

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

December 11, 2019

10 a.m.

The Board of Commissioners of the South Carolina Education Lottery met on Wednesday, December 11, 2019, at 10:09 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	Otis Morris
Dr. Edward Keith, Vice Chairman	William Crosby
Keith Munson, Secretary/Treasurer (by phone)	William Newsome
Richard Chapman	Ryan Langley
Bo Russell	

The Chairman called the meeting to order and welcomed guests. The Chairman then welcomed Commissioners Newsome, appointed by the Speaker of the House and T. Ryan Langley, 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 August 14, 2019.

Election of Officers

The Chairman asked for any nominations of officers other than those currently serving, and after receiving none, entertained a motion to close the nominations and elect the current slate of officers for another one-year term in accordance with the by-laws. Commissioner Russell so moved, seconded by Commissioner Chapman, and the motion passed unanimously.

Palmetto Cash 5 Proposed Matrix Change

The Chairman recognized Ammie Smith, Product Director and Joe Boyle, Chief Financial Officer, to discuss proposed changes to the Palmetto Cash 5 (PC5) matrix. PC5 is a South Carolina game with annual sales of about \$23 million for the past several years and a transfer value of \$8 to \$9 million. Over the years, the frequency of the draws has gone from 3 nights a week to 7 nights a week. In 2017 and 2018, the "10X Promotion" was successfully tested for several months during which the 5X multiplier ball was replaced with a 10X multiplier ball, providing a chance to win \$1 million.

Mr. Boyle stated that during the 10X promotion PC5 sales were up about 30% compared to the previous year. However, the "simple" exchange of the 5X ball with a 10X ball increases the payout ratio of PC5 from 63% to well over 70% and heightens the risk of statistical variation. Accordingly, SCEL asked IGT to develop a new matrix that included a 10X multiplier, but which retained the payout ratio at 63%. To maintain payout stability, staff recommends doubling the number of "2X" and "3X" balls, removing the "4X" ball, retaining the "5X" ball, and adding the "10X" multiplier ball.

In response to questions, Mr. Boyle confirmed that the proposed changes should give PC5 a “lift” and bring the overall payout more in line with other terminal games. Ms. Smith added that other states with comparable populations offer a five number game with a fixed \$1 million top prize but a much larger population is needed to sustain a rolling jackpot.

Motion Adopted

On motion of Commissioner Chapman, seconded by Commissioner Keith, the Board unanimously approved the PC5 matrix change.

Quarterly Advertising Review

The Chairman recognized Ammie Smith, Director of Product, and Josh Whiteside, Director of Marketing to present the following items for the Quarterly Advertising and Social Media Review:

Holiday Advertising: (Give A Little Jingle); Digital Billboard – Holiday Games Version 1 and 2; Online Ad, PID, Play Station Poster, Ticket Topper; Digital Billboard – Mega Millions and Powerball Holiday Digital Billboard; and PID – Mega Millions and Powerball Holiday.

Game of Suits: (King of Spades & Queen of Hearts) - After concluding an oversized instant game offering, Ms. Smith explained that SCEL developed a creative way to utilize the oversized dispensers. The “King of Spades” and “Queen of Hearts” will both fill this oversized single unit dispenser, as they are two conventional-size \$10 games. This novel approach to using available counter space will also include a “competition” between these games in a second-chance promotion. She also presented ad concepts: Digital Billboard, PID, Play Station Poster, and Writing Surface Launching for this game, which is launching on February 11, 2020.

Mr. Whiteside then discussed social media in the context of paid content versus organic content (not paid). He stated that the Marketing Department’s social media team meets regularly to determine the content to publish. SCEL bases paid content around products, beneficiaries, and responsible play. Organic content includes items such as 12 Days of Giveaways during the holidays and winners’ stories.

Next, he addressed SCEL’s strategic approach to social media content. Strategic examples are title sponsorships of sporting events with the University of South Carolina and Clemson University. Each sponsorship includes an on field presentation, game program exposure, signage, and radio interviews. The focus is on beneficiaries. He showed a video of the Lugoff-Elgin High School football coach telling his SCEL scholarship story. Media value from Thursday to Saturday for South Carolina’s football game is estimated at \$85K, reaching 200,000 people on social media platforms. At Clemson’s Military Appreciation Weekend, we received about \$90K in media value, reaching about 400,000 people.

Although the spots were still in post-production, Mr. Whiteside provided more details on “Tiny Stories”, the TV and social media campaign focusing on small winnings. Ms. Smith then mentioned the new beneficiary messaging that is emerging from the concept phase. Using the actual beneficiaries, the theme is to show their passion: Sarah, a violinist; Daniel, a muralist; and Ciara, who is involved with a children’s reading program. An audio clip of Daniel explaining how the LIFE scholarship helped him fulfill his dreams was played.

