottery organizations access to its customizable online loyalty gaming platform, PlayOn™.

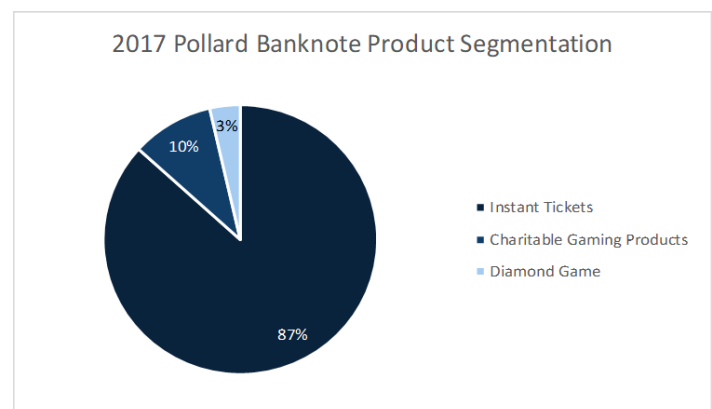
### Dividend Policy

Pollard Banknote has issued a dividend ever since going public. The dividend has remained \$0.03 per share since 2011 and neither the board nor management has expressed any interest in changing it. Therefore, we have assumed a quarterly dividend of \$0.03 per share for the foreseeable future in our analysis.

## Segment Information

### Product Lines

Pollard Banknote divides their product offerings into three segments: Instant Tickets, Charitable Gaming Products, and Diamond Game (Innova Game). Instant tickets are Pollard Banknote's most important product offering, contributing \$ 247.7 million in revenue during 2017, or 86.7% of overall revenue. Charitable gaming products contributed \$27.7 million to Pollard's top line in 2017 or 9.7% of total revenue and includes products such as bingo paper and pull tab cards

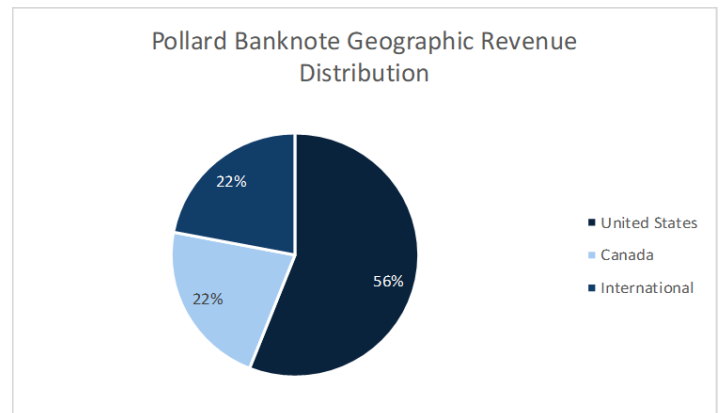


Source: [Company 2017 MD & A](#)

marketed for charity events and lotteries. Finally, Diamond Game contributed \$10.3 million in revenue during Q1 2018, or 3.6% of total revenue and includes products offered by Pollard's recently acquired Innova Game division such as the 'Gem 3' gaming cabinet. The revenues generated by the Diamond Game and Charitable Gaming segments will be much higher in 2018 as Diamond Game was only acquired in August of 2017 and International Gamco, a charitable gaming company, was acquired in February of this year.

## Geographic Segments

Pollard classifies their revenue into three geographic segments: Canada, United States, and International. The majority of Pollard's revenue (56%) was generated in the United States in 2017. Canadian sales accounted for a further 22% of 2017 revenue and the international segment made up the remaining 22%. Some of Pollard's largest international lottery customers are located in France, Taiwan, and Israel, among others.



Source: [Company 2017 MD & A](#)

## Acquisitions

### Diamond Game

In August 2017, Pollard Banknote acquired Diamond Game, a Los Angeles based company specializing in the design and manufacture of interactive lottery kiosks. Diamond Game's best-selling product is the LT-3 ITVM 'Gem 3', an instant win ticket dispenser which displays the results of the ticket on the kiosk, much like a slot machine. The LT-3 ITVM offers many opportunities for integration with Pollard Banknote's existing instant win products. It also offers lotteries the opportunity to vastly expand their retail presence by strategically placing the kiosks in non-traditional retail locations such as bars and parking lots, engaging players who would have otherwise not had the chance to play.

### International Gamco

In February 2018, Pollard Banknote acquired International Gamco, an Omaha based company specializing in the design and manufacture of charitable gaming products. Gamco's best-selling products include the TabBOXX lottery pull tab dispenser and a variety of break open charitable lottery tab tickets.



LT-3 'Gem 3' Source: [Company Website](#)

## Notable Products and Technologies

### Scratch FX®

Scratch FX® is a brand of materials and printing methods designed by Pollard Banknote which add sparkle, shine, and vibrancy to Pollard instant lottery tickets. These effects allow Pollard scratch tickets to stand out at retail, attracting players and increasing the overall value of the ticket. One example is Spectrum FX®, a method of four-colour printing over top of cold foil which produces extremely vibrant designs in any desired colour. Another is Shine FX™, a method of micro-embossing the tickets to produce a holographic effect aimed at catching the consumer's eye and prompting an impulse purchase.



Source: [Company Website](#)

### Social Instants™

Social Instants™ is an app developed by Pollard Banknote which allows players to share their winning experiences on social media by scanning QR codes on their tickets using Pollard's patent pending Quick Link™ technology. By doing so, players are rewarded with second chance draws on non-winning tickets and exclusive prizes. The primary aim of Social Instants™ is to seamlessly integrate the instant ticket gaming experience with social media, increasing its allure to the 18-35 year-old demographic.



