CALIFORNIA STATE LOTTERY COMMISSION

Minutes – April 14, 2011 Sacramento, California

1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 9:34 a.m. at the California State Lottery Headquarters, 600 North 10th Street, Sacramento, CA 95811

2. Pledge of Allegiance

John Mass led the Pledge of Allegiance. Mass congratulated Susan Kossack on her upcoming retirement with 23 years of State service.

3. Roll Call

Mass asked Glenda Lewis to call the roll.

Commission Members Present:

Commissioner John Menchaca Commissioner Alex Fortunati Chairman John Mass

CSL Staff and presenters:

Linh Nguyen, Acting Director
Lisa Hightower, Chief Legal Counsel
Ed Fong, Chief of Product Development
Ellen Ishimoto, Deputy Director of Information Technology Services
Jim Hasegawa, Deputy Director of Business Planning
Michele Tong, Deputy Director of Sales
Barbara Krabbenhoft, Deputy Director of Human Resources
Michael Brennan, Deputy Director of Sales/Marketing
Elisa Topete, Assistant to the Commission
Glenda Lewis, Recording Secretary

4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the April 14, 2011 agenda as proposed. Menchaca moved to approve the agenda. Seconded by Fortunati. The motion passed unanimously (3-0).

5. Approval of Minutes

Mass asked if there were any additions or corrections to the February 10, 2011 minutes. Menchaca moved to approve the February 10, 2011 minutes. Seconded by Fortunati. The motion passed unanimously (3-0).

6. Commission Liaison Reports

Mass announced that Commissioner Menchaca will now be assigned the Security Liaison in addition to the Audit Liaison. Commissioner Fortunati offered to take the role as Liaison for Education and Community Relations and in addition to Mass' Marketing and Procurement Liaisons, he will assume the responsibility of the Budget and Legislative and Legal Liaisons. The new liaison reports will be given at the next Commission Meeting.

Commissioner Menchaca:

Menchaca provided the Audit Liaison Report. The following is the status of for the State Controller's Office (SCO) audits: The Lottery responded to the draft report on April 7, 2011 of the Fourth Quarter Transfer Report FY 2010. The final report is pending. Field work is complete and is under review for the First Quarter Transfer Report FY 2011. There are no preliminary issues. Field work as been completed on the implementation of past SCO audit recommendations. Five preliminary issues will be noted once the draft report is issued in April.

The Lottery responded to the draft report on March 24, 2011 of the 3 Ball Production Contract and took corrective actions to mitigate the five issues noted in the report. The final report is pending. Field work is complete and is under review of the Alcone Marketing Group Contract. There are no preliminary issues and the final report is pending. Field work has been completed on the Otto Construction Contract. Six preliminary issues will be noted once the draft report is issued.

Field work is complete and is under review of the LPA Sacramento Inc. Contract and there are no preliminary issues to report. Field work began on February 20, 2011 on the Samuel Ramirez and Co. Contract and is expected to last through the end of May 2011. There are no preliminary issues. Field work began in March 2011 on the budget process and is expected to last through the end of July 2011. There are no preliminary issues. Field work began in March 2011 of the Risk Assessment and is expected to last through the end of July 2011. There are no preliminary issues.

KPMG continues to observe and report on the Lottery's daily draws. No significant issues were noted since the last Commission Meeting. Delehanty Consulting has completed audits of Scientific Games Incorporated and GTECH Printing. Final reports are pending.

For the Lottery's internal audits: Field work is complete and under review of the Camelot Contract. Two preliminary issues will be noted once the draft report is issued. Field work began in August 2010 on Asset Management. The audit scope expanded in November to include the return process for Scratchers® tickets. Field work is expected to last through the end of April 2011. There are six preliminary issues. Field work began in February 2011 on the Scratchers ticket activation and is expected to last through the end of May 2011. There are no preliminary issues. Field work began in

March 2011 on the Travel Program and is expected to last through the end of May 2011. There are no preliminary issues.

Finally, the Audit Committee will have a formal meeting following today's Commission Meeting.

Chairman Mass:

As Marketing Liaison, Mass was updated on the "Imagine what a buck could do" brand advertising support for MEGA Millions®. The commercial aired for three weeks through April 3 in key markets of Los Angeles and San Francisco. Media elements included: TV, radio, digital/social media and digital outdoor and gas pump screens. The Lottery will air "Imagine what a buck could do," 30 TV spots titled "Funhouse" along with new 15 TV spots where the visuals use only words to expand the "dream" mindset with statements like: "Imagine flying to Belgium…just for waffles. Imagine throwing a block party…for your entire zip code," and "Imagine building a sunroom…for the doghouse."

