

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

August 8, 2018

10 a.m.

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, August 8, 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
Richard Chapman
Mickey Renner

The Chairman called the meeting to order and welcomed guests. Next, the Chairman welcomed Dr. Richard N. Chapman as the newest member to the Board, appointed by the President Pro Tempore of the Senate. The Chairman stated that Dr. Chapman was the Provost of Francis Marion University until his recent retirement.

Approval of Minutes

On motion of Commissioner Munson, seconded by Commissioner Keith, the Board unanimously approved the minutes for meetings held on May 9, 2018; May 15, 2018; and May 30, 2018.

Quarterly Advertising Review

The Chairman recognized Ammie Smith, Senior Marketing Manager, to present the quarterly advertising review. Commissioner Renner, Marketing and Retailer Relations Committee Chair, provided an overview of SCEL's advertising mediums prior to 2014 when SCEL used only traditional advertising: TV, radio, and our website. He further explained that in 2016, SCEL launched Twitter and Instagram. He reminded the Board that the current FY 2019 Media Plan has shifted money away from traditional media and toward digital platforms (channels) that include Facebook, YouTube, and Snapchat.

Mrs. Smith began her presentation explaining that SCEL's use of Facebook, YouTube, and SnapChat enhances the SCEL's overall participation in Digital Media. She reviewed statistics of each channel's exposure and explained that the recommended mix of content is engaging with the target audience (80%) and self-promotion (20%). Mrs. Smith opined that SCEL should customize content for each channel. For example, Facebook consumers want engagement with questions and contests in conjunction with viewing video, with or without sound. Consumers on Twitter seek news and current events. Press Releases and Winner Awareness work well on this channel. SCEL has experienced success with Twitter Promotions that engage consumers with contests and trivia. Instagram has been used to focus on telling SCEL's story through visuals that work well for beneficiary and brand messaging, product advertising, and contests. YouTube allows SCEL to broaden and continue to drive awareness to its brand and allows consumers to watch long form video that is ideal for beneficiary stories. Mrs. Smith presented specific examples of SCEL's FY 2019 Digital Media Plan for the "Dude Ranch" campaign to be used for promoting Mega Millions and Powerball on Instagram; Dude Ranch (YouTube) Mega Millions and Powerball (You Tube).

Mrs. Smith next presented the remaining Advertising Review items for the following campaigns:

The Voice® (Game Launches on September 11th): Buckslip; Digital Billboard; Player Information Display (“PID”); Playstation Poster; and Ticket Topper.

PID: Beneficiary: Eric and Kim; Dude Ranch: Mega Millions and Powerball.

Other Point of Sale: CleanSweep Buckslip; Palmetto Cash 5 Digital Billboard; and Million Dollar Multiplier Writing Surface.

Other Online Advertising: Social Media Web Links; Retailer Newsletter Selling Points for May, June, and July 2018.

Commissioner Munson asked whether SCEL’s TV commercials drive people to its social media channels. Mr. Brown stated that other lotteries are not using traditional and social media to tie all media together as SCEL is currently planning. Others lotteries tend to use several types of messaging on the respective channels. The Chairman initiated a general conversation reflecting upon how the use of social media by SCEL has evolved. Several favorable comments were made and concerns were expressed over the use of certain channels. Mr. Brown responded that SCEL is looking at ways to ensure that social media content is current and adequately monitored which requires adequate staffing. The Chairman then asked about “geofencing” and whether it is included in SCEL’s marketing plans. Geofencing could be used for pop-up ads based on their proximity to a retail outlet but Mr. Brown expressed concerns about the intrusive nature of such use.

The Chairman recognized Commissioner Munson who inquired about various aspects of the CleanSweep (CleanSweep) Promotion, including whether the prize should be increased from \$50 to \$100. Staff indicated that the participation level has not decreased and that if it does, staff will consider increasing the prize from \$50 to \$100. Staff also explained why entries for this contest were required to be in envelopes rather than simply mailing in each instant ticket. Commissioner Munson then asked several questions concerning The Voice® instant game and the associated second-chance promotions. Staff explained that the odds for the second-chance promotion are dependent upon the number of entries received, which is unknown until the entry period ends. A discussion followed concerning the odds of not winning and what is required to be placed adjacent to the point of sale. Lastly, Commissioner Munson suggested The Voice® ticket should specify that entry in the second-chance promotion provides a chance to win \$125k as well as a VIP trip to Los Angeles, CA.

There were no further questions from the Board. Having heard all the questions and concerns, 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.

Reports

The Chairman recognized Mr. Boyle to present the Financial Update.

Actual FY 2018 Results Compared to Actual FY 2017 Results

Overview

FY 2018 was a record year for the South Carolina Education Lottery. Transfers were \$434.8M compared to \$400.3M last year, an increase of \$34.5M. Net Income increased \$39.6M¹ to \$437.9M.

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 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.