Source: [Company Website](#)

### PlayOn™

PlayOn™ is Pollard Banknote's customizable, online loyalty gaming platform. Players subscribe to their local lottery organization's PlayOn™ website to receive exclusive offers, prizes, and second chance draws on non-winning tickets. PlayOn™ also allows lotteries to track the demographics and the spending habits of their most valuable customers.

### LT-3 ITVM

Diamond Game's LT-3 ITVM instant ticket dispenser allows players to purchase instant win lottery tickets in unconventional retail locations like bars and restaurants. It also encourages player interaction and excitement by displaying player results graphically on the dispenser. The aim of the LT-3 ITVM is to attract new lottery players, especially in the 18-35 year-old demographic, in environments not served by traditional retail lotteries.

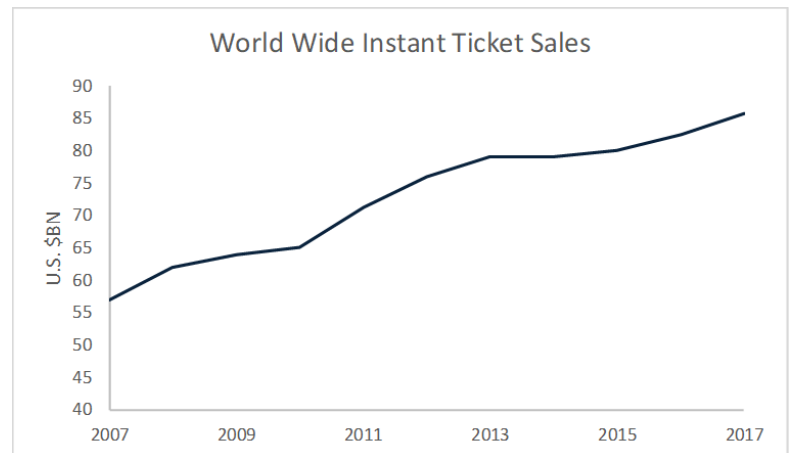
### TabBOXX

Much like Diamond Game's LT-3 ITVM instant ticket dispenser, International Gamco's TabBOXX pull-tab dispenser allows Gamco to supply and market its charitable gaming products in novel gaming environments. The wall mounted dispenser

uses a 17" touch screen to provide an interactive gaming experience and to attract new players with flashy graphics and advertising.

## Industry Analysis

The global lottery and charitable gaming industry has been growing steadily for the past decade, with revenues increasing at a CAGR of 5.7% between 2012 and 2016, according to the World Lottery Association ((WLA)). In the U.S. alone, state lottery sales were \$70.1 billion in 2014, more than sports, books, video games, movies, and music combined. Instant win tickets represent approximately 55% of global lottery sales and this percentage continues to grow rapidly. In 2017, U.S. scratch sales rose 7.4%, according to the North American Association of State and Provincial Lotteries ((NASPL)). Between 2006 and 2016, instant scratch



Source: 2018 AGM Presentation

sales grew 67% worldwide. We believe that the strong growth in scratch sales worldwide will continue for the foreseeable future. Gaming organizations will continue to rely on companies like Pollard Banknote to help them expand their product lines and to develop ways of attracting new players to drive revenues for cash strapped governments.

### Government Reliance on Lottery Revenues

In 2016, U.S. lotteries generated \$22.57 billion for local and state governments. In 2011, 11 out of 43 U.S. state lotteries generated more revenue for their jurisdictions than state corporate-income taxes. Since then, government deficits and funding shortfalls have continued to worsen around the globe. Lotteries offer cash strapped governments ways to raise revenue without implementing new taxes. In fact, lotteries are almost universally popular among different political ideologies and in the U.S. there is no significant lobby that opposes their implementation, with the exception of Nevada. Studies have shown that governments with inferior financial health are more likely to develop a lottery organization ((UNC)). Therefore, as deficits grow, it is expected that governments will be more reliant on state sponsored lotteries to fill their coffers. In turn, those lottery organizations will need to devise new and novel ways to squeeze more revenue out of their existing customers and to attract brand new players, especially in the 18-35 year old demographic. Companies like Pollard Banknote are well positioned to take advantage of these trends.

### Resiliency of the Lottery Industry

The lottery industry has proven to be somewhat resilient to economic downturns. Pollard Banknote grew its revenue by 9.7% in 2008, at the height of the financial crisis. In addition, various surveys and studies have shown that poorer households tend to spend more on lottery tickets than higher income households (Huffingtonpost). Many studies have also found that lotteries are regressive, with elasticities of income less than one. This means that the less income one has, the more they spend on lottery purchases. Blalock, Just, and Simon (2004) "[examined] lottery sales data from 39 states over 10 years and



[found] a strong and positive relationship between sales and poverty rates". Therefore, it is reasonable to expect lottery sales to remain stable in the event of an economic downturn as people continue to spend on the lottery despite their worsening financial health. However, this resiliency does not come at the expense of growth during more prosperous times. As previously mentioned, the lottery industry has seen steady worldwide growth since the 2007 economic crisis, with instant ticket lottery sales seeing the highest growth. During any future downturn, desperate governments facing even larger deficits than they currently do are likely to expand state sponsored lotteries rather than curtail them. The economic resiliency of lotteries bodes well for Pollard Banknote's revenues in the event of a recession in the near to mid-term while the rapid growth of the instant ticket market allows them to increase profits rapidly in the meantime.

