

SOUTH CAROLINA EDUCATION LOTTERY
BOARD OF COMMISSIONERS MEETING MINUTES
August 14, 2019
10 a.m.

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, August 14, 2019, at 10:00 a.m., in the first-floor conference room located at 1333 Main Street, Columbia, South Carolina, with the following members, representing a quorum, participating:

Sam Litchfield, Chairman	Richard Chapman
Dr. Edward Keith, Vice Chairman	Bo Russell
Keith Munson, Secretary/Treasurer	Otis Morris
	Bill Crosby

The Chairman called the meeting to order and welcomed guests. The Chairman then welcomed Commissioner Crosby who was appointed by the Governor.

Approval of Minutes

On motion of Commissioner Munson, seconded by Commissioner Keith, the Board unanimously approved the minutes for the meeting held on February 6, 2019.

Quarterly Advertising Review

The Chairman recognized Ammie Smith, Senior Marketing Manager, to present the following items for the Quarterly Advertising Review:

Dick Clark's New Year's Rockin' Eve: Buckslip (Outside And Inside); Digital Billboard' Gas Station TV; Online Ad; PID; and Writing Surface.

Millionaire Series Second Chance Promotion: Digital Billboard; PID; Playstation Poster (Left And Right); and Ticket Topper.

Monopoly Jackpot: Digital Billboard; Online Ad (Available Soon and Available Now); Outdoor Advertising (App/Koozie Sandwich Board); and Promotion Handout.

Porches of Time: TV and PID for Powerball and Mega Millions.

Print Advertising: Diversity Works Magazine Ad; and Clemson, Citadel, College Of Charleston, Furman University, South Carolina, and Wofford College Ads.

Selling Points Retailer Newsletter for June, July, and August.

Ms. Smith next recognized Mr. Whiteside, Director of Marketing, to introduce the SCEL's proposed new advertising campaign referred to as "Tiny Stories" with a host like character/personality ("Tina Tiny") conducting field interviews with actors representing players with small lottery prize stories, meaning "tiny wins." Ms. Smith and Mr. Whiteside described the selection process for Tina and then explained the role of the other actors. The spots will be filmed in the fall and more information will be presented at the December Board meeting.

Mr. Whiteside reviewed SCEL's social media efforts. He stated that he and his staff meet every week and strategically plan 99% of all posted content to go on the content calendar. He explained the difference between an organic post and a paid post on Facebook, Instagram, and Twitter. An organic post is a non-funded (free) post such as a post of a winner's picture. SCEL can get a lot of feedback from an organic post. SCEL gets "likes," "shares," and comments from organic posts.

Conversely, social media budget dollars go towards paid posts similar to a directed ad campaign, e.g., the Monopoly Game Promotion (Monopoly). SCEL uses a 25/25/50 messaging split (25% beneficiary, 25% play responsibly and 50% product). In response to a question by Commissioner Munson, Mr. Whiteside stated that paid posts come up on the feed more often than organic posts and followers receive paid posts whether or not they follow a particular person. Only SCEL's followers on social media receive organic posts. Projected Jackpots and information on promotions and wheel spins are examples of organic posts.

Social media numbers have increased over the last 6 months. SCEL now has 20K followers on Facebook; a 10% increase on Instagram; and Twitter followers are up 2.3%. SCEL is also reengaging email marketing by focusing on Monopoly. There over 68K+ Players' Club Accounts, up from 5K. He stated that there is a 30% "open" rate on the email compared to the standard open rate of 18% and of that 30%, 20% are "clicking" through the email. He stated that 45% of email readers use a mobile device and that there have been about 3K app downloads that can be attributed to email marketing.

Since no one expressed concerns, at the 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.

Reports

The Chairman recognized Mr. Boyle, Chief Financial Officer to present the Update. FY 2019 was another record year for SCEL.

Actual FY 2019 Results Compared to Actual FY 2018 Results

Overview

Transfers were \$487.6M compared to \$434.8 last year, an increase of \$52.8 (12.1%). Net Income increased \$50.6¹ to \$488.6M. Mr. Boyle stated Transfers were within \$1M of net income, which have over a 99% correlation. Total Game Revenues increased \$230.8M to \$1,980.9M (13.2%). Instant Game Revenues were \$1,450.4M, an increase of \$189.8 (15.1%). Terminal Game Revenues were \$530.5M, an increase of \$40.9M (8.4%). Overall, Game Margin² on both Instant and Terminal Games increased by \$68.5M but the Game Margin Percentage decreased 0.53%. The Margin Percentage increased on Terminal Games and decreased on Instant Games.

