Minutes of the Commission Meeting
Strategic Planning Meeting
View 34 – Pierre, SD
April 22, 2015 – April 23, 2015

Lottery Commission Chairman Chuck Turbiville called the April 22, 2015 meeting of the South Dakota Lottery Commission to order at 1:08 p.m.

MEMBERS PRESENT: Jim Putnam, Chuck Turbiville, Brent Dykstra, Bob Hartford, and Roger Novotny

MEMBER ABSENT: Jim Towler and Doyle Estes

SUPPORT STAFF PRESENT: Andy Gerlach, David Wiest, Andy Fergel, Norm Lingle, Clark Hepper, Joe Willingham, Kelly Thompson, John Keyes, Jennifer Baker, Sherry Lauseng, Julie Pirnat-Schultz, and Robyn Seibel

APPROVAL OF THE AGENDA
Commissioner Putnam moved that the agenda be approved. Commissioner Hartford seconded. Motion carried.

OVERVIEW OF CURRENT STRATEGIC PLAN
Executive Director Norm Lingle reported on the following:

Accomplishments made from the current strategic plan:
- Mission Statement
- Eliminate Bet/Award Ratio
- $50’s and 100’s
- Eliminate Seating Requirement
- Digital Subscriber Line (DSL) Trial
- Red Tape/Obsolete Law Review
- Video Lottery Marketing
- Agency Sponsorship of Legislation
- Free Play/Match Play
- Site Promotions
- Video Lottery Study
- Purchase of Multi-Drop Connectivity Devices (MCD) for Slot Accounting System (SAS) Machines

Short Term Objectives:
- Game Performance Sharing – The Lottery is developing a memorandum of understanding (MOU) to allow the posting of game performance information on its website. Manufacturers who sign the agreement will also be able to access information about game development/software.
- Management System – A system upgrade is needed so operators could access information directly from the video lottery central system. The Lottery has also started using electronic billing statements. These
statements are downloaded from a secure portal and offer information operators can use to do analysis of their games.

- Player Loyalty and Rewards – This was briefly discussed but would ultimately require a system upgrade.
- Increase Max Bet and Max Award – Will require Legislative action.
- Themed Games – Will require Legislative action.
- Approve Placement of Electronic Table Games – Currently allowed although there are none in the South Dakota market at this time.
- Bar Top Machines – Currently allowed.

Medium Term Objectives:
- Progressive Jackpots – Will require Legislative action.
- Increase Number of Video Lottery Terminals per Establishment from 10-15 – Will require Legislative action.
- Slot Tournaments – The Lottery is determining how to structure these tournaments to maximize revenue to the state. More information will be offered at the June Commission meeting.
- Grant Lottery Commission More Authority – Will require Legislative action.

Long Term Objectives
- State-Owned Terminals – Will require Legislative action.
- Game-to-System (G2S) Protocol – Will require Commission involvement.
- Multiple Licenses In Single Room – Will require Legislative action.

FY15 VIDEO LOTTERY PERFORMANCE

Business Analyst John Keyes reported on the following:

*Data provided through the end of March

Video lottery total net machine income (NMI) peaked in FY08 at $224.6 million and dipped to $176 million in FY12. In fiscal years 2013 and 2014, video lottery showed modest gains. The total FY15 NMI is currently projecting $198.5 million, which is 7.23% ahead of FY14.

In a three year monthly comparison of video lottery NMI, each month in FY15 the NMI has been higher than the past two years. November was video lottery’s worst performing month and March was the strongest month with the highest NMI since October 2010. The average daily NMI was $499,000 per day for the past three years and $543,000 per day for this year. Keyes mentioned Fridays and Saturdays were the two biggest days of the week but surprisingly Sundays showed the most growth. Cash in and cash out drives the NMI. Cash in is up 8.65%, cash out is up 9.30%, and NMI is up 7.23%.

Keyes discussed the revenue per county; 49 counties showed an increase in revenue, up from 41 in December and 11 counties showed a decrease, down from 19 in December.

