

**SOUTH CAROLINA EDUCATION LOTTERY
BOARD OF COMMISSIONERS MEETING MINUTES
May 9, 2018
10 a.m.**

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, May 9, 2018, 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:

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

Bo Russell
Otis Morris
Buck Limehouse

The Chairman called the meeting to order and welcomed guests.

Approval of Minutes

On motion of Commissioner Munson, seconded by Commissioner Limehouse, the Board unanimously approved the February 7, 2018, meeting minutes.

Quarterly Advertising Review

The Chairman recognized Ammie Smith, Senior Marketing Manager, who presented the quarterly advertising in the various media for the following campaigns:

Extreme Millions (Game Launched on March 13th) Extreme Millions Second-Chance Promotion: Online Ad; PID; Website; and Play Station Poster.

Harley-Davidson[®] (Game Launched on May 8th) Harley-Davidson[®] Second-Chance Promotion: Buckslip; Digital Billboard; Online Ad; Play Station Poster; PID (IGT messaging currently in development); Website; and TV.

Powerball[®] ***Power Cruise***[™] (scheduled for the summer): Brochure; Digital Billboard; Writing Surface; Ticket Topper; Website; Online Ad; Online Video (How to Play); and TV.

Beneficiary Videos (scheduled for the fall); “Eric”: 30 and 60 Second TV spots; and Social Media Video. “Kim” : 30 and 60 Second TV spots; and Social Media Video.

Other Point of Sale Material: Digital Billboard – PC5 10X: “It’s Back”; Other Online Advertising - Website – Social Media Promotions; Retailer Newsletter: Selling Points (February, March and April 2018)

New IGT PID messages currently in development and scheduled to be introduced after conversion were presented: Videos: Harley-Davidson[®]; Palmetto Cash 5; 10X; Play Responsibly. Static: Student Beneficiary; Lucky For Life; Social Media; Pick 3/Pick 4 Evening/Midday Results; Jackpot Awareness; Mega Millions; Powerball; Top Prize Winner Awareness: Mega Millions, Palmetto Cash 5, and Powerball.

At the conclusion of questions on the presentation, the Chairman commented that the beneficiary ads were touching because they depict real people who have benefitted from the lottery. Ms. Smith explained how SCEL, in collaboration with Chernoff Newman and Mad Monkey, seeks out and selects the participants and the stories for these spots.

As no concerns were expressed, the Chairman stated 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.

Review and Approval of FY 2018-19 Budget

The Chairman recognized Mr. Joseph Boyle, Chief Financial Officer. He explained the process used to develop SCEL's FY19 Budget and Financial Plan ("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 FY18 projected expenditures through June 30, 2018, based upon the actual expenditures through March (nine months of FY18).

Overall, the Plan exceeds projected FY18 spending by slightly more than \$1.2M, most significantly in the following areas: (1) \$308K for Salaries and \$204K for Benefits (the employer pension contribution for employees increased by 1%) and (2) \$388K for Advertising Production and Placement. Although not an operating expense, Instant and Terminal Game costs increased by \$2.4M. Mr. Boyle noted that Plan Operating Expenses are generally consistent with previous requests. Over the past five years, revenue growth has been 39%, however, our operating expense levels have grown at only 10% (roughly 2% per year). The Plan projects Operating Expenses at 1.35% of gross revenue, of which, advertising is .51%.

The Chairman noted the economic impact of \$124M SCEL pays to its retailers. Commissioner Munson asked if planned revenue for FY19 over FY18's actual represents a less conservative approach to revenue forecasting. Mr. Boyle stated that the FY 2019 revenue projections for \$5 and \$10 Instant Tickets represents a modest 2% increase, which is less conservative than FY18, and was done to more accurately align with historical sales trends.

Commissioner Limehouse recommended that SCEL publish more information about our achievements. After a question by Chairman Litchfield, Commissioner Limehouse stated that the information should go to each of the three member appointing authorities. Chairman Litchfield asked Mr. Brown to generate a draft.

