



Minutes of the Commission Meeting
Room 412, Capitol Building
June 1, 2017

Chair Putnam called the June 1, 2017 meeting of the South Dakota Lottery Commission to order at 9:30 a.m.

MEMBERS PRESENT: Dave Mickelson, Jim Putnam, Joe Kafka, Robert Faehn, and Brent Dykstra attended. Cheryl Laurenz Bogue attended via teleconference.

MEMBER ABSENT: William Shorma was absent.

SUPPORT STAFF PRESENT: Norm Lingle, Clark Hepper, Sherry Lauseng, Kelly Thompson, Jennifer Baker, Sam Stanforth, Robyn Seibel, Justin Pierson, Andy Gerlach, Tonya Johnson, John Hanson, and Andrew Fergel.

APPROVAL OF THE AGENDA

Commissioner Faehn moved that the agenda be approved. Commissioner Dykstra seconded. Motion carried.

APPROVAL OF THE MINUTES FROM THE MARCH 24, 2017, MEETING

Commissioner Dykstra moved that the minutes be approved. Commissioner Mickelson seconded. Motion carried.

CONFLICT OF INTEREST

Chair Putnam asked if there were any conflicts of interest and there were none.

SECRETARY OF REVENUE COMMENTS

Secretary of Revenue Andy Gerlach reported on the following:

STATE BUDGET

State Revenues through April 2017 were 1% or \$11.5 million below projected revenues.

- The sales and use tax revenue was down 2.5% when compared to 2016.
- The contractors' excise tax was up 6.8% over the previous year. Healthy commercial and residential construction was considered a factor.
- Video lottery revenue was up 2.2% with new machines performing well.
- Looking forward to the year-end budget, a State budget shortfall in the \$10 million range is forecast. State agencies were asked to curb spending and not use reserves.

South Dakota's economy will keep growing, but slowly. Slight growth during 2016 is projected to continue into 2017. Key factors include the agricultural industry, tourism, and retail and e-commerce. The agricultural industry has been steady, but the tourism industry is predicted to grow due to gas prices and SD being seen as a destination for families. With 10% of all retail dollars being spent online, remote sales continue to increase and were up 15%. Purchasing trends show that baby boomers and millennials don't purchase what they don't need and that affects revenue.

DEPARTMENT INITIATIVES

- A tax increment financing (TIF) workgroup was developed to work on consistency in classification and how it affects the state aid to education formula. TIFs are popular in a lot of communities and a great economic development tool that involves local, industrial, and economic development.
- An alcohol laws workgroup is looking at the three tiered system of manufacturer, wholesaler, and retailer. Focusing on farm wineries and craft breweries that have their hands in all three tiers.
- License plates on demand will offer direct delivery of license plates to your door.
- The Department of Revenue (DOR) is looking into how workforce housing is tied to economic development and TIFS.
- Tax policies haven't kept up with online hosts, like Air B&B, etc. DOR will start working to get them in the system and remitting tax.

Chair Putnam asked if products shipped to a store would be taxed and if the profits would stay in SD. Gerlach stated that sales taking place in SD can be taxed, so if products are picked up at the store the tax would be applied. Ship to store puts revenues back into SD communities.

Chair Putnam asked Gerlach to explain the TIFs directive. Gerlach said that the DOR was putting together documents explaining TIFs and offering guidance on classification. They are working on classification continuity between economic, government, and local sectors.

Commissioner Faehn wondered if revenues were as expected after the start of collecting taxes through Amazon and other online retailers. Gerlach stated that efforts to work with online retailers had been successful and that the state had picked up \$1.5 million so far.

EXECUTIVE DIRECTOR'S COMMENTS

Executive Director Norm Lingle reported on the following:

Lingle updated Commissioners on the Lucky for Life lotto game saying that the Legislative Rules Review Committee passed the rules at a hearing on May 1. Software and user acceptance testing worked on getting the kinks out and the game will launch on Sunday, June 4.

A Mega Millions game change is on the horizon. The last game change was in October of 2013.

MEGA MILLION GAME CHANGES	
NEW GAME	CURRENT GAME
\$2 Per Play	\$1 Per Play
\$40 Million Starting Jackpot	\$15 Million Starting Jackpot
5 Of 70 White Balls Plus 1 Of 25 Mega Balls	5 Of 75 White Balls Plus 1 Of 15 Mega Balls
Jackpot Odds = 1 in 302.5 million	Jackpot Odds = 1 in 259 million
Overall odds = 1 in 24	Overall Odds = 1 in 14
\$1 million Second Prize = 1 in 12.6 million	\$1 million Second Prize = 1 in 18.5 million
"Just the Jackpot" – 2 plays for \$3 playing for the jackpot only	Not offered in the current game

Mega Millions changes will go into effect October 28 with the first drawing on October 31. A Rules Hearing will occur at the August 24 Commission Meeting to allow continued participation in the Mega Millions game.

