

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

February 8, 2017

10 a.m.

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, February 8, 2017, at 10 a.m., in the first-floor conference room located at 1333 Main Street, Columbia, South Carolina, with the following members participating:

Sam Litchfield, Chairman
Dr. Edward Keith, Vice Chairman
Keith Munson, Secretary/Treasurer

Bo Russell
Tom DeLoach
Otis Morris
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 November 30, 2016, meeting minutes.

REPORTS

The Chairman recognized Mr. Brown, Interim Executive Director, who gave an overview of the ensuing presentation noting the format changes from previous quarterly advertising reviews (QAR) and the newly added agenda items. After conversations with Chairman Litchfield, Mr. Brown worked with staff to ensure advertising that has yet to be aired or placed in the field is included in the QAR. Material will also be presented by topic and/or ad campaign, not grouped by type (i.e., in-store material, followed by website material, then TV ads, etc.). At the end of the QAR, staff will explain how the Media Plan is developed and how the Plan is used throughout the year. In agenda item 2.b., future advertising concepts slated for the remainder of FY17 and the first half of FY18 will be presented. Those items are not part of this QAR because the material is still under development. The intent is to afford a glimpse of the ideas that will be presented in final form in May or in subsequent QARs. In agenda item 2.d., following the 4-year sales trend presentation, Jay Johnson will explain instant product development and show examples of past product decisions that have positively affected the trend lines.

Quarterly Advertising Review

Mr. Brown recognized Jay Johnson, Director of Marketing and Product Development, and Ammie Smith, Senior Manager of Marketing and Product Development, to review the quarterly advertising material.¹ Mrs. Smith reported on:

Know the Numbers: 3rd Quarter Campaign, 3 TV Spots: "Zero", "One", and "Twenty-Two"; Radio Spot; Digital Board; Play Station Poster; Writing Surface; Ticket Topper; Play Station Poster, "6 Number Games, 7 Days a Week"; Writing Surface, Mega Millions/Powerball.

¹ SCEL'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."

Instant Ticket Advertising: Website, "Light Up Your Holiday"; Digital Outdoor and Play Station Poster, "Cash on the Spot"; "Big \$100 Explosion"; and Writing Surface - "\$50 or \$100!".

Winner Awareness: Digital Billboard and Website - "\$1 Million Mega Millions Ticket Sold".

Social Media Contests: Clemson Basketball Tickets and Yeti Tumbler.

Responsible Play: 3rd and 4th Quarter TV Spot, "Bicycle".

PC5 10X Promotion: Play Station Hat; Window Poster and Buck Slip.

Other Items: "Selling Points" and Legal Odds Advisement (placed adjacent to the point of sale).

Loteria Instant Ticket: Mr. Brown explained this licensed property ticket, a three-dollar price point, extended play game, that indexes well in neighboring states. Although the game name is Spanish, Mr. Brown does not believe this game targets a particular group in violation of the Lottery Act. It is included in the QAR to solicit feedback and comment from the Board. Mr. Johnson gave other details regarding the origin of the game and the staff modifications to the play symbols. Mr. Brown read aloud the specific statutory provision regarding the standard the Board must use in its QAR.

The Chairman asked the Board for any questions or concerns. After receiving questions and comments, the Chairman stated 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.

Ad Production Plans for FY17 and FY18:

Mr. Johnson explained concepts for FY17, which includes a new beneficiary ad designed to build upon past themes by highlighting Technical College students whose education is supported with lottery proceeds.

The previously produced, but not released, campaign called "Change Your Weekend" is being updated and is expected to be ready for airing in FY17. Two or three new jackpot awareness ads "What Would You Do If You Ran into Powerball?", "Dude Ranch", and "Dragon" are under development for production in FY17 and FY18.

Financial Update

FY17 Financial Results and Highlights

The Chairman recognized Joe Boyle, Chief Financial Officer who reported that during the first six months of FY 2017 (July through December 2016), transfers decreased by \$2.9 from \$196.3 to \$193.4. Overall Game Revenues increased \$25.2 to \$765.7. Net Income increased \$2.9² to \$187.8 resulting from Instant and Terminal Game Revenues, as more fully discussed below.

Instant Games: Instant Game Revenues increased by \$10.4 to \$548.4. Of the overall increase, \$10 Instant Tickets increased by \$6.8 (1.9%) and \$5 Instant Tickets increased by \$5.8 (6.2%). In both cases, the rate of revenue growth is significantly less than in the prior year. Revenues associated with the \$1, \$2 and \$3 price points, in aggregate, decreased by \$2.2, or 2.7%. The Game Margin on Instant Game Revenues increased \$1.9, or 1.2%.

² All dollar amounts are expressed in millions. Net income 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.