Motion Adopted

At the conclusion of questions and comments, Commissioner Munson moved for approval of the FY19 Plan, seconded by Commissioner Keith, and the Board unanimously adopted the motion.

Reports

The Chairman continued to recognize Mr. Boyle to present the Financial Update.

Actual FY 2018 Results Compared to Actual FY 2017 Results

Overview

Mr. Boyle stated that during the first nine months of FY18, Transfers increased by \$31.5M,¹ from

¹ Unless otherwise noted, all references to dollar amounts are expressed in millions.

\$302.8 to \$334.3M. Net Income² increased \$37.4M to \$331.8M. Overall Game Revenues increased \$100.6M to \$1,310.0M, or 8.3%. Instant Game Revenues were up \$56.9 (6.5%) and Terminal Game Revenues were up \$43.7M (13.2%). Overall Game Margin percentage on Instant Games was very consistent. Overall Game Margin percentage on Terminal Games was up more significantly and increased by 1.7%.

Instant Games

Instant Game Revenues were \$933.9M, up \$56.9M (6.5%) over the same period last year. Of the overall increase, \$10 Instant Tickets increased by \$43.0M (7.2%) and \$5 Instant Tickets increased by \$9.6M (6.3%). Revenues associated with the \$1, \$2 and \$3 price points, in aggregate, were up \$5.1M (4.1%). Game Margin on Instant Games increased by \$17.7M (7.3%) and the Game Margin percentage increased slightly (.21%) during the period.

Terminal Games

Terminal Game Revenues were \$376.1M, an increase of \$43.7M (13.2%). With the exception of Lucky For Life, all Terminal Games performed very well compared to the previous year. Powerball and Mega Millions Revenues were up \$13.9M (22.18%) and \$3.4M (23.8%). During the period both of these national games experienced substantive jackpot runs. Pick 3 was up by \$15.9M (11.0%) and Pick 4 increased by \$3.6M (5.0%). Interestingly, the growth in revenues was accompanied by a substantive increase in Game Margin that, in aggregate, increased by \$16.2M (15.3%). Palmetto Cash 5, because of the timing of the 10X promotion, also performed very well compared to the same period last year. Revenues increased \$8.4M (30.25%). Lucky For Life continued to be under pressure and revenues were down \$1.5M (13.4%). Aggregate Terminal Game Margin increased by \$27.8M (17.0%).

Other Revenues and Game Costs

Other Revenues, which consist primarily of license and retailer maintenance fees, were \$2.9M and \$2.8M in the first nine months of FY18. Other Direct Game Costs were \$14.0M compared to \$12.9M in FY17. In both periods, Other Direct Game Costs were very consistent at 1.06% of revenues.

Advertising and G&A Expenses

Advertising Expense was \$5.7M in FY18 and \$6.1M in FY17. G&A Expenses (the primary component of which is employee compensation) were \$10.8M in FY18 and \$10.4M in FY17. The \$4M increase in G&A Expenses resulted primarily from increased consulting (mostly systems related) and legal expense.

Actual FY 2018 Results Compared to the FY 2018 Financial Plan

To date, actual financial results have exceeded Plan. Game Revenues were \$1,310.0M compared to Plan of \$1,201.8M. Instant and Terminal Game Revenues are summarized as follows: Better than expected sales of \$10 and \$5 Instant Tickets. These price points exceeded Plan by \$48.4M (8.2%) and \$10.1M (6.6%). Revenues associated with the \$10 price point were conservatively planned due to the above average sales growth in recent years and, in fact, the rate of increase has slowed. We continue to be cautious concerning the sustainability of \$10 Instant Ticket sales levels. In aggregate, the \$1, \$2, and \$3 price points exceeded Plan by \$5.6M (4.5%).

² 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.

Overall, Terminal Game Revenues were up across all games except for Lucky for Life, which was off Plan by \$1.6M (15.0%). Pick 3 and Pick 4 Revenues were over Plan by \$16.4M (11.4%) and \$3.1M(4.2%).

In aggregate, Mega Millions and Powerball sales were over Plan by \$23.6M (26.4%). Both these games were up significantly over Plan because of unanticipated jackpot runs. Palmetto Cash 5 exceeded Plan by \$3.5M (24.5%).