MEGA Millions jackpot specific messages ran during the recent MEGA Millions run of \$319 million to support jackpots of \$70 million or more in Los Angeles and San Francisco. The Lottery is launching advertising on the "Red Hot 7's" Scratchers this month at the \$5 dollar price point offering 16 chances to win. The ticket will be featured in an advertising campaign that will include separate commercials for General Market television and Spanish language television. The campaign began on April 11 and will run through May 1.

As Procurement Liaison, Mass was briefed by staff and requested approval of the following: A proposal to issue an Invitation to Bid to invite responses from qualified bidders to provide courier services from Lottery Distribution Centers for Scratchers ticket deliveries to Lottery retailers throughout California; An interagency agreement with the Department of Justice to provide criminal history checks and FBI inquiries of employees, retailers, and contractors as well as Subsequent Arrest Notifications to the Lottery.

7. Director's Report

a. Lottery Report Card

Linh Nguyen, Acting Director, stated that the Lottery Report Card would be presented in two parts, with the first part being presented by Jim Hasegawa, Deputy Director of Business Planning. Hasegawa presented the Lottery sales update. A solid sales growth has been attributed by higher prize payouts, the initiatives from the Lottery's three-year strategic plan which is in place, and some beneficial roll patterns in the MEGA Millions game. The sales growth will be the largest sales gain that the Lottery has seen in the last 18 years.

Lottery sales have been around \$3 billion for the last two years. With this year's growth, the profits to education are slated to increase for the second year in a row, reaching

\$1.1 billion this year, which marks the 11th consecutive year that the Lottery has provided over \$1 billion to public schools in California. The Lottery is likely to end the year nearly \$400 million higher than last fiscal year. In terms of sales of the Lottery's products, total sales are running about 16 percent ahead of last year's pace. The product with the highest sales increase is MEGA Millions, which is up about 34 percent relative to last year.

The year-to-date goal percentage is running about 97 percent. In terms of the Lottery's products, they are ahead except for the Scratchers line, which is currently at \$1.467 billion. Although it is up 19 percent, it is slightly behind the pace staff originally anticipated. However, the other products are making up quite a bit of that difference. Overall sales are projected to come in at about \$3.425 billion. Even though sales numbers might be slightly behind, the profit number is at goal because the Lottery is receiving much more sales from more profitable games such as MEGA Millions and SuperLOTTO Plus® (SLP), than originally anticipated.

MEGA Millions is anticipated to end the year at over \$530 million, which is the highest year ever for the game. Two key factors in the success are that there were two jackpots over \$300 million in a single fiscal year and the periodic advertising through jackpot alerts and the brand overall. Staff received information from a MEGA Millions consortium partner, Virginia, as well as GTECH, that California has had some of the strongest growth in MEGA Millions compared to the other counterparts in other states. California is the only state that did not add Powerball in the cross-sell initiative. The Lottery's per capita sales have grown more with just MEGA Millions compared to other states that have both MEGA Millions and Powerball sales. MEGA Millions sales went up 20 percent because of the Lottery's effort in concentrating on building a stronger and more differentiated brand in MEGA Millions rather than adding a very similar product like the \$1 Powerball product would be.

The decline of SLP has been noticed over time since the launch of MEGA Millions, but has moderated a bit this past fiscal year. It will be the smallest year-over-year decline since fiscal year 2008 and SLP will definitely be ahead of goal. There is evidence that SLP benefits from large MEGA Millions jackpots as it drives players into retailers to purchase that product. The Daily Games, as a combined effort that includes Daily 3®, Daily 4, Fantasy 5, and Daily Derby®, will end the year at about \$325 million, which is 4 percent ahead of last year's numbers. Hot Spot® will be up about 15 percent relative to last year, which is the first year-over-year sales gain in six years. Because of the higher prize payout promotions due to Assembly Bill (AB) 142, Hot Spot has done really well.

Scratchers sales will reach an all-time high this year of over \$2 billion in sales, which is higher than fiscal year 2005-06, when it was over \$1.9 billion. AB 142 has allowed the Lottery to have multiple \$5 games being sold simultaneously. The combination of the higher prize payouts, additional \$5 games, advertising, and supporting the retailers through the Ex\$ell program are all contributing factors to the success of the Scratchers. In summary, Lottery sale totals will be over \$3.4 billion which is the largest sales gain,

both in terms of dollars perspective as well as a percentage increase since fiscal year 1992-1993.

