



Minutes of the Commission Meeting

Room 412, Capitol Building

September 17, 2015

Chairman Turbiville called the Sept. 17, 2015 meeting of the South Dakota Lottery Commission to order at 10:00 a.m.

MEMBERS PRESENT: Jim Putnam, Chuck Turbiville, Doyle Estes, Roger Novotny, and Bob Hartford were present. Jim Towler was present by teleconference.

MEMBER ABSENT: Brent Dykstra

SUPPORT STAFF PRESENT: Secretary Andy Gerlach, Norm Lingle, Clark Hepper, Joe Willingham, John Keyes, Sherry Lauseng, Andrew Fergel, Jennifer Baker and Robyn Seibel.

APPROVAL OF THE AGENDA

Commissioner Putnam moved that the agenda be approved. Commissioner Novotny seconded. Roll was called: Aye - Estes, Hartford, Novotny, Towler, Putnam, and Turbiville. Motion carried.

APPROVAL OF JULY 30, 2015 COMMISSION MEETING MINUTES

Commissioner Hartford moved that the minutes be approved. Commissioner Putnam seconded. Roll was called: Aye - Estes, Hartford, Novotny, Towler, Putnam, and Turbiville. Motion carried.

SECRETARY OF REVENUE COMMENTS

Secretary Andy Gerlach reported on the following:

Secretary Gerlach discussed the main areas the Department of Revenue (DOR) tracks during the year, which included the sales and use tax, contractors' excise tax, tourism tax and Lottery. Sales and use tax was up 6.78% over last year, which is about 4% higher than what the Appropriations Committee adopted last year. Contractors' excise tax was up 8.67% over last year, which is also 4% higher than the Appropriations Committee adopted last year. Tourism Tax was up 14% over last year with western South Dakota having a strong tourism season.

The 75th Annual Sturgis Motorcycle Rally was held Aug. 3-9. DOR worked closely with temporary and permanent vendors, the City of Sturgis, and cities throughout the Black Hills to license vendors and collect taxes. This year DOR offered online and credit card options. A record number of vendors were licensed this year - 1,438 temporary vendors. Revenue from the Rally was up 76% over the previous year with total taxable sales at \$33,184,000; 4% of that will go to the state.

The Governor's Blue Ribbon Education Task Force is looking to increase teachers' salaries. Gerlach stated that DOR will work with the task force to find ways to fund the increase.

Commissioner Estes asked if the task force had considered partnering with the Lottery to help fund the teachers' salary increase. Gerlach said all options are on the table and with video lottery up 7%, it's a consideration. Estes stated that line games were generating more money and wondered if the Lottery could incentivize operators to purchase more line games by letting them know the money goes toward funding teacher salaries.

Commissioner Towler asked if there were any unlicensed vendors at the Rally. Secretary Gerlach replied that DOR visited with vendors to ensure compliance and collected most, if not all, of the tax revenue that was available.

EXECUTIVE DIRECTOR'S COMMENTS

Executive Director Norm Lingle reported on the following:

Lottery is undergoing its annual audit with a goal to be finished by Sept. 30.

Video Lottery Electronic Billing Statements are working well. E-statements are posted to a secure website and operators will have log in credentials to access their information. An email will be sent when the statement is ready. On Oct. 1 paper bills will no longer be sent out. Lottery has been informing operators of the change through the video lottery newsletter and a brightly colored informational sheet included with the billing statement.

Lingle announced the Lottery is looking at improving the inspection report process. Inspections are performed through an agreement with Public Safety. They conduct inspections at video lottery terminals and fill out a paper document that is given to Lottery, and then Lottery staff scans the documents to have an electronic file. Lottery would like the inspection reports to be done electronically to make the process more efficient.

The Sioux Falls Office is relocating to Western and 41st Street just south of the Western Mall. Lottery is working with the building owner to improve the outside of the building. Sioux Falls is the busiest Lottery office as far as walk-ins and claims and also serves as the warehouse for the Lottery.

