

**SOUTH CAROLINA EDUCATION LOTTERY
BOARD OF COMMISSIONERS MEETING MINUTES
September 16, 2020
11:00 a.m.**

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, September 16, 2020, at 11:01 a.m., at 1333 Main Street, Columbia, South Carolina, First Floor Conference Room, with the following members, representing a quorum, participating:

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| Sam Litchfield, Chairman (in person) | Bo Russell |
| Dr. Edward Keith, Vice Chairman (in person) | Richard Chapman |
| Keith Munson, Secretary/Treasurer (in person) | William Newsome (in person) |
| Otis Morris | Ryan Langley |

The Chairman called the meeting to order and welcomed guests.

Approval of Minutes

The Chairman entertained a motion on the approval of the May 27, 2020, minutes. On motion of Commissioner Munson, seconded by Commissioner Newsome, the Board approved the May 27, 2020, minutes unanimously.

Action items

a. Quarterly Advertising Review

The Chairman recognized Commissioner Morris who reported that the Marketing Committee had recently met and reviewed three (3) new beneficiary concepts and the next phase in the advertising campaign featuring Tina Tiny and Tiny Stories (both are described below). Commissioner Morris then asked Mrs. Ammie Smith, Director of Product, and Josh Whiteside, Director of Marketing, to present the following concepts and ads for review by the Board:

Palmetto Cash 5 - Window Poster, Play Station Poster, and Play Station Writing Surface.

WONDER WOMAN™ - Digital Billboard, Online Ad, PID, and Ticket Topper. This \$2 Instant Game launched Tuesday, July 28th. SCEL is the first state to launch this licensed property offered through Scientific Games. In response to a question, Mrs. Smith explained that player age demographics could not be measured because there is no second-chance component to this ticket.

Double Your Million! - Digital Billboard, Online Ad, Play Station Poster, PID, Writing Surface, and Online App. Launched on August 28th, it allows scratch and second-chance prizes to be doubled. This is the first instant game where a player can win a two million dollar prize.

SPACE INVADERS™ - Digital Billboard, Online Ad; PID, and Ticket Topper. Launched on September 8th. An outdoor promotional event will be held in October at the Steel Hands Brewery with ticket sales and an actual Space Invaders game. All COVID protection protocols will be followed.

PID Messaging - Claims Center Drop-Off and General Information, Instant Games: \$125,000 Cash Blast, \$250,000 Cash Bonus, Loose Change, Triple Luck, Bonus Payday, Hit \$500, Lucky Win, Cherry Blast, Extra Play, Win It All, Hit \$50, Multiplier Money, Wild Cash, and Money.

Tina Tiny Stories - SCEL is in the process of selecting actors for the upcoming “Tiny Stories 2” campaign. The concepts were explained and the focus will be the situational comedy of “Tiny”.

Sponsorships - Charleston Battery Ad, Citadel Program Ad, Greenville Scene Ad, Clemson Program Ad, USC Program Ad, and Wofford Program Ad for digital billboards and website messaging. Each ad includes how lottery proceeds have contributed to each institution or region.

NASCAR - Mr. Whiteside explained SCEL's association with the Southern 500 given there were a very limited number of fans. Tickets were not sold but SCEL was offered a tremendous opportunity to be the entitlement sponsor of the Truck Series race which included SCEL branding on the surface of the racetrack, signage throughout the venue, and logos displayed in the Winner's Circle and on the winning trophy. Three (3) lottery beneficiaries were able to participate in featured aspects of race and videos were shown of their participation in the events associated with the Southern 500.

Beneficiary: New concepts for beneficiary messaging were presented. They are intended to draw a more personal connection in the viewer's mind between the beneficiaries and lottery-funded programs. The main theme of the new campaign is passion with a sub-theme of entrepreneurship. The ads are produced in a documentary style to enhance the emotions being conveyed. "Erin" grew up in Bennettsville and graduated from the USC with a degree in Hotel, Restaurant, and Tourism Management. She now owns her own bakery. The voiceover points out how more than \$4.9 billion in SCEL-generated funds helps students answer their calling. "James" grew up in Rock Hill and graduated from Denmark Technical College with help from the Lottery Tuition Assistance Program. He returned home to pursue his dream of opening his own barbershop with family members working at his side. The voiceover states how SCEL has provided more than \$800 million to support students who attend technical colleges. Lastly, "Kristen" is a photographer who attended the USC with a Life Scholarship and now resides in Charleston. The voiceover directly ties the scholarship and students like her who are preparing for their dream job.