Commissioner Menchaca asked if staff was doing anything different for 2011-12 with respect to reducing the goal from a marketing standpoint to increase the Scratchers sale. Nguyen stated that it was the Lottery's first year of the higher prize payout strategy, so it was difficult to predict exactly when consumers would catch on and sales would increase. Heading into the next fiscal year, there is a trend line therefore staff can do better in terms of projecting what the growth is for next year. The Lottery is working on the business plan for the second year and staff believes the growth is going to continue on a very strong trend. There are several new efforts and strategies that will be presented in May.

Chairman Mass asked if staff predicted what the Powerball analysis concluded, that the other states sales were up only 7½ percent while the Lottery's was up 20 percent because of not entering into Powerball? Hasegawa stated that staff did anticipate that conclusion because Powerball is not very different from MEGA Millions and SLP. Staff concentrated on trying to differentiate MEGA Millions to make it a different-looking product so that the Lottery could have multiple jackpot games in the portfolio. MUSL, which is the Powerball jurisdiction, is looking at changes to Powerball, including being a \$2 product. Nguyen stated that as part of the business plan, staff presented a new marketing strategy, which was to focus on the brand image of MEGA Millions, and to support jackpots through signage and jackpot alerts. The combination, in combination with not introducing Powerball, has led to the growth.

Ed Fong, Chief of Product Development, provided the project updates. The six key projects are Retailer Sales Support, Scratchers End-to-End, Draw and Jackpot Games, Market, Digital Communications and Public Website, and Business Optimization. For the Retailer Sales Building Program, staff is finalizing mechanics for an incentive program for execution early first quarter next fiscal year. Staff is implementing the Ex\$ell Project using baseline findings from four key components: Full facings, activation of key games, maximizing facing of \$5 games, and increased external Point of Sale (POS) exposure at retail as a benchmark. Staff has developed a new charter for pilot visitation, which is to maximize the retail services through the retailer segmentation plan.

There is a key success component for the Scratchers inventory and distribution. Because staff is in a closeout phase, findings from the project identified the need to create two new charters. The first was to evaluate the Lottery's efficiencies in the distribution of the games based on the potential growth of Scratchers. The second is developing a Scratchers inventory management center pilot to revitalize the existing operational processes for continuity inefficiencies. The Retailer Network Optimization is a new project and staff is developing a charter to evaluate the Lottery's retailer distribution base and address equipment placement to maximize sales performance.

Retail Communications is also a new project to address message continuity that is more efficient to retailers.

There are two initiatives in progress for the Scratchers End-to-End. A pre-launch research will be conducted to understand the wants and needs of players prior to games being released through player research. Staff is also finalizing the \$10 game design and started research on ways to expand the Lottery's \$5 game category with new concepts and features. Staff will utilize findings from the two studies to develop the Scratchers product plan for next fiscal year.

Staff has completed two RENEW workstreams and identified the following steps for the draw and jackpot games: Staff is looking to modify the Hot Spot® game to have all ten spots, plus a Bulls-Eye™ on every spot. For possible improvements in SuperLOTTO Plus, staff is in the process of planning a brainstorming session with the Lottery's ad agencies to generate ideas to reposition and differentiate the game. Once a position is completed, staff will need to regain the top-of-mind awareness for the game through Lottery-owned devices. Some value-add programs such as second chance draw features and programs that offer a purchase incentive will need to be developed.

The workstream that addresses the Lottery's marketing communications processes documents the current marketing practice in terms of how the Lottery develops communications for games. Staff identified over 80 detailed process mappings and broke them down into two distinct categories. The first will incorporate complex maps and involves many other divisions or external agencies which will need further review. The second will consist of simpler mappings that can be reviewed and completed by just a project manager or a smaller group of individuals.

Staff is currently in the procurement process of the Hispanic market advertising service RFP. The Lottery's new web site will launch this summer however, the completion of longer-term public web site projects might be delayed due to resources and the State hiring freeze. Finally, one of the key initiatives under business optimization is developing a marketing response analytics for media buys.

b. Business Intelligence Demonstration

Ellen Ishimito, Deputy Director of Information Technology Services, Michele Tong, Deputy Director of Sales and Hasegawa presented the demonstration of Business Intelligence (BI). BI is a set of tools and processes to organize Lottery data to allow information to be easily accessible by all levels of the organization. It is about timely decision-making, and it is about helping track performance against the Lottery's business objectives. BI was implemented in phases called "iterations." The first iteration was to build out a technical infrastructure to focus on supporting the Scratchers end-to-end and the Ex\$ell RENEW workstreams. Staff focused on the data around sales, distribution, and inventory of Scratchers.

