STATE OF CALIFORNIA

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CALIFORNIA STATE LOTTERY COMMISSION

COMMISSION MEETING

TIME: 10:00 a.m.
DATE: Thursday, June 21, 2018
PLACE: California State Lottery Headquarters
600 North Tenth Street
Sacramento, California

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TRANSCRIPT OF PROCEEDINGS

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California State Lottery Commission

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Chair of the Commission
Commissioner

CONNIE PEREZ-ANDREESEN
Vice Chair of the Commission
Commissioner

NATHANIEL KIRTMAN III
Commissioner

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Participating Lottery Commission Staff

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Acting Chief Counsel

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NICHOLAS BUCHEN
Deputy Director
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ELISA S. TOPETE
Assistant to the Commission

GLENDA LEWIS
Recording Secretary

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CHAIR AHERN: Okay, we’ll call our commissioners’ meeting to order; and we’ll stand for the Pledge of Allegiance.

Please join me.

(The Pledge of Allegiance was recited.)

CHAIR AHERN: Okay, we’ll go to roll call of commissioners.

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Here.

MS. TOPETE: Commissioner Libang-Bobila.

(No response)

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Here.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Here.

All righty. Item Number 4, Election of the Chair and Vice Chair of the California State Lottery.

I’d like to introduce Nicole, the Lottery’s chief counsel, to review the rules of running the elections.

MS. SOLURI: Thank you, Chair Ahern.

The California State Lottery Act provides that
the Commission shall elect annually from its membership a chairperson. The Commission may also elect a vice chairperson of the Commission.

Any commissioner can put the name of any other commissioner into nomination; and a commissioner can nominate himself or herself to serve as the chair or vice chair.

The Lottery Act does not require a particular method of making nominations.

Once nominations have been made, Chair Ahern shall declare the nominations closed.

The votes are asked of each commissioner on a nomination as with all Commission votes under the Lottery Act; and it takes three votes to take an action. Chair Ahern will then declare the results of the election.

CHAIR AHERN: All righty. Thank you, Nicole.

We shall open nominations for the positions of chairperson and vice chairperson of the Commission.

I’d like to continue as the chair of the Commission; and I would I’d like to nominate Ms. Perez-Andreesen to continue as vice chairperson.

MS. SOLURI: Thank you, Chair Ahern.

I would like to note for the record that Chair Ahern has self-nominated for chair -- Commission chair and has nominated Ms. Perez-Andreesen as Commission
Now, other than Sheriff Ahern, are there any other nominations for the position of chair of the Commission?

(No response)

CHAIR AHERN: Hearing none, I’ll declare the nominations closed.

Can we please call a vote by roll call?

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes, for both.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes, for both.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes -- for both.

I was more leaning towards my nomination.

(Laughter)

CHAIR AHERN: My election as chairperson of the California State Lottery is approved; and --

MS. SOLURI: You skipped ahead of me.

CHAIR AHERN: Okay.

MS. SOLURI: Other than Ms. Perez-Andreesen, are there any other nominations for the position of vice chair of the Commission?

(No response)

CHAIR AHERN: Okay, I declare those nominations
closed.

Now, can we have a vote by roll call?
Do we have to do another one for both?

MS. SOLURI: Well, we should do another one.

CHAIR AHERN: Okay. All right.

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.

Now, the election of Ms. Perez-Andreesen as vice chairperson of the California State Lottery is approved.

MS. SOLURI: So the reelection of Sheriff Ahern as our chairperson of the Commission takes effect immediately; and because Mr. Ahern has been reelected, he will retain the gavel.

Thank you.

CHAIR AHERN: Thank you very much.

I’m good with these things.

All right. So, now, can we go to Item Number 5, Consider Approval of the Agenda?

Commissioners do -- does anyone want to suggest any changes to today’s agenda?
COMMISSIONER KIRTMAN: None for me.

CHAIR AHERN: All right, do I hear a motion to adopt the agenda?

VICE CHAIR PEREZ-ANDREESEN: I’ll make a motion to adopt.

COMMISSIONER KIRTMAN: Second.

CHAIR AHERN: We have a motion and a second. We’ll call for the vote.

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.

All right, Item Number 6, Approval of the Minutes, that was for the May 24th Commission meeting, the next item on the agenda.

Are there any corrections to the minutes?

(No response)

CHAIR AHERN: Do I hear a motion to approve the minutes?

COMMISSIONER KIRTMAN: A motion to approve the minutes.