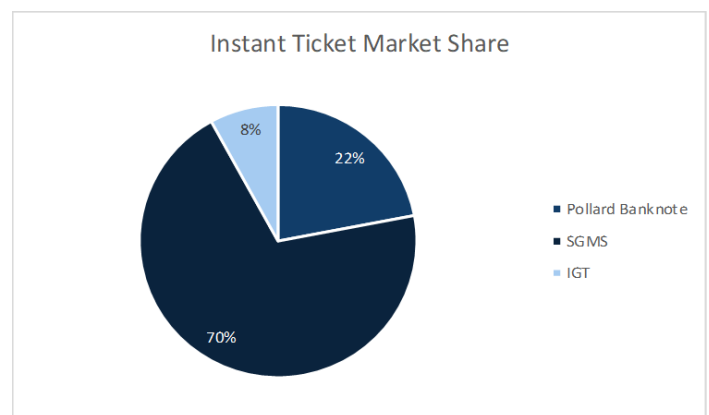
## High Barriers to Entry

The instant lottery ticket industry presents high barriers to entry for new competitors. The reasons for this are three-fold. Firstly, costs are already extremely low, with instant tickets being sold to lotteries at prices of roughly one penny per ticket. The risks are too high and the savings too low for lotteries to award contracts to new entrants in the space (BNNBloomberg). Secondly, new entrants lack the expertise of the established players, especially when it comes to ticket security and algorithm development - areas that are integral to the success of the lottery (BNNBloomberg). Finally, Pollard Banknote maintains an extensive repertoire of patents and registered intellectual property which gives them a competitive edge against any newcomers in the instant ticket space.

In addition, lotteries in the United States are prohibited from purchasing instant tickets from companies outside of the US, except for Canada, thanks to a provision in NAFTA, although it is unclear if this advantage will remain once NAFTA renegotiations are concluded. These high barriers to entry greatly benefit Pollard Banknote and its handful of competitors, enabling them to maintain high profit margins.

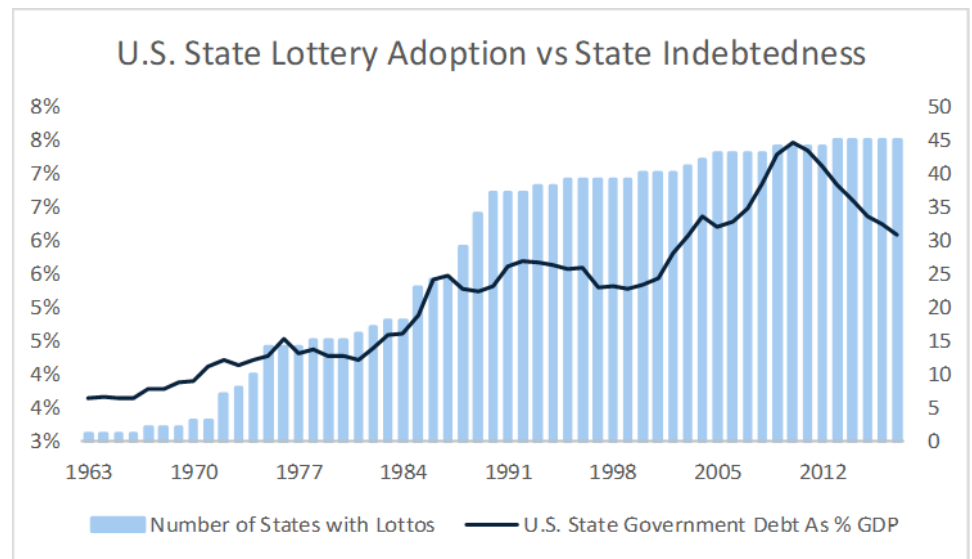
## Competitors

Pollard Banknote has identified two principal competitors in the instant ticket lottery industry: Scientific Games Corporation (NASDAQ:SGMS) and International Game Technology (NYSE:IGT). Scientific Games Corporation is by far the largest player in the space, controlling roughly 70% of the market share compared to 22% for Pollard Banknote and 8% for IGT (based on Pollard's own estimates). Both Scientific Games Corporation (SGMS) and IGT have significantly larger market capitalizations than Pollard, at \$4.33 and \$5.08 Billion US, respectively, compared to Pollard's \$397.49 Million US market cap. Both companies also boasted much larger revenues than Pollard with SGMS reporting revenues of \$3.08 Billion US in 2017 and IGT reporting revenues of \$4.94 Billion US in 2017 compared to Pollard's \$215.0 Million US in revenues.



Source: [Company 2017 MD & A](#)

Pollard Banknote is unique in the lottery industry in that it derives nearly 90% of its revenue from sales of instant tickets compared to only 20% for SGMS and 13% for IGT. We believe this is a benefit for Pollard as it allows them to be more focused when developing new instant ticket products and when searching for acquisition opportunities, especially considering that the instant ticket market is the fastest growing in the lottery industry. Pollard Banknote also has significantly less debt than its competitors, with a Net Debt/EBITDA ratio of 1.71 x compared to 6.10 x for SGMS and 4.11 x for IGT. Scientific



Source: [The Big Gamble](#), [usgovernmentdebt.us](#)

Games Corp even admitted in its 2016 annual report that its high leverage may force it to pass on otherwise favourable business expansion or acquisition opportunities. Pollard's comparatively low leverage levels give it tremendous flexibility and opportunity to expand at the expense of its competitors who are saddled with large debt loads.

## Catalysts

### Growing Government Deficits and Continued Government Reliance on Lottery Revenue

Local and federal governments in North America and across the globe continue to post growing deficits despite the relative strengthening of the global economy. Lotteries offer increasingly cash strapped administrations ways to generate badly needed revenue without raising taxes (which is politically agreeable). It is reasonable to expect that governments which currently do not support lotteries will move to adopt them in the future, especially if they are suffering from poor fiscal health ((UNC)). In addition, governments which currently do support lotteries are likely to expand their scope to raise even more revenue. As the second largest instant ticket manufacturer in the world and with many existing contracts with some of the world's largest lotteries, Pollard Banknote is well positioned to take advantage of this trend.