Total Game Revenues increased \$114.5M to \$1,750.2M (7.0%). Instant Game Revenues were \$1,260.6M, an increase of \$70.9M (6.0%). Terminal Game Revenues were \$489.6M, an increase of \$43.6M (9.8%). Game Margin² increased \$50.9M. The overall Game Margin percentage increased 0.71% relative to last year. Game Margins increased on both Instant Games and Terminal Games.

Instant Games

Instant Game Revenues exceeded last year by \$70.9M (6.0%). For the year, \$10 Instant Ticket Revenues increased by \$60.1M and \$5 Instant Tickets increased by \$6.1M. This volume increase represents revenue growth in these price points of 7.4% and 2.9%, respectively. Revenues associated with the \$1, \$2 and \$3 price points, in aggregate, increased by \$6.3M (3.8%). The Game Margin percentage on Instant Game Revenues increased slightly (0.19 %) during the year.

Terminal Games

Terminal Game Revenues were \$489.6M, an increase of \$43.6M (9.8%). With the exception of Lucky for Life, all Terminal Game Revenues were up for each Terminal Game. Pick 3 was up \$16.9M (8.6%). Pick 4 was up \$3.9M (4.0%). However, Prize Expense on Pick 4 decreased a significant \$1.9M resulting in a Game Margin increase on Pick 4 of \$5.8M. As a result, the Game Margin percentage on Pick 4 was 56.8%, about 7% higher than the statistical model would project.

Powerball and Mega Millions also performed very well for the fiscal year. Powerball and Mega Millions Revenues were up \$10.6M (12.8%) and \$10.7M (30.7%), respectively. Even though there were no “mega” Jackpot Runs, both Games experienced a number of solid Jackpot Runs that added significantly to their better performance in FY 2018. Palmetto Cash 5 also performed well with a Revenue increase of \$3.2M (15.2%). Staff believes the Revenue growth was attributable to the second 10X promotion.

As a result of higher Terminal Game Revenues and positive statistical variation, Game Margin on Terminal Games increased \$29M (1.48%).

Other Revenues and Game Costs

Other Revenues, which consist primarily of license and telephone fees, were \$3.7M in FY 2018 and \$3.6M in FY 2017. Other Direct Game Costs were \$18.8M in FY 2018 compared to \$17.4M in FY 2017. The increase of \$1.4M was primarily attributable to expenses associated with the system conversion and changes to Instant Tickets.

Advertising and G&A Expenses

Advertising Expense was \$8.3M in FY 2018 and \$8.1M in FY 2017. G&A Expenses (the primary component of which is employee compensation) were \$15.7M in FY 2018 and \$14.0M in FY 2017. Most of the \$1.7M increase was due to increases in Advertising (\$.2), Salaries and Benefits (\$.9), Consultants (\$.4 due to Conversion testing and Holiday Cash Add-A-Play report) and Legal (\$.3 due to Online Protest and Holiday Cash Add-A-Play).

Actual FY 2018 Results Compared to the FY 2018 Financial Plan

Actual financial results exceeded Plan in FY 2018. Game Revenues were \$1,750.2M compared to Plan of \$1,623.8M.

The positive variance in Instant Game Revenues is primarily attributable to better than expected sales of \$10 Instant Tickets of \$70.1M (8.8%) and \$5 Instant Tickets of \$10.2M (4.9%). Revenues associated with the \$10 price point were conservatively planned due to the rate of growth in recent

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

years. In addition, the \$3 Instant Tickets performed well and exceeded Plan by \$3.3M (8.0%). The \$1 and \$2 price points performed close to Plan, and in aggregate, were over Plan by \$1.1M (0.9%).

The positive variance in Terminal Game Revenues is attributable to the performance of all games, other than Lucky for Life, which was under Plan by \$2.4M (15.7%). Otherwise, all Terminal Game Revenues exceeded Plan as follows: Pick 3, \$18.2M (9.4%); Pick 4, \$2.9M (3.0%); Powerball, \$6.7M (7.8%); Mega Millions, \$13M (40.1%); and Palmetto Cash 5, \$4.7M (24.4%).

As a result of the better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$461.9M compared to the planned amount of \$420.6M for a positive variance of \$41.3M (9.8%).

Advertising Expense was under Plan by \$.7M or 7.0% (\$8.3M Actual vs. Plan of \$9.0M). Other Operating Expenses (“G&A”) were over Plan by \$1.4M (\$15.7M Actual vs. Plan of \$14.3M). The variance to Plan was caused by the same items as discussed above: Salaries and Benefits (\$.8M); Consultants (\$.4M), and Legal (\$.2M).

As a result of the aforementioned factors, Net Income for FY 2018 was \$437.9M compared to Plan of \$397.3M.

