

**SOUTH CAROLINA EDUCATION LOTTERY
BOARD OF COMMISSIONERS MEETING MINUTES
May 15, 2019
10 a.m.**

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, May 15, 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
Dr. Edward Keith, Vice Chairman
Keith Munson, Secretary/Treasurer

Mickey Renner
Richard Chapman
Bo Russell
Otis Morris (by phone)

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 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.

Carolina Millions Instant Game: Online Ad, PID, Play Station Poster, Writing Surface, and Ticket Topper. **Monopoly™ Instant Game Promotion:** Buckslip, Digital Billboard, PID, Play Station Poster, Ticket Topper, and Writing Surface. **Powerball & Mega Millions:** Television – Meet Mitch; PID – Meet Mitch; and Mega Millions and Powerball with Example Text. **Online Advertising Web:** SCEL Site Images. **Outdoor Advertising:** Digital Billboard – Mega Millions Jackpot. **Play Responsibly (“Past Due”):** Television, PID, and Radio.

Other Point of Sale Materials: CleanSweep Buckslip; Play Station Topper – Front and Back; Play Pane – Education; Wallet Cards: Powerball, Mega Millions, Palmetto Cash 5, Lucky For Life, and Claim Center.

Print Advertising: Beneficiary: Teacher Of The Year, Kim: Black Pages Ad, Colonial Athletic Association Ad, Pickens Azalea Festival Ad, USC Baseball Ad, and Retailer Newsletter, Selling Points: March, April, and May 2019.

The Chairman next recognized Josh Whiteside, Director of Marketing and Product Development, to discuss SCEL’s efforts in social media. He began by explaining the creation of an SCEL style guide to standardize all SCEL marks and logos to ensure proper use both internally and externally. A new, “dynamic” website (the content adjusts to any viewing medium, desktop, tablet, or phone) is scheduled for mid-June before the new SCEL app is launched. The IT and Marketing departments have replaced outdated technology with a more secure, efficient site that allows for better content management.

Mr. Whiteside also discussed SCCEL’s social media strategy, social media guidelines (posted on the sites) and SCCEL’s recent launch of Facebook®. From a strategic standpoint, social media is simply another tool used in conjunction with and to complement other media such as television and outdoor advertising. Facebook® helps accentuate the other channels and allows SCCEL to get in front of our players and non-players. Social media posts are generally organic, meaning that material is presented daily and in the moment. These posts are divided among product offerings (50%), beneficiary messaging (25%), and responsible play (25%). Other social media content is designed to tie into items produced for television. As an example, a short, behind-the-scene video was presented from the “Meet Mitch” series of spots that will run on Facebook®. The overall goal is to get the right content on the right social media channel.

While predicting future results is difficult, thus far, with the new internal resources (personnel) and the shift in funding provided by the Board in FY19, the results are very promising. In the last 30 days, Facebook® has had 1.5M impressions for lottery content, 300K for Instagram®, and 665K for Twitter®. SCCEL also has 4K followers on Facebook®, 530K video feeds and 40K post engagements. The Chairman asked about the impact of promotional items such as Yeti coolers on social media performance. Mr. Whiteside stated that promotions have a significant impact on SCCEL brand awareness.

The next topic was the upcoming Powerball second-chance promotion, New Year’s Rockin’ Eve, wherein five players will win a trip to New York. There, in a televised event hosted by Ryan Seacrest, just after midnight one person, selected from trip winners from all participating states across the country will win \$1M. This promotion will last only a few weeks and will allow us to tailor a promotion geared primarily to social media channels.

While on the subject of social media, Mr. Brown explained that through the mobile app, scheduled to launch in June, SCCEL will send notifications. The strategy is not to inundate players with messages. Tying geolocation with messaging will not be done until Board input is sought. As with other apps, SCCEL messaging can be disabled at the player’s discretion.

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.