Keyes reviewed revenue percent changes in cities. The top 15 towns (Huron, Watertown, Box Elder, Yankton, Mitchell, Hot Springs, Sturgis, Rapid City, Brandon, Pierre, Aberdeen, Sioux Falls, North Sioux City, Brookings, Vermillion) all show an increase in NMI over last year, with the biggest gains in Huron (21%) and Watertown
and Massachusetts deployments. Commissioner reports the
Robin VENDOR PRESENTATIONS
machine income. Players are winning more.

Commissioner Putnam asked how the four campaign regions were chosen. Keyes responded they were defined by geographic area as well as population.

Putnam asked Director Lingle who controls hold limiting and who it benefits. Lingle stated the hold percentage looks at win and net. The percentage increase in cash out is greater than that of cash in, which means that players are winning more. There is a need to keep players engaged and still increase revenues. When looking at hold percentage versus net machine income, a little decrease in hold percentage equals a greater increase in net machine income. This is driven by the game software and the 92% payback requirement.

VENDOR PRESENTATIONS
Robin Drummond, Senior Vice President with International Game Technology (IGT), congratulated the Lottery on the results achieved. He stated that IGT supports having names of manufacturers and games included in public reports because it stimulates competition and gives a more accurate picture to help develop better programs for the Lottery.

Commissioner Putnam asked if hold percentage is controllable by Lottery. Drummond said no, it’s a combination of two things – return to the player (around 90% meaning over time the player will lose) and volatility of the game. Hold percentage is a combination of the emotions of the player, volatility of game, return to the player, and the management of the route operation. More play can compensate for lower hold percentage.

IGT (formerly GTECH) was the first to supply G2S to the world. Drummond noted in 2010 there were two G2S deployments in Italy and one in Maryland, and in 2011 Sweden and Switzerland were added. There was a wave of replacements in Canada between 2012 and 2013 and in 2015 Greece, Oregon, Pennsylvania, Portugal, and Massachusetts moved to G2S as the main protocol. This shows G2S is becoming the dominant protocol in bar and restaurant markets.
G2S protocol is managed by the Gaming Standards Association (GSA) which is an independent body with membership containing lottery vendors and machine manufacturers. GSA’s purpose is to define the standard and manage its evolution. The point was to get away from proprietary protocol and even the playing field. GSA certifies manufacturers to ensure their products comply with the G2S standard.

Key G2S features:
- Game Play Notifications
- Cross Site Ticket Validations
- Game Authentication Terminal (GAT)
- Event and Occupancy Data
- Game Features (banner, real stop, duration)
- Stand Alone Progressive (QPJ & SPC Class)
- Game Downloads
- Peripheral Firmware Downloads
- Player Tracking
- Player User Interface (PUI) Window
- PUI based Responsible Gaming, Loyalty Rewards, Cashless and Cashless Meters, and Wide Area Mystery Jackpot

Value added features include:
- Distributed Game Management – Controls the selection, scheduling, distribution, and auditing of downloadable software packages to one or more video lottery terminals (VLT) at remote retail sites. This significantly reduces operating expenses associated with manually changing games on thousands of VLTs.
- Proactive Diagnostics – Monitors the operational health of equipment and provides predictive analysis to maximize end-to-end system availability.

PUI turns the VLT into a browser. An on screen window provides the ability to communicate with the player directly and offer new games and jackpots designed specifically to enhance the player experience.

Features of PUI include:
- Player Loyalty and Rewards – Requires a player account that is stored in the central system. Players can accumulate points that can be used for several redemption options.
- Responsible Gaming – A comprehensive set of flexible and configurable tools used to facilitate the player’s informed choice about their gaming activity and voluntary management of their own behavior. The central system uses the same information to reward players and help them play responsibly.

Drummond discussed progressives, pointing out that to manage a progressive at the State level, the Lottery would need to move to a new protocol like G2S. A progressive should be kept relatively small ranging between $5K and $10K that’s hit a few times per week. If the progressive jackpot is too high, players will lose interest because it would hit too infrequently. A progressive jackpot builds by taking a percentage of all play on the games the Lottery wants contributing to the progressive jackpot. Drummond also gave summaries of the two progressive products that GTECH has developed and how they work.