### Capturing Millennial Interest in the Lottery

The future of the lottery industry relies on lottery organizations being able to engage the 18-35 year old demographic. This segment of the population traditionally spends the least on lottery purchases (CBC, Walkerd). Otherwise, lottery revenues will stagnate and demand for Pollard Banknote's products will drop. Pollard Banknote has shown an exceptional ability to innovate to meet this challenge. Pollard's Social Instants™ app and Quick Link™ technology allow for the seamless integration of social media with the instant ticket experience. Products like Play3D™ and the LT-3 ITVM use eye catching designs and engaging player experiences to attract younger gamers. It is expected that Pollard's penchant for innovation

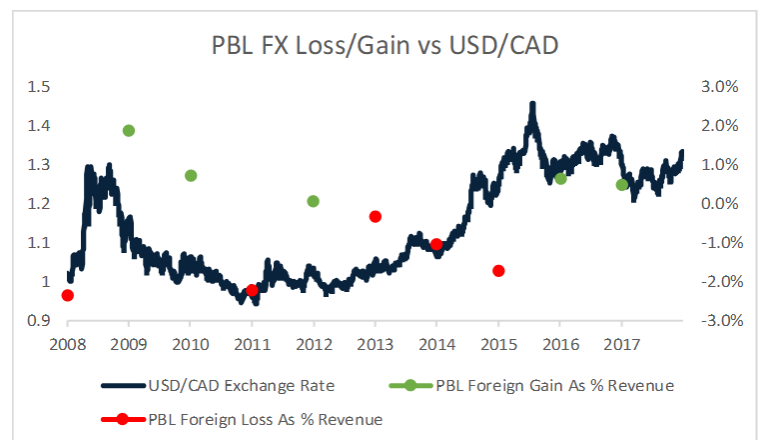
will continue to pay dividends in the future as their products boost lottery revenues by engaging members of this critical demographic.

## Acquisitions

Management has expressed an interest in continuing to acquire new businesses in interviews and in investor presentations, although they have given little in the way of specifics. Pollard finished their acquisition of Innova Gaming in August of 2017 and quickly followed up with the acquisition of International Gamco in February of 2018. The Innova Gaming acquisition gave Pollard access to novel technology in the form of Innova's gaming cabinets. These cabinets should open new markets for Pollard's instant tickets as they are deployed in non-traditional retail environments. In addition, the most recent Gamco acquisition should provide significant synergies and allow for continued expansion of Pollard's charitable gaming segment, which has not grown at the same rate as its instant ticket segment in recent years. Continued acquisitions of related businesses could provide an excellent avenue for revenue growth and synergies going forward.

## Weakening of the Canadian Dollar

A weaker Canadian dollar positively impacts Pollard Banknote's bottom line as the majority of their revenue is generated in U.S. dollars (approximately 65% during 2017). If the Canadian dollar were to weaken significantly against the U.S. dollar this would be a major boon for Pollard Banknote.



Source: [investing.com](http://investing.com)

## Risks

### NAFTA Negotiations

Pollard Banknote is the only international company permitted to supply American lotteries with instant tickets through NAFTA (BNNBloomberg). With the recent deterioration of NAFTA negotiations and with U.S. president Donald Trump threatening to repeal NAFTA entirely, Pollard's ability to do business in the U.S. may be negatively affected. Fortunately, many of Pollard's American instant tickets are manufactured in the U.S. and they recently finished an expansion of their Michigan manufacturing facility to meet the American demand. Despite this, a sizeable portion of the tickets Pollard sells in the U.S. must still be imported from Canada. If NAFTA is repealed Pollard Banknote's bottom line will undoubtedly be impacted but to what extent it is difficult to predict and management has admitted as much.

### Failure to Innovate

One of the key risks highlighted by Pollard's management team is the possibility that their new product offerings, especially their digital products like Social Instants™ and PlayOn™, may fail to attract new players and will not contribute significantly to Pollard's continued growth. In our model we assume that these products will prove to be successful and that Pollard will continue to devise novel, innovative ways of attracting new instant ticket lottery players. Failure to do so would have a significant negative impact on Pollard's business.



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## Dependence on Major Customers

57.4% of Pollard's 2017 revenues came from its 10 largest customers, mostly American state lotteries, and 12.0% came from its largest customer alone. Although Pollard Banknote has been extremely effective at retaining its customers to date, boasting a 100% retention rate in 2017, it would be a major blow to Pollard's business if one of its larger customers switched to a competitor.

## Strengthening of the Canadian Dollar

Because Pollard Banknote generates most of its revenue in U.S. dollars a strong Canadian dollar negatively impacts Pollard's bottom line. If the Canadian dollar appreciates significantly against its U.S. counterpart Pollard's profitability will suffer. Management has stated that they have hedging strategies in place but that these may contribute to the potential volatility of earnings results.

## Management Priorities

The majority of Pollard Banknote's outstanding shares (67.56%) are owned directly by the Pollard family. In addition, members of the Pollard family occupy many upper management and board positions. This arrangement creates the possibility of management and the board acting in the interest of the Pollard family over the interest of shareholders. Although there have been no examples of this occurring in the past, it is certainly something that shareholders should be cognizant of.

## Management Team

### Mr. Douglas Pollard – Co-CEO

Mr. Doug Pollard joined Pollard Banknote in 1997 and since then has served in a variety of roles at the company. His senior leadership roles included managing PBL's international subsidiary in Paris and running the company's lottery management service efforts in a multitude of jurisdictions. Mr. Doug Pollard was appointed Co-CEO in 2011. Before working at Pollard Banknote, he was a senior consultant with PricewaterhouseCoopers in their supply chain management group. He holds a Masters of Business Administration from the University of Western Ontario and a Bachelor of Arts from the University of Manitoba. Mr. Douglas Pollard received \$315,774 total compensation in 2016, of which \$289,205 was base salary, \$1,569 was annual bonuses, and \$25,000 was pension contributions. No stock-based compensation was awarded.

