

**SOUTH CAROLINA EDUCATION LOTTERY
BOARD OF COMMISSIONERS MEETING MINUTES
May 11, 2022
10:00 a.m.**

The Board of Commissioners of the South Carolina Education Lottery (SCEL) met on Wednesday, May 11, 2022, at 1333 Main Street, Columbia, South Carolina, First Floor Conference Room, with the following members, representing a quorum, participating:

Sam Litchfield, Chairman
Dr. Edward Keith, Vice Chairman
Keith Munson, Secretary/Treasurer
Otis Morris
Billy Newsome

Patrick Earle
Dr. Vareva Evans-Harris
Andre Bauer (via phone)
Jay Young

The Chairman called the meeting to order at 10:06 a.m. and welcomed guests.

Approval of Minutes

On motion of Commissioner Munson, seconded by Commissioner Keith, the Board approved the February 16, 2022, Minutes unanimously.

Action Items

a. Quarterly Advertising Review

The Chairman recognized Ammie Smith, Director of Product Development, and Josh Whiteside, Director of Marketing, who discussed the following:

Scenic South Carolina: Digital Billboard, Version 1 & 2, and Play Station Poster.

SC Staples: Digital Billboard, Low-Country Boil, Peaches, and Sweet Tea and Play Station Poster.

CASH POP: Play Station Poster; and Ticket Topper.

Twentieth Anniversary Promotion: Online Ad; Ticket Topper; Writing Surface; and PID.

Mrs. Smith stated that although it is still early in the 20th Anniversary Promotions Series, several of the games have done very well. Three Times Lucky is the highest selling \$1 game, Carolina Riches is the highest selling \$5 game and Scenic South Carolina is the fifth highest selling \$5 game. These games offer extended engagement: an opportunity to win something else.

Next Mrs. Smith discussed the concept of a rewards program as a reason to promote continued shopping among SCEL's player base. She presented statistics showing that more than 90% of companies have some form of rewards program and that the average consumer belongs to 14 rewards programs. She also presented statistics, which showed 79% of consumers say rewards programs make them more likely to continue doing business with the brand.

Beneficiary: Infographic; Digital Billboard; Radio; TV, Elevate, Talking Billions.

Promotional Events: 2.1 Million Retractable Banner; App Banner; Players' Club Koozie Sign; and Wheel Spin Sign.

General PID (Player Information Display): Updates and April and May Instant Games.

MISC: Instant Millions Retro Riches and Digital Billboard; Play Station Topper, Players' Club.

Mrs. Smith and Mr. Whiteside discussed the University of South Carolina and Clemson University themed scratch-off games. Retailers will receive an initial order of tickets for each game and will receive future orders based on sales as is done with all games. The games will have a second-chance promotion to be conducted during the football, basketball and baseball season. SCEL currently has sponsorship agreements with both schools and details for adding value to the promotion are ongoing.

At the conclusion of the presentation, the Chairman stated, without objection, that it is the consensus of the Board that the advertising presented 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.

b. Proposed Financial Plan (Budget) for FY23

The Chairman recognized Hogan Brown, Executive Director and Brian Ford, CFO, to discuss the FY23 Budget. Mr. Brown provided a brief overview of the Financial Plan (Plan) process and explained that the revenue projection is in collaboration with the Board of Economic Advisors (BEA). He also explained the revenue projection for FY23 given the expected results in FY22 and factors beyond SCEL's control such as record high inflation and potential for a recession. Mr. Brown stated that FY22 Net Proceeds above \$540.1M will carry forward to FY23 to augment the FY23 Plan revenue forecast of \$517.6M (reduced from \$540.1M prior to the development of the Plan).

Mr. Ford discussed the FY23 Plan starting with a little background. He stated that FY22 has been a great year for SCEL, albeit down from the anomaly of FY21, a \$607.6M Transfer. Consistent with the FY22 Plan, to date, SCEL is down 4.8% in Total Game Revenue. Typically, SCEL bases future revenue (and transfer) estimates on the most recent results adjusted for anticipated changes. COVID-19 and the stimulus, among other factors, disrupted the trend lines that would have been anticipated from FY19 through FY22. To estimate FY23 revenues, SCEL used the first nine months of actual FY22 results and decremented revenues by 5% for what Mr. Brown mentioned regarding the general economic uncertainties. For the remaining three months of the forecast, SCEL used its original FY22 plan, which started with the most recent year not impacted by COVID-19 (FY 2019) and built in a reasonable and sustainable rate of growth for each year leading up to FY22 of 5%. Using base sales not impacted by COVID-19, staff then applied additional assumptions based on recent game changes. No new products are anticipated in FY23.