Drummond encouraged the Lottery to consider migrating to G2S in future. The Lottery’s current contract expires in 2019, but giving several years notice before changing central systems is a good idea.
Commissioner Novotny asked if G2S has been rolled out in Manitoba. Drummond responded they are using G2S but not the progressive. Novotny then asked how successful G2S has been. Drummond responded that the ability to change the games and not have to go to each machine has been a huge benefit operationally and financially. Secretary Gerlach asked about the Lottery’s current protocol and Director Lingle asked Drummond if G2S is running real time communication. He responded that a minimum of 256K bandwidth is required to run G2S. Lingle stated that the Lottery currently runs the Gaming Machine Monitoring System (GMMS) and SAS protocols and asked if there are any options to move to G2S without being penalized for investing in SAS. Drummond answered that it’s a software change not a hardware change and most jurisdictions would roll it out slowly in order to support SAS and the G2S protocol at same time. Some features available under G2S wouldn’t be available statewide until everything was under the G2S protocol. Lingle questioned whether there is a way to allow GMMS to communicate with G2S. Drummond responded no. Lingle asked how the various modules were added to the system. Drummond explained that value added modules can be added in stages. Lingle asked what the max bet that funds the progressive award would be. Drummond responded that with a mystery progressive, every time the player hits play on an eligible game, they could win regardless of what their bet is. Every play takes a fraction of the percentage and funnels it into the progressive jackpot. Lingle asked if the jackpot funding is coming from the players or the state. Drummond said that is a jurisdictional decision.

Revenue Secretary Gerlach advised the Lottery to start thinking about protocol now as the contract will expire in 2019 and a decision will need to be made regarding next steps. The Lottery currently runs a mainframe system supported by the Bureau of Information and Telecommunications. Commissioner Dykstra questioned whether the Lottery could change protocol without going to the Legislature. Secretary Gerlach responded that a change to G2S was possible without legislation, but a progressive would need approval by the Legislature.

A break was taken at 2:48 p.m. and the meeting was back in session at 3:00 p.m.

Steve Angelo, Scientific Games International (SGI) provided some background information on SGI. They recently acquired Williams Manufacturing WMS and Bally gaming. They have 3 divisions – lottery (scratch, Lotto, etc.), gaming (video lottery, bingo, etc.), and interactive (social gaming, play for fun, etc.).

Angelo stated that strong content is essential in the video lottery industry. South Dakota has multiple operators and business interests and there’s limited capitol for the operators to put back into the games. The content should be a significant portion of the investment by the operators and stake holders.

In regard to the legacy games, Angelo said while keeping games that players love is important to the market, it’s also important to acquire new players. The goal is to provide multiple math models to retain multiple player segments in the video lottery market.

Director Lingle asked how to work with manufacturers to get new content into the market and how often new content should be introduced. Angelo responded that making performance data available to all manufacturers is a good idea because it helps them understand what’s working and makes them competitive. Open protocol offers a large library of content to choose from. Partnering with manufacturers on market research is also a good idea.

Deputy Executive Director Hepper asked what the best approach is to move toward new protocol. Angelo responded that the system today has many capabilities of the G2S system. Operators need to have the ability to change out equipment in a timely manner. He also suggested the Lottery provide marketing dollars to video lottery establishments to reinvest in promotions or new machines.
Angelo then discussed operations. Yield management, expense reduction, performance analysis, operational reports, service and support, etc. are all enabled by the central system. The current protocol is capable of offering a web based operator portal where operators and manufactures can log in to access billing statements, data reports, transaction reports, and communications. Performance reports should be available per manufacturer to help understand what works well to provide the best product available to the marketplace.

Director Lingle asked if this type of system requires real time communication. Angelo responded that the Lottery’s current system is capable, but there would be lag time.

In terms of technology, Angelo said G2S is where the industry is headed because it’s an open protocol with real time capabilities. Other important factors are security and integrity and real time communication which offers remote configuration capabilities. The system also has the ability to integrate with mobile devices allowing operators to control a machine from a mobile device. Progressives are an option with statewide progressives rather than per game progressives as the best choice for South Dakota.