The Hot Lotto game group discussions included everything from changes to the current game to ending the current game and replacing it with a new one. A decision may happen soon, meaning the Lottery could be bringing another rules package to the August 24 meeting. The current Hot Lotto jackpot run has the jackpot up over \$7 million with an 80 draw roll/ 40 weeks without a jackpot winner, so it is performing well.

FY17 Audit prep was underway. Lottery met with Legislative Audit staff and all documents requested were provided.

To adhere to the Conflict of Interest Rules, Commissioner Faehn disclosed that he owns and operates a radio station that occasionally works with Lawrence & Schiller (L&S), the Lottery's advertising agency of record.

Lawrence & Schiller (L&S) Research Presentation

Courtney Slaight and Kristin Duesterhoeft of L&S reported on the following:

STUDY OVERVIEW & APPROACH

Revenue provided to the State from the Lottery had been decreasing, so L&S looked at competition like Deadwood and Native American casinos, as well as at operational issues. They identified three goals – to understand who current players were, to understand the perception of the Lottery in South Dakota, and to build a brand identity according to their findings.

L&S started by sending out a survey via mail and online focusing on the behaviors and motivations of lottery play. The survey resulted in 1,700 responses. Next they conducted nine in-person focus groups across the state to find out the public's perceptions of the Lottery. They discussed different types of entertainment and gambling, and offered different statements about the Lottery to see how participants responded. Last, they conducted nine one-on-one interviews with retailers and establishments from across the state.

L&S decided to focus on image and experience to influence opinions which in turn would influence behavior.

Questions about past Lottery experience showed that a lot of people play the Lottery. When asked about perception, 54% were neutral or unfamiliar, which was encouraging, but 34% of focus group participants said playing the lottery was NOT entertainment.

L&S offered focus group participants five statements about the Lottery ranging from the General Fund to giving away a million dollars in prizes a day and asked which statements were most appealing. A statement about the \$100 million going to General Fund was most appealing, but there was conflict because the General Fund isn't very specific. While participants found certain messages appealing, they were skeptical as to whether or not they were true because their experience didn't always match the statement.

Through their research L&S decided that the Lottery's image should be tied to entertainment and being social and focus on winners and the benefit to the State. They then decided to leverage the unique experiences of each game through individual campaigns to impact opinions which in turn impacts behavior.

The image or brand campaign combined GOOD and FUN – GOOD because it gives money to the State – FUN because winning is fun – GOOD FUN – Good for South Dakota, Fun for South Dakotans.

To develop campaigns L&S needed to understand who players were. Scratch and lotto had two audiences, frequent and infrequent players. Video lottery had one audience. Each target audience had their own stats, such as what type of media they consume, their age, gender, and income. From there L&S developed ideas on messaging and when to target each audience.

L&S then figured out who the target audience was for each campaign. The scratch ticket campaign focused on everyday wins, like hitting all green lights on the way to work, and reminded players that luck happens every day. The holiday scratch campaign was about having fun together and shared anticipation. The Lucky for Life campaign will focus on a younger audience, because the idea of winning \$1,000/day for life gives them a sense

of financial security and stability. They developed a GoodOrFun.com landing page where players can find out if they're good or fun and share their results on social media.

Upcoming campaigns will include Powerball, Mega Millions and Hot Lotto, along with a reemergence of the Good Fun branding campaign.

In the fall a brand perception benchmarking study will be used by L&S to find out if their campaigns had an impact.

Chair Putnam asked for the number of people surveyed. Slight said that L&S sent out 5,000 mail surveys, as well as an online panel and email to the Lottery's Players Club. They received 1,700 total responses. She said there were nine focus groups – three in Sioux Falls, three in Aberdeen, and three in Rapid City with one hundred participants total. Nine interviews with retailers and establishments were conducted.

Commissioner Kafka wondered if on average players really win \$1 million per day. Duesterhoeft said that figure was based on data they received from the Lottery. Kafka followed up by saying that statement should be included in the Lottery's advertising. She responded that initially people were excited about that statement but began questioning it - asking why they didn't know anyone who won and how much people in the state spend on Lottery products.