Lingle addressed the current budget issues facing the Illinois Lottery. The Illinois Lottery has a budget deficit due to their governing officials not agreeing on how to balance the budget – leaving no budget available, therefore the Illinois Lottery cannot pay any prize over \$25,000. This is a problem unique to Illinois and has no effect on any other lotteries across the United States at this time.

Commissioner Towler asked if the inability of Illinois to pay prizes had any effect on lottery play in South Dakota. Lingle said that the Lottery hasn't received any questions regarding the Illinois problem. The Lottery staff will remain vigilant and if questions arise, will reassure players that South Dakota will pay winning tickets.

STRATEGIC PLAN

Executive Director Norm Lingle reported on the following:

Lottery is working on real time connectivity using IP cellular to provide it and is working with a handful of establishments to do a trial project. Lottery needed to verify connectivity issues with BIT regarding the backup system, but that has all been verified and communicated to Scientific Games. It is important to get real time connectivity, because it can be used for video lottery allow Lottery to move forward on strategic plan items.

FY2017 BUDGET REQUEST

Executive Director Norm Lingle reported on the following:

The Lottery operates off two budgets, an instant/online budget which is an informational budget controlled by the Commission and a video lottery budget that is part of the overall DOR budget and approved by the Legislature.

INSTANT/ONLINE INFORMATIONAL BUDGET

The budget for FY2017 is at the same level as the FY2016 budget. Director Lingle went through the budget, drawing attention to certain line items.

Commissioner Hartford commented that the prize expense and retailer commission skews the budget and wondered if they should be a stand-alone line item. He stated that the total is \$41 million, but \$30 million of that is prize money. Lingle said this is an informational budget because it needs the flexibility to make the prize payments when they occur so the Lottery doesn't end up in a situation like Illinois is in. Lingle said he would discuss this with Lottery staff to see if they can come up with a solution.

Commissioner Towler asked why the retailer commission doesn't track with the prize expense. Lingle explained that we need to look at the breakdown between the budgeted amounts and see if it is equalized as we move through the year. The Lottery would need to look at the budget amounts to see that they're in proportion with the actual amounts spent. Towler asked if the retailer commissions were fixed. Lingle responded that retailers receive 5% off each sale and also a bonus commission on winning tickets sold. Some commissions are fixed, but some are a percentage of a prize payout.

Commissioner Estes asked that line 18 regarding the IGT (formerly GTECH) expense be explained. Lingle explained that IGT provides lotto terminals to each retailer as well as a monitor and ticket checker. They also provide the equipment used to communicate with retailers, a primary and backup system, the maintenance of terminals within each retailer, and the maintenance of all the primary and backup systems. The contract with IGT is for five years with five one-year extensions. Lottery is under contract with IGT through Aug. of 2019. These systems are proprietary and include lotto central systems and terminals so everything is compatible. SG+ was the provider previous to 2009 and when GTECH came in everything had to be replaced.

Commissioner Estes wondered if the retailers on reservations get a commission of 50%. Lingle explained that the retailers get the same 5% commission as the retailers off the reservation. The 50% payments go back to the tribes not the retailers.

Commissioner Novotny expressed concern that retailer commission and prize expense (lines 38-39) skew the budget, making it hard to get a grasp on the actual budget. Lingle agreed that for this type of a presentation Lottery could move those items down and break them out more to give a clearer picture, but when it comes to the actual budget submission for the State process, those items will need to be kept in there.

VIDEO LOTTERY BUDGET

The budget for FY2017 is at the same level as the FY2016 budget. Director Lingle went through the budget, drawing attention to certain line items.

Commissioner Hartford asked why there are two budgets. Lingle responded it is set up in statute that way. The informational budget allows Lottery the ability to pay prizes as they are incurred. Video lottery can define costs, because there are fewer unknowns.

Commissioner Towler wondered how long Lottery can get by without increasing the budget. Lingle said the Lottery is supposed to be self-funded. Money comes in through video lottery license fees and the .5% of NMI received. License fees are fairly flat with around 1,350 establishments and around 8,900 active machines. Increases in NMI makes the Lottery's .5% share a little greater, but there will be a need to look at this in the next few years, as the budget is getting tighter and tighter.