### Mr. John Pollard – Co-CEO

Mr. John Pollard joined Pollard Banknote in 1986 and served as VP, Operations and VP, Finance for 11 years before being appointed co-CEO in 1997. He is a former member of The Institute of Chartered Accountants of Manitoba and worked for the accounting firm of Deloitte & Touche before joining Pollard Banknote. Mr. John Pollard holds a Bachelor of Commerce (Honors) degree from the University of Manitoba and attained his Chartered Accountant designation in 1986. Mr. John Pollard received \$310,774 total compensation in 2016, of which \$289,205 was base salary, \$1,569 was annual bonuses, and \$20,000 was pension contributions. No stock-based compensation was awarded.

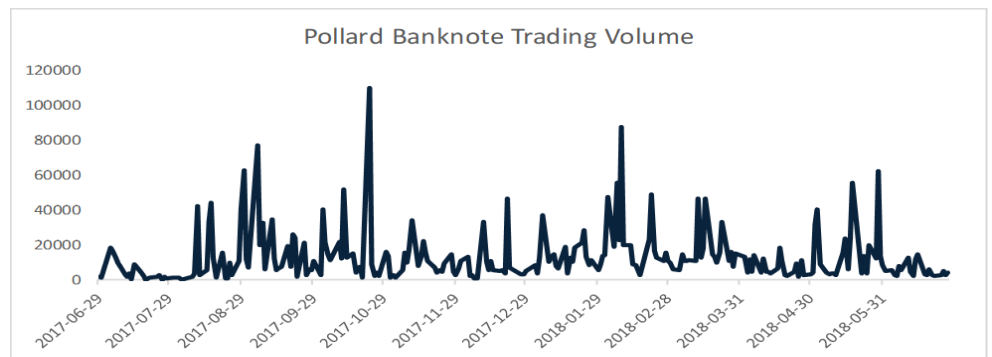
## Shareholder Base, Liquidity

### Shareholder Base

Pollard Banknote has 25.6 million shares outstanding. The majority (67.56%) of the shares are held by Pollard Equities Limited on behalf of the Pollard family. A further 761,928 (2.97%) of the shares are held by institutions, with Norrep Capital Management Ltd. having the largest position, owning 0.78% of outstanding shares. Because many of the outstanding shares of Pollard Banknote are held by the Pollard family and few are held by institutional investors we cannot conclude that the stock is of institutional quality.

### Liquidity

For the past 12 months the average daily trading volume has been a mere 12,600 shares or 0.00049% of shares outstanding, with as little as 1,000

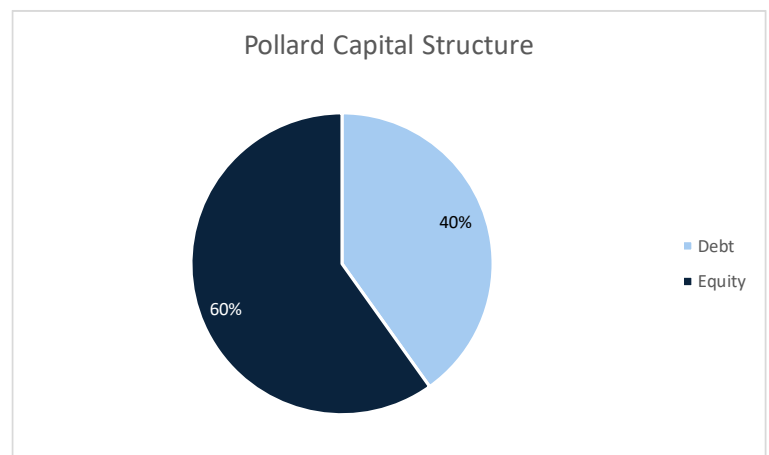


Source: [Yahoo! Finance](#)

shares exchanged on some days. The largest single day trading volume of the past twelve months was on October 23, 2017 when 110,000 shares changed hands. The stock's extraordinarily low liquidity poses significant liquidity risks for institutional investors and even for retail investors looking to enter or exit large positions.

### Capital Structure

Pollard Banknote has a strong balance sheet with \$67.6 Million in debt and a further \$50.7 Million unused credit facility with \$100.8 Million in shareholder equity and assets of \$249.8 Million as of Q1 2018. This gives Pollard a conservative capital structure with a debt to equity ratio of 0.67 x. Pollard's current net debt to EBITDA ratio is 1.71 x and Pollard pays a variable interest rate of between 3.5 and 4.6% on debt issued through its long term credit facility. Recently, Pollard has been drawing on this credit facility to facilitate its acquisitions and this is expected to continue.



Source: CapIQ

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## Comparable Companies Analysis

For our comparable companies analysis, we compared Pollard Banknote to other publicly traded companies which provide products and services for the lottery and gambling industry. Unfortunately, very few companies focus exclusively on instant ticket manufacturing like Pollard Banknote. However, we believe the economic, social, and political factors which influence the lottery and gambling industry as a whole also affect the instant ticket business in similar ways.

### **Intralot S.A.**

Intralot S.A. is a multinational company headquartered in Athens that designs and develops integrated on-line lottery systems. The Company produces and markets hardware and software.

### **Scientific Games Corporation**

Scientific Games Corporation provides services, systems, and products to both the pari-mutuel gaming and instant ticket lottery industries. The Company operates an instant ticket and online lottery products, systems, and services business. Scientific Games also operates wagering and communications, venue management, and telecommunications products businesses. Scientific Games is the largest producer of instant tickets in the world.