VICE CHAIR PEREZ-ANDREESEN: I’ll second.

CHAIR AHERN: Motion and a second.
Will the secretary please call the roll?

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.

All right, Item Number 7, the Director’s Report.

On to you, Hugo.

DIRECTOR LÓPEZ: Good morning, Chairman Ahern, Members of the Lottery Commission. As always, it’s good to see all of you again.

Before I begin, special thanks to all Lottery staff who worked behind the scenes to make this Commission meeting possible.

For today’s Commission meeting, the Director’s report, I’ll provide you with our updated sales information, which will be followed by our action items, where we will hear presentations from Ms. Allen, Mr. Brickner, Mr. Buchen.

So on this slide, we see that, with about 11 and a half months completed in the fiscal year, total Lottery sales through June 16th are nearly $6.7 billion. Our sales are currently ahead of our sales goal by over
$200 million, or about 3 percent.

Also reflected on this slide, is the fact that current sales amounts are about 12 percent ahead of the sales at the same time a year ago.

Scratchers® sales through June 16th were over $4.87 billion, which is ahead of its sales goal by $180 million, and are running 11 percent higher than sales through the same period last year.

I’ll touch a little more on Scratchers® and their profitability on the next slide.

As you can see, both of our multistate games, Powerball® and MEGA Millions®, are performing well. Combined, the games have sales close to $1 billion and are exceeding both their sales goals and last year’s performance.

SuperLotto Plus®, our in-state draw game, has cumulative sales that are more than $250 million. However, this is below its sales goal and below last year’s sales. The primary reason being is that there have been significantly fewer draws where the jackpot was about $40 million this fiscal year when compared to last fiscal year.

Our Daily Game sales are running about where we thought they would be and are ahead of last year’s figures.
With regards to Hot Spot, sales through June 16th are more than $275 million, which is 13 percent higher than last year’s figures. However, Hot Spot sales are running slightly behind the very high sales goal established for this fiscal year.

So to quickly summarize how we are closing out the fiscal year, all product categories, except SuperLotto Plus®, have sales that are higher than last year’s levels; and all product categories, except SuperLotto Plus® and Hot Spot, are currently exceeding their respective sales goals for this fiscal year.

As previously noted, Scratchers® sales have been growing this year, particularly at the $30 price point. While this is good news, we also need to evaluate whether our profits from Scratchers® are also higher. The chart on this slide shows how sales at each price point are performing relative to their sales goals. As you can see, the $30 price point is well above its goal, while the $1 and $2 price points are selling below their anticipated levels.

Although not noted on the chart, let me read the percent of sales goal achieved by each price point: For the $1 price point, it reached 95 percent; $2, currently at 86 percent; $3, 110 percent of goal; $5, 106 percent; $10, 101 percent; $20, 99 percent; and the
$30, 125 percent.

In the boxes to the right, you’ll see our year-to-date profit goal for Scratchers® and our year-to-date estimated profits based on actual sales. So based on these projections, estimated profits from Scratchers® through June 9th are about $33 million ahead of their goal, or about 4 percent higher than projections. The higher-than-expected sales from the $3 and the $5 price points help balance Scratchers® portfolio.

Prospectively, we will continue to evaluate the Scratchers® product mix and profitability to ensure that we maximize our contribution to public education.

Now, the last time we met, I told you that I would provide you with the revised estimated year-end sales number. Well, if sales trends continue for the next week and a half, our actual sales will be more than $200 million higher than the original goal of $6.75 billion for this fiscal year. Our current sales estimate is nearly $100 million higher than the figure brought to the Commission just last March.

So our revised total Lottery sales estimate for the current year is a record $6,956,000,000, or just $44 million shy of $7 billion. But who knows? Once we reconcile our numbers, the $7 billion milestone just
might be reached. Regardless, and more importantly, we estimate a record $1,640,251,000 contribution to public education.

So we’d also like to thank you, Commissioners, for your support and direction this past year, which has contributed to a very successful year for the Lottery.

So that concludes my remarks. I’d be happy to answer any questions that you may have.

CHAIR AHERN: I think we are bigger in the role of support than direction. So you guys did a fantastic job in setting records that are very impressive. So, thank you.

DIRECTOR LÓPEZ: Thank you.

VICE CHAIR PEREZ-ANDREESEN: Congrats.

CHAIR AHERN: All righty, moving on to Item Number 8, Consent Calendar, the next item on the agenda. There are no items under “Consent,” so we’ll proceed to the action items, starting with 9.a, Marketing Promotions and Point-of-Sale Service Contract Extension.