Commissioner Towler asked if machine fees are set through legislation. Lingle answered that fees for operator licenses were set in statute not to exceed \$100 per machine and Lottery is charging \$100 per machine right now.

Commissioner Estes wondered if positive results were seen from the advertising done in the southeast part of the state. Lingle said the Lottery saw positive effects while the campaign was occurring and would like to see if the uptick in sales continued after the ads ended. Numbers are showing around a 2% decrease after the ads ceased.

Commissioner Estes asked if video lottery brought in around 90% of the Lottery's revenue. Lingle responded in the affirmative. Estes then inquired as to why Lottery is spending less to advertise video lottery than instant and online. Lingle reminded the Commission that the instant/online budget cannot be used to advertise video lottery and vice versa. The Lottery cannot stop advertising instant and online, because those sales need to be increased. Estes responded that if it is justified to spend \$675,000 to advertise instant and online which is 10% of the revenue, why not spend more to advertise video lottery which is 90% of the revenue. Estes stated that he was glad to see an extra \$100,000 in the video lottery advertising budget.

Commissioner Towler wondered if the advertising budget was set through legislation. Lingle responded that the budget for video lottery is approved by the legislature.

Commissioner Putnam stated that video lottery is a creature of the legislature and anything done requires the vote of the legislature. In the past, the Appropriations Committee limited advertising spending because it felt the citizens' money shouldn't be used to advertise video lottery. The Lottery needs to prove itself and its business plan. There's an opportunity to prove the need to advertise video lottery to the legislature.

Commissioner Hartford moved that the FY2017 instant/online informational budget be approved. Commissioner Towler seconded. Roll was called: Aye - Estes, Hartford, Novotny, Towler, Putnam, and Turbiville. Motion carried.

Commissioner Hartford moved that the FY2017 video lottery budget be approved. Commissioner Putnam seconded. Roll was called: Aye - Estes, Hartford, Novotny, Towler, Putnam, and Turbiville. Motion carried.

VIDEO LOTTERY PERFORMANCE REPORTS

Deputy Executive Director Hepper reported on the following:

Deputy Executive Director Hepper discussed the product performance agreement that was sent to Grand Vision Gaming, Harms Gaming, International Game Technology (IGT formerly GTECH), MTD, Scientific Games, and Techlink Entertainment. Lottery would like to enhance and increase sales by providing manufacturers with product performance information. A legal document has been put together and currently one manufacturer has signed the agreement; two have verbally agreed to sign, one manufacturer is no longer in business and two others are in the process of merging and will revisit this once they get settled. Manufacturers are being called monthly to get signatures, but Lottery is in a holding pattern at this time.

Chairman Turbiville wondered how long the Lottery should wait for signatures. Hepper said that he and Director Lingle will visit with these individuals in person to discuss this in October.

Chairman Turbiville asked if the Lottery could release the information of the manufacturer that has signed the agreement to incentivize the rest to sign. Hepper replied that for the manufacturer that has signed, it's a sales pitch and possible incentive for others to sign.

Commissioner Hartford commended the Lottery staff on their efforts, but agreed with Chairman Turbiville that the Lottery should go ahead with the one manufacturer that has signed. Director Lingle asked that they have the opportunity to talk with the manufacturers face to face in October.

Commissioner Novotny proposed that a deadline be set to sign the agreement.

Commissioner Estes stated that if one manufacturer shows their product performance numbers and others don't, people buying the machines will see this and that will get other manufacturers on board to want to show their performance data as well. Hepper replied that Lottery could start publishing the numbers for the manufacturer that has signed on.

Hepper said that legislative authority is needed to share information without the signed legal agreement. Lingle added that legislation could force the manufacturers to comply, but the Lottery is trying to get them to sign the agreement of their own volition.

Commissioner Estes moved the video lottery product performance report of the manufacturer(s) that have signed the agreement should be shared starting Oct. 1, 2015. Commissioner Novotny seconded. Roll was called: Aye - Estes, Hartford, Novotny, Towler, Putnam, and Turbiville. Motion carried.

