

**SOUTH CAROLINA EDUCATION LOTTERY
BOARD OF COMMISSIONERS MEETING MINUTES
May 6, 2015
10 AM**

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, May 6, 2015, at 10 a.m., in the first-floor conference room located at 1333 Main Street, Columbia, South Carolina, with the following members participating:

Tim Madden, Chairman	Tom DeLoach
Dr. Edward Keith, Vice Chairman	Otis Morris, Jr.
Nancy Cannon, Treasurer (via phone)	Keith Munson
Sam Litchfield, Secretary	Mickey Renner

The Chairman called the meeting to order. He introduced and welcomed Mickey Renner who was recently appointed to the Board by Governor Nikki Haley.

Approval of Minutes

On motion of Commissioner DeLoach, seconded by Commissioner Litchfield, the Board unanimously approved the January 7, 2015 meeting minutes.

Action Items

Potential Powerball Matrix Changes

The Chairman recognized Executive Director Paula Harper Bethea to review the proposed matrix changes for Powerball (PB) that are summarized in the Board meeting materials. The Executive Directors from the Multi-State Lottery Association (MUSL) states have been reviewing potential revisions for over two years as sales have trended downward throughout the country. SCCEL sales are 14% below last year, due in significant part to the number and level of Powerball jackpot runs.

Two months ago, Ms. Bethea attended a MUSL meeting where a decision was made to conduct more research on all of the proposed changes. Nevertheless, momentum continued to move toward the matrix change before the Board. Mrs. Bethea and other Executive Directors (most notably Florida's) have expressed concern about moving forward without additional research. Nevertheless, a vote of all MUSL members is expected tomorrow. Mrs. Bethea believes the proposal is counterproductive because:

- (1) jackpot odds will be significantly higher than the current Mega Millions (MM) odds even though the cost of a PB ticket is \$2.00 versus \$1.00 for MM;
- (2) lower tier prize odds will improve only marginally (from 1 in 31 to 1 in 24); and
- (3) the matrix change is coupled with reserve fund contribution changes designed to minimize jackpot fatigue among players by "managing" the jackpot runs in order to lessen the likelihood of excessively large jackpots (over \$1B).

In sum, these changes may cause a player to question why he or she is playing PB when a MM ticket is half the cost of PB.

Mrs. Bethea explained that even though it appears the new proposal will pass, she intends to vote against the current matrix change proposal unless the Board directs otherwise. If MUSL approves the matrix change, SCEL staff will work diligently for its success, as the only other option is discontinue PB sales in South Carolina.¹ There was no objection.

Fiscal 2016 Budget Proposal

The Chairman recognized Mrs. Bethea and Joe Boyle, Chief Financial Officer, to present the proposed budget for FY16, included in the meeting materials distributed prior to the meeting. In sum, the budget proposal is realistic and conservative in both revenue and expenditures. Mrs. Bethea also highlighted an analysis prepared by Mr. Boyle graphically showing revenue and transfers going up while operating expenses and expenses in relation to revenue declining. All lines are going in the correct directions.

The conservative approach to revenue forecasting is evident across all product lines:

Terminal Game Revenue is projected to decrease by \$21.3M, primarily from Pick 3 and Pick 4, both of which grew at unusually high rates in FY15 (Pick 3, almost 10% and Pick 4, almost 19%). Both products had a statistically unusual number of winners early in the current fiscal year which staff believes created a sales spike. Accordingly, the budget projects a decrease of \$9.1M for each game (5.6% for Pick 3 and 10.7% for Pick 4) which puts the sales trend in line with FY13 and FY14. PB and MM sales are projected to decrease by \$5.4M and \$6.7M. Mr. Boyle explained the methodology used for these projections given the unpredictability of jackpot runs. In the past four fiscal years, sales attributable to jackpot runs have generated additional annual revenue from \$19.8M to \$39.7M. The FY16 budget attributes revenue from jackpot runs at the lower end of this range, \$20.1M. Additionally, PB sales appear to be experiencing an "organic" decrease due to a shift in sales to MM, likely due to the lower price point for MM.

Sales of Lucky for Life (LFL), introduced in January 2015, have been consistent and FY16 revenue is projected to be \$21.4M. There appears to be a \$65,000 per week shift in player preference from Palmetto Cash 5 (PC5) to LFL causing a projected decrease of about \$3.4M for PC5 in FY16.