Terminal Games: Terminal Game Revenues were \$217.3, an increase of \$14.9, or 7.4%. Powerball and Mega Millions Revenues drove the increase. Powerball Revenues were up \$5.6, or 15.1%. Mega Millions Revenues increased by \$2.3, or 13.8%. In both cases, revenues were unusually high at the beginning of the year due to jackpots and have since normalized. Pick 3 continued to perform well and revenues were up \$6.4, or 7.4%. Conversely, Pick 4 Revenues were up \$2.0, or 4.5%. Moreover, prizes paid on Pick 4 were up over last year and even with an increase in Revenues, the Net Margin on Pick 4 was down \$1.7 from last year. Lucky for Life Revenues were \$7.2, a decrease of \$1.6, or 17.8%. Palmetto Cash 5 Revenues were essentially flat, but the margin increased by \$1.1. The overall Game Margin % on Terminal Games was 49.34% compared to 51.52% last year. The 2.18% reduction was a result of lower margins on Pick 4 and Lucky for Life.

Advertising and G&A Expenses: Advertising Expense was \$4.0 in FY 2017 compared to \$4.1 in FY 2016. G&A Expense (the primary component of which is employee compensation) was \$6.6 in FY 2017 and \$6.3 in FY 2016.

Financial Report (Actual FY 2017 Results Compared to the FY 2017 Financial Plan)

To date, actual financial results have exceeded Plan. Game Revenues were \$765.7 compared to Plan of \$743.5. The positive variance in Instant Game Revenues is primarily attributable to better than expected sales of \$3, \$5 and \$10 Instant Tickets. These price points exceeded Plan by \$3.3 (21.1 %), \$6.1 (6.5%) and \$7.0 (1.9%), respectively. Aggregate revenues associated with the \$1 and \$2 price points were under Plan by \$2.3, or 3.6%. The positive variance in Terminal Game Revenues is primarily attributable to better than expected sales of Pick 3, Pick 4 and Mega Millions. In aggregate, Pick 3 and Pick 4 exceeded Plan by \$7.4 (5.6%); however, it appears that much of the sales were driven by higher prize payouts. As a result, our margin on the sales increase was only \$0.4. Mega Millions exceeded Plan by \$1.9 (10.9%). Powerball and Palmetto Cash 5 were very close to Plan and Lucky for Life was under Plan by \$1.4 (16.3%). As a result of better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$198.5 compared to the planned amount of \$195.5 for a positive variance of \$3.0 or 1.5%.

In aggregate, Operating Expenses were \$ 0.9 under Plan. Advertising Expense was under Plan by \$0.5 (\$4.0 Actual vs. Plan of \$4.5). Other Operating Expenses ("G&A") were \$0.4 under Plan. We expect most of the variances will normalize to planned annual amounts as the year progresses. As a result of the aforementioned factors, Net Income for the six months ending December 31, 2016, was \$187.8 compared to Plan of \$183.9, a positive variance of \$3.9.

4-Year Sales Trends: Mr. Boyle directed the Commissioners to a set of graphs that showed sales by game and product type emphasizing the \$10 Instant Tickets sales chart. Sales growth through November was minimal, but sales picked up in December. The importance of the \$10 price point is the continuing focus of management's attention. The graphs for all Instant Tickets, Pick 3, Pick 4, and all Terminal Games were also discussed.

Overview - Instant Ticket Planning

The Chairman recognized Jay Johnson to explain SCEL's planning process for instant game development. A spreadsheet similar to the Media Plan handout is used to track various price points, prize structures, play styles, and themes that are needed in the marketplace at any given time throughout the fiscal year. The planning for FY18 is nearing completion and a more in-depth presentation will be made in May. This overview is focused on a few of the new items under consideration and to provide a few examples of past product decisions that have positively impacted sales as demonstrated in the 4-year sales trend graphs.

A new \$10 ticket, Gigantix, is twice the size of a regular ticket. The overall payout in this game will mirror the others in this price point, but it can provide the player with several play areas on the ticket face as well as a play area on the ticket back. Mr. Johnson noted that this ticket indexes well in other states, and he believes it will not cannibalize other \$10 tickets. The plan is to launch a basic Gigantix game in December and to introduce other features in subsequent games such as those in the handout to keep the game fresh.

The FY18 plan keeps two \$10 tickets with \$1M top prizes and with a \$1M second-chance component that has come to be expected by our players. Among other items, Mr. Johnson pointed out the sales spike in the \$5 sales trend graph when the "Scratch My Back" (a ticket with a play area on the reverse side of the ticket) feature has been offered. Staff may introduce this added-value feature to \$10 games in FY18. He then handed out examples of several \$10 games using custom inks and printing enhancements that will place SCEL among the first in the industry to offer these features. SCEL is also taking a fresh look at licensed property games. In addition to Loteria, a "Walking Dead" ticket at the \$2 price point is slated for sale in September, just before the new season begins airing in October.

