

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

August 2, 2017

10 a.m.

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, August 2, 2017, 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

Bo Russell

Dr. Edward Keith, Vice Chairman

Otis Morris (by phone)

Keith Munson, Secretary/Treasurer

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 May 10, 2017, meeting minutes.

ACTION ITEMS

Powerball Winner-take-All

The Chairman recognized Mr. Brown, Interim Executive Director, who gave an overview of the “Winner-take-All” (WTA) feature that was adopted by the MUSL Board of Directors in Denver this past June. Mr. Brown stated WTA is really a separate game: a game within a game. The MUSL Board discussed several launch options because some states wanted a late February launch while a few others wanted a June launch. Mr. Brown indicated that he lobbied for June due to the online conversion and that the group compromised on an April 15, 2018, launch date.

Mr. Brown explained that a Monday and Thursday draw is added to allow a player to make a \$1 wager that is pooled with other WTA wagers to fund the prize. The numbers selected for Powerball (PB) are used for the next WTA draw. A purchase on Monday for the Wednesday PB draw that adds a WTA wager will be for the Monday night WTA draw. A Friday PB purchase for the Saturday PB draw with a WTA wager will be for the Monday night WTA draw. The name “Winner-take-All” does not mean there will be only one winner; it means that the entire prize is paid after the draw with no carryforward to the next draw. To that point, one of the WTA challenges is that it will be very difficult to advertise a jackpot amount for a given draw. For example, even though each sale adds to the WTA prize, the actual payout for each winning ticket could range from 18K to \$1.5M¹ (as demonstrated in the meeting materials based on sales of \$3M). The MUSL board voted to require a \$2 PB purchase with a \$1 PowerPlay as a prerequisite to a \$1 WTA wager. The MUSL Board is scheduled to meet by phone on August 3,

¹ Dollar amounts are expressed as complete numbers, or in thousands (K) or in millions (M) throughout.

2017, to consider whether to allow a WTA wager without the requirement to purchase PowerPlay.

Without objection, the Board unanimously approved the Powerball Winner-take-All Game and authorized the Interim Executive Director to take the necessary steps to implement this game's features.

Quarterly Advertising Review

The Chairman recognized Ammie Smith, Senior Marketing Manager, who presented the quarterly advertising review. Mrs. Smith stated that the Marketing Department intended to focus on jackpot games even before changes were approved for both. She presented advertising materials in television, radio, PIDs, POS Digital Outboard, and online formats for the following advertising campaigns:

Dude Ranch: TV and Radio–Mega Millions and Powerball. **In A Flash:** Digital Billboard and Playstation Poster. **Change Your Weekend:** Digital Billboard; Playstation Poster; Ticket Topper; Website: Hammock, Hotel Gift Card, and Yeti Social Media contests. **Other Television:** TV–Play Responsibly 2017. **Other Point Of Sale:** Buckslip–Clean\$weep; Writing Surface–Jumbo Bucks Family. **Other Online Advertising:** Website–Palmetto Cash 5 10X–SC Pillow. **Retailer Newsletter:** Selling Points (Most recent issue) was also presented.

In response to a question, Mrs. Smith stated she did not believe there to be a problem using the same commercial for both Powerball and MegaMillions as it is intended raise awareness for both games depending on the jackpot level. Regarding the reference to “loaded with top prizes” in “\$50 In a Flash”, Mrs. Smith explained that the term “loaded” means substantially more prizes at this level in relation to the other games in the same price point, which is intended to create increased sales through word-of-mouth among players and retailers. Next, Mrs. Smith concluded with an update on the status of the advertising materials for the “Dragon” and “Walking Dead” campaigns.

After receiving questions and comments, the Chairman determined 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.

Consideration of Pay Philosophy and Compensation Study Report

The Chairman recognized Mr. Brown who presented an overview of SCEL's current pay philosophy. The Board adopted its current pay philosophy in 2007 as a result of a classification and compensation study prepared by Milliman in 2006. However, since the pay philosophy drives and informs the pay structure, it is most appropriate to first adopt the pay philosophy. While there are no substantive differences from 2007, the updated philosophy prepared for consideration by the Board has been streamlined.

The Chairman entertained a motion by Commissioner Keith, seconded by Commissioner Russell, to adopt the pay philosophy as presented, which the Board unanimously approved.

Next, Mr. Brown asked Claire Jones, Director of Human Resources, to provide an overview of SCEL pay history and classification and compensation program. Since 2007, SCEL has gone from approximately 165 employees to 118 employees today, largely due to the closing of the regional claim centers, consolidating responsibilities, and through attrition. Although compensation studies may be conducted every few years, staff has kept the Milliman study

current by monitoring the market, assessing new and/or hybrid positions, and participating in salary studies conducted by other lotteries.

SCEL contracted with MGT Consulting Group to conduct the most recent Classification and Compensation Study. The Study included onsite interviews between MGT and department directors, and the surveyance of information through a Job Content Questionnaire (JCQ). This instrument collects data for job classification analysis and assists in updating job descriptions. All SCEL employees completed JCQs to provide MGT with current job data, to use in job comparisons from the identified recruitment markets. Mrs. Jones explained that MGT collected market salary and benefits data by surveying comparable organizations, divided into two groups: Non-Lottery and Other Lotteries. The resulting compensation program consists of a grade-level pay schedule, with 25 grades, which allows room for career advancement within a relatively flat structure, reduces salary compression, and reflects the competitive market. No Board action was required for acceptance of the MGT report.