Instant Ticket Revenue is projected to be \$991.8M in FY16, \$3.1M less than the FY15 annualized sales but \$113.2M more than actual instant game sales in FY14. \$1, \$2, and \$3 tickets have been trending down in South Carolina for the past six years, but not as dramatically as the national decline. \$5 game sales decreased slightly in FY14, were flat in FY15, and are expected to be flat in FY16. Staff remains concerned that the growth in \$10 game sales is not sustainable (up more than 20% in FY15, which followed significant growth in FY14 and FY13). Accordingly, the budget projects \$10 ticket sales to remain at FY15 levels.

Operating expenses vary from annualized FY15 and actual FY14 expenses by \$391K and \$1.9M, respectively. Instant Game costs are projected to increase due to the purchase of new games, possibly from secondary vendors, and certain other game

¹ The proposed Matrix change was adopted and will be implemented in October of 2015.

enhancements. Terminal Game costs are up primarily as a result of the introduction of LFL. Otherwise, costs as a % of projected revenue are consistent with prior years.

Chairman Madden noted that when SCEL started, the conventional wisdom was that after three years sales would level off and never improve. SCEL has exceeded all expectations. Commissioner Keith thanked staff for the quality and depth of the budget presentation, noting that that this was the best budget discussion since SCEL began.

Motion Adopted

After a brief discussion and comments, on motion of Commissioner Munson, seconded by Commissioner Litchfield, the Board unanimously approved the FY16 Budget.

Reports

Marketing Report and Quarterly Advertising Review

The Chairman recognized Jay Johnson, Director of Marketing and Product Development, to review the quarterly advertising material² made available to the Board in advance of the meeting:

- Television: Lucky for Life, Trucks and Bucks, Domino Card (April), One Ticket Winter (November), Seasonal Card (March)
- Player Information Displays (PID): Instant Replay April 21 Drawing, Lucky for Life, Trucks and Bucks
- Point of Sale (Print): Trucks and Bucks, Heritage, Need a Do-Over?, Lucky for Life
- Ticket Topper and Play Station Surface Poster: Lucky for Life, Trucks and Bucks, Happy New Tickets, More Tickets to Love
- Digital Billboards (outdoor): Second-Chance promotions, Need a Do-Over?, Lucky for Life, Trucks and Bucks
- Online Advertising: Second-Chance promotion, Need a Do-Over?, Lucky for Life, Trucks and Bucks, Twitter Contests

No objections or concerns were expressed regarding the advertising materials submitted to the Board for review. It was therefore the consensus of the Board that SCEL's past advertising and proposed concepts for major media campaigns presented today, did not and do not target, with the intent to exploit, specific ethnic groups or economic classes of people, and that the content is accurate and not misleading.

Staff also played Mrs. Bethea's interview by WHHI-TV at the RBC Heritage Tournament, which amounted to 3 minutes and 30 seconds of free advertising. Sales at the RBC Heritage were approximately \$35,000 and exposed our products to new players and tourists. Sales for all special events and festivals are growing.

The Chairman asked staff to set up a play station and to have void tickets available at for the next Board meeting.

²SCEL's enabling legislation requires a quarterly review by the Board of "all past lottery advertising and proposed concepts for major media campaigns to ensure that the advertising did not and does not target with the intent to exploit specific ethnic groups or economic classes of people, and that the content is accurate and not misleading."

Financial Update

The Chairman recognized Mr. Boyle to highlight key items from the financial report submitted to the Board prior to the meeting. FY15 Year-to-date transfers up \$10.7M (from \$250.3M to \$261M). Consequently, the initial FY15 transfer estimate of \$298M has been adjusted once during this fiscal year and is expected move to at least \$330M before June 30th. A projected FY16 transfer of \$321M will be presented to the Board of Economic Advisors.

Year to date, Net Income³ increased \$1.9M to \$254.8. Overall Game Revenues increased \$88.6M to \$1,033.7B (\$83.8M from \$10 games). Game margin increased \$8.2M but the Overall Game Margin % decreased by 2.34% to 34.14%.

Revenue associated with the \$1, \$2, \$3, and \$5 instant game price points increased by \$2.3M, or .9% while the \$10 tickets grew by 20.7%. The Game Margin % on Instant Game Revenues decreased from 28.28% to 27.47% due to the higher prize payout for \$10 tickets. The overall increase in Instant Game Revenues, even with the decrease in the Game Margin %, resulted in an increase in Instant Game Margin of \$18.4M.