As to more detailed aspects of the revenue forecast, staff is being very cautious and does not anticipate the record Instant Ticket Revenue growth seen in recent years. Instant Tickets (led by the \$10 price point), Pick 3 and Pick 4 have grown at rates of at least 10% per year. A trailing off from FY21 into FY22 is expected to continue into FY23. \$1 and \$2 price point revenues have been more modest in recent years and have been under some pressure. Year to date, these price points are essentially flat. \$3 price point revenues are up 11.6% due to increased game launches while the \$5 and \$10 price point revenues are down 5.2% and 8.5%, respectively. Over the past several years, staff has reported concerns regarding the sustainability of \$10 price point sales, and recent trends provide evidence that the long term trend lines may not be holding. Given the recent volatility, staff is projecting all Instant Ticket Revenues to be down 5% in FY23 from projected FY22 results. The FY23 revenue plan (i.e. timing of ticket releases by price point into the market) for Instant Tickets is generally consistent with FY22 (i.e. games delivered into the market).

To summarize, SCEL is projecting revenues to be down \$85.4M or 3.7% in FY23 from FY22, as market conditions continue to normalize from FY19. In addition, we are projecting Game Costs and Operating Expenses to increase a combined \$6.1M or 11.0%. The combination of these two factors would result in a projected Transfer of \$517.6M, a decrease of \$22.5M or 4.2% from our projected FY22 Transfer.

After questions, the Chairman entertained a motion by Commissioner Newsome, seconded by Commissioner Keith, to approve the FY23 Budget. The Board unanimously approved the motion.

Reports

Audit Committee Report – Meeting of April 13, 2022

The Chairman recognized Commissioner Keith, Chairman of the Audit Committee, to provide a report on the committee's April 13, 2022, meeting. After brief remarks, he asked Mrs. Sonja Erickson, Internal Auditor, to provide a summary of her activities since October 2021 including an update on the IT systems access audit. There were no high-risk findings and several recommendations to improve efficiency and documentation for which management has agreed to implement action plans. She will conduct follow-up work on every management action plan and provide progress updates to the Audit Committee.

Mrs. Erickson also stated that she had followed up on recommendations from three management action plans from the Lottery Act compliance audit, which have all been implemented. She stated that she provided the committee with an updated audit plan which includes purchasing and travel cards. The next Audit Committee meeting is set for October 12, 2022. After her report, Commissioner Keith complimented Mrs. Erickson on her work.

Financial Update

Actual FY22 Results Compared to Actual FY 2021 Results

The Chairman recognized Brian Ford to report on the first nine months of FY22. Transfers decreased from \$467.7M to \$435.6M, \$32.1M (6.9%). Overall Game Revenues decreased \$85.0M to \$1,685.1M (4.8%). Net Income¹ decreased \$15.6M to \$420.8M resulting from decreased Game Revenues on \$1, \$5 and \$10 Instant price points as well as decreased Terminal Game Revenues from Pick 3 and Mega Millions. These decreases are a reflection of the unprecedented record results from FY21.

Instant Games

Instant Game Revenues decreased by \$85.9M to \$1,198.5M (6.7%). Of the overall decrease, \$10 Instant Tickets decreased by \$81.4M (8.5%) while \$5 Instant Tickets decreased \$10.1M (5.2%). The \$3 and \$2 price points, in aggregate, increased \$7.0M (6.7%) while \$1 Instant Tickets decreased by \$1.3M (4.4%). The Instant Game Margin decreased by \$18.3M (5.3%) largely due to the decreases in \$5 and \$10 Instant Ticket Revenues.

Terminal Games

Terminal Game Revenues were \$486.7M, an increase of \$.8M (.2%). The increase in Terminal Game Revenues was driven by increases in Pick 4, Powerball, Palmetto Cash 5 and Cash Pop. Importantly, Powerball and Cash Pop performed well through the first nine months of FY22. Game Margin, as more fully discussed below, decreased \$2.1M (.9%). Pick 3 Revenue decreased \$11.2M (4.9%) while Pick 4 increased by \$2.3M (2.0%). Pick 3 Game Margin decreased as

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.

expected by \$5.2M (4.5%) while Pick 4 decreased \$.6M (1.0%). Mega Millions Revenues decreased \$16.2M (32.0%) due to less favorable jackpot run activity while Powerball Revenues increased \$17.8M (28.3%) due to the addition of a third draw, Double Play, and more jackpot runs. Palmetto Cash 5 Revenues increased to \$.2M (.8%) and game margin was down \$1.1M (10.8%) due to statistical variation.

More specifically, during the comparable period in FY21, there was a \$1 billion Mega Millions jackpot run that generated \$34.1M in Revenue. The highest jackpot run in FY22 was \$432.0M in September. Powerball has had two jackpot runs cross \$600M which contributed significantly to the increased revenues. Cash Pop performed very well adding \$18.0M in revenue and \$6.8M in Game Margin since it launched in January. Terminal Game Margin was essentially flat, decreasing by \$2.1M (.9%). The overall Game Margin percentage on Terminal Games was 50.1% compared to 50.6% primarily from lower margins on Pick 4 and Palmetto Cash 5 caused by statistical variation.

