

**SOUTH CAROLINA EDUCATION LOTTERY
BOARD OF COMMISSIONERS MEETING MINUTES**

**May 10, 2017
10 a.m.**

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, May 10, 2017, at 10 a.m., in the first-floor conference room located at 1333 Main Street, Columbia, South Carolina, with the following members, representing a quorum, participating:

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| Sam Litchfield, Chairman | Bo Russell |
| Dr. Edward Keith, Vice Chairman | Otis Morris |
| Keith Munson, Secretary/Treasurer | Mickey Renner |

The Chairman called the meeting to order and welcomed guests.

Approval of Minutes

On motion of Commissioner Munson, seconded by Commissioner Keith, the Board unanimously approved the February 8, 2017, meeting minutes.

ACTION ITEMS

Mega Millions Matrix Changes

The Chairman recognized Mr. Brown, Interim Executive Director, who gave an overview of the changes adopted by the Mega Millions Consortium for the Mega Millions game. South Carolina is not a member of that group and did not have input or a vote on the changes just as the Consortium members do not vote on Powerball changes. The most significant change is going to a \$2 price point, from a \$1 price point. The game matrix will change to 5/70 + 1/25 from 5/75 + 1/15. The odds of winning \$1M improves from 1:18.5M to 1:12.6M. With the proposed changes, Mega Millions resembles Powerball with one optional feature that SCEL does not intend to offer: a \$3 wager for two plays at winning only the jackpot, not any lower-tier prizes. Mr. Brown believes the potential for retailer and player confusion outweighs any marginal increase in sales and therefore recommends that staff track the results of this feature in other jurisdictions before requesting Board approval to offer this play option. As for the other items, he recommended that the Board adopt the Mega Millions game changes that are scheduled to become effective on October 28, 2017.

Without objection, the Board approved the Mega Millions game changes for the October 28, 2017, launch date, minus the jackpot only feature, and authorized the Interim Executive Director to take all steps necessary to implement the changes.

Quarterly Advertising Review

The Chairman recognized Ammie Smith, Senior Marketing Manager, who presented the quarterly advertising review. Mrs. Smith covered advertising materials in television, radio,

PIDs, POS Digital Outboard, and online formats for the following advertising campaigns: “Know the Numbers,” “PC5 10X,” “Double Diamond Extra Play,” “My Million Dollar Series,” Winner Awareness, and “Change Your Weekend,” (Pick 3 and Pick 4). Mrs. Smith then presented advertising themes for a “Walking Dead” instant game derived from the top-rated AMC original network series. To solicit feedback, a Walking Dead commercial, produced by the Minnesota Lottery, was shown because SCEL is considering seeking the rights to its use. The ad would run primarily on cable networks and only after 9 pm.

After receiving questions and comments, the Chairman determined that it is the consensus of the Board that the lottery advertising and proposed concepts for major media campaigns 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.

Website Upgrades – Overview of Website Design (Board approval not needed)

Mrs. Smith asked Mr. Doug Lunn, Senior Digital Marketing Manager, to explain SCEL’s latest website design initiative to make SCEL’s webpage information more easily accessible across a broader range of mobile devices. This upgrade eliminates the need for two website versions: a non-responsive (static) one for desktop computer screens and an adaptive one for mobile devices (tablets and cell phones). He noted that more than 70 percent of traffic to SCEL’s website comes from mobile devices. Mr. Lunn proceeded to show prototypes of proposed responsive website templates with sample content to demonstrate the functionality of a responsive layout.

FY18 Instant Ticket Game Planning (Board approval not needed)

To elaborate on information presented at the last Board meeting, Mrs. Smith provided a detailed presentation of the process staff employs to develop the Instant Game Product Plan using FY18 as the model. It begins with a thorough review of sales trends for all of the various types of instant games offered in prior fiscal years. Based on this data, in collaboration with the Chief Financial Officer, staff establishes a sales target for the upcoming fiscal year and then formulates a product mix for each price point.