### **Playtech PLC**

Playtech PLC develops unified software platforms and content for the online, mobile, and land-based gaming industry. The Company's gaming applications include casino, poker, bingo, sports betting, live gaming, casual and fixed odds games.

### **Jumbo Interactive Limited**

Jumbo Interactive Limited is the leading digital retailer of national and charitable lotteries in Australia.

### **Gamehost Inc.**

Gamehost, Inc. owns and operates gaming and hospitality businesses across Alberta.

### **Great Canadian Gaming Corporation**

Great Canadian Gaming Corporation operates a number of casinos, bingo halls, and racetracks across North America.

## Comparable Analysis Summary

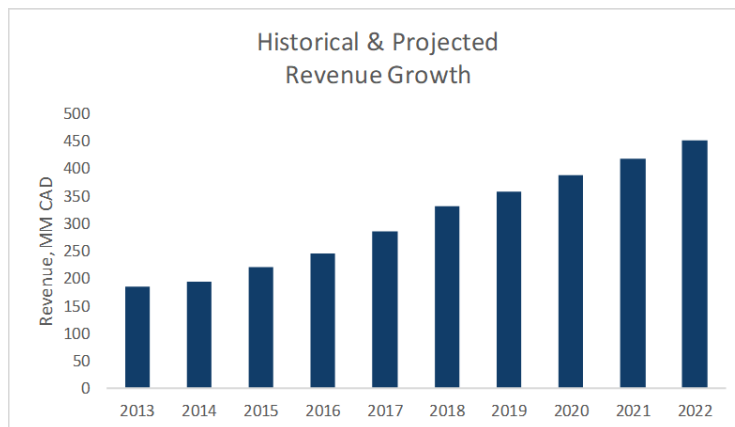
Our comparable companies analysis indicated a target share price of approximately \$15.75 utilizing an implied EV/EBITDA of 8.5x and a target share price of approximately \$13.68 utilizing an implied P/E multiple of 20.2x, representing a downside of 22.1% and 33.9% respectively. For comparison, Pollard's estimated 2019 EV/EBITDA multiple is 10.1x and its estimated 2019 P/E multiple is 25.7x, among the highest in the industry. However, we believe that the strengths which underlie the instant ticket lottery industry in general and the opportunities Pollard has to expand its business both organically and inorganically more than justify the higher multiples. Pollard has a significantly lower Debt/EBITDA ratio than its direct

competitors, which gives it the ability to seize future business opportunities which will be unavailable to its contemporaries who are more leveraged.

## Discounted Cash Flow Analysis

### Revenue Growth

This assumes that instant ticket sales will continue to grow rapidly worldwide and that the factors which have been driving lottery expansion around the world for the past several decades will continue to hold true. It also assumes that Pollard will capture more market share with their innovative product offerings, especially Social Instants™ and other products aimed at attracting the 18-35 year-old demographic. The 8% annual growth rate is also taking into consideration Pollard's favourable credit situation compared to its competitors. Following these assumptions, revenue is projected to reach \$428 million by 2022.



Source: WestPeak Estimates

### Costs

The cost of goods sold represents around 72% of Pollard's revenue on average and sales, general, and administrative expenses represent around 12%. Management has not provided any guidance suggesting that these numbers are likely to change and we have not uncovered anything which would suggest otherwise.

### Working Capital

Pollard Banknote's accounts receivable as a percentage of revenue has averaged around 13% and inventories as a percentage of revenue have averaged around 12%. Management has stated that they expect the amount of working capital to be slightly lower in the near future and this is reflected in the model.

### Capital Expenditure

Over the past seven quarters, capital expenditure has represented, on average, 4.25% of revenue. Management has expressed that they believe that capital expenditures will remain at roughly this level going forward. We have assumed the same in our discounted cash flow analysis. Historically, capital expenditures have been limited to upgrading plant and equipment.

### Effective Tax Rate

Pollard Banknote's effective tax rate has fluctuated wildly over the past four years, from a high of 41.8% in 2013 to a low of 15.4% in Q1 2016. These fluctuations are largely due to differences relating to the foreign exchange impact of Canadian

dollar denominated debt in Pollard's U.S. subsidiaries. Management has stated that they expect an effective tax rate of 27.0% going forward, although we believe this to be overly optimistic as the effective tax rate has been consistently higher than 27.0% since Q1 2016. Therefore, we have assumed an effective tax rate of 30% in our analysis.

## Weighted Average Cost of Capital

We determined a weighted average cost of capital ((WACC)) of 8.1%. We calculated the WACC based on the cost of equity using a risk-free rate of 1.95%, which is the 5-year Canadian Treasury benchmark yield, and a market risk premium of 9% based on historic S&P 500 returns. Pollard Banknote has an average cost of debt of roughly 4.1% and a cost of equity of 9.0% based on the risk-free rate and the expected market return. We used a beta of 1.00 because we expect Pollard to grow in line with the market.

## Terminal Growth Rate

We used a terminal growth rate of 2.0% to calculate an implied price target of \$19.71 per share.

## Terminal EV/EBITDA Multiple

We used a terminal EV/EBITDA multiple of 10x for our discounted cash flow analysis. We believe that this multiple, although elevated by lottery industry standards, appropriately embodies the opportunities for growth in the instant ticket space and underscores the strengths of Pollard Banknote. In particular, we believe that Pollard's ability to innovate and their low Debt/EBITDA ratio compared to their competition will fuel their continued growth and success. A terminal EV/EBITDA multiple of 10 x gives an implied share price of \$21.62.