Good morning.

MS. ALLEN: Good morning, Chairman and Commissioners. I’m Sharon Allen, deputy director of Sales and Marketing, presenting Items 9.a and 9.b.

First, Item 9.a, Marketing Promotions and Point-of-Sale Services Contract Extension. The Lottery
currently contracts with Alcon Marketing Group for promotional and point-of-sale, POS, services. The current contract term is set to expire on August 31\textsuperscript{st} of this year. In 2014, a four-year contract was awarded by the Commission to Alcon, with an option to extend for three additional one-year terms and the maximum expenditure amount of $40 million.

The marketing promotions and POS services contract is an integral part of the Lottery’s overall marketing plan, and requires a strategic and creative agency partner that can help motivate consumers to make a Lottery purchase amidst retail clutter. In the four years of this contract, Alcon has proven to be an agency partner that has consistently developed impactful point-of-sale materials and promotional programs that attract consumers and drive sales.

The Lottery will need to exercise the first one-year extension option that is available under the current contract in order to continue critical marketing efforts that will maintain the Lottery sales and retailer growth momentum without interruption.

To fund the requested extension, it will be necessary to increase the contractor expenditure authority by $10.2 million. This amount allows for a modest increase in expenditures to account for
servicing a growing retailer network, replacing outdated play-center equipment, potential new-game initiatives, and an anticipated increase in promotions and experiential marketing activities to appeal to new and casual players.

With the approval of the one-year extension and a $10.2 million increase in spending authority, the new contract will expire August 31st, 2019; and the maximum authorized contract expenditure amount will be $50.2 million.

We request that the Commission approve an amendment to the Alcon contract to extend the contract term by one year, and increase the total contract expenditure authority by $10.2 million.

Are there any questions I can answer regarding this extension?

CHAIR AHERN: Any commissioners have any questions?

COMMISSIONER KIRTMAN: No questions from me.

CHAIR AHERN: All right. And does any member of the public wish to address the Commission at this time?

(No response)

CHAIR AHERN: All righty, do we hear a motion to approve 9.a?
COMMISSIONER KIRTMAN: Motion to approve 9.a.

CHAIR AHERN: And do I have a second?

VICE CHAIR PEREZ-ANDREESEN: Second. I’ll second.

CHAIR AHERN: All right, will the secretary please call the roll?

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.

All righty.

MS. ALLEN: Okay, thank you.

CHAIR AHERN: Sharon, it looks like you’re up for 9.b as well.


The RFP solicited bids from qualified agencies to provide lead-agency advertising services for all
Lottery products, with the objective of maximizing net revenue from Lottery sales for the benefit of public education.

The RFP was advertised on the Lottery’s public Web site; the advertising trade Web sites Adweek and AdAge; Fi$Cal; Small Business Exchange; and sent to over 200 potential bidders obtained from the Lottery’s vendor database, and a list of California-based advertising agencies.

The Lead Agency Advertising Services RFP was developed with the understanding that the Lottery needs an advertising agency partner to help reach California’s diverse population through advertising. To realize this goal, the Lottery requires an agency that would be able to work collaboratively with other partner advertising agencies, understand the common themes that are relevant to the broader audience within the state, and develop advertising that leverages these insights.

Through the RFP, the Lottery sought a strategic, highly creative agency partner that would provide a strong collaborative approach in developing cohesive advertising plans. Additionally, the Lottery was searching for an agency with best-in-breed media planning and buying capabilities across all channels and different audiences.
The Lottery needed an agency team capable of developing breakthrough work and highly integrated cross-channel media communication solutions that would successfully elevate its brand, motivate consumer engagement, and spur product purchases.

In terms of expenditures, the current annual general-market contract expenditure is approximately $54 million. This covers advertising costs for jackpot alerts, as well as campaigns for draw and instant games. This includes approximately six to eight traditional TV spots and various media elements which vary by campaign. It can include video, radio, digital, social, print, out-of-home, and sponsorships.

In addition, tactics have been produced in multiple languages in conjunction with partner agencies for a total-market approach.

The RFP process consisted of three phases, each with a diverse Lottery evaluation team comprised of subject-matter experts from consumer marketing and advertising, product development, and business planning, as well as a representative from contract development services.

The first phase focused on agencies’ current samples of working capabilities. It was open to all agencies and joint ventures that met specified minimum
qualifications associated with the number of years of experience, the size of the agency, digital experience, the agency’s location, and some basic business requirements.