Commissioner Faehn commented on the misunderstanding of the General Fund, saying that most people thought all the money was supposed to go to education, but education funding comes out of the General Fund. He wondered how the Lottery could help the public to understand that the General Fund is not a bad thing. Putnam mentioned that the Lottery's website offers great information on where the money goes. Lingle said that before this year's Legislative Session, L&S put together two handouts explaining where the money goes.

Commissioner Kafka wondered why the Lottery mentions the General Fund if the money is actually going to fund education, highways, and the environment, saying the General Fund is simply where the money is captured.

REQUEST FOR ADVERTISING AND RELATED SERVICES CONTRACT EXTENSION

Director of Advertising and Public Relations Kelly Thompson reported on the following:

Thompson gave a recap of how L&S became the Lottery's advertising agency, saying that an advertising request for proposal (RFP) was issued in March of 2015. The five agencies that responded to the RFP were rated in seven areas: overall proposal, understanding of the Lottery's advertising standards and policies, effective billing methods, effective performance measurement practices, cost proposal, experience, creativity and innovation, and overall ability to meet the Lottery's advertising needs.

L&S was awarded the contract for advertising and related services because of their emphasis on performance measurement, effective media placement, market research, and innovative advertising techniques. The base contract was for two years ending on June 30, 2017, and allowed for three extensions of one year each.

L&S proved to be adept at performing the in-depth research needed to better identify and target current and new players. They researched, developed and assisted the Lottery in rebranding itself with the Good Fun campaign and introduced the Lottery to new advertising techniques aimed at reaching people where they live – social media, online radio, and digital messaging to mobile devices.

The challenge is always to increase sales and in the first two years, the groundwork was laid by introducing potential players to the brand and researching the Lottery's player base.

Developing long-term marketing strategies, not just for the next fiscal year, but several years down the road requires a consistent partner. L&S helped the Lottery figure out who their audience is and what they should be telling them. The next step is finding the right balance between new media and traditional media to get the message out and that takes both the Lottery and L&S's expertise.

The Lottery recommended that all three of the one year extensions be exercised to run consecutively – extending the contract from July 1, 2017 to June 30, 2020 with no change in commission rate, but the Lottery will receive access to advertising data on Lawrence & Schiller’s business intelligence dashboard.

Thompson respectfully requested the Commission’s approval to proceed with the necessary paperwork to extend the contract.

Chair Putnam stated that long-term contracts can be good or bad and wondered if the Commission would have the opportunity to see the numbers and be sure that L&S’s performance was as good as it seems. Thompson said that the Lottery could share the performance measurement information that L&S provided to the Lottery, but some clarification will be needed to understand what the measurements mean. The commissioners will be able to see the reports on a consistent basis to see how campaigns are performing and what the numbers are.

Commissioner Dykstra asked if L&S could raise the cost of the contract if they extended it for one year at a time instead of three years at once. Thompson said that every time an extension is given, there is a chance to re-negotiate. Dykstra wondered if it would be better to extend the contract on a yearly basis because when there’s an end date to a contract, complacency sets in. Lingle stated that each year the contract is extended, L&S could re-negotiate and it could cost more. He also felt consistency was important to make an impact on sales.

Commissioner Mickelson asked if the rate was 15% of advertising spending. Thompson answered in the affirmative. He then asked what percent of the budget was spent on advertising and if the Lottery had spent more than normal in the last two years. Thompson said that the Lottery had two budgets, a video lottery budget of \$200,000 and an instant/online budget of \$850,000, but referred to Lingle to answer what percent of those budgets were for advertising. Mickelson said that he didn’t need to know the percent, just that there was a definitive amount set aside for advertising. He wondered if sales increases could be tied to advertising. Thompson responded that increases in sales could be attributed to advertising, but picking the right games also played into sales numbers.

Commissioner Faehn mentioned that since starting in radio in 1984, he’d worked with hundreds of ad agencies across the country and feels L&S is one of the best. He said that 15% is standard in the industry, but creative services and research charges can fluctuate. He wondered if the Lottery spent more or less than the 15% on creative/backroom expenses. Thompson said that production costs were higher than 15%. Faehn stated that the hourly rate is where agencies have the opportunity to charge more. Thompson stated that rates were different depending on the type of project. For example TV advertising costs more to produce.

Commissioner Kafka moved that the contract extension be approved. Commissioner Mickelson seconded. Roll was called: Aye – Bogue, Dykstra, Kafka, Mickelson, Putnam. Faehn abstained. Motion carried.