Upon conclusion of the Advertising and Social Media Report, the Chairman stated, without objection, that it was the consensus of the Board that the advertising concepts presented 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.

b. Continuation of Lucky for Life Game

The Chairman recognized Joe Boyle, Chief Financial Officer, and Mrs. Smith to discuss the Lucky for Life Game (L4L). Mr. Boyle stated over the past three years L4L sales have been flat, stuck at about \$12.5M. As a percentage of total sales, L4L is down over the past four years from .85% to .60%. The margin percentage is very volatile, ranging from 31% to 51% while the statistical model calls for a 40% margin. The wide variability is due to low sales volume and to some extent, the costs of the grand prize, which can be over \$9M if a winner selects the annuity option. The transfer value of L4L is also volatile (following the margin percentage variability), and has ranged from \$3.4 million to \$5.5M. The expected transfer value at a \$12.5M sales level should be a little over \$4M (approximately .80% of the total transfer). Accordingly, if SCEL exits L4L, we must generate \$4M in transfer value. Mrs. Smith does not see significant growth potential in L4L if the group expands from two draws to seven per week. Mrs. Smith explained that she has been working closely with IGT, the lottery's online ticket vendor, and internally to create new game opportunities. Mr. Brown then explained contractual details related to termination of the game.

Motion Adopted

On motion from Commissioner Russell, seconded by Commissioner Munson, the Board approved giving the Executive Director all powers and discretion necessary to continue L4L or withdraw SCEL from the game, as he deems appropriate.

c. Potential Powerball Game Changes

The Chairman recognized Mr. Brown who discussed potential changes to Powerball, namely international sales and 7 draws per week. The Multi-State Lottery Association's (MUSL) Legal Committee has been assisting with drafting an agreement with Australia. If negotiations are successful, the full MUSL Board must approve it, which may occur by the end of 2020. If approved, sales would likely begin with a one-year trial period. The concept is for Australia to sell Powerball as a licensee and not as a MUSL member. Next, Mr. Brown discussed the latest proposal of MUSL's Development Committee to expand to seven from two draws per week. There may be a proposal for three or four draws per week. A MUSL vote on this issue is expected in October.

Mr. Brown expressed his support for international sales, subject to the final details, but not for seven draws per week. Mr. Brown is open to approving three or perhaps four draws per a week. In response to a question, Mr. Brown gave an overview of lottery games that are currently offered in Australia and shared thoughts on ways to increase Powerball sales. He asked the Board for discretion to vote for Powerball international sales and expanded draws as he determines appropriate after all information is presented to the MUSL Board.

Motion Adopted

On motion from Commissioner Newsome, seconded by Commissioner Munson, the Board adopted a motion to delegate authority to the Executive Director to use his discretion to vote as he deems appropriate regarding any upcoming proposals to increase number of Powerball draws days and/or permit MUSL to execute an agreement to allow the sale of Powerball in Australia. The motion was adopted unanimously.

The commission took a five-minute recess. After which, the Board reconvened.

Reports

Financial Report

The Chairman recognized Mr. Boyle, Chief Financial Officer, who provided a high-level overview of his written presentation, submitted to the Board in the meeting materials prior to the meeting.

Actual FY 2020 Results Compared to Actual FY 2019 Results

Overview

FY20 was another record year for SCEL. Transfers were \$492.8M compared to \$487.6M last year, an increase of \$5.2M (1.1%). Net Income increased \$2.1M to \$490.6M. Total Game Revenues increased \$125.4M to \$2,106.4M (6.3%). Instant Game Revenues were \$1,582.2M, up \$131.8M (9.1%). Terminal Game Revenues were \$524.2M, down \$6.4M (1.2%). Game Margin increased on Instant Games and decreased on Terminal Games. Overall, Game Margin increased \$13.3M while the overall Game Margin Percentage decreased 1.39% relative to last year.