Twenty agencies from partnerships and joint ventures, that included creative advertising agencies and media firms, submitted proposals in response to the RFP. Agencies were required to submit background materials and facts sheets outlining their qualifications, as well as case studies that demonstrated their creative and media skills and experience.

Thirteen agencies advanced to Phase 2. This phase consisted of agency-site visits, focusing on a culture and chemistry check. The objective of these face-to-face meetings was to provide each agency the opportunity to give the evaluation team a sense of its agency that went beyond the written work and credentials in Phase 1.

The evaluation team wanted to personally meet with the staff that would be assigned to the Lottery account to assess the depth of resources, measure the strategic process, and evaluate the intensity of the agency’s interest and commitment to the Lottery’s business.

Five agencies advanced as finalists to Phase 3,
which focused on a Lottery work assignment and evaluation of the agency’s proposed staff plan and compensation. The five finalists were asked to prepare and present a strategic, creative, and integrated work assignment, including media and digital components. The Lottery was looking for each agency’s recommendations and creative capabilities, as well as the analytical and strategic thinking used to derive its proposed direction.

Finalists also provided staff plan and compensation proposals to demonstrate how it would staff the Lottery account and to present its compensation requirements. This was evaluated on both a stand-alone and comparative basis.

Following the agency’s final work assignment presentations and submission of the staff plans and compensation proposals, the evaluation team performed a best-value analysis to determine which proposal provided the Lottery with the maximum benefits in the areas of security, competence, experience, qualifications, performance, and price.

As a result of the analysis, the evaluation team determined that David&Goliath, an advertising agency located in El Segundo, California, would provide the Lottery with the best value in the desired areas. David&Goliath demonstrated the ability to provide
innovative solutions for the Lottery to achieve its goal of becoming the number-one lottery by 2020. The quality of the agency’s strategic thinking, creativity, and capability to lead partner agencies are exemplified by its rating of “significantly exceeds” in each of the three phases of the RFP. Additionally, David&Goliath’s staff plan included strong account management staffing levels dedicated to the Lottery account, which would enable it to provide advertising services that better assist the Lottery in meeting its strategic goal of becoming the largest lottery in the nation.

We recommend that the Commission approve awarding a contract to David&Goliath to provide lead agency advertising services for five years, with the option to unilaterally extend the contract for up to two additional one-year terms, with a maximum total expenditure authority of $295 million.

The contract expenditure amount of $295 million was calculated by applying an assumed 3 percent annual media cost inflation factor to the current annual general marketing budget of approximately $54 million. Note that this contract expenditure authority level assumes that the Lottery’s annual general market advertising expenditures over the next five years will remain at
current levels. To an extent that the expansion of our
general market advertising is required to meet future
strategic objectives, the Lottery will subsequently
request that the Commission increase the contract
expenditure authority as needed.

And finally, I would like to sincerely thank
the many Lottery staff in all of the divisions that
worked so hard on this project, and their dedication to
it. It took over a year to get through this process.
And especially Chairpersons Elizabeth Wills and Agnese
Cramer.

And with that, I’d be happy to answer any
questions about this recommendation

CHAIR AHERN: All righty. Do you have any
questions?

COMMISSIONER KIRTMAN: No questions from me.

Thank you.

VICE CHAIR PEREZ-ANDREESEN: No.

Thanks for the info.

CHAIR AHERN: I’d like to thank you for the
briefing you gave us earlier this week. It went very
well.

MS. ALLEN: Thank you.

CHAIR AHERN: Do we have any members of the
public that wish to address Item 9.b?
(No response)

CHAIR AHERN: All right, do I hear a motion to approve Action Item 9.b?

(Laughter)

CHAIR AHERN: You okay?

MS. ALLEN: David Angelo is the founder of David & Goliath.

CHAIR AHERN: All right. Congratulations in just a minute.

All right. Do we have a motion to approve Action Item 9.b?

VICE CHAIR PEREZ-ANDREESEN: I’ll make a motion to approve.

COMMISSIONER KIRTMAN: Second.

CHAIR AHERN: We have a motion and a second. Will the secretary call the roll?

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.

Now, congratulations.

MS. ALLEN: Okay, thank you

CHAIR AHERN: Okay, moving on to Action
MR. BRICKNER: Good morning, Commissioners.

CHAIR AHERN: Good morning.