Overall, Terminal Game Revenues increased only \$2.5M to \$301M due to the unusually high increase in Pick 3 sales (up \$11.1M, 10.0%) and Pick 4 sales (up \$10.6M, 19.5%). Pick 3 prize expense was up \$10.6M (22.7%) and Pick 4 prize expense was up \$13.2M (57.8%) due to draws favorable to the players. PB revenue is down \$10.4M (13.9%) while MM revenue is down \$10.1M (23.6%). Terminal Game Margin decreased by \$10.2M (6.3%). Likewise, Terminal Game Margin % (“profit margin”) decreased by 3.84%. Due to these factors, the Game Margin for Terminal Games decreased by \$2M.

Executive Director’s Report

Ms. Bethea explained the issues associated with Hot Lotto, a game administered by MUSL, not offered by SCEL. The MUSL Chief Security Officer is believed to be responsible for discrepancies relating to a random number generator (RGN) and the purchase of a “winning” Hot Lotto ticket. His trial is expected to begin this summer. The ticket in question was not paid and there is no indication that any other game offered by MUSL is implicated. Our Internal Auditor, Bethany Parlor, along with her counterpart in Kentucky have been asked to go to Iowa later this month to conduct an independent investigation of the security measures in place for the RNG and its use.

As presented in the budget, SCEL is moving from leasing State Fleet cars to purchasing nine vehicles used by Columbia staff and the Regional Sales Managers. Given the age of the leased cars provided by Fleet, the base lease payments, and the monthly per mile charge, purchasing is more cost-effective particularly since the cars are being bought pursuant to a general state procurement contract well below “sticker” price.

Ms. Bethea will attend the NASPL Directors meeting in New Orleans in June. The discussions will include proposed revisions to the Wire Act currently under great scrutiny in

³ Net income as used herein is means “Change in Net Position” as generally used for governmental agencies. Further, the increase in net income will not necessarily result in the same amount of transfers because transfers are “cash basis” and net income is on the accrual basis. The primary difference will be in accounts such as accounts receivable, the growth in which is reflected in net income, but not in transfers since amounts recognized as income have not been received.

Congress. Senator Graham has been very supportive of traditional lotteries. Tony Cooper is going Washington D.C. to make a presentation in the morning on our successful launch of the Lucky for Life game. SCEL's sales lead all other states that joined the game in January.

\$20.00 Ticket

Given the concerns expressed today and in the past regarding the sustainability of \$10 ticket sales, staff would like to have a \$20 game option available, if needed. Players' interest may wane at any time and some are attracted to this price point as they see \$20 tickets offered across our borders. SCEL may be the only state that does not have a \$20 instant game. Last year staff evaluated offering a \$20 ticket and did not ask the Board for approval because, in large part, the prize payout for \$20 ticket in other jurisdictions is very close to SCEL's payout for a \$10 ticket. Given the quarterly Board meetings and the lead-time needed to develop an instant game (the play style, artwork, and prize structure and the printing schedule), Mrs. Bethea is asking for permission now. If approved, all of the prep work could be done and if staff notices a lag in \$10 sales, a \$20 game could quickly replace a print slot being reserved for one or more \$10 tickets.

Motion Adopted

Commissioner DeLoach moved to authorize the Executive Director to issue \$20 instant game tickets when she determines it is appropriate. Commissioner Morris seconded the motion, which was unanimously approved.

Other Business

Commissioner Munson asked about the terms of current Board members and the effect any turnover may have on the operation of the Board. Hogan Brown, Director of Legal Services, was recognized. Although some letters of appointment are not in sync with the staggered terms established in the Lottery Act, as is the case for virtually all other boards and commissions, SCEL Board members remain in office, in hold-over status, until a successor is appointed.

There being no further business, the meeting was adjourned.

The next Board Meeting will be August 5, 2015.

_____/s/
Timothy E. Madden, Chairman

_____/s/
Sam Litchfield, Secretary

As required by § 30-4-80, notification for this meeting was posted at SCEL administrative offices, 1333 Main Street in Columbia. As provided in the Board Bylaws, the meeting notice and agenda were also posted on the SCEL website (sceducationlottery.com), and sent via facsimile transmission pursuant to requests made by media outlets and other organizations. These notifications included the time, date, place, and agenda of the meeting.