Impact of 4th Quarter Performance on FY20

The revenue and other comparisons of the FY20 final results to FY19 are significantly skewed due to significantly higher sales in Q4 of FY20. During Q4, SCEL, like many other lotteries, and some retail businesses experienced significant increases in sales. Several factors, such as pent-up demand as the government lifted the stay-at-home orders, the lack of other entertainment options, and the federally instituted stimulus programs near the end of the fiscal year are likely causes.

During Q4, Instant Game revenues increased \$83.7M (21.75%) compared to an increase of \$48.1M (4.5%) in Q1-Q3 of FY20. Terminal Game revenues, excluding Powerball and Mega Millions, increased \$27.4M (28.55%) compared to an increase of \$30.7M (11.73%) in Q1-Q3. In aggregate, Powerball and Mega Millions were down \$9.6M (27.7%) in Q4. The decrease is likely due to lowering of the beginning jackpots to \$20M from \$40M and dropping the minimal incremental jackpot rolls of \$10M in Powerball.

Irrespective of the underlying cause, the rate of increase in sales experienced in Q4 is not likely sustainable throughout FY21. However, during the first two months of FY21 compared to FY20, the sales have seen percentage increases comparable to Q4. Instants were up 20.6% and Terminal Games were up 31.2%, excluding Powerball and Mega Millions, which continue to underperform and were down, in aggregate, 10.6% in the first two months of FY21.

Instant Games

Instant Game Revenues exceeded FY19 by \$131.8M (9.1%). \$10 Instant Ticket Revenues increased by \$110.3M (10.4%). In addition, \$3 and \$5 games increased by \$8.7M (19.7%). Revenues associated with the \$1 and \$2 price points, in aggregate, increased by \$3.3M (2.9%). The net effect of these increases was an Instant Game Margin increase of \$34.6M (8.8%).

Terminal Games

Terminal Game revenues were \$524.2M, down \$6.4M (1.2%). This decrease is due to significant decreases in Powerball and Mega Millions. There were no significant Jackpot Runs in FY20, and the pandemic resulted in changes to the jackpot structure, which affected the sales of these two National Games. Powerball revenues decreased \$29.7M (31.8%) and Mega Millions revenues decreased \$34.7M (43.3%) resulting in a net margin decrease of \$33.8M (37.5%).

The decreases in Powerball and Mega Millions were offset by Pick 3 and Pick 4 which performed very well for the year. Pick 3 was up \$37.7M (17.3%) and Pick 4 was up \$19.2M (18.5%). The Game Margin Percentage on Pick 3 and Pick 4 decreased from 51.8% to 49.0%, and 55.2% to 47.5%, respectively, in FY 20. In total, this is about 3.5% lower than the statistical model (negative result of statistical variation). Nevertheless, the increase in revenues contributed \$12.2M, or 10.9% and \$1.1M, or 1.9%, in Game Margin.

Palmetto Cash 5 remained consistent with last year. Revenues increased \$1.2M (4.9%) and Prize Expense increased \$3.4M (28.2%), due to statistical variation. As a result, Game Margin decreased \$2.2M (19.0%).

As a result of lower aggregate Terminal Game Revenues and statistical variation, Game Margin on Terminal Games decreased \$21.3M. Overall, Game Margin Percentage was down 3.43%.

Other Revenues and Game Costs

Other revenues, which consist primarily of license and telephone fees, were \$3.7M, the same as last year. Other direct game costs were \$22.4M compared to \$21.3M in FY19. The increase of \$1.1M was primarily due to expenses associated with instant game licensing fees and printing costs (\$1.6M) offset by a decrease in shipping costs of \$.5M.

Advertising and G&A Expenses

Advertising Expense was \$9.0M versus \$8.6M in FY19. G&A Expenses (the primary component of which is employee compensation) were \$15.6M compared to \$14.6M in FY19. The increase was related to an increase in Salaries and Benefits (\$1.3M) due to several factors including

implementation of the final phase of the compensation plan and other salary adjustments, higher pension costs (\$.5M) and employer health premiums (\$.3M). This increase was offset slightly by decreases in auditing and financial, promotions, and rent expenses, collectively \$.3M

Actual FY20 Results Compared to the FY20 Financial Plan

Actual financial results exceeded Plan in FY20. Game Revenues were \$2,106.4M compared to Plan of \$1,943.1M. Net Income for FY20 was \$490.6M compared to Plan of \$449.2M. The positive variance in Instant Game Revenues is primarily attributable to better than expected sales of \$5 and \$10 Instant Tickets of \$18.7M (8.7%) and \$87.6M (8.0%), respectively. \$10 price point revenues were conservatively planned due to concerns regarding the sustainability of double-digit sales growth in recent years. The \$3 Instant Tickets exceeded the Plan by \$7.4M (16.2%). The \$1 and \$2 price points in aggregate, were \$.8M above the Plan. .