Instant Games

Instant Game Revenues exceeded last year by \$189.8M (15.1%). For the year, \$10 Instant Ticket Revenues increased by \$195.5M (22.5%) and \$5 Instant Tickets increased by \$7.3M (3.4%). Revenues associated with the \$1, \$2, and \$3 price points, in aggregate, decreased by \$11.5M (6.7%). The Game Margin Percentage on Instant Game Revenues decreased slightly (0.7%) due to the increase in \$10 Instant Ticket Revenues relative to other price points.

Terminal Games

Terminal Game Revenues were \$530.5M, an increase of \$40.9M (8.4%). Because of higher Terminal Game Revenues and a favorable statistical variation, Game Margin on Terminal Games increased \$25.9M and Game Margin Percentage was up 0.93%.

¹ 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 reason for the difference is in accounts receivable; the growth in which is reflected in net income, but not in Transfers since amounts recognized as income have not been received.

² Game margin is defined as game revenue minus prize expense.

Pick 3 and Pick 4 performed well with increased revenues of \$4.5M (2.1%) and \$2.6M (2.6%). Prize Expense on Pick 3 decreased \$2.5M, resulting in a Game Margin increase of \$7M with a Game Margin Percentage of 51.84%, almost 2% higher than the statistical model. Pick 4 Prize Expense increased by \$2.7M, resulting in a slight decrease in the Game Margin.

National Games, Powerball and Mega Millions performed well for the year. Specifically, Mega Millions Revenues increased \$34.6, (76%) because of the \$1.5B Jackpot Run in October 2018. This substantial increase in Revenues contributed to an \$18.1 increase in Mega Millions Game Margin. Powerball Revenues and Prize Expense were essentially flat at \$92.9M and \$44.2M, respectively. In addition to the record-setting Mega Millions Jackpot Run, both Games experienced several solid Jackpot Runs that added to their performance in FY 2019. SC remains a Powerball state with core weekly revenue approximately twice that of Mega Millions.

Palmetto Cash 5 Revenues remained relatively consistent with a decreased \$4M (1.7%) but Prize Expense decreased \$2.4M (16.6%). As a result, Game Margin increased \$2M (20.5%). Generally, Lucky for Life performed consistently from FY 2018 to FY 2019.

Other Revenues and Game Costs

Other Revenues, which consist primarily of license and telephone fees, were \$3.7M, the same as FY 2018. Other Direct Game Costs were \$21.3M compared to \$18.7M in FY 2018. The \$2.5M increase was primarily attributable to expenses associated with fees paid to the new Gaming Vendor (\$.9M), Consumables (\$.2M), and enhancements in Instant Game offerings (such as Monopoly and other licensed properties) (\$1.3M).

Advertising and G&A Expenses

Advertising Expense was \$8.6M compared to \$8.3M in FY 2018. G&A Expenses (the primary component of which is employee compensation) were \$14.6M versus \$15.7M in FY 2018.

Actual FY 2019 Results Compared to the FY 2019 Financial Plan

Actual financial results exceeded Plan in FY 2019. Game Revenues were \$1,980.9M compared to Plan of \$1,762.7M.

The positive variance in Instant Game Revenues is primarily attributable to better than expected sales of \$10 Instant Tickets of \$182.8M (20.7%). SCEL conservatively planned \$10 price point sales because of significant growth recent years and SCEL continue to be cautious concerning the sustainability of \$10 Instant Ticket sales levels. In addition, the \$3 Instant Tickets performed well and exceeded Plan by \$.6M (1.3%). The \$1, \$2, and \$5 price points performed under Plan, and, in aggregate, were \$14.1M less than Plan (4.0%).

The positive variance in Terminal Game Revenues is attributable to Mega Millions and Powerball. Mega Millions was \$47.6M above Plan (146.0%). Powerball was \$5.9M above Plan (6.7%). Lucky for Life also performed slightly above Plan by \$.4M (3.5%). Each of the other terminal games performed within 2% of Plan. In aggregate, Pick 3, Pick 4 and Palmetto Cash 5 were under Plan by \$4.8M (4.1%), with each game under Plan as follows: Pick 3, \$3.7M (1.7%); Pick 4, \$.7M (0.6%); and Palmetto Cash 5, \$.4M (1.8%).