REPORTS

Financial Update

Overview of Actual FY17 Results Compared to Actual FY16 Results

The Chairman recognized Mr. Boyle who reported that FY17 was another excellent year for the SCEL. Transfers were \$400.3M compared to \$405.0M last year. Even though Transfers were less than last year, the prior year totals were artificially high due to approximately \$20M related to a \$1.6 billion Powerball jackpot run in January 2016. Adjusted for that extraordinary event, Transfers from “core operations” exceeded FY16 by approximately \$15M (3.9%). Net Income² decreased \$6.1M to \$398.3M. Total Game Revenues increased \$35.4M to \$1,635.7M. Instant Game Revenues were \$1,189.7M, an increase of \$51.9M (4.6%). Terminal Game Revenues were \$446M, a decrease of \$16.5M (3.6%). Game Margin³ decreased by \$3.7M. The overall Game Margin percentage decreased 0.97% relative to last year. Game Margins increased on Instant Games and decreased on Terminal Games.

After a flat start to the year, Instant Game Revenues picked up and exceeded last year by \$51.9M (4.6%). To achieve this overall growth rate, Instant Game Revenues grew by 6.6% in the last seven months of the year. The primary driver of Instant Game Revenue growth was the \$10 price point. Since the end of November, Revenue growth in this price point was 8.1%. For the year, \$10 Instant Tickets increased by \$41.1M (5.4%) and \$5 Instant Tickets increased by \$12.5M (6.3%). Revenues associated with the \$1, \$2, and \$3 price points, in aggregate, decreased by \$1.8M, or 1.1%. The Game Margin percentage on Instant Game Revenues decreased slightly (by 0.14%) during the year.

Terminal Game Revenues were \$446M, a decrease of \$16.5M (3.6%). With no jackpot close to January 2016, Powerball Revenues were down \$36.9M in FY 2017 compared to last year. Similarly, Mega Millions and Lucky for Life Revenues were down by \$2.1M (5.7%), and \$2.8M (16.1%). Conversely, Pick 3 and Pick 4 Revenues were up \$17M (9.5%) and \$6.5M (7.2%). Much of the increased Pick 3 and Pick 4 Revenues were paid back to players, and, in fact, Prize Expense on Pick 4 increased \$7.9M, or \$1.4M more than the increase in Pick 4 Revenue.

² Net income as used herein is 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.

³ Game margin is game revenue minus prize expense.

Palmetto Cash 5 also performed well with a Revenue increase of \$1.7M (9.1%), all of which was realized after the \$10X promotion began in April 2017. As a result of lower Powerball, Mega Millions and Lucky for Life Revenues and statistical variation, Game Margin on Terminal Games decreased \$16.3M. Game Margin percentage was down 1.75%.

Actual FY 2017 Results Compared to the FY 2017 Financial Plan

Actual financial results exceeded Financial Plan (Plan) in FY17. Game Revenues were \$1,635.7M compared \$1,568.2M in the Plan. The positive variance in Instant Game Revenues is primarily attributable to better than expected sales of \$10 Instant Tickets of \$37.2M (4.8%) and \$5 Instant Tickets of \$12.3M (6.2%). SCEL conservatively planned Revenues associated with the \$10 price point due to the above average sales growth in recent years. SCEL continues to be cautious concerning the sustainability of \$10 Instant Ticket sales levels, especially after the very flat performance in the beginning of FY17. In addition, the \$3 Instant Tickets performed well and exceeded Plan by \$6.7M (20.3%). Conversely, the \$1 and \$2 price points performed poorly, and, in aggregate, were under Plan by \$9.8M (7.2%). The positive variance in Terminal Game Revenues is attributable to the continued good Revenue performance of Pick 3 and Pick 4, which in aggregate, exceeded Plan by \$24.5M (9.1%). Conversely, Powerball and Lucky for Life were under Plan by \$2.1M, or 2.5%, and \$3.4M (19.1%). Mega Millions performed on Plan and Palmetto Cash 5 exceeded Plan by \$1.7 (8.9%). As a result of the better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$420.3M compared to the planned amount of \$408.7M for a positive variance of \$11.6M (2.8%). Advertising Expense was under Plan by \$.4M (4.6%) (\$8.1M Actual vs. Plan of \$8.5M). Other Operating Expenses (“G&A”) were \$0.4M below Plan (\$13.9 Actual vs. Plan of \$14.3). As a result of the aforementioned factors, Net Income for FY17 was \$398.3M compared to Plan of \$385.8M.

Executive Director’s Report

The Chairman recognized Mr. Brown who began by thanking Jay Johnson, Director of Marketing, Ammie Smith, Senior Marketing Manager, Ann Scott, Director of Sales and Retailer Relations (Sales), and their staff for the extraordinary success in 2017. Mr. Brown also thanked Chairman Litchfield and Commissioner Morris for attending the employee appreciation event at the Columbia Fireflies ballpark.

Mr. Brown stated that he had recently attended the South Carolina Association of Convenience Stores Meeting along with several members of the Sales staff. SCEL enjoys a great relationship with this group, and they expressed their appreciation for how we support the retailers. Unfortunately, he was unable to gain any new insights into retailers’ opinions on the use of debit cards for lottery transactions. Mr. Brown also stated that he would be attending the Legislative Oversight Committee meeting on October 10, 2017, and that Senator Peeler and Representative Allison will be co-chairing.

Mr. Brown reported on other items relating to MUSL. Their strategic plan effort was very successful and the lottery directors and MUSL staff are working on its implementation. MUSL has moved past the “Tipton incident” and, is now a much stronger organization. The MUSL directors approved the use of certain reserve funds to fund prizes in the “Cruise Away” promotion, which will allow SCEL to stretch its advertising dollars to promote Powerball. Finally, Mr. Brown took the opportunity to remind the Board that expenses associated with attending MUSL Director meetings are paid for by MUSL, not SCEL.