Executive Director's Report

The Chairman recognized Mr. Brown who began by discussing procurement matters. He reminded the Board that the procurement office is solely responsible for managing the evaluation process for the Online RFP. The evaluation panel has met and will meet several more times before reaching a decision. March 10th is the scheduled date for posting the award but the actual award date is likely to be closer to the date of the next Board meeting. Another significant purchase is the acquisition of a new IWON automated call-in service used by players to learn the draw results. The current analog system will not be supported after June 30th and the call volume is too high to discontinue this service. SCEL will move to a digital system that is available under statewide term contract. Two other contracts are set to expire prior to the end of the calendar year: media placement services and advertising production. Approval will be sought from the procurement office to adjust the termination dates to better accommodate SCEL's business needs. Finally, SCEL issued an "under \$50,000 RFP" for a compensation study which was awarded to MGT. Although our current classification and compensation system is updated as needed, the last comprehensive, independent study was completed more than 11 years ago.

Although MUSL's Powerball Group has ongoing discussions to find a replacement game for Powerball, no recommendations were made at the December Directors' meeting in Austin, Texas. The MUSL, Mega Millions, and NASPL study regarding cost sharing and/or reducing duplication was put on hold at the Austin meeting. A renewed effort will be made among the groups to foster better communication prior to deciding whether the expense of the study is warranted. Mr. Brown stated that MUSL is currently conducting its own strategic plan, reviewing its internal operational and staffing needs, and he feels the organization is on sound footing. MUSL is still dealing with past issues as it was recently served with a class action lawsuit concerning the Tipton incident, in which the class alleges its members would have won but for Tipton's criminal acts. Given SCEL's class action suit that ended in 2009, Mr. Brown has been asked to assist the MUSL Legal Committee in the present action.

As has been previously reported to the Board, NASPL has embraced the 2011 Department of Justice (DOJ) opinion allowing Internet sales of lottery tickets, so long as the purchaser is physically within the state at the time of the sale. Recently, for the first time, NASPL was considering funding a lobbying effort in Washington to prevent the passage of a bill that would overturn the DOJ opinion. The plan was for funding to come from dues paid by all members.

Mr. Brown stated that he informed NASPL that the Lottery Act does not allow our lottery proceeds to be used to fund lobbying, even on the federal level. Since those conversations, the momentum for this effort seems to have subsided, as other jurisdictions seem to be faced with withdrawing from this very worthwhile organization. He will update the Board as necessary.

Mr. Brown stated that on January 17th there was a conversation with officials from the North Carolina Education Lottery and SCEL staff to discuss a joint five or six number draw game. While it is far from certain whether a mutually beneficial product can be designed, Mr. Brown asked if there was any objection to continuing this effort to determine if a game could be submitted to the Board for approval. There were no objections.

Regarding debit cards, since the last meeting, Mr. Brown has spoken with Robert Adams, S.C. Association of Convenience Stores (SCACS), and he invited Mr. Brown to attend the April 27th meeting of the SCACS Board. Mr. Adams requested, and was provided, a copy of the SCEL's Debit Card research that was presented to the Board in November.

Mr. Brown next gave an overview of his understanding of how the mobile app, AutoLotto, operated from what is available from public sources. Mr. Fred Allen, a lobbyist representing AutoLotto, requested a meeting with Mr. Brown this past December. He declined the meeting pending input from the Board. Among other issues, Mr. Brown expressed concern over the loss of control since Auto Lotto would not, and could not, be a licensed retailer while selling through an app. Although Mr. Allen said AutoLotto saw no statutory impediment to operating in South Carolina, Mr. Brown informed the Board that he did not share that opinion, but that it would be inappropriate to discuss potential legal positions in an open meeting. Several Commissioners expressed various concerns and asked numerous questions. Commissioner DeLoach asked staff to address several specific items and report to the Board. Mr. Brown will not decide whether to meet with representatives of AutoLotto until more research is completed.

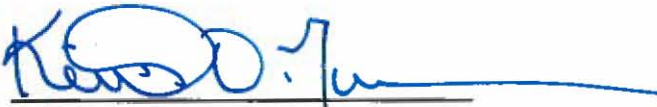
Mr. Brown concluded by stating that many of the items discussed regarding instant games, new advertising production, and other procurement items may require requests for budget increases when the FY18 budget is presented for consideration in May. While staff will look for reductions in other areas, there is little room for further cuts in operating expenses if SCEL is to maintain transfers in excess of \$375M.

Other Business

There being no further business, the Board adjourned the meeting. The next Board meeting is scheduled for May 10, 2017.



Sam Litchfield, Chairman



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.