**EXECUTIVE SESSION PURSUANT TO SDCL 42-7A-60 (4) – 10:55 A.M.
LICENSE DENIAL – THE POUR HOUSE LLC**

Commission Chair Jim Putnam:

Commissioner Faehn moved that the South Dakota Commission go into executive session pursuant to South Dakota Codified Law 42-7A-60 (4). Commissioner Dykstra seconded. Roll was called: Aye – Bogue, Dykstra, Faehn, Kafka, Mickelson, Putnam. Motion carried.

The Lottery Commission entered into executive session at 10:55 a.m. CT. The room was cleared and the recording stopped.

Commissioner Faehn moved to adjourn the executive session. Commissioner Dykstra seconded. Roll was called: Aye – Bogue, Dykstra, Faehn, Kafka, Mickelson, Putnam. Motion carried.

The Commission came out of executive session at 11:33 a.m.

Commissioner Kafka moved to accept the hearing examiners recommendation to deny The Pour House LLC a video lottery license. Commissioner Mickelson seconded. Roll was called: Aye – Bogue, Dykstra, Faehn, Kafka, Mickelson, Putnam. Motion carried.

FY17 INSTANT AND ONLINE PERFORMANCE REVIEW

Business Analyst Sam Stanforth reported on the following:

Stanforth presented an instant and online performance review for fiscal year 2017 through the end of April. Scratch ticket sales had been down 5-7% at the previous meeting, but were back up with sales projections at \$25.75 million.

Instant sales performance by county showed most of the increases in sales coming from mid-eastern SD. The southern part of the state had a large percentage increase, but not as much of a dollar increase. Most of the increases came from Minnehaha and Beadle counties. Codington, Brown, and Pennington counties were all down.

Sioux Falls had a 4.20% increase in instant sales, which is an increase of \$208,417. Huron had the largest percentage increase at 20.5%, which is an increase of \$82,479. Watertown was down 17.37% and Yankton was down 19.25%.

\$5 tickets had a good couple of months and were back up to where Christmas sales had been. \$10 and \$20 tickets were also on the upswing and \$3 tickets saw some good weeks in February and March, but have gone back down since.

Lotto ticket sales have had a steady decline, with the exception of the Powerball run last January. Lotto sales took a big hit in year over year figures because of that \$7 million two week period in January 2016. There wasn't a single county in the state with a year over year increase in lotto sales, but the numbers had improved since the previous Commission meeting. Sioux Falls was down \$1.5 million, due to Powerball, because sales on all other lotto games were up.

Jackpots increase sales in all products except Hot Lotto, with no spike in sales when there's a jackpot run.

EZ MATCH UPDATE

Since sales began on August 28, 2016, EZ Match brought in \$447,531 in sales and resulted in \$253,816 paid out to winners. The base rate of participation in EZ Match was strong, averaging around 31-32% when jackpots are low at the beginning of a new run, but participation dips to around 22% as jackpots pass \$100,000.

SUMMARY

- Instant revenues were recovering; approaching 2% down in May compared to 5.49% down in February.
- Sioux Falls and Rapid City accounted for about 35% of both instant and lotto sales and the top ten cities alone accounted for about 60% of all sales in the state for both products.
- Lotto sales are driven primarily by jackpots; while sales were 25.68% behind FY16, replacing just the two weeks of record sales in FY16 with average weekly sales from the year would put this year's sales ahead by 1.73%

Commissioner Faehn commented that Sioux Falls and Rapid City make up 50% of the population making 35% of sales not as impressive.

VIDEO LOTTERY REPORT

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

Seibel reported on net machine revenue and terminal and establishment averages for FY17 as of April 30, 2017. Net machine income (NMI) for FY17 was \$177.01 million which was a 1.85% increase over FY16. The number of

terminals was at 9,090, which was up 1.50% from the previous year. The number of establishments was at 1,346, which was .67% more than in FY16.

Video lottery FY17 revenue projection as of April 30, 2017 was \$104.66 million versus \$102.76 million in FY16.

PUBLIC RELATIONS/ADVERTISING REPORT

Director of Advertising and Public Relations Kelly Thompson reported on the following:

BIG WINNERS CLAIMED (SINCE 3/24/17)

Lotto games produced eight winners of over \$2,500. Powerball had two big winners, one from Martin for \$150,000 and one from Pierre for \$50,000. A \$30,000 Hot Lotto ticket was sold in Sioux Falls and there were four \$3,000 Hot Lotto winners – two in Sioux Falls, one in Watertown and one in Rapid City. One \$2,500 Mega Millions with Megaplier ticket was sold in Yankton.