Due to better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) were \$511.7M compared to the planned amount of \$452.7M for a positive variance of \$59M (13.0%).

Advertising Expense was under Plan by \$.4M or 4.6% (\$8.6M versus \$9M). Other Operating Expenses (“G&A”) were \$.3M under Plan (\$14.6M versus \$14.9M). The variance to Plan was

primarily attributable to lower Depreciation (\$.2M), and Legal Expenses (\$.2M). Due to the aforementioned factors, Net Income was \$488.6M compared to Plan of \$428.8M.

Mr. Boyle concluded his remarks with brief comments on the National Games. It now takes on average 19 Powerball draws to reach \$400M and 22.25 draws for Mega Millions. Mr. Boyle also discussed the "annuity factor", the impact of low interest rates on the build of jackpots concluding that if interest rates are higher, the principal will grow to a larger amount.

Audit Update

The Chairman recognized Ms. Bethany Parler, Director of Audit Services, who cited International Standards for the Professional Practice of Internal Auditing which includes being independent and qualified as being important to the Audit Services Department. Ms. Parler stated she reported to the Board providing independence and gave a brief review of her qualifications.

Ms. Parler explained the department used a risk-based annual audit plan, which scored potential audits using four factors. One consideration is the impact of the specific audit topic on SCEL as a whole and/or on SCEL departments. Another consideration is change or growth potential of the audit area to SCEL in terms of investment in assets, revenues, expenditures, program or mission growth, and/or change in current operations. A third consideration is the control environment of the audit area. The higher the ranking, the greater the risk associated with the control environment and the higher the concern by management or internal and external auditors. Certain areas will always carry a higher ranking due to their high risk nature, since even though controls may be considered sound, the possibility exists that controls may not always work as intended or may not always be adhered to. The final attribute considered is the need for audit based on such factors as whether the topic was specifically requested for review by management, the time passed since the last internal or external audit, the results of prior audits, and whether the Audit Director participates on an on-going basis on project teams which already address the area, such as disaster recovery and network penetration exercises. Certain areas are audited systematically every two of three years due to high risk such as Claims payments, MSR travel, and equipment inventory.

Ms. Parler stated the fact that SCEL underwent a full lottery system conversion in the prior year affected development of this year's audit plan. The system impacted all departments and retailers, was a major change, its controls were still being tested, and other than acceptance testing, it had not been audited recently. Accordingly, items placed on the current annual audit plan included post system implementation audits of the Claims area; Licensing; Instant Ticket Processing; Inventory and Warehousing; Draw procedures; and other related areas. Other audits planned for this year include a SSAE 18 SOC 2 audit; financial statement audit assistance; Multi-State Lottery Association (MUSL) compliance; Legislative Audit Council follow-up; and, the Internal Control Self-Assessment among others.

The Internal Control Self-Assessment is an annual "Tone at the Top" survey that requests input from all employees. It asks questions designed to determine whether the potential for fraud or misstatement is prevalent. Ms. Parler went over the results of the last survey. The Chairman asked if the survey results were consistent year after year. Ms. Parler replied that in general the responses are consistent and favorable. In times of significant change in the organization or in an area, the responses change slightly.

Corporate Sales and Retailer Relations Update

The Chairman recognized Mr. Antonio Robertson, Corporate & Product Sales Manager, within

the Sales & Retailer Relations Department. Mr. Robertson described corporate retailers as those with five or more retail locations. He stated that corporate retailers continue to grow including both national chains and local mergers. Corporate locations have grown from 1,301 in 2002 to over 1,600 stores in 2019 (80% are convenience stores and 20% are grocery stores). SCEL currently has 54 corporate partners that make up about 43% of SCEL's retailer base and almost 40% of overall sales.

SCEL's largest convenience store partner is Circle K with 285 locations and \$135M in annual sales averaging \$9K per week per store. SCEL's best-in-class retailer is Parkers (based in Savannah, Georgia) averaging \$12K per week per store. SCEL's largest grocery store retailer is Food Lion with 99 locations. Publix leads in per store sales of Powerball. Quick Trip Convenience Stores came to SC in 2011 along the I-85 corridor and now has 53 locations.

Mr. Robertson explained how critical communication is in supporting these retailers. Strategic plans are developed monthly for SCEL's Regional Sales Managers and Sales Representatives for implementation at the store level. Training at the retail level and sharing sales data with district managers are essential for success. Corporate retailers have developed a better understanding of how lottery drives sales of other items. Corporate partners have begun to drive customers into stores by advertising lottery at the pumps and advertising the jackpot amount on receipts.