Legislation, regulations, and rules were discussed with the following topics mentioned:

- Top award – Two games per manufacturer per game set with platinum series jackpots ranging from $1,500 to $10,000. Director Lingle asked what the max bet would be to get the top award. Angelo answered that it varies by manufacturer. The top award would be paid at the Lottery office – not the establishment. Lingle questioned whether most wins could stay under the taxable amount, but some could be above that amount. Angelo said that depends on hold percentage. With a larger payout, the cycle to that game will be larger so that it acquires enough money during play to pay out when a jackpot is hit.
- Max Bet
- Progressives
- Video Lottery Terminal Cap Per Location
- Electronic Table Games
- Themed Games

Angelo advised the Lottery to invest in content, make game performance data available, increase the max top bet and award, remove the VLT cap per location, and allow electronic table games and progressives. He stated that a partnership between operators, manufacturers, and the Lottery will equal more success, the current system can manage progressives, and a lot can be done in the short term, mid-term and long term.

Lingle asked if there was a need for real time communication to run progressives on the current system. Angelo responded that only local area progressives could be used with dial up. The Lottery would need a new network to run progressives, but not necessarily a new system.

Rich Ward, a local operator, asked if local progressives would require all machines to have the same game content. Angelo responded that a mystery progressive can run on any game or any manufacturer. Ward then asked how the progressive jackpot would be funded. Angelo answered that the Lottery would decide where the funding would come from.

**ASSOCIATION PRESENTATIONS**

Bob Riter, representing the Music and Vending Association (MVA), reminded the Lottery MVA members have been involved in this industry from the start. He acknowledged that legislators are hesitant to make modifications in video lottery. MVA suggests that the State could incentivize purchasing new machines to
encourage the move from legacy to line games and that the removal of the legacy machines could be resolved by attrition. Core players are accustomed to certain games and they should be considered in the decision making process. The MVA understands that change is necessary, but advises the Lottery to be cautious and support what is out there now. He said legacy machines can help fund the changes that need to be made. Changing the central system may give operators a reason to quit, because the amount they’d need to spend to get the new machines may be more than they can afford. Riter advised the Lottery to think about the operators and what their needs are.

Hartford said he understands 75% of industry contains legacy machines and agrees that Lottery needs to include them in the plan but the legislative process is difficult. He thinks Lottery needs to find things that can be done without legislation. Hartford asked Riter for specific suggestions to address the legacy games. Riter reiterated that it’s important for protocol to continue to support legacy machines. He understands that there is interest in progressives as well, but while the changes are made, the operators need legacy machines supported in order to make money to upgrade.

Larry Mann, Association of Video Lottery Establishments (VLE) thanked the Commission, staff, and department for taking on aggressive projects and said his organization supports the objectives. He recapped action by the 2015 Legislature noting that while the Property Tax Reduction Fund was eliminated, a proposed increase in the number of video lottery machines per location failed. Mann said there’s a need to communicate to legislators the possible impact of modest changes and that addressing the social impact of gaming should be communicated to them. He thinks the new protocols sound great, but will cost money.

Mann agrees with Riter that legacy machines do produce revenue that operators can use to buy new machines. He believes there needs to be a plan to phase out the legacy machines and move to new technology.

Matt Krogman, registered lobbyist for the Licensed Beverage Dealers, expressed frustration with the inability to get more machines into establishments and believes that a change of atmosphere in video lottery casinos could make a difference in perception. He thinks allowing multiple licenses in one room might provide for a better player atmosphere. Krogman also asked what would be necessary to make a ticket in – ticket out system where you could cash out, walk from one machine, and use the ticket to play on another machine.

**OTHER INTERESTED PARTIES**

Britt Bruner, general manager of D & E Vending in Mitchell, expressed interest in the new technology, but asked the Lottery not to set an artificial end date for the legacy machines. He explained out of 90 establishments he services, 52 would close because they couldn’t afford the new protocol, which would leave some towns without video lottery. Bruner estimated the State would lose about $1.2 million just from his business and said he couldn’t reinvest in new technology without revenue from the legacy games.