Review and Approval of FY 2019-20 Budget

The Chairman recognized Mr. Joseph Boyle, Chief Financial Officer, to discuss the FY20 Budget. Mr. Boyle explained the process used to develop SCCEL’s FY20 Budget and Financial Plan (“Plan”) including revenue forecasts built into the Plan, the involvement of each department, and the Executive Director in arriving at the requested spending.

Overall, the FY20 Plan is slightly less than \$1.2M above the projected FY19 actual expenses. To provide some context, the average year-to-year increase in operating expense over the last four fiscal years is \$850K. As to major components of the \$1.2M increase¹ in the FY20 Plan, employee benefits (mandated by law) and salaries account for \$308 thousand (\$50K and \$258K respectively) or 26% of the overall increase. An increase in advertising accounts for another \$419K, or about 36% of the overall increase (primarily for social media and for ads at gas pumps, the latter of which is under review). Depreciation is planned to increase by \$212K, or about 18% of the total increase as we make more investment in capital improvements. Audit & Financial (\$63K for SOC-2 audit, conducted every other year, and a slight increase in the draw auditor certification fees), Consultants (\$55k for a

¹ The total percentage increase presented in this paragraph exceeds 100% due to rounding.

demographic study, last done in 2016, and other marketing studies), and Legal expenses (\$135K to cover potential litigation expenses) are, in the aggregate, planned to increase by \$254K, or about 22% of the total increase.

Overall Instant Ticket sales are planned at a modest increase of 1.8% over FY19 sales levels. The primary driver of the overall increase in Plan sales is an increase in the \$10 price point of 2.5%. Even though this percentage increase is much less than the actual sales growth in FY19, the 2.5% increase for FY20 equates to a sales increase of \$26.5M. Mr. Brown pointed out the data that shows how important the \$10 tickets are in relation to the other price points. Due to the continued pressure on the \$1 and \$2 price points, SCEL is planning a \$2.3M decrease given the average decrease over the past two years. A modest increase of less than \$1M is planned in the \$3 price point (2%) and \$1.4M in the \$5 price point, a .65% increase.

Commissioner Keith asked why SCEL's projections are so conservative and Mr. Brown explained that he pulled back on the projections because of the continuing concerns of hitting a plateau in the \$10 price point. Mr. Boyle added that the margin is about 17% on \$10 tickets. He continues to approach the sustainability of its Instant Ticket sales growth conservatively, especially considering the volatility of the different price points in FY19, while the growth in the \$10 price point is currently 23% above last year.

Mr. Boyle stated that Terminal Game sales are planned to decrease by \$42.5M, or 8.2%, due largely to a planned decrease in Mega Million sales of \$38.0 million and a decrease in Powerball sales of \$4.4M. In both cases, FY19 revenues were higher than expected due to several jackpot runs, especially the unprecedented \$1.5B Mega Millions jackpot run. Consequently, most of the effects of the jackpot runs have been eliminated from SCEL's Plan due to the speculative nature of the jackpot runs and the risk of "jackpot fatigue." SCEL is planning no increases in Pick3 and Pick4 based on recent (flat) sales trends. Similarly, SCEL is planning no sales increases in the other Terminal Games - PC5 and Lucky for Life.

Mr. Boyle then reviewed the remaining footnotes in the worksheet explaining the variances between the Plan and FY20 projected expenditures through June 30, 2019, based upon the actual expenditures through March (nine months of FY19).

Motion Adopted

At the conclusion of questions and comments, Commissioner Munson moved for approval of the FY20 Plan, seconded by Commissioner Keith, and the Board unanimously adopted the motion.

Mr. Brown explained staff's desire to begin implementing "Sales Wizard", a software program presented in IGT's proposal. "Sales Wizard" allows SCEL's Marketing Sales Representatives to increase productivity and customer service through the use of real-time data from the IGT system when calling on retailers (i.e. inventory, sales trends, and route management). Mr. Brown wanted to ensure that the Board was comfortable moving forward using FY19 funds for the upfront costs considering that funding was not requested when the budget was approved last May. Implementation will take approximately nine months and after that, there will be an annual maintenance/licensing fee. After several questions, no objection was made to the plan as discussed.