VIDEO LOTTERY MANUFACTURER LICENSING PROCESS

Deputy Executive Director Hepper reported on the following:

Deputy Executive Director Hepper presented the licensing process for video lottery manufacturers in South Dakota. As part of the licensing process the South Dakota Lottery does background and financial records reviews of the company and associated owners, along with an onsite visit to the manufacturing plant to conduct a security review of the facility. The Lottery works with DCI to help conduct these security reviews. The manufacturer must submit a \$500 application fee to help recoup any processing fees that are related to the background checks and site visits. The manufacturer is responsible for any amount about that processing fee along with the payment of a \$20,000 license fee. As part of the application process the manufacturer must submit the last three years of financial statements for review by the Lottery, along with background forms for owners, operators, officers, and stakeholders with 5% or more stakes in the business.

Over the past 25 years the South Dakota Lottery has licensed 25 different manufacturers to supply video lottery terminals in the state. Of these 25 manufacturers only two of them had filed for bankruptcy while still doing business in South Dakota due to lack of sales and not having finances to sustain when the market was down. Lottery may need to start doing nationwide background and credit checks and scrutinize financial records to ensure manufacturers can maintain business even when sales are weak. The license is renewable on a yearly basis.

In the case of the manufacturer that declared bankruptcy, operators can no longer get proprietary parts to keep machines running and there is a lack of technical support when the machines go down. Lottery staff continues to work on solutions to keep machines operational by finding ways to obtain proprietary parts from other customers of the Techlink machines. Currently there are 105 Techlink machines owned and operated by 10 operators in South Dakota. The South Dakota Lottery staff have obtained a limited number of parts from Techlinks instate storage unit that will be made available to those operators.

Commissioner Estes stated that the Lottery should think about including a bond in the licensing procedure to help out operators in the case of a manufacturer going bankrupt.

Commissioner Hartford wondered if operators post bonds at this point. Hepper responded in the affirmative.

Commissioner Towler wondered how often the manufacturer's financial records are reviewed. Hepper replied that financial records were only looked at during the initial licensing process. The Lottery renews the license every year, but doesn't review financials.

Commissioner Putnam stated there is a reason to check into how the bond can be used, the amount, etc. The Lottery needs to get out in front and fix this issue for the future.

Chairman Turbiville asked Director Lingle and Deputy Executive Director Hepper to look into the specifics of the bond issue.

A 10 minute break was taken – back in session at 12:02 p.m.

VIDEO LOTTERY REPORT

Director of Video Lottery and Security Robyn Seibel reported on the following:

Seibel reported the NMI for FY2016 was \$36.52 million and in FY2015 it was \$34.63 million, 5.45% ahead of the previous year.

Looking at terminals, there are currently 8,923 terminals which is .58% down from FY2015 which had 8,975 terminals.

The number of establishments in FY2016 was 1,357, which is down 2.37% from the 1,390 in FY2015.

The revenue projections through the end of August show \$103.35 million and in FY2015 it was \$98.29 million.

LAWRENCE AND SCHILLER MARKET RESEARCH PROJECT

Business Analyst John Keyes reported on the following:

Keyes reported that Lawrence and Schiller are putting together a market research report studying audience motivations and engagements as well as brand perception.

The audience motivations and engagement study goals are to determine the habits of active and inactive players. The goal is to understand the play tendencies and key motivators for people who play the lottery and the key inhibitors of people who do not play the lottery.

Lawrence and Schiller plan to gather this information through a survey available online and also mailed out. They'd like to receive 400-600 surveys back, but have already received 800 online surveys, putting them ahead of their target. The survey consists of 30 questions and takes around 10 minutes to complete.

Once the surveys are reviewed, one-on-one phone interviews will be done with 15-20 participants that indicated on the survey they were willing to participate in a more in depth interview that will take up to 60 minutes.

The brand perception study's goal is to determine the perception of the lottery amongst active and inactive players and understand what encourages consumers to play more often and what messages resonate with consumers.