The positive variance in Terminal Game Revenues is also attributable to Pick 3 and Pick 4, \$39.7M (18.4%) and \$21.1M (20.7%), respectively. Mega Millions performed above Plan by \$8.1M (21.8%). Palmetto Cash 5 also performed slightly above plan, \$1.0M (4.2%). Conversely, Powerball performed below Plan by \$21.1M (25.0%).

As a result of the better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$515.3M compared to the Plan of \$473.8M for a positive variance of \$41.5M (8.7%).

Advertising Expense was under Plan by \$.5M or 4.6% (\$9.0M Actual vs. Plan of \$9.5M). Other Operating Expenses (“G&A”) were \$.5M above Plan (\$15.6M Actual vs. Plan of \$15.1M), primarily attributable to higher salaries and benefits expense.

Mr. Boyle concluded with a few comments on Mr. Brown’s decisions in reaction to the impact of the coronavirus. Retailer settlement practices (the timing for when revenue is due to SCEL) were not suspended or relaxed and SCEL collected unsold instant ticket inventory from stores before June 30th. These decisions were contrary to the actions taken by other lotteries to loosen their requirements. As a result, SCEL was able to close out FY20 without carrying over liabilities from FY20 into FY21 that would have muddled year-to-year comparisons going forward. More importantly, it maintained a high level of financial discipline as retailers are required by law to hold lottery cash proceeds in trust for collection by SCEL.

Executive Director’s Report

The Chairman recognized Mr. Hogan Brown who began by explaining two items that were not included in the FY20 Financial Plan (Budget) that was approved in May due to of the uncertainty of revenue forecasts due to the pandemic. The first is a plan to expand the fourth floor print room to allow full utilization of the work area needed for new sophisticated printer, purchased nearly a year ago. The plan also includes better office space, adjacent to the print room, for several members of the Finance Department. The second item is a request to restart the project to acquire digital jackpot awareness signs for retailer outlets. Since these items had not been previously approved, Mr. Brown expressed his intent to move forward unless a member of the Board had an objection. There was none, and he will keep the Board informed regarding costs.

Mr. Brown went on to report that the landlord has renewed conversations concerning relocating the draw studio to an area on the first floor that will allow them to lease our Main Street facing space to another tenant at a higher rate. The move should include more square footage for SCEL,

at no additional costs, and with the landlord paying for most, if not all, of the up fitting costs for the new studio. As the talks progress, the Board will be updated. Mr. Brown next explained the implementation progress of Sales Wizard application that will allow the MSRs to provide retailers with real time information and analytics to assist them in improving sales. Finally, he thanked the Claims staff for their efforts in reducing the backlog of claims that accrued due to the pandemic and explained the protocols SCEL instituted at the Claims Center in response to Covid-19.

Executive Session

The Chairman made a motion to go into executive session as authorized by S.C. Code Ann. § 30-4-70(a) (1), for the specific purpose of discussion of employment. Commissioner Newsome seconded the motion. The motion adopted unanimously and the Chairman announced the Board would proceed to executive session for the sole purpose of discussion of employment.

The Chairman stated that the meeting had returned to open session. The Chairman stated that the executive session was held in accordance with the adopted motion, no other business was discussed, and no actions were taken in executive session.

Motion Adopted

Commissioner Russell moved, seconded by Commissioner Munson, to delegate authority to the Chair of the Audit Committee to proceed with any action within the authority of the full Board and/or the Audit Committee that he deems reasonably necessary for restructuring the operations of the Lottery’s Internal Audit Department, and for this delegation to terminate automatically at the end of the first regular meeting of the full Board in 2021, unless earlier revoked or extended by act of the full Board. The motion was approved.

Other Business

There being no further business, the meeting adjourned at 1:51 p.m.

_____/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 emails pursuant to requests made by individuals, media outlets and other organizations. These notifications included the time, date, place, and agenda of the meeting.