As a result of the better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$348.2M compared to the planned amount of \$312.3M for a positive variance of \$35.9M (11.5%).

In aggregate, Operating Expenses were \$1.1M under Plan. The variance to Plan was due to Advertising Expense, which was under Plan by \$1.2M. We expect that much of the variance in Advertising Expense will normalize as the year concludes.

Based on the aforementioned factors, Net Income for the nine months ended March 31, 2018 was \$331.8M compared to Plan of \$294.8M. The positive variance of \$37.0M consisted of the better than planned Gross Profit of \$35.9M and lower than planned Operating Expenses of \$1.1M.

Executive Director's Report

The Chairman recognized Mr. Brown, Interim Executive Director, who began with an overview of the conversion process from Intralot to IGT. Since last August, the process has been moving at a rapid pace. Nevertheless, the Intralot procurement protest necessitated a two-month extension to allow IGT the conversion time called for in the new contract

Initially, a lead person from each SCEL department was selected to interact with IGT to assist them in learning our business operations and to help the IGT developers in customizing the system to the extent required. As expected, converting data from the current system to the new system proved to be one of the more challenging aspects of this project. User acceptance testing and training of SCEL staff was done throughout the spring. IGT then deployed new equipment in the field over the last two months. Retailers are to be commended for their understanding and patience as those terminals were wired to receive downloads and updates even though they were still using the Intralot terminals until the conversion. Retailer training was also occurring in late March and April. Final testing and parallel data processing began at the end of April to ensure the transactions on the new system were in balance and that all reporting was ready for cutover. The current system will be turned off at 11:45 p.m. on Saturday, May 12, and IGT is expected to go live Sunday, May 13, after lunch. Mr. Brown stated that retailer questions and issues are expected on Sunday and that SCEL and IGT will be prepared.

Mr. Brown then reported on the Heritage Golf Tournament noting that SCEL has supported the event for several years. This event exposes SCEL to a broader audience that may not be familiar with lottery games. Sales exceeded last year even though the final round concluded mid-afternoon due to the weather. He congratulated Ann Scott, Director of Sales, and her team on a successful event.

SCEL was recently honored in two areas: a SC Human Affairs Commission award as one of the top 10 agencies in the state for demonstrating equal employment opportunity during the 2016-2017 employment reporting period and three regional awards from the American Advertising Federation Awards. Two awards were for Best in Broadcasting for Dude Ranch and Dragon. The other award was for SCEL's integrated advertising campaign for Dragon and Dude Ranch and incorporating these campaigns in multiple levels of advertising.

Mr. Brown next discussed several procurement matters. He noted Intralot has not yet appealed the Procurement Review Panel decision on its protest. SCEL has finalized the Media Placement contract award to Chernoff Newman for 5 years with two one-year renewals. The Media Creative Production RFP would go out shortly. Although SCEL had approval to procure the contract through an in-house procurement, through a misunderstanding, MMO withdrew that authority. The Draw Production RFP would be released after the Media Production RFP is issued. A draw machine RFP will be issued in the fall.

Mr. Brown provided an update for the Winner-Take-All game (WTA), a Powerball add-on game that the Board approved last August 2017. Mr. Brown stated that in April, the Chair of MUSL brought the game up for reconsideration and that MUSL voted to scrap the game for the foreseeable future.

Since the Board's last discussion on debit cards, several states have approved debit card use such as Arkansas and Oklahoma. Without consultation with SCEL, the S.C. House passed a budget proviso that permitted debit card use for the lottery sales. He has explained the Board's position to Senate staff and the Convenience Store Association appears not ready to move forward at this time. The Board will be apprised of any further legislative actions.

Finally, Mr. Brown informed the Board the SCEL would have its year-end party on June 22, 2018, earlier than usual so employees retiring in June could be acknowledged for their service. The event will be held at the SC State Farmers Market in Cayce, S.C.

Other Business

There being no further business, the Board unanimously adjourned the meeting.

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