MR. BRICKNER: Good morning. My name is Derick Brickner. I’m a manager from the Operations Division; and I will be presenting the next two action items. Both of these action items are in regards to the furtherance of the Facilities Master Plan and the Lottery’s transition from lease-to-own facilities.

So Action Item 9.c, the Termination of the Van Nuys District Office Lease, we are progressing with the construction of a Chatsworth District office. The Chatsworth District office will replace the currently leased Van Nuys District office.

We anticipate the construction and the move to happen sometime in the spring of 2019. In order to terminate the existing lease, we need to provide a 180-day notice to the landlord. And for that, I’m seeking your approval.

If you have any questions, I can answer them right now.

CHAIR AHERN: Okay. Do any commissioners have any questions on Action Item 9.c?

COMMISSIONER KIRTMAN: No questions from me.

CHAIR AHERN: No questions? All righty.
Does any member of the public wish to address the Commission regarding Action Item 9.c?

(No response)

CHAIR AHERN: Do I hear a motion to approve 9.c?

VICE CHAIR PEREZ-ANDREESEN: I’ll make a motion.

COMMISSIONER KIRTMAN: Second.

CHAIR AHERN: We have a motion and a second. Will the secretary please call the roll?

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.

Okay, and I think you’re up for 9.d as well.

MR. BRICKNER: Yes. Thank you, Commissioners.

So Action Item 9.d, the Termination of the Santa Ana District Office Lease, this is similar to the last action item. We are under -- we’re in the progress of construction of the Costa Mesa District office. The Costa Mesa District office is the replacement facility for the currently leased Santa Ana District office. We anticipate the construction and move happening also
sometime in the spring of 2019.

We have a similar provision in the lease to terminate our lease provision; and we need to provide a 180-day notice in order to terminate that lease. So for that, we also seek your approval.

Thank you.

CHAIR AHERN: Okay. Do any commissioners have any questions regarding 9.d?

COMMISSIONER KIRTMAN: No questions.

CHAIR AHERN: Do we have any member of the public who wish to address the Commission regarding 9.d?

(No response)

CHAIR AHERN: Is there a motion to approve Action Item 9.d?

VICE CHAIR PEREZ-ANDREESEN: I’ll make a motion to approve.

COMMISSIONER KIRTMAN: Second.

CHAIR AHERN: We have a motion and a second. Will the secretary please call the roll?

MS. TOPETE: Commissioner Kirtman.

COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.
All righty, thank you very much.

MR. BRICKNER: Thank you.

CHAIR AHERN: All right.

Okay, Nick, Action Item 9.e for our budget.

MR. BUCHEN: All right, good morning, Commissioners.

CHAIR AHERN: Good morning.

MR. BUCHEN: So I will be presenting the Lottery’s fiscal year 2018-19 budget for your approval.

As included in our 2018-19 business plan, which was adopted at the May Commission meeting, there are four main objectives for investment in this budget to enable us to maximize our contribution to education, and to put us further on the path of becoming the largest lottery in the nation.

The four key objectives are creating significant growth in our jackpot games and Hot Spot; continuing the momentum in Scratchers® sales growth; improving the customer experience for players, retailers, and internal customers; and elevating perceptions about the Lottery to grow future player base. All initiatives included in this budget tie back to at least one of those four initiatives.

And here it is.

So I’ll take us through this section by
section; but here’s the big spoiler: This budget projects the highest level of sales and, more importantly, the largest contribution to education in Lottery history.

So this chart, and the ones I’m about to go through with you, compare our estimated revenues and expenditures for the 2018-19 fiscal year to our estimate of how we will end the current fiscal year on June 30th.

CHAIR AHERN: I just have a question.

MR. BUCHEN: Sure.

CHAIR AHERN: How old was the person that put that print together?

MR. BUCHEN: It’s one of those Millennial whippersnappers.

CHAIR AHERN: Oh, now, it’s better.

MR. BUCHEN: There will be bigger charts ahead.

So all dollars in these charts are in thousands. And before I dive into each separate section, let me quickly highlight the major changes from the draft budget that I presented last month.

So for the current fiscal year, that ends on June 30th, last month I simply presented the figures from our revised budget for the 2017-18 fiscal year that you adopted at our March Commission meeting. And what we have today, instead reflects an updated estimate of how
we will end this current fiscal year in a little over a week.

So current-year sales are on pace to come in even higher than was estimated in the revised budget. And several of the administrative expenses are estimated to be lower than included in the estimated -- in the revised budget. So the net impact of these changes is an increase of nearly $57 million to our estimated contribution to education for this current fiscal year.