The second iteration is in the process of developing detailed requirements to expand it to the draw game portfolio. Staff will be doing some enhancements to the Scratchers and retailer support area and will be looking at some internal information in the Lottery's financial area. Tong provided a demonstration of how the Sales Division utilizes the system to improve the Scratchers business. Tong focused on three key categories: new games, \$5 game performance, and the ideal game mix, which are the core games the retailers carry. All of the data can be tracked by district office so the numbers can be pulled weekly to see how the games are performing. The district offices value the information as well so they can identify areas that could do better, plus they can compare themselves to other districts that have similar characteristics.

Hasegawa explained that prior to BI's existence; the Business Planning staff would use MS Excel and manually calculate the data that was important to the Sales Division. That process entailed his staff to take a spreadsheet of about 21,000 rows, representing each individual retailer, and approximately 30 columns, representing all the different games, along with other retailer characteristics. Staff would then compile the data to come up with the statistics. It would take several hours to do that manually versus the click of a few buttons. Hasegawa demonstrated the various features of the BI program. Ishimoto thanked the IT staff, GTECH, Hasegawa and his staff.

c. Workforce and Succession Plan Update

Barbara Krabbenhoft, Deputy Director of Human Resources (HR) presented an update on the Lottery's Workforce and Succession Plan. There are four phases in the plan and in Phase I, staff analyzed the Lottery's current workforce demographics through age profiles and retirement statistics. The process identified the Sales and Marketing Division and leadership classifications as mission-critical areas of priority. Sales and Marketing's managers and supervisors have the highest percentage of employees eligible to retire. Gap analysis identified the need to evaluate and develop basic core competencies for all employees in an effort to establish baseline training development programs resulting in a workforce development training plan draft.

Phase II activities include assessing future needs by completing assessments and gap analysis. The methodologies included surveys, training session evaluations, employee feedback sessions, and the analysis of the Lottery's employees' individual development plans. Ongoing Lottery-wide training need assessments helped identify leadership core competencies which were then used to develop the Leadership Academy. A job analysis was completed for the Sales classifications and the information was used to develop training strategies and online examinations which will increase the candidate pools and greatly shorten the time it takes to administer an exam.

Phase III includes the Workforce Development Training Plan which sets forth the structure and components of training needed to ensure that critical class requirements and core competencies are developed. The plan includes; all-staff core competencies; the succession planning and training which focuses on leadership; and the mandatory training for all staff plus job-specific mandatory training. Staff is currently administering

the 2010/11 Individual Development Plan (IDP) and Performance Appraisal Summary (PAS) Process. Guidelines and training is provided to employees and supervisors.

In order to improve communication, and with the help of the Lottery's Information Technology Department, the Human Resources web page was created to provide employees a resource for information on job vacancies, pay and employee benefits, training opportunities, and health and safety information. HR partnered with Communications and Corporate Social Responsibility to develop and present Employee Survey Results. The overall survey results were positive, with a 72 percent response rate. The survey results will be used to develop additional action plans focused on the four lowest rated areas.

The Leadership Academy Program was a six session certificate program mandatory for all supervisors and managers in 2010 and will be repeated in 2011. New Employee Orientation is a mandatory training program that educates new employees about Lottery history, mission, vision, and culture. A Career Counseling Program was created to position employees for upward mobility. The program allows employees to be proactive in their pursuit of professional development and provides tools and resources for employees. The last action plan addresses the area of health and safety and wellness. HR staff organized a multi-differential effort to bring a half day training session to each of the nine district offices, both warehouses, and headquarters. Topics included injury and illness prevention; personal safety and crime prevention; EEO and sexual harassment prevention; and stress reduction. Staff hopes to evaluate and modify action plans in Phase IV.

8. Consent Calendar

- a. South San Francisco District Office Lease Extension
- b. New Headquarters Project Management Contract Amendment
 Menchaca made the motion to approve Consent Calendar Items 8(a) and (b).
 Seconded by Fortunati. The motion passed unanimously (3-0).