Executive Session

Commissioner Russell moved to go into executive session to receive legal advice relating to the pending contract controversy involving Intralot in accordance with *S.C. Code Ann.* § 30-4-70 (a)(2); and to receive an update of the LAC Preliminary Audit Report as discussion in open session

is prohibited by *S.C. Code Ann.* § 2-15-120. Commissioner Munson seconded the motion that passed unanimously. The Chairman then restated the adopted motion as required by law and then asked everyone to leave the room except: Hogan Brown, Joe Boyle, Bethany Parler, Jorge Bravo, Dolly Garfield, and outside counsel, Liz Crum and her colleagues.

Return to Open Session

Upon the return to open session, the Chairman stated that the Board met in executive session in accordance with the terms of the adopted motion and that the Board took no action while in executive session.

Reports

Financial Report – Overview

Actual FY19 Results Compared to Actual FY18 Results

The Chairman recognized Mr. Boyle to present the Financial Update. During the first nine months of FY19, Transfers increased from \$334.3M to \$382M, an increase of \$47.7M (14.3%). Net Income increased \$38.3M² to \$370.1M. Overall Game Revenues increased \$155.4M to \$1,465.4M (11.9%). Instant Game Revenues were up \$131.6M (14.1%) and Terminal Game Revenues were up \$23.8M (6.3%). Overall Game Margin Percentage on Instant Games was down 0.8%. Overall Game Margin Percentage on Terminal Games was up 2.7%.

Instant Games

Instant Game Revenues were \$1,065.5M, up \$131.6M (14.1%) over the same period last year. The increase was driven by the \$10 price point, which increased \$145.1M (22.7%). With the exception of \$3 Instant Tickets, all other price points declined. In aggregate, \$1 and \$2 Instant Ticket Revenues were down \$7.7M (7.9%) and the \$5 price point was down \$5.0M (3.0%). Instant Game Margin increased by \$28.1M (10.8%) and the Game Margin Percentage on Instant Game Revenues decreased by 0.8% during the period. The large decrease in Game Margin Percentage was due to the relative large increase of the \$10 Instant Ticket Revenues.

Terminal Games

Terminal Game Revenues were \$399.9M, an increase of \$23.8M (6.3%). With the exception of Mega Millions, all Terminal Games were down. Mega Millions Revenues were up \$29.0M (80.5%). Conversely, Powerball Revenues were down \$3.4M (4.4%). Pick3 and Pick4 Revenues were essentially flat, down \$1.4M (0.6%). Palmetto Cash 5 and Lucky for Life also showed very slight decreases. Aggregate Terminal Game Margin increased by \$22.9M (11.9%). Aggregate Terminal Game Margin Percentage increased by 2.69%, due to statistical variation. This margin increase alone added about \$10.1M to transfers relative to the prior period.

Other Revenues and Game Costs

Other Revenues, which consist primarily of license and telephone fees, were \$2.7M and \$2.9M in the first nine months, respectively. Other Direct Game Costs were \$15.3M during the period compared to \$14M in FY18. In both periods, Other Direct Game Costs were very consistent at 1.04% and 1.06% of revenues, respectively.

Advertising and G&A Expenses

Advertising Expense was \$6M in FY19 and \$5.7M in FY18. G&A Expenses (the primary component of which is employee compensation) were \$10.8M in both FY19 and FY18.

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.