There were fifteen top prize winners of \$2,200 - \$100,000 since March 24 in fourteen different instant games.

LUCKY FOR LIFE

The new Lucky for Life lotto game will launch on June 4. The Lottery educated players about the new game through *How to Play* rack cards, a game page on the Lottery's website, social media posts, point of sale (POS) advertising, and articles in the Players Club newsletter. The ad campaign consisted of network and cable TV (launch in July), social media, POS, online and traditional radio, a landing page, and digital displays (launch next week).

PLAY IT AGAIN – MONTHLY MOOLA

The new second chance promotion began March 1 and will run through June 30. Three winners are drawn each month— one for \$2,500 in cash and two for \$100 in scratch tickets. Entries so far are a little ahead of previous promotions. Lottery staff will meet after the final June 29 drawing to determine if the smaller cash prize every month was an effective draw. The sales division will continue working on a new promotion to start July 1.

30TH ANNIVERSARY

The Lottery's 30th Anniversary celebration will kick-off at the 605 Summer Classic June 23-24 in Sioux Falls. The Lottery will have a booth with Lottery trivia, premium items, and ticket giveaways. An official anniversary party will take place at the State Fair on September 1 from 1:00 to 4:00 p.m. with an expanded booth, anniversary cake, giveaways, photo opportunities utilizing Snap Chat, a large selfie with players, and State Fair advertising. Throughout the summer months there will be press releases on past big winners, Lottery history, retailer appreciation, and beneficiary awareness. There are plans to get players involved by giving them the opportunity to get their photo taken with a giant check during 30th anniversary events that they can share to social media.

Chair Putnam wondered what L&S is doing and what Lottery staff are doing as far as advertising is concerned. He also asked if advertising performance data was merged or kept separate. Thompson stated that the Lottery works with the agency and also produces some material in house.

SALES REPORT

Sales Director Justin Pierson reported on the following:

SCRATCH TICKETS

In May a \$5 30th Anniversary ticket and \$3 Cashword ticket were introduced. In June the \$2 Winner Winner Chicken Dinner and \$5 Queen of Hearts tickets will go on sale, with White Hot Bingo and Lucky 7's following.

Instant game sales were down 3.48%, sitting at \$21.7 million versus \$22.89 million the previous year. Sales in May were up 7.1% over the previous year.

Lotto sales were down 25.68% at \$18.71 million versus \$25.18 million the previous year. Last year's \$1.5 billion Powerball jackpot generated two weeks of sales averaging \$3,575,000 per week and is the reason for the decline.

GAME BY GAME

- Powerball was down 33%, at \$12.21 million versus \$18.31 million the previous year.
- Mega Millions was up 20%, at \$3.32 million versus \$2.79 million the previous year.
- Hot Lotto was up 23%, at \$2.78 million versus \$2.26 million the previous year.
- Dakota Cash was up 28%, at \$2.50 million versus \$1.96 million the previous year.

REVENUE PROJECTIONS

- Instant - \$5.15 million
- Lotto - \$6.77 million
- Video - \$104.66 million
- TOTAL - \$116.58 million

Chair Putnam asked who would be making the decision regarding the Hot Lotto game, saying sales had been steady. Pierson said that a jackpot run didn't boost sales the way it did in other lotto games. Lingle said the game group would get together to discuss options, a motion would be made to either change the game or leave it alone, a vote would be taken and that would determine the direction of the game group. After that it would be up to individual lotteries to decide whether to stay in the game or exit.

Commissioner Faehn commented that Powerball jackpots had grown significantly since the game change, the billion dollar jackpot raised the bar, and now a \$300 million jackpot doesn't get as much play. Lingle said that the Powerball jackpot was now at \$300 million and was finally starting to get attention. Lotteries need to look at jackpot games to figure out what should be done to drive sales other than making the jackpot harder to win, because that is a difficult challenge to fix. The Lottery is working with vendors, but hasn't found the right balance yet. The Mega Millions "Just the Jackpot" option is one way of changing that.

NEXT MEETING DATE

Director Lingle was looking at August 24, 2017, in the same place and at the same time for the next meeting date.

ADJOURNMENT

Commissioner Dykstra moved to adjourn the meeting. Commissioner Faehn seconded. Roll was called: Aye – Bogue, Dykstra, Faehn, Kafka, Mickelson, Putnam. Motion carried. Chairman Putnam adjourned the meeting at 12:15 p.m.