Lastly, Ms. Smith introduced new employee Caroline Hinson, Product Manager and Mr. Whiteside introduced Sam Bond, Marketing Manager.

At the conclusion of the Advertising and Social Media Report, hearing no concerns or objections, 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

Information Technology Report

Jorge Bravo, Director of Information Technology, was recognized to report on the recent activities and accomplishments in this area. First, he explained the role of the three IT sections: Systems and Network (design management, infrastructure, servers, website, databases, back up, recovery and security); Database and Development (internal and external websites, database research, and secure data exchanges); and Lottery Gaming Systems (quality assurance and testing for instant and online games and software changes affecting SCEL users). He also explained IT's operational role in processing the draw results for local and multi-jurisdictional games.

Commissioners asked several questions. Regarding the recent instant game printing error, staff explained that our testing did not reveal the vendor error. The computer system correctly recognized the winning amount programmed for the tickets in question, but the face of certain tickets displayed an incorrect caption under the dollar amount shown. Regarding the technology used to verify the win, Mr. Bravo stated the "winner's file" is provided by the instant game vendor (SG) and is processed by the online vendor's system (IGT). Mr. Brown stated that SG's response to the printing error was quick, appropriate, and professional and that no similar instance had occurred in South Carolina. Regarding online games, staff explained how the Internal Control System (ICS) detects anomalies for the online games prior to a draw.

IT has upgraded and redesigned SCEL's network to maintain industry standards for intrusion detection and prevention. The cabling for our entire network has been reconfigured and mapped while also migrating communications to fiber. The data center is being upgraded to create a better testing environment, separate from the network servers. IT is revamping SCEL's Disaster Recovery (DR) site to remove any dependencies on the main site so that it will be completely stand-alone. SCEL hired a Cybersecurity Manager in the Security Department who is working with IT to enhance overall network protection. We have also replaced our outdated website to better fit with players' reliance on mobile devices and provide easier and quicker navigation by more users. It is now more functional for those with visual impairments. Lastly, Mr. Bravo thanked his staff for their tireless efforts on these and other projects, noting that a significant portion of this work was done despite vacancies within IT.

Financial Report

Actual Year to Date FY 2020 Results Compared to Actual FY 2019 Results

Overview

Mr. Boyle was recognized. During the first four months of FY 2020, Transfers decreased from \$176.4M to \$163M, a decrease of \$13.4M (7.6%), attributed primarily to the Mega Millions and Powerball jackpot runs during this period last year. On the strength of Instant Game revenues, overall Game Revenues increased \$3.4M to \$636.6M (0.5%). Net Income decreased \$13.9M¹ to \$149.1M (8.5%) due to a decrease in Terminal Game Revenues, as more fully discussed below.

Instant Games

¹ Net income as used herein means "Change in Net Position" as generally used for governmental agencies. Net income is recorded on an "accrual basis" and transfers are on a "cash basis". Therefore, a receivable cannot be included in the transfer until the cash is received.

Instant Game Revenues increased by \$34M (7.7%) to \$476.9M, mainly due to an increase of \$27.2M (8.5%) in \$10 Instant Ticket sales. \$5 Instant Tickets increased \$6.0M (8.7%) while, in aggregate, \$1, \$2, and \$3 Instant Revenues were up a modest \$0.8M (1.6%). The overall Game Margin on Instant Game Revenues increased \$7M (5.8%). The overall Game Margin Percentage on Instant Games was consistent with last year, 27.0% compared to 27.5%.

Terminal Games

Terminal Game Revenues were \$159.7M, a decrease of \$30.7M (16.1%), due to significant decreases in Mega Millions and Powerball Revenues. During October 2018, the Mega Millions jackpot reached \$1.5B and Powerball reached \$750M. Mega Millions Revenues were \$14.1M compared to \$43.1M last year, a decrease of \$29M (67.3%). Powerball Revenues were \$21M compared to \$33.4M last year, a decrease of \$12.5M (37.3%). Pick 3 and Pick 4 were up by \$6.5M (9.4%) and \$4M (12.1%), respectively. The overall Game Margin Percentage on Terminal Games was 49.5% compared to 51.5% during the same period last year, largely attributable to statistical variation in Pick 4 which decreased by 7.5%.

Other Revenues and Game Costs

Other Revenues, which consist primarily of license and telephone fees, were \$1.2M compared to \$1.1M in FY 2019. Other Direct Game Costs were \$7M compared to \$5.9M in FY 2019.

Advertising and G&A Expenses

Advertising Expense was \$3.3M compared to \$2.8M in FY 2019. G&A Expenses (the primary component of which is employee compensation) were \$4.8M versus \$4.7M in FY 2019.