Other Revenues and Game Costs

Other Revenues, consisting primarily of license and telephone fees, were \$2.8M and \$2.7M, respectively. Other Direct Game Costs were \$17.7M in FY22 and \$17.8M in FY21. As a percentage of revenues, both of these items are consistent from FY22 to FY21.

Advertising and G&A Expenses

Advertising Expense was \$7.5M in FY22 compared to \$6.8M in FY21. The variance is the result of timing and is expected to normalize. G&A Expenses (the primary component of which is employee compensation) were \$11.7M in FY22 and \$11.3M in FY21.

Actual FY22 Results Compared to the FY22 Financial Plan

To date, actual overall financial results have exceeded Plan. Game Revenues were \$1,685.1M compared to Plan of \$1,672.3M. The negative variance in Instant Game Revenues is primarily attributable to lower than anticipated sales in all price points with the exception of \$3 Instant Tickets. The \$10 and \$5 price points were below Plan by \$38.5M (4.2%) and \$25.1M (11.9%). The \$3 price point performed well and was \$9.7M (23.7%) over Plan. Aggregate Revenues associated with the \$2 and \$1 Instant Tickets were below Plan by \$5.1M (5.4%).

The positive variance in Terminal Game Revenues is attributable to better than expected sales of all Terminal Games with the exception of Mega Millions. Pick 3 and Pick 4 exceeded Plan by \$20.2M (10.3%) and \$17.4M (17.8%). Powerball performed above Plan by \$24.5M (43.4%) while Mega Millions performed below Plan by \$1.3M (3.6%). Palmetto Cash 5 exceeded Plan by \$1.9M (9.6%). Cash Pop exceeded Plan by \$9.1M (102.5%). As a result of the better than planned Game Revenues, Gross Profit (Revenues less Prize Expense, Commissions and other game-related costs) was \$440.0M compared to Plan of \$405.8M for a positive variance of \$34.2M (8.4%).

In aggregate, Operating Expenses were \$0.7M (3.7%) under Plan. Advertising Expense was \$0.2M under Plan (\$7.5M vs. \$7.7). Other Operating Expenses (“G&A”) were within \$.6M of Plan. Most of the variances will normalize to planned annual amounts. Net Income was \$420.8M compared to Plan of \$385.8M, a positive variance of \$35.0M (9.1%).

Executive Director Report

The Chairman recognized Hogan Brown, Executive Director, who discussed the following items:

Motherboards Update: The IGT contract calls for over 250 motherboards or seven percent of the terminals SCEL has deployed for routine maintenance. However, due to supply chain issues,

the actual number on hand is roughly 10. SCEL is among the three direct jurisdictions facing this shortage and he thanked IGT for its efforts to assist SCEL. Mr. Brown gave an overview of how staff is addressing this problem and stated that in the worst case SCEL might have to consider removing terminals from the lowest selling retailers.

Jackpot Signs: Jackpot signs are now being deployed in the midlands which will be followed by the upstate in June. The coastal region is awaiting the arrival of the signs.

Pick3/Pick4 Incident: Mr. Brown provided an update on the Pick 3 plus Fireball and Pick 4 plus Fireball software maintenance patch IGT installed last fall (November 15, 2021) that caused a problem with the games' advance play feature resulting in the suspension of sales for a total of 10 hours. SCEL computed lost sales and IGT did not contest that assessment.

UPS Ticket Shipping Costs: Staff is continuing to look for ways to reduce costs.

Fourth Floor Renovation: Largely complete except for installation of the air conditioning unit.

Performance Evaluations: Training for senior management has begun.

MUSL: MUSL is attempting to license the Powerball brand to generate operational revenue. It is also seeking to partner with the NFL and/or NASCAR to find new product offerings.

Executive Session

The Chairman entertained a motion by Commissioner Munson, seconded by Commissioner Newsome, to go into Executive Session for the purpose of receiving legal advice and an update on pending litigation as authorized by Section 30-4-70(a)(2). The Board approved the motion and the purpose of the executive session was restated. All staff and guests were asked to leave except Hogan Brown, Dolly Garfield, General Counsel, and outside counsel, Lisle Traywick.

At the conclusion of the Executive Session, the Board returned to open session and the Chairman affirmed that the Board discussed no other matters beyond those in the adopted motion and took no action while in Executive Session.

Other Business

The Chairman announced without objection, the Standing Committee appointments as follows: Commissioner Young to serve on the Audit Committee, Commissioners Earle and Bauer to serve on the Marketing Committee. The Chairman thanked them for their willingness to serve.

There being no further business, the meeting adjourned at approximately 12:49 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.