Actual FY 2019 Results Compared to the FY 2019 Financial Plan

To date, actual financial results have exceeded Plan. Game Revenues were \$1,465.4M compared to Plan of \$1,304.5M. The positive variance in Instant Game Revenues is attributable to better than expected sales of \$10 Instant Tickets. The \$10 price point exceeded Plan by \$132.3M (20.3%). SCEL continues to be cautious about the sustainability of \$10 Instant Ticket sales levels. In aggregate, the \$1, \$2, and \$3 price points fell short of Plan by \$5.7M (4.4%). Similarly, the \$5 price point was under Plan by \$8.3M (5.0%).

In aggregate, Pick3 and Pick4 Revenues were under Plan by \$6.1M (2.6%). In aggregate, Mega Millions and Powerball were \$48.6M (54.1% over Plan). Mega Millions alone exceeded Plan by \$40.5M (165.7%). In aggregate, Palmetto Cash 5 and Lucky for Life were on Plan.

Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$386.9M compared to the Plan amount of \$335.2M for a positive variance of \$51.7M (15.4%).

Operating Expenses were \$1.1M under Plan due primarily to Advertising Expense, which was under Plan by \$0.7M (\$6.1M Actual vs. Plan of \$6.8M). Much of the variance in Advertising Expense should normalize as the year concludes. Net Income for the first nine months was \$370.1M compared to Plan of \$317.3M. The positive variance of \$52.8M consisted of the better than planned Gross Profit of \$51.7M and lower than planned Operating Expenses of \$1.1M.

The Chairman asked Mr. Boyle for an update on the projected transfer amount and he stated that it should be \$490M plus or minus \$5M.

Executive Director's Report

The Chairman recognized Mr. Brown who highlighted certain aspects of the overall instant game performance reflecting on FY19 and what that may foretell for FY20. He then discussed the issues associated with social media and the Board's statutory role in quarterly review. Staff is examining how to address dynamic organic content (which cannot wait until a Board meeting) along with the major campaigns presented in the quarterly review. He said staff will continue to consider the best ways to keep the Board informed and will revisit this topic with the Board.

Mr. Brown reminded the Board that SCEL is three days removed from the first anniversary of the online cutover date (May 12). As expected, IGT is continuing the process of software releases. Overall, the process has gone well and should be completed in the fall. The Chairman asked Mr. Brown about a conversion issue involving retailer terminals. Mr. Brown stated that a feature called "Plays Print Preview" which allows for viewing multiple purchases on a single screen to verify accuracy or to edit the purchase prior to the sale is in the next software release.

Mr. Brown next addressed the New Year's Rockin' Eve promotion that he previously told the Board was not a good fit for SCEL. After a recent, more fully developed presentation to the MUSL Marketing Committee, he asked SCEL Marketing staff to consider a social media focused approach, as a few more prize trips were still available. He added that MUSL is becoming more involved with promotional concepts for the game group.

Next, Mr. Brown addressed upcoming procurements. The Draw Studio RFP would go out within the next few weeks. After that, an RFP will be issued for draw machines. Mr. Brown stated that the Instant Ticket production RFP should go out sometime in the fall (current contract ends in October 2020).

Ms. Garfield was asked to provide a legal update and stated that one of the Holiday Cash-Add-A-Play (HCAAP) class action lawsuits has been dismissed along with a another suit unrelated to HCAAP. They have been appealed to the Court of Appeals and SCEL is waiting for scheduling. In the remaining HCAAP class action lawsuit, SCEL is still awaiting a circuit court ruling.

Lastly, Mr. Brown mentioned SCEL's New Year Party, celebrating the beginning of the new fiscal year, will be held on June 13, 2019, with two team-building sessions at Escapology.

Mr. Brown stated that he appeared before the Senate Finance Committee on March 7, 2019 to explain SCEL's FY19 results up to that time.

Other Business

The Chairman recognized Commissioner Keith who moved that the Board delegate authority to the Executive Director to make decisions in consultation with the Legal Committee Chairman regarding litigation with Intralot. Commissioner Renner seconded the motion, which passed unanimously.

There being no further business, the Board unanimously adjourned the meeting at 12:25 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.