Mr. Brown stated that the challenge in FY 2019 would be explaining to the Board of Economic Advisors (BEA) that it would be extremely difficult to exceed the FY 2018 results because the three biggest drivers of transfers were all positive. Instant Games sales were up, Mega Millions and Powerball sales were up (our highest profit games), Pick 3 and Pick 4 sales were up, and Game Margin across the board was up. If one or more of these factors had trended down, the transfer increase of \$34.5M from FY 2017 to FY 2018 would have been \$5M to \$10M less, which would have been more consistent with the transfer growth over last few fiscal years. In addition, staff will explain to the BEA that higher online gaming costs associated with the new contract as well as health care, and pension costs may affect the transfer. Instant Game costs are also budgeted to be higher than FY 2018 as we continue incorporate product enhancements and added value for our players.

Executive Director’s Report

The Chairman recognized Hogan Brown, Executive Director, who began by discussing the online gaming conversion. He stated that beginning last fall, SCEL and IGT have operated under a compressed schedule. He noted that SCEL had three team leaders: Jorge Bravo, Lynette Crolley and Dan Beatty. They coordinated the entire SCEL team that consisted of representatives from each department who acted as liaisons for their functional area to learn IGT’s system, explain our needs to IGT, manage data conversion, engage in extensive documentation and testing for every aspect of the system, and facilitate training for SCEL staff and retailers. Mr. Brown specifically acknowledged and individually thanked each of the team leaders. He also recognized Mrs. Crolley for receiving the Powers Award from the National Association of State and Provincial Lotteries (NASPL). The Powers Award is named after Ed Powers (the first US lottery director). Mr. Brown further thanked IGT and the entire SCEL staff for a successful conversion as total team effort is required for a project of this scope.

Mr. Brown reported on the NASPL Professional Development Seminar (PDS). A key topic at the PDS meeting was sports betting. Mr. Brown further explained that a constitutional change would be necessary in South Carolina to legalize sports betting and might not produce as much revenue as some predicted. Tony Cooper, Chief Operations Officer, will monitor developments in other jurisdictions for SCEL. Mr. Brown also recognized Jeremy Kyzer, Regional Vice President of Sales, SGI, for highlighting SCEL’s approach and success with instant products in a presentation he delivered at the PDS. Mr. Kyzer is in Columbia to discuss product development with SCEL for the upcoming year. Lastly, Mr. Brown mentioned that IGT representatives would present industry-level marketing and new game ideas for SCEL staff to consider tomorrow.

Mr. Brown mentioned SCEL's efforts to enhance its relationship with the South Carolina Association of Convenience Stores (SCACS). He stated that he would like for the incoming president of SCACS to attend the December 5, 2018 Board meeting to allow her to meet the Commissioners. Mr. Brown then reported that one of the topics at SCACS' annual meeting in July was the use of debit cards. He reminded the board that during the consideration of the Annual General Appropriation Act debit card use for lottery transactions was approved but later withdrawn from the final conference report. Certain members of SCACS expressed some of the same concerns as the SCEL Board. Mr. Brown noted that a few states have started allowing debit card sales for lottery products such as Arkansas and Oklahoma.

Next, Mr. Brown asked Mrs. Dolly Garfield, Senior Legal Services Manager, to update the Board on various legal issues. She discussed three pending lawsuits; two involving the Holiday Cash Add-A-Play Game and one relating to a Mega Millions ticket. Mrs. Garfield stated that SCEL's outside counsel, Nelson Mullins Law firm, has argued motions to dismiss in each case. The motions are under advisement. She also updated the Board on SCEL v. Glassmeyer, the pending FOIA litigation, explaining that it is on appeal in the SC Court of Appeals and is set for oral argument on September 12, 2018, at 10 a.m. The Chairman then asked the Board members to call Mrs. Garfield if anyone would like more information.

SCEL released the Ad Production RFP a few weeks prior to the meeting. Mr. Brown noted that the release of the RFP was later than expected due to a change in the Procurement Officer assigned to SCEL by the Materials Management Office (MMO).

Mr. Brown discussed the upcoming retailer rallies that will occur throughout the state in nine cities: Aiken, Anderson, Beaufort, Charleston, Columbia, Florence, Greenville, Myrtle Beach, and Rock Hill. The rallies offer an opportunity to show our appreciation for the efforts of our retailers in a fun environment. The Chairman encouraged members to visit a rally noting the importance the retailers play in selling SCEL products.

Mr. Brown stated that some challenges for FY 2019, in addition to those referenced during Mr. Boyle's financial report, include Human Resources. He stated that with the TERI Program ended, several retiring employees create opportunities for current staff to accept new challenges and for SCEL to hire new employees. Commissioner Keith asked how SCEL addresses vacancies. Mr. Brown stated that the first question is always whether SCEL can consolidate or shift responsibilities to enhance overall productivity. While SCEL seeks to hire from within, fresh talent can be beneficial to the organization.

Other Business

There being no further business, the Board unanimously adjourned the meeting at 11:30 a.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 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.