Mrs. Smith used numerous handouts including sales charts, “planning rainbow charts,” PowerPoint slides, examples of instant tickets, and other material to explain the six major components of developing an instant ticket game:

- (1) **Prize Fund** - planning the payout for each game, designed to balance between raising proceeds and providing sufficient winning experiences;
- (2) **Prize Structure** - designing prizes that attract players within the Prize Structure;
- (3) **How the Game Looks** - creating appropriately themed games with appealing graphics and images;
- (4) **Product Positioning** - distinguishing products among game price points in the dispenser;
- (5) **Number of Games in the Market Place** - offering more games with smaller print runs to ensure product offerings are “fresh” (SCEL is a leader in this area); and
- (6) **Odds** - reviewing year-over-year target odds data to determine its impact on player behavior.

Review and Approval of Fiscal Year 2018 Budget

The Chairman recognized Mr. Joseph Boyle, Chief Financial Officer. He explained the process used to develop SCEL’s FY18 Budget and Financial Plan (the “Plan”) including revenue forecasts built into the Plan, the involvement of each department, and the Interim Executive Director in arriving at the requested spending. Mr. Boyle then reviewed each footnote in the worksheet explaining the variances between the Plan and FY17 projected expenditures through June 30, 2017, based upon the actual expenditures through February (eight months of FY17).

Overall, the Plan exceeds projected FY17 spending by slightly less than \$1.2 M, most significantly in the following areas: (1) Salaries and benefits, \$340K, or 26% of the increase; and (2) Advertising Production and Placement, \$466K, 41% of the increase. Although not an operating expense, Instant Game costs increased by \$2.5 M. Mr. Boyle noted that Plan Operating Expenses are generally consistent with previous requests over the past five years. During that period, revenue growth has exceeded 40%. The Plan projects Operating Expenses at 1.46% of revenues and .89%, if advertising expenses are excluded.

Motion Adopted

At the conclusion of questions and comments, Commissioner Munson moved for approval of the FY18 Plan, seconded by Commissioner Keith, and the Board unanimously adopted the motion.

REPORTS

Financial Update

Overview of FY17 Actual Results Compared to Actual FY16 Results

The Chairman recognized Mr. Boyle who reported that through the first nine months of FY17, Transfers decreased from \$307.8M to \$302.8M. Net Income decreased \$7.2M¹ to \$294.4M even though overall Game Revenues increased \$15.3M to \$1,209.3M. The decrease in Net Income resulted from a substantive decrease in Terminal Game Margins of \$13.8M. Instant Game Margin was very consistent while Terminal Game Margin was down 1.24%.

Instant Game Revenues were \$877.0M, up \$34.3M, or 4.1% over the same period last year. Of the overall increase, \$10 Instant Tickets increased by \$27.2M (4.8%) and \$5 Instant Tickets increased by \$7.0M (4.8%). Revenues associated with the \$1, \$2 and \$3 price points, in aggregate, were flat. The Game Margin on Instant Game Revenues decreased slightly (by 15%).

Terminal Game Revenues were \$332.4M, a decrease of \$19.1M, or 5.4%. In FY16, the unprecedented Powerball “Jackpot Run” drove revenues to record levels in January. With no comparable Powerball Jackpot Run in FY17, Terminal Game Margin was reduced by \$15.9M. Pick 3 and Pick 4 continued to perform well and Revenues were up by \$12.5 (9.4%) and \$3.8 (5.5%) however, prize expense was also up significantly resulting in an aggregate increase in Game Margin of \$1.8M. In aggregate, the other Terminal Games, Mega Millions, Palmetto Cash 5, and Lucky for Life were essentially flat.

In summary, Instant Game Revenues grew relative to last year, but at a much lower rate, resulting in an \$8.3M increase in Instant Game Margin. Conversely, the decrease in Terminal Game Revenues, coupled with the adverse effect of statistical variation on Terminal Game Margin percentage, resulted in a decrease of \$13.8M. The net reduction in aggregate Game Margin of \$5.5M is the primary reason Net Income is down. Advertising Expense was \$6.1M in FY17 and \$5.9M in FY16. G&A Expenses (the primary component of which is employee compensation) were \$10.4M in FY17 and \$9.8 in FY16.