Legal update

The Chairman recognized Ms. Dolly Garfield who reported on Glassmeyer v. SCEL stating that last month the S.C. Court of Appeals issued a favorable ruling while remanding one issue that the lower court failed to address. Mr. Glassmeyer has recently asked the Court of Appeals to reconsider its initial opinion.

Ms. Garfield stated that the Intralot protest is pending in circuit court. SCEL asked the judge to rule based on the filings on July 26, 2019; Intralot objected and was granted a continuance. SCEL is awaiting the court to select a hearing date. On SCEL's contract controversy against Intralot, the parties are entertaining mediation to resolve the case. Meanwhile, the Chief Procurement Officer has requested suggested dates for an initial meeting.

Regarding the update on Holiday Cash Add-A-Play (HCAP) and Mega Millions class action lawsuits, Ms. Garfield stated that the circuit court dismissed all cases. The parties in one Add-A-Play case and the Mega Millions case have appealed to the Court of Appeals and have filed initial briefs. They will be scheduled for oral arguments unless the Court makes a decision based on the briefs.

In Ladd and Coggins, the plaintiffs' lawyers have suggested a settlement in which SCEL would reimburse players their purchase price in exchange for plaintiffs not filing an appeal. SCEL is awaiting further information from the plaintiffs in considering that settlement.

Ms. Garfield stated an Attorney General's opinion was requested because of the Legislative Audit Council's SCEL audit over the interpretation for what constitutes a resell of lottery tickets. SCEL provided input in that process and the AG opinion should be forthcoming.

Executive Director's Report

The Chairman recognized Hogan Brown who began his report with debit cards. The S.C. Convenience Store Association (SCACS) leadership has recently expressed some concerns over the proviso considered last year in the General Assembly. Although the Board has not taken a formal position, Mr. Brown indicated that unless there was an objection, he would continue conversations with SCACS to better understand their concerns. No objection was stated.

The lottery industry is moving forward with in-lane sales that allow sales in the normal checkout instead of the customer service counter. A player either receives a terminal generated ticket on plain cash register paper or obtains a card during checkout that contains a Powerball or Mega Millions play for the next draw. Although the National Association of State and Provincial Lotteries (NASPL) had been working on Application Protocol Interface (API) standards for several years, it appears that the market has moved faster. In-lane sales using API to communicate securely with the central gaming system to achieve a lottery purchase will begin for the first time in a meaningful way in several jurisdictions. Texas will start in-lane sales with 1,800 Dollar General Stores in October or November.

In other items on national scale, Mr. Brown explained that the New York lottery requested and was granted MUSL membership thereby leaving the Mega Millions Group. Mississippi is expected to start its terminal game sales in 2020 and has joined MUSL. Recently, discussions for offering the current Powerball game for sale outside the US (most likely in the United Kingdom) seem to be gaining momentum. Mr. Brown expressed concern as to whether this idea is in the best interest of Powerball and is awaiting more information. If approved by the MUSL directors, sales would not begin until sometime in 2021. He said that MUSL eliminated a dual voting scheme for certain matter that called for one vote per jurisdiction and pro rata voting based on sales. Now, each jurisdiction has a one vote on all matters. Lastly, while the Board may see news class action settlements with MUSL over the Eddie Tipton/Lotto America random number generator incident, those matters has no financial or other impact on SCEL as the games in question were not offered by SCEL.

Mr. Brown mentioned that SCEL is working with IGT on ways to insert a permanent 10X multiplier in Palmetto Cash 5 without materially changing the overall payout. He stated SCEL might have a recommendation for the board as early as December 2019.

As for upcoming major procurements, the contract for instant ticket printing, warehousing, and distribution expires in October of 2020 and given the intervening holidays, SCEL will probably award the new RFP in early spring of 2020.

All SCEL employees are undergoing online active shooter training and after everyone has completed that course, SCEL will conduct onsite classroom training. SCEL has upgraded and enhanced physical security of the perimeter and interior areas on the fourth floor in 2019.

In conclusion, Mr. Brown recognized Ammie Smith for her significant contributions to SCEL's success, which were also acknowledged by receiving a 2019 NASPL Powers Award.

Other Business

There being no further business, the meeting adjourned at 12:29 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.