And for the 2018-19 fiscal year, although the sales goal I’m presenting today is the same as it was included in last month’s draft budget, both prize expense and several of the administrative expense categories are estimated to be lower than what I presented last month. So the net impact of those changes is an increase of more than $24 million in our projected contribution to education for the 2018-19 fiscal year.

So as I’ve said many times, the Lottery’s budget follows a basic formula comprised of four major elements: Sales from our products minus the associated prize expense, minus the administrative expenses, equals our contribution to education.

So for the first of those major components, sales, you can see in the middle dollar column that we are projecting a total of $7.09 billion for 2018-19.
And the far right column, it shows that this is an increase of $134 million over the level with which we are projecting to end this current fiscal year. And this represents a 1.9 percent increase.

So of this year-over-year growth, the largest dollar increase is in the Scratchers® product line, with a projected gain of $84 million, or 1.7 percent. And that projected increase is based on several factors, including continuation of a $20 crossword game, and having a $30 game in market for the entire fiscal year, growing our retailer network, realizing a full year of sales from retailers recruited during this current fiscal year, and implementing a communications strategy that will enable us to reach non-players and casual players.

And on the next line, our Powerball® projection is showing a year-over-year decrease of $30 million, or 5.5 percent. And that decrease is due to assuming a more conservative jackpot rollover pattern in 2018-19, as compared to what actually happened with Powerball® in this current fiscal year. So in other words, we had some better-than-average Powerball® jackpots in the current year; and we cannot assume that we will have the same luck in the coming year.

As I mentioned earlier, one of our key objectives for the coming year is to generate significant
sales growth in jackpot games and Hot Spot, since these
are more profitable on a dollar-for-dollar basis. So to
that end, we are estimating year-over-year sales growth
in each of the remaining product categories.

For MEGA Millions®, we are projecting a
year-over-year increase of $35 million, or 8.1 percent.
And that increase is mainly due to having a full fiscal
year of the game changes that were made last October,
that increased the MEGA Millions® ticket prices and
changed the game matrix to have more frequent, larger
jackpots.

And for SuperLotto Plus®, we are projecting a
year-over-year increase of $11 million, or 4.2 percent.
And that growth is actually significant because ignoring
the SuperLotto Plus® sales anomaly that happened last
fiscal year, this increase would reverse a year-over-year
decline in sales experienced in this game for the past
several years. So the 2018-19 sales projection assumes
that SuperLotto Plus® advertising will be spread more
evenly across the fiscal year, to continue building brand
awareness.

And moving on to the next line, the largest
year-over-year percentage increase in projected sales
revenue is in Hot Spot, with an estimated increase of
$24 million, or 8.4 percent. And that growth is
primarily attributable to plans to add a net of 75 social trade style retailers.

And as a whole, the Daily Games, including Fantasy 5, are projected to increase by $10 million, or 2.7 percent, from the current year, to 2018-19. And that increase is mainly due to projected growth in retailers selling Lottery products and the full-year impact of retailers brought on during this current fiscal year.

So the next major area of the budget is prize expense, which is estimated to total $4.6 billion in 2018-19. Now that’s an increase of $82.6 million, or 1.8 percent from current-year estimate; and that growth is mainly attributable to the estimated growth in sales.

And on to administrative expense, which the Lottery Act caps at 13 percent of total annual sales revenue. So the first area of administrative expense is retailer compensation, which is estimated to total $499 million in 2018-19. And that’s an increase of $15.9 million, or 3.3 percent from the current-year projection. And the bulk of that increase is due to the projected increase in sales.

And the next area of administrative expense is gaming costs, and those are projected to total $132.5 million in 2018-19. And that’s an increase of
only $98,000, or 0.1 percent from the current-year projection.

So, typically, the growth in this area would be more proportional to the estimated growth in sales. However, this very modest increase can primarily be explained by two factors:

First, there is a greater anticipated use of licensed properties for Scratchers® planned for 2018-19, which is the reason for the disproportionate year-over-year increase on the Scratchers® ticket cost line. And that increase is nearly offset by the decrease showing on the gaming contract line. So that year-over-year decrease is due to having a full fiscal year of the more favorable terms included in the gaming contract extension that the Commission adopted in September of 2017. And those terms became effective four months into this current fiscal year. So the coming year has a full year of those terms.