## Discounted Cash Flow Analysis

Using the aforementioned assumptions, our discounted cash flow analysis implies a target share price of approximately \$20.67 when giving the terminal growth rate and exit EV/EBITDA multiple equal weighting. This is roughly what shares of Pollard Banknote trade at as of writing.

## Valuation

Despite the positive outlook for the instant ticket lottery business and Pollard Banknote's penchant for innovation, our comparable analysis determined significant downside risk when using both implied EV/EBITDA and implied P/E multiples with an average implied share price of \$14.72 (using 2018 E). Our discounted cash flow analysis painted a slightly more bullish picture with an implied share price of \$20.67. Averaging the implied comparable and DCF share prices gives us a target share price of roughly \$18.00. The positive outlook for the instant lottery business and for Pollard in particular is reflected in the current share price and therefore we are initiating a HOLD rating. Current shareholders can be confident in their positions while those looking to initiate a new holding may wish to wait for a pullback.



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## Recommendation

We believe instant ticket lottery sales and lottery sales in general will continue to grow for the foreseeable future, as will Pollard Banknote's revenue. This growth will be driven by two main factors: continued government reliance on lottery revenues, and Pollard Banknote's ability to engage members of the 18 to 35 year-old demographic. Governments across the globe continue to post growing deficits and will search for politically convenient ways to increase revenues. This means new potential customers for Pollard as well as an increased demand for creative, engaging, and revenue driving instant tickets and ancillary products from Pollard's existing customers. In addition, lotteries who wish to increase their revenue will have to attract more players from the critical 18 to 35 year-old demographic and squeeze more revenue from their older players. This is a challenge which Pollard has set out to meet with products and technologies like Social Instants™, PlayOn™, and the LT-3 ITVM. Ultimately, we believe Pollard will be successful with these ventures. However, we believe that Pollard's shares are already fairly valued given the success they've had growing their business and the success they should continue to enjoy moving forward.

If Pollard's share price drops substantially in the coming months or their revenue continues to grow at faster than expected rates, then we would likely re-evaluate our position on the company.

## Appendix 1 (all figures in CAD):

	Operating Model													
	FY2013	FY2014	FY2015	FY2016	FY2017	Q1-2018	Q2-2018	Q3-2018	Q4-2018	FY2018	FY2019	FY2020	FY2021	FY2022
Cash flow from operating activities	12.3	18.8	19.7	11.7	28.4	20.1	(0.8)	15.7	4.2	39.3	153.6	(77.5)	42.2	46.0
Cash used in investing activities	(8.4)	(18.8)	(16.5)	(6.4)	(51.2)	(26.6)	(2.3)	(2.3)	(2.2)	(33.5)	(8.8)	(8.2)	(10.1)	(9.9)
Cash from financing activities	(1.2)	(1.6)	(2.3)	(5.4)	21.3	8.8	(0.8)	(0.8)	(0.8)	6.5	(3.0)	(3.0)	(3.0)	(3.0)
FX effect	0.1	0.0	0.5	0.0	(0.4)	(0.2)				(0.2)				
Net change in cash	2.8	(1.6)	1.4	(0.1)	(1.9)	2.1	(3.9)	12.6	1.2	12.1	141.8	(88.7)	29.1	33.1
<b>Balance Sheet</b>														
Total current assets	53.8	56.4	63.3	80.0	90.5	91.9	98.0	97.6	108.1	108.1	253.7	172.0	208.7	250.0
Total non-current assets	79.5	92.9	100.8	96.8	137.8	158.0	156.9	155.8	154.7	154.7	150.4	146.5	145.4	144.3
Total assets	133.4	149.3	164.1	176.8	228.3	249.8	254.9	253.3	262.8	262.8	404.1	318.5	354.1	394.3
Total current liabilities	20.6	26.2	24.2	30.5	45.9	49.9	49.3	43.5	47.6	47.6	165.6	52.4	55.7	59.3
Non-current liabilities														
Total liabilities	99.7	115.4	120.5	124.9	170.7	149.1	148.4	142.6	146.8	146.8	264.7	151.5	154.9	158.5
Total shareholders' equity	33.6	33.9	43.6	51.8	57.6	100.8	106.4	110.7	116.0	116.0	139.3	167.0	199.2	235.8
Total liabilities and shareholder's equity	133.4	149.3	164.1	176.8	228.3	249.8	254.9	253.3	262.8	262.8	404.1	318.5	354.1	394.3