Rich Ward, owner of the Golden Isle Casino in Pierre, said he’s happy with the progress that’s been made over the last three years. He pointed out there are line games in the market that are really legacy games because they’re running on the old protocol. Ward said almost half of his machines are the new games and the content of the games is what drives players to the machines. Line games are more entertaining to play than the legacy games, but some players are comfortable with legacy games and wouldn’t want them to disappear. He doesn’t think it’s necessary to set an end date for legacy games because business owners will buy new machines as they can afford them.
Department of Revenue Deputy Secretary Wiest asked what defines a legacy machine. Ward responded that the legacy machines are any machines not using SAS protocol. Lingle added that legacy machines run off the old protocol and that some legacy machines have line games on them.

Lingle briefly mentioned theme games and how they work off a participation model. He thinks the struggle of needing the capitol to buy new machines could be addressed and suggested the possibility of offering a lease option where establishments could lease the machine for a certain length of time and at a certain point they would either own that machine or look into leasing a new model.

RECESS
Chairman Turbiville declared the meeting in recess at 4:45 p.m.

RECONVENE
Chairman Turbiville called the meeting to order at 8:35 a.m. on April 23, 2015

RECAP OF PREVIOUS DAY
Executive Director Norm Lingle and Deputy Executive Director Clark Hepper reported on the following:

Director Lingle reiterated the Lottery’s mission statement.

The decision was made to focus on three areas: progressives, increasing the maximum bet, and multiple licenses under one roof. All of these objectives will require Legislative approval and to get them passed there will need to be a united front.

Non-Legislative objectives included: sharing of information, management system, and real time communications. The Lottery plans to focus on these objectives over the next year.

To accomplish the main objectives, the Lottery will need to figure out how to replace old machines. It is not possible to offer progressives on legacy machines, and with the attrition rate at 3-5% and 7200 legacy machines, it will take several years to get the legacy machines out of the market.

DOR Secretary Gerlach asked that everyone start thinking about a case to make for each of the Legislative objectives. He said proposals need to resonate with the Legislature and Governor and that the Governor wants to see the business aspect of the legislation.

Commissioner Turbiville stated that Lottery has tried to move from 10-15 machines, but to some legislators that’s an increase in gaming. He feels these three objectives could pass easy but everyone needs to be united in the effort.

Rich Ward, local operator, supported the idea of progressives but is concerned that the changes would involve proprietary games for communications of the progressive jackpots. He also reminded everyone that state law doesn’t allow revenue to be shared and he’d like it to stay that way. He cautioned the Lottery against opening the door to the unintended consequences of having a manufacturer or distributor come in and take over the industry. Ward pointed out that someone has to administer the progressive and they’ll need to be paid for it and he doesn’t have a problem with that, but he doesn’t want the State to take a larger cut from the operators. Lingle responded that the system is capable of operating progressives. The structure for paying for the progressives can be done a number of ways – operator funded, state funded, or part of the pay table. Lingle told Ward that a lot of his concerns could be alleviated through the administrative rule process.
Drummond stated that if the progressive was controlled by the state it may be more palatable for the Legislature. High tier winners would take a ticket to the Lottery office to be paid. Lingle compared that system of claiming a prize to the instant ticket method of payout. He said that running progressives through the state would be the best way because a critical mass of funds is needed for the progressives.

Hartford asked what needed to be done to get the progressives passed by the Legislature. Lingle thinks the max payout needs to be raised.

Commissioner Dykstra reiterated that progressives should go through the legislative process to increase the max payouts. He wondered if that could be avoided if progressive jackpots only went up to $1,000, but occurred more frequently. Secretary Gerlach asked if that would still be considered a progressive. Angelo responded that a progressive is the connection of multiple games driving a meter – contributing to an overall award. Mystery progressives mean anyone connected to the link can win at any time. A progressive controller selects a random variable between $500 and $1,000 and then selects an eligible player to win that jackpot. Angelo explained that there are three connections – the game, the network that needs to communicate with the game, and the system. A state run jackpot seems to be the best option, but the network and system need to be able to run a progressive.