And the final area of administrative expense is operating costs, which are projected to total $290.2 million in 2018-19. And that’s an increase of $62 million from the current-year projection. However, this comparison is a little misleading since the 2018-19 column reflects both a reserve for insurable risk and an administrative spending reserve, while the 2017-18
column reflects zeroes for both of those items. So I’ll talk more about the reserves a little later. But if we exclude them for now, the year-over-year increase in operating costs is projected to be $21.1 million. So more than half of that growth is in personal services, which reflects a year-over-year increase of $11.9 million. And that growth is primarily made up of four factors:

There is a statewide general salary increase.

Its increased retiree health benefit costs.

There’s the new positions we are proposing in the 2018-19 budget.

And the full-year cost of the positions that were approved on a partial-year basis in last year’s budget.

So the statewide general salary increase of 4 percent was negotiated to help employees offset increases in their retiree health benefit contributions and becomes effective on July 1st.

And in addition to employees, employers are also required to contribute more to health benefits. So this explains some of the year-over-year increase in personal services as well.

And the Lottery is proposing to add 33 new positions for fiscal year 2018-19; and 30 of those new
positions will be in our nine district offices, and will facilitate issuing checks to pay prizes of $1,000 or less to eligible claimants. I’ll talk more about that in a moment.

And the year-over-year increase in the remaining operating costs categories is primarily due to the resources required to execute the 2018-19 business plan initiatives, as well as to make operational improvements.

Now, back to the reserves, those last two items within the operating costs. In the current year, we’ve zeroed out the reserves, since anything that we funded from them is already reflected as expenditures in the appropriate operating cost categories above. And for 2018-19, we are again maintaining a $5 million reserve for insurable risk to cover fiscal exposures for the areas of our organization that we are self-insuring.

And the 2018-19 budget also includes $35.8 million for the administrative spending reserves shown on the next line.

And you can see that the bottom line, administrative expenses, including both of the reserve line items, are projected to be $921.7 million in 2018-19, which is exactly 13 percent of the $7.09 billion in projected sales.
And when we close our books at the end of the fiscal year, any unspent administrative funds below that 13 percent cap, including funds within both reserve line items, are transferred in their entirety to education.

So this next slide is a summary of resources needed for the proposed initiatives and other revisions that are reflected in the administrative expenses for 2018-19.

So costs for the proposed initiatives are summarized within the key objectives from our 2018-19 business plan. And I’ll explain what’s going on with a few items here.

For the objective to create significant sales growth in jackpot games and Hot Spot, the $75,000 cost shown is to conduct consumer research on potential new Hot Spot game features. That research will be used to determine tactics for Hot Spot that will drive sales growth in future fiscal years.

The other efforts that we will be making to increase sales in the jackpot games and Hot Spot in this coming year do not require additional funding beyond what is already included in the base budget. For example, having a full fiscal year of the MEGA Millions® game changes that I spoke of earlier doesn’t result in any new costs to the Lottery.
And this same explanation applies to the objective to continue the momentum of Scratchers® sales growth. Some of the efforts I spoke of earlier of having a $30 game, $20 crossword, bringing new retailers on. None of those require new costs to the Lottery. So that’s why that particular objective doesn’t even show on this summary.

The “improve the customer experience” objective reflects, among other proposals, 30 new positions required to process claims and issue checks for valid winning tickets of $1,000 or less in our District offices.

We are currently running a pilot at the Sacramento District office, whereby office staff processes claims instead of sending them here to headquarters for processing, so that eligible winners receive their checks from the State Controller’s Office faster. And we are monitoring this faster-claims pilot, and are making tweaks to enhance the customer experience in the claims process.

All signs are pointing to the pilot being a success. So we will be looking to begin issuing checks out of our District offices beginning sometime in the second quarter of the 2018-19 fiscal year. And this will also be done on a pilot basis, again, starting with
the Sacramento District office, to ensure that we have all of the logistics worked out before expanding statewide later in the fiscal year.

So the second-to-the-last line of this summary reflects costs associated with other proposed revisions that do not fit cleanly within the four key objectives. For example, this includes the depreciated cost of the replacement vehicles for the Lottery’s fleet that Terry presented and you adopted at last month’s Commission meeting.

So I’d like to take a moment to provide some context to our administrative expenses. On the surface, having a 13 percent administrative budget disguises how lean we truly run. But as shown in this pie chart, 81 percent of our administrative expense is comprised of retailer compensation, gaming expenses, and marketing costs. And these three components of our administrative expense are unique to our business operations and have a direct impact on our sales and profits.