Actual FY 2020 Results Compared to the FY 2020 Financial Plan

Higher than planned Game Revenues resulted in higher Gross Profit (Revenues less Prize Expense, Commissions and other game costs) of \$157.2M versus Plan of \$144.7M, a \$12.5M (8.6%) increase. Instant Game Revenues were \$636.6M compared to Plan of \$605.1M. The positive variance is due to better than expected sales of \$10 and \$5 Instant Tickets, which are above Plan by \$11M (3.3%) and \$8.5M (12.8%), respectively. In the aggregate, \$3 and \$1 Instant Tickets performed above Plan by \$3.1M (12.2%) while \$2 Tickets were off Plan by \$.7M (2.6%). All Terminal Game Revenues exceeded Plan, except for Powerball. Pick 3 and Pick 4 performed significantly better than Plan by \$8.6M (12.9%) and \$5.4M (17.2%), respectively. Mega Millions exceeded Plan by \$1.7M (13.4%). In the aggregate, Palmetto Cash 5 and Lucky for Life exceeded Plan by \$0.9M (17.7%). Powerball performed under Plan by \$7.1M (25.4%).

Operating Expenses were \$0.3M under Plan. Advertising Expense was under Plan by \$.08M, \$3.27M versus \$3.35M. Other Operating Expenses ("G&A") were \$0.2M under Plan. The variances should normalize to Plan annual amounts as the year progresses. Based on the aforementioned factors, Net Income for the four months ending October 31, 2019, was \$149.1M compared to Plan of \$136.3M, a positive variance of \$12.8M (9.4%).

Instant Game Forecast

Mr. Boyle next shifted to a discussion of the FY 2020 transfer estimate of \$467.3M and the instant game projections for the remainder of FY 2020 given sales trends in FY 2019. Sales patterns week over week are generally reflective of the same weeks in a prior year but that is not expected to be the case as we look to close the first six months of FY 2020. As background, Ms. Smith briefed the Board on the planning required for the roughly 17 product deployments (85 different instant games) conducted each year. The life cycle (launch to end of sales) for a \$10 game is generally twelve weeks. Last year \$10 games were performing so well, games were deployed outside of the schedule. In late fall of calendar 2018, SCEL launched two more \$10 games than planned because

players flocked to this price point when there were insufficient inventory levels for some of the lower prices points. In short, while staff is confident in meeting the transfer estimate, it was important to explain to the Board why the sales peaks between November 2 through December of 2018 would not be replicated or exceeded in 2019. However, the current game deployment plan should show sales above comparable weeks in the prior year as we move into January and beyond.

Executive Director's Report

The Chairman recognized Mr. Brown who began by thanking Ms. Leila Wilson for her service to SCEL and noted for the Board that Ms. Wilson had retired.

Next, Mr. Brown asked Ms. Dolly Garfield to provide a legal update. Regarding the pending case of *SCEL v. Glassmeyer*, a request for a rehearing by Glassmeyer is pending before the Court of Appeals. In response to a question presented as a result of the Legislative Audit Council report, the Attorney General issued a 14-page opinion addressing the legality of discounting lottery tickets and concluded with a suggestion for legislative clarification. No legislative bill has been pre-filed. Regarding the contract controversy with Intralot pending before the Chief Procurement Officer, SCEL had agreed to participate in mediation on December 17, 2019. The Board previously authorized Mr. Brown to make decisions regarding this matter, in consultation with the Chairman Legal Committee, Commissioner Russell.

Mr. Brown briefed the Board on the RFP process and stated that the Instant Ticket RFP process should be completed by mid-April. For the first time, each evaluation panelist will consider cost during the scoring process of the proposals. Next, Mr. Brown thanked several staff members for their efforts in drafting the RFP: Petrina Marsh, Senior Procurement Manager; Dolly Garfield, Senior Legal Services Manager; Ann Scott, Director of Sales and Retailer Relations; Ammie Smith, Director of Product; Elizabeth Leber, Senior Security Operations Manager; and Dan Beatty, Chief Compliance Officer.

Mr. Brown next addressed sales trends for Powerball, noting that is taking longer for the jackpots to become funded solely based upon sales. Powerball uses a reserve fund to ensure the Jackpot rolls from draw to draw in \$10M increments. The reserve fund usually stopped contributing to the jackpot around the \$100M mark but recently reliance on the reserve fund is ending in the \$140M to \$150M range. As a result, the Powerball Group is considering several options including international sales.

Next, Mr. Brown stated that SCEL is looking at various options for in-store jackpot awareness signs that are readable from the gas pumps. More information will be provided at the next meeting.

Other Business

There being no further business, the meeting adjourned at 12:27 p.m.



Sam Litchfield, Chairman



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.