9. Action Items

a. <u>Amendment to Extend the Term of the Marketing Promotions and Point-of-Sale</u> Services Contract

Michael Brennan, Deputy Director of Sales and Marketing, stated that previously there had been direction to try to bring the advertising services contracts under one or two providers. It meant that the Request for Proposal (RFP) timelines had to be condensed to allow for the process to be implemented. Later it was determined that it was not in the best interest of the Lottery to follow that strategy, therefore the contracts now need to be separated so that staff resources can devote the proper time to the process.

Over the past 12 to 16 months, staff has been challenged with implementing the many RENEW initiatives that were critical to the Lottery's ability to implement its three-year business plan. Staff has also worked through the General Marketing

advertising services contract RFP and is now engaged in the RFP process for the Spanish language advertising services contract. Staffing shortages and vacancies require that the Lottery carefully assess the priorities and direct the limited resources accordingly.

Alcone Marketing Group (Alcone) continues to provide a consistently high level of service, above what is expected, and would continue to play a critical role in supplying the Lottery with marketing promotions and point of sale services. These materials and services are required to furnish the over 20,000 Lottery retailers statewide with the proper equipment and materials, to prominently display and sell Lottery products. Staff recommends the extension of the Alcone contract for 18 months, under the same terms and conditions, to ensure that the Lottery will continue to receive business-critical marketing promotions and point of sales services through February 28, 2013. The 18-month extension requires no additional funding; and the total expenditure authority for this contract will remain at \$40 million.

Mass asked if anyone from the audience had any questions on Action Item 9(a). No one came forward so he proceeded to the motion of approval. Mass proceeded to the motion of approval.

Menchaca made the motion to approve Action Item 9(a). Seconded by Fortunati. The motion passed unanimously (3-0).

b. Amendment to Extend the Term of the African American Advertising Contract Brennan stated that Muse Communication continues to provide a consistently high level of service and will continue to provide competitive pricing and low market rates. Extending Muse's contract will ensure that the Lottery obtains the desired media purchase with the lowest possible rates for the remaining 2011 year and potions of 2013. Staff recommends the extension of the Muse contract for one year, with the nine-month emergency extended service option under the same terms and conditions through October 31, 2013. To carry out the 21-month extension, staff recommends an increase of contract expenditure authority by \$2 million, for a total expenditure authority under the contract of \$8.5 million.

Mass asked if anyone from the audience had any questions on Action Item 9(b). No one came forward so he proceeded to the motion of approval.

Menchaca made the motion to approve Action Item 9(b). Seconded by Fortunati. The motion passed unanimously (3-0).

c. Amendment to Hot Spot® Game Regulations

Fong proposed to adopt amendments to the regulations for Hot Spot resulting in an increase to the number of ways a player can play Hot Spot by incorporating additional spots. Hot Spot was identified as a game that needed further evaluation to determine if there were ways to improve the overall game performance. The recommendations were to revise the Hot Spot game and offer more spots, 1 through 10; offer a Bulls-Eye feature on both of the 10 spots; and create a more meaningful prize between \$50 and \$75. Staff is also recommending keeping a wager-prize fund at 56 percent, and increasing the typical prize payout percentage from 49½ to just under 50.6 percent. This will allow the Lottery to strategically increase prize payouts over time as the retailer network increases.

Higher payout promotions in the past have proven to be very instrumental in maintaining player interest in the Lottery's games. The game regulation amendments presented still require a game payout at 56 percent per fiscal year and staff will do promotions that periodically increase the payout above 51 percent to achieve a balanced prize structure. The approved amendments will be implemented in the summer of 2011.

Mass asked if anyone from the audience had any questions on Action Item 9(c). No one came forward so he proceeded to the motion of approval.

Menchaca made the motion to approve Action Item 9(c). Seconded by Fortunati. The motion passed unanimously (3-0).

10. Commissioner General Discussion

Mass commended Lottery staff for having incredible results in sales and record contributions to public education, despite the many changes the Lottery has seen in the last six months. Mass thanked employees for completing the Employee Survey and stated that the increased communication to the Commissioners and Lottery staff is contributing positively to the agency.

11. Scheduling Next Meetings

The next Commission Meetings are tentatively scheduled for May 19, June 23, September 8, October 27, and December 8, 2011 in Sacramento.

12. Public Discussion

Mass asked if anyone from the public had anything to discuss. No one had signed up prior to the meeting and no one came forward, so he proceeded to the next item on the agenda.

13. Adjournment

Meeting adjourned at 10:50 a.m.