So, excluding the reserves, our “other operating costs,” which is our overhead, accounts for less than one-fifth of our total administrative expenses, and only 2.4 percent of our projected revenues. So that speaks to us doing an excellent job of managing our costs, which enables us to maximize our contribution to
education -- which, of course, is why we even do this.

So remember our easy formula of sales minus prize expense, minus administrative expense, equals the contribution to education.

There are a couple of additional items that factors into the final contribution.

So, first, the unclaimed prizes and interest earnings on our cash sitting within the State Treasury are mandated to be transferred directly to education; and any unspent funds within both reserve line items will be transferred to education as well.

So assuming that both reserves remain unspent, the total projected contribution to public education is estimated to be $1.65 billion in 2018-19, which would mark the highest contribution in what will be the Lottery’s 34-year history.

And that concludes my presentation.

But I’d like to take a moment to thank the Lottery’s budget officer, Bret Grosso, and his team of analysts: Jeneah, Larry, Greg, Ruth, Brit, and Francisco. They had a lot going on this year with using a new tool to create the budget and all of the associated displays. And they actually had quite a bit of practice using this tool, in a relatively short time span, since they used it to create the revised budget in the March
Commission meeting, the draft 2018-19 budget last month; and, of course, the final proposed 2018-19 budget for today.

So a sincere “thank you” to the team for their hard work behind the scenes to put together the budget.

So with that, I’d be happy to take any questions.

CHAIR AHERN: All right, do any Commissioners have any questions regarding the budget?

VICE CHAIR PEREZ-ANDREESEN: Yes.

Can you just talk a little bit about the goal and the number of retailers and how many you want? Or do you need to meet the budgeted numbers for next year; and what it is for this year, how many new retailers we have?

MR. BUCHEN: Sure. So, currently, all retailer categories, we have a little over 23,000 retailers.

The social trade style retailers that I spoke of, we currently have approximately 1,600 of them. So the increase of 75 that we’re looking for -- and that’s a net increase. We bring on, generally, a lot more than that because we lose some. Many of our retailers are small businesses that go out of business.

So that net of 75 that we’re looking for is about a 5 percent increase in that area. And the reason we’re targeting social trade-style retailers for Hot Spot
is, that’s more conducive to that style of playing.

For our overall retailers, generally, we look for a net increase of around 200 in each given year. And we’ve been on pace to do that the last several fiscal years.

So -- and we’re actually refining the ability to be able to kind of project a retailer’s ability to make money for themselves and the Lottery. So we’re doing a better job of being able to recruit retailers that are going to be, you know -- with the Lottery, more in the long haul than, you know, just churning. So that’s our goal.

VICE CHAIR PEREZ-ANDREESEN: Okay. Thank you.

MR. BUCHEN: Uh-huh.

CHAIR AHERN: All righty.

Does any member of the public wish to address the Commission regarding 9.e?

(No response)

CHAIR AHERN: All right. Do we have a motion to approve the budget?

COMMISSIONER KIRTMAN: Motion to approve.

VICE CHAIR PEREZ-ANDREESEN: Second.

CHAIR AHERN: We have a motion and a second.

Will the secretary please call the roll?

MS. TOPETE: Commissioner Kirtman.
COMMISSIONER KIRTMAN: Yes.

MS. TOPETE: Commissioner Perez-Andreesen.

VICE CHAIR PEREZ-ANDREESEN: Yes.

MS. TOPETE: Chairman Ahern.

CHAIR AHERN: Yes.

Great job. Thank you very much. I really appreciate the detail.

MR. BUCHEN: Uh-huh.

CHAIR AHERN: All right, moving on to Item Number 10, the Commission -- our general discussion. Any commissioners have anything you’d like to bring up at this time?

COMMISSIONER KIRTMAN: Nothing from me.

CHAIR AHERN: All righty.

Number 11, scheduling our next Commission meetings. We are scheduled for September 20th and November 8th. Both of those will be held in Sacramento.

Item Number 12, is there any item for public discussion?

(No response)

CHAIR AHERN: All righty. If so, we’re adjourned.

Thank you very much. And congratulations.

(The California State Lottery Commission meeting concluded.)
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This is to certify that: I transcribed to the best of my ability from an audio file provided to me by the California State Lottery Commission; and the foregoing pages 1 to 43, inclusive, contain a full statement and record of said audio recording.

In witness whereof, I have hereunto set my hand on the 5th day of July 2018.

________________________________
Cathy S. Dizon