Actual FY17 Results Compared to the FY17 Financial Plan

To date, actual financial results have exceeded Plan. Game Revenues were \$1,209.3M compared to Plan of \$1,160.1M (a variance of \$49.3M). The positive variance in Instant Game Revenues

¹ Dollar amounts are expressed as complete numbers, or in thousands (K) or in millions (M). Net income as used herein 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. 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.

is primarily attributable to better than expected sales of \$10 and \$5 Instant Tickets. SCEL planned revenues associated with the \$10 price point conservatively due to the above average sales growth in recent years and, in fact, the rate of increase has slowed significantly (less than half the growth rate of prior years). In aggregate, the \$1, \$2, and \$3 price points are on Plan. The overall positive variance in Terminal Game Revenues is primarily attributable to increases in Pick 3 and Pick 4 Revenues relative to Plan. Pick 3 and Pick 4 Revenues, in aggregate, exceeded Plan by \$16.3M but prize expense exceeded Plan by \$13.3M due to the statistical variation in payouts. In aggregate, Mega Millions and Powerball were \$1 over Plan. Palmetto Cash 5 exceeded Plan by a small amount and Lucky for Life was under Plan by \$2.4M, or 17.8%.

Due to better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$310.8M compared to the planned amount of \$303.0 for a positive variance of \$7.8M or 2.6%. Operating Expenses were \$ 900K under Plan. Advertising Expense was under Plan by \$600K (\$6.1M vs. \$6.7M). Other Operating Expenses (“G&A”) were \$300K under Plan. SCEL expects most of the variances will normalize to planned annual amounts as the year concludes. Because of the aforementioned factors, Net Income for the nine months ended March 31, 2017 was \$294.4M compared to Plan of \$285.7M. The positive variance of \$8.7M resulted from better than planned Gross Profit and lower than planned Operating expenses.

Executive Director’s Report

The Chairman recognized Mr. Brown who began by discussing the PC5 10X promotion which included a retailer incentive program for the month of April. It resulted in 17% sales increase vs. March and a 26% increase over April of 2016. Mr. Brown noted that 300 retailers increased their sales by 100% or more and 800 retailers increased their sales by 50% or more.

Mr. Brown next reported on various procurement matters. An RFP for Insurance Broker Services will be issued soon. The On-line Gaming Services RFP went out on March 10th and responses were submitted on April 25th. The Evaluation Panel is currently reviewing proposals and SCEL expects MMO to issue a Notice of Intent to Award by the end of May or in early June. The Chairman requested that the Board receive an update at the end of May. He then updated the Board on the status of the compensation study that is nearing completion and provided a handout that gave an overview of the methodology. Mr. Brown noted the initial draft indicates that a few employees will need a modest adjustment to their compensation as our current salary grades are modified to reflect market conditions and the funds needed were approved in the FY18 budget. A report on the Compensation Study will be made at the August meeting.

On April 25th, Mr. Brown attended the SC Association of Convenience Stores (SCACS) Board meeting as part of SCEL’s review of the potential use of debit cards to purchase Lottery tickets. He gave SCACS Board members a copy of the materials presented to the SCEL Board in November. The feedback was in line with the survey results from last fall. Mr. Brown explained that although it was not on their agenda, he was asked about AutoLotto. He informed the SCACS Board that SCEL does not agree with AutoLotto’s position that there are no statutory impediments to what it seeks to do via its app and that he could not promise no punitive action would be taken if a retailer sought to contract with AutoLotto.

Mr. Brown then proceeded to discuss a meeting that he, Dolly Garfield, and a representative from the SC Attorney General’s Office had with representatives of AutoLotto on May 2, 2017. They explained the company’s business plan, the states in which it operates, and how the app

functions. He informed Auto Lotto of the Board's initial negative reaction when it was discussed in the Board meeting on February 8, 2017. AutoLotto indicated that they would not pursue operations in South Carolina if SCEL was not interested working with them. Mr. Brown said that for various reasons, he could not recommend moving forward with AutoLotto. After comments and questions, the Chairman asked if any Board member thought this matter should be discussed or pursued further. Absent a request to do so, it was the consensus of the Board that SCEL is not interested in pursuing further discussions and Mr. Brown was asked to communicate the Board's position to AutoLotto. Mr. Brown stated that if AutoLotto began operating in SC, SCEL would be prepared to issue a cease and desist letter and take other appropriate actions.

Next, NASPL and MUSL will have their Spring Directors Meeting in Denver in mid-June where they will discuss the Powerball group's proposal for a "Winner Take All" draw but a discussion on a matrix change to Powerball is not expected in the near future.

Other Business

There being no further business, the Board adjourned the meeting. The next scheduled Board meeting is August 2, 2017.

_____/s/
Sam Litchfield, Chairman

_____/s/
Keith Munson, Secretary/Treasurer

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