## Appendix 2: Comparable Companies Analysis (all figures in CAD, share prices as of 7/30/2018)

Comparable Company Analysis									
Company	Ticker	Equity Value	Enterprise Value	EV/EBITDA Multiple			P/E Multiple		
				NTM EV/EBITDA	2018E EV/EBITDA	2019E EV/EBITDA	NTM P/E	2018E P/E	2019E P/E
International Game Technology PLC	(NYSE:IGT)	6,459.6	16,461.9	7.1 x	7.1 x	6.9 x	15.3 x	20.0 x	14.6 x
Intralot S.A.	(ATSE:INLOT)	166.8	947.0	3.4 x	3.5 x	3.3 x	(10.1 x)	(10.1 x)	(20.1 x)
Scientific Games Corporation	(NASDAQ:SGMS)	5,603.4	17,241.7	9.5 x	9.6 x	9.1 x	(422.5 x)	(22.2 x)	67.4 x
Jumbo Interactive Limited	(ASX:JIN)	212.8	167.8	12.7 x	12.1 x	10.4 x	26.5 x	24.8 x	22.1 x
Gamehost Inc.	(TSX:GH)	296.2	308.3	10.4 x	10.4 x	9.8 x	16.2 x	16.2 x	14.9 x
Great Canadian Gaming Corporation	(TSX:GC)	2,826.7	3,045.4	8.0 x	8.2 x	7.2 x	15.8 x	19.8 x	17.1 x
Pollard Banknote	(TSX:PBL)	521.6	592.1	10.4 x	10.7 x	10.1 x	22.9 x	30.6 x	25.7 x
Median				8.7 x	8.9 x	8.1 x	16.0 x	19.9 x	17.1 x
Mean				8.5 x	8.5 x	7.8 x	18.5 x	20.2 x	17.2 x
High				12.7 x	12.1 x	10.4 x	26.5 x	24.8 x	67.4 x
Low				3.4 x	3.5 x	3.3 x	16.2 x	16.2 x	14.6 x
				EV/EBITDA Implied Price			P/E Implied Price		
Median				\$ 16.85	\$ 16.68	\$ 16.19	\$ 14.50	\$ 13.48	\$ 13.77
Mean				\$ 16.37	\$ 15.75	\$ 15.38	\$ 16.68	\$ 13.68	\$ 13.83
High				\$ 25.77	\$ 23.63	\$ 21.57	\$ 23.92	\$ 16.79	\$ 54.27
Low				\$ 4.93	\$ 4.87	\$ 4.99	\$ 14.68	\$ 10.99	\$ 11.78

## Appendix 3: Discounted Cash Flow Analysis (all figures in CAD)

Discounted Cash Flow Analysis														
	FY2013	FY2014	FY2015	FY2016	Q1-2017	Q2-2017	Q3-2017	Q4-2017	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
WACC Calculations														
Cost of Equity														
Risk-free rate	1.95%													
Expected market return	9.0%													
Market risk premium	7.1%													
Beta	1.00													
Cost of equity	9.0%													
Cost of Debt														
Pre-tax cost of debt	4.1%													
Effective tax rate	30.0%													
Cost of debt	2.0%													
WACC														
Market value of equity	437.6													
Total outstanding debt	103.2													
Total capitalization	540.8													
Cost of equity	9.0%													
Cost of debt	4.1%													
WACC	8.1%													
Free Cash Flow														
EBIT	13.5	17.5	18.1	20.3	3.8	9.3	6.7	7.4	27.0	38.8	44.4	49.9	55.8	61.4
Less: Tax expense	(4.1)	(5.3)	(5.4)	(6.1)	(1.1)	(2.8)	(2.0)	(2.2)	(8.1)	(11.6)	(13.3)	(15.0)	(16.7)	(18.4)
Add: Depreciation and amortization	8.6	7.9	8.4	10.8	2.6	2.6	3.6	4.4	13.2	14.2	13.0	12.1	11.2	11.0
Less: Capital expenditures	(4.6)	(17.6)	(15.4)	(5.0)	(0.8)	(1.0)	(3.3)	(1.8)	(6.9)	(9.8)	(8.8)	(8.2)	(10.1)	(9.9)
Less: Change in net working capital	(4.1)	(0.7)	(2.8)	(16.9)	9.2	(6.0)	(4.7)	(1.3)	(2.9)	0.9	114.2	(120.2)	(4.2)	(4.6)
Unlevered free cash flow	9.3	1.9	2.8	3.1	13.6	2.1	0.2	6.4	22.3	32.5	149.6	(81.4)	35.9	39.5
Discount factor					-	-	-	0.25	0.25	1.25	2.25	3.25	4.25	5.25
Present value of unlevered free cash flow					-	-	-	6.2	6.2	30.6	125.6	(63.2)	25.8	26.3
Discounted Cash Flow Valuations														
Perpetuity Growth Method														
Perpetuity growth rate	2.0%													
PV sum of unlevered FCF	151.3													
PV of terminal value	433.4													
Enterprise value	584.7													
Add: Cash	14.1													
Less: Debt	103.2													
Less: Other EV adjustments	-													
Equity value	495.6													
Shares outstanding	25.2													
Implied share price	\$ 19.71													
Exit Multiple Method														
Terminal EV/EBITDA multiple	10.0 x													
PV sum of unlevered FCF	151.3													
PV of terminal value	481.6													
Enterprise value	632.9													
Add: Cash	14.1													
Less: Debt	103.2													
Less: Other EV adjustments	-													
Equity value	543.8													
Shares outstanding	25.2													
Implied share price	\$ 21.62													
WACC														
Perpetuity Growth Rate		9.10%	8.60%	8.10%	7.60%	7.10%								
	1.00%	\$ 14.62	\$ 15.81	\$ 17.16	\$ 18.73	\$ 20.56								
	1.50%	\$ 15.42	\$ 16.75	\$ 18.28	\$ 20.06	\$ 22.16								
	2.00%	\$ 16.35	\$ 17.84	\$ 19.57	\$ 21.63	\$ 24.08								
	2.50%	\$ 17.41	\$ 19.10	\$ 21.10	\$ 23.50	\$ 26.42								
3.00%	\$ 18.64	\$ 20.59	\$ 22.93	\$ 25.78	\$ 29.32									
WACC														
Terminal EV/EBITDA Multiple		9.10%	8.60%	8.10%	7.60%	7.10%								
	8.0 x	\$ 16.91	\$ 17.33	\$ 17.76	\$ 18.20	\$ 18.66								
	9.0 x	\$ 18.74	\$ 19.20	\$ 19.67	\$ 20.16	\$ 20.67								
	10.0 x	\$ 20.56	\$ 21.06	\$ 21.59	\$ 22.12	\$ 22.67								
	11.0 x	\$ 22.38	\$ 22.93	\$ 23.50	\$ 24.08	\$ 24.68								
12.0 x	\$ 24.20	\$ 24.80	\$ 25.41	\$ 26.04	\$ 26.69									

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