To understand the consumers better, Lawrence and Schiller has put together 3 focus groups each consisting of 6-8 people in Sioux Falls, Rapid City, and Aberdeen. In each of these cities there will be three focus groups: active players aged 21 to 65 who have played the lottery in the last 3 months, lapsed players aged 21 to 39 who have not played the lottery in last 3 months, and lapsed players aged 40 to 65 who have not played the lottery in the last 3 months.

To better understand retailers, Lawrence and Schiller will conduct interviews with 25-30 retailers as well as do store visits.

The Lottery hopes to have the results of the market research report by the Dec. Commission meeting. Research allows us to get the most out of the advertising budget.

PUBLIC RELATIONS/ADVERTISING REPORT

Business Analyst John Keyes reported on the following:

BIG WINNERS

There was one big lotto winner since the last Commission meeting. Josh Johnson of Sioux Falls won the \$178,607 Dakota Cash jackpot in the Sept. 2, 2015, drawing.

The instant games had 12 top prize winners from 10 different games. The biggest winner, Joseph Olson of Sioux Falls, took home \$400,000 playing the \$20 Maximum Money game.

Play It Again

The \$30,000 grand prize drawing was held on Aug. 28, 2015. This was a 6 month promotion that began in February. 1,942 players entered 82,980 tickets into the Play It Again Drawing. A winner has been contacted, but Lottery is awaiting final paperwork to process their prize.

The next Play It Again promotion, Lucky Leap, will have a deadline of Feb. 27, 2016, to enter non-winning \$2 and \$3 scratch tickets. The \$30,000 grand prize drawing will be held on Leap Day, Feb. 29, 2016.

Monopoly Millionaires Club (MMC)

The MMC drawing was held in August for trips to Las Vegas to appear on the national TV game show with three winners drawn. The winners are Dawn Larson of Rapid City, Sweet Fisher of Sioux Falls, and John Johnson of Rapid City.

DECLARATORY RULING 16-1: LOTTO RETAILER INCENTIVE

Sales Director Joe Willingham reported on the following:

Willingham discussed the Powerball game change effective Oct. 4, 2015. The changes will affect the retailer bonus program in a couple of areas. The third level prize went from \$10,000 to \$50,000 and the 10X multiplier was added to the game. Bonuses will stay at \$1,000 with a cap at \$2,000.

Commissioner Estes moved that the Declaratory Ruling 16-1: Lotto Retailer Incentives, be approved. Commissioner Novotny seconded. Roll was called: Aye - Estes, Hartford, Novotny, Towler, Putnam, and Turbiville. Motion carried.

SALES REPORT

Sales Director Joe Willingham reported on the following:

Willingham reported instant ticket sales were up 3.9%, that's \$4.64 million versus \$4.46 million last year. This increase was led by sales of the new \$20 Money Money Money game along with the new crossword game, Big Money Cashword.

Tis The Season, Snow Days, and Holiday Magic are three new tickets coming out in early November.

Sales of Lotto Games were down 11.59%, \$3.92 million versus \$4.44 million a year ago.

Powerball - \$1.99 million versus \$2.18 million - down 8.7%

Mega Millions - \$641,000 versus \$659,000 - down 2.73%

Hot Lotto - \$489,000 versus \$841,000 – down 41.8%

Dakota Cash - \$469,000 versus \$403,000 - up 16.4%

Wild Card - \$392,000 versus \$351,000 – up 11.7%

New Powerball game testing is nearly complete and on schedule for the Oct. 4 start date.

REVENUE PROJECTIONS

Instant - \$5.67 million

Lotto - \$6.28 million

Video - \$103.35 million

Total - \$115.30 million

NEXT MEETING DATE – DECEMBER 10, 2015

Commissioner Turbiville set the next meeting date for Dec. 10, 2015. The meeting may be held in Sioux Falls to allow Commissioners to take a look at the new Sioux Falls office location.

ADJOURNMENT

Commissioner Estes moved to adjourn the meeting. Commissioner Novotny seconded. Motion carried. Chairman Turbiville adjourned the meeting at 12:20 p.m.