Commissioner Hartford asked how the progressives are funded. Angelo replied that the game/software controls the number of hits. A lower jackpot with more connected terminals and higher hit frequency allows for more awards more often and more play will fund the progressives. Director Lingle used a scratch ticket analogy, saying when the Lottery launches a scratch game they know the dollar amount within the game. The Lottery could launch a game and on the first day someone could win the top prize. In this analogy not enough tickets have been sold yet to fund it, but over time enough will sell to fund the prize payouts. Director Lingle thinks progressives should be statewide, mystery, with a pay table, and prize amounts between $10,000 and $20,000.

Commissioner Novotny asked what that would mean financially for the State. Angelo replied that SGI has market data and could share that with the Lottery. He encouraged the Lottery to talk with North American Association of State and Provincial Lotteries to get information on the business model. Commissioner Novotny asked if $1,000 could drive the progressive. Angelo replied that it would need to be analyzed and focus group testing could be used to choose top awards.

Commissioner Turbiville asked if a progressive could be put on a legacy machine. Drummond responded no, and that means the rate of filling up the bucket is less with fewer machines contributing to the progressive. He also advised the Lottery that it would be at minimum a year long process to get progressives going in South Dakota.

Angelo pointed out that it goes back to the games the network and the system. SAS/G2S is the easiest way to run a progressive. The real time communications objective will help with the progressive objective. The protocol on the legacy games will not allow progressives.

Commissioner Putnam asked Riter how to keep legacy machines running since parts are no longer available and they are obsolete. Bruner responded by saying that he’s upgraded everything in the legacy machines and that the only thing that’s still original is the box. He reiterated that legacy games are popular with players so they invested in fixing them. Putnam asked if there’s a parts house for legacy machines. Bruner said yes but he believes there will be a natural attrition because some of these parts are going to run out and the legacy machine creator is no longer in business.
Director Lingle stated an individual business should be setting aside a percentage of profits to fund their own upgrades. Commissioner Turbiville asked what the legacy owners would like from the Lottery to help them. Riter said if there are other games out there to attract customers then the attrition will occur naturally on the legacy games. Riter wondered if the State could take a lower share or offer matching funds. He feels there is a method possible to help incentivize through assistance in funding the purchase of new machines to then take an old machine out of the market. Commissioner Turbiville said that the government was short on their budget and therefore it seems impossible to get the funding. Riter explained that this is a business relationship between public and private sectors and if one of the partners wants to move into the future then they need to invest new money into the private sector.

Mann said in looking at these objectives, most people are going to say the Lottery is expanding gaming and politicians will wonder what’s in it for them. There needs to be evidence to back up the objectives and explain this is something that is needed to keep the Lottery profitable.

Commissioner Putnam pointed out that it’s hard to bring everyone together on the objectives due to the technology issues. The Lottery has contracts that need to be considered. The technology is expensive but the Lottery needs to bet on the new technology. Hartford added that no matter what avenue is taken there is a need to be sure that the new games are profitable enough to make the new games worth the price.

Secretary Gerlach said the Commission needs to make a decision on what to go forward with. There needs to be research done and the Governor and administration need to be on board before legislation is proposed.

Commissioner Novotny said Lottery needs to be forward thinking because it's a competitive environment. Establishments should be laying out a percentage of profits every year to pay for upgrades.

Commissioner Dykstra stated the Lottery is scrutinized because it’s a State-owned business and should work to change its image.

Deputy Secretary Weist said that sharing of information is an immediate thing that will be helpful today. The Lottery needs this information to make good business decisions. Real time communication is the wave of the future so there needs to be energy put behind that as well as a new management system like G2S.

Deputy Executive Director Hepper said Lottery should utilize these new tools because it may be difficult to wait 20 years for the legacy machines to die of attrition. These non-legislative objectives need to be pushed forward in order to make the other objectives possible.

Commissioner Hartford stated that establishments aren’t making enough money to invest in the new machines all at once.

Director Lingle said Lottery needs certain tools to increase revenue and meet the mission statement. The non-legislative items will move the Lottery closer, but the Legislative objectives need to be met as well and everyone will need to be on board to be successful.

**ADJOURNMENT**
Commissioner Turbiville moved to adjourn. Commissioner Putnam seconded. Motion carried and at 10:33 a.m. the Strategic Planning Meeting was adjourned.