



DRAFT MEETING TRANSCRIPTION

Finance Committee

Special Meeting

May 8, 2020 at 10:00 a.m.
via teleconference

Committee Members: Patti Maroney, Chair of the Finance Committee; Patrick Birney; and Manny Langella (all via teleconference).

Staff Members Present: Greg Smith, President & CEO; Paul Granato; Matthew Stone; and Annmarie Daigle.

I. Welcome:

(P. Maroney): Welcome to our Special Meeting of the Finance Committee on Friday, May 8, 2020. I'd like to call the meeting to order at 10:00 a.m. In accordance with Governor Lamont's Executive Order 7B, the public has been provided access to our meeting via teleconference. That line is now open. There will be no in-person public attendance at this meeting pursuant to the Governor's order. The public dial-in information was provided via regular notice of this meeting. I will point out also to conform to our meeting procedures, everyone please identify yourself for the record when speaking as we do have a public line open.

II. Approval of the February 20, 2020 Finance Committee Meeting Minutes:

(P. Maroney): The first item on the agenda is approval of the February 20, 2020 Finance Committee Special Meeting Minutes. Do I have a motion on those?

(P. Birney): Patrick Birney, so moved.

(P. Maroney): Second. Any discussion? All in favor?

(All): Aye.

(P. Maroney): The minutes pass. Thank you.

III. New Business:

a. Review of Financial Statements for period ended March 31, 2020:

(P. Maroney): Next is the Review of Financial Statements for the period ended March 31, 2020.

(P. Granato): Thank you Patti. This is Paul Granato. Good morning Finance Committee members. In your package that you received earlier this week you have your normal quarterly financial statements as well as year to date financial statements which we've been producing for you in perpetuity. We customarily had my yellow highlighted page as the forefront to those discussions. I have also included a narrative. This week you also received a new file, it's called P&L Game Third Quarter and Year-to-Date. It is a four-page document that we'll go through which will lead our discussion for the financial statements for this quarter. I'm very excited to share this with you because it's been quite an undertaking for me and my team to get to this point of producing monthly financial statements. This is the presentation that we are going to use

with the Committee and also at the senior management level for our more in-depth discussions. I'm going to ask you to jump to the last two pages because that is the monthly presentation for the month of March. It's comparing the actual results with the budget and also the prior year. The far right columns include the variances. I've also included number lines for our discussion to make it easier to read at least for this discussion today and I'm happy to include them going forward. We had a great year so far through the month of March with \$961 million in sales and we are \$26 million behind budget and \$37 million behind last year at this time. If you scroll up from those numbers you can see where the largest variances are that make up those balances and as we've discussed throughout this period, our multi-state games, Mega Millions and Powerball continue to have a negative effect in terms of our sales for comparative purposes, not only to budget but also to the prior year. Having said that, \$961 million is a fabulous number. You can see we've had tremendous growth in some games for instance, the Keno, up \$5 million that's over 6% compared to budget and over \$12 million a year ago or 16.6%. Those are really good growth numbers. I'm jumping over to the instant ticket portfolio, we're up \$6 million compared to the same period last year although we are still slightly behind budget at \$3.5 million. I'm going to leave my comments there for discussion on the sales portion and jump down to the Cost of Sales. The Cost of Sales expense is primarily impacted by prize expense, that's the biggest component. About 62% of our total for the year. The breakdown, if you look in that second column, that percentage represents the payout compared to the sales number. The payout is 68.5% for instant tickets compared to the instant ticket revenue of \$553 million. This is something new for the Committee, if you look at the fourth column, we have a budget of 69.5% so we are better than budget by a full percent on our instant ticket expense. I'll remind the Committee that is partially due to our unclaimed prizes in the instant ticket portfolio being higher than anticipated. Right now our budget is running right where we expect it to be, it's approximately 69.5% and we expect it come in roughly there, absent these unclaimed prizes. Additionally, in that percent column, the 9-month budget variance by game, you can see the large discrepancy in some of the multi-state games, the Mega Millions, the Powerball and the Lucky for Life, the prize expense is greatly different than what we've anticipated because the sales are drastically different. This is not an error in the budgeting, this is an end result in missing our sales results. Moving on to our commissions, gaming system, marketing expense, and production expenses, those all come right in about where we expect them to be at 5.6%, just about 1.1% for gaming systems, 1% for marketing and advertising and our production expenses at about one half a percent. All of these are coming in just about where we expect to be, we are at \$288.1 million for gross profit year-to-date, through the month of March. Turning to page two, we'll go over the operating expenses. Our total operating expenses were \$18.4 million, we are about \$1.8 million behind budget and about a half million ahead of last year at this time. The biggest difference there is on the salary line, we have budgeted positions that are still vacant at this time so we are not spending the money we had budgeted. If you look at the 9-month budget variance column, most of those have negative variances, that's a very good sign. All of our expenses are coming in and we have one that's slightly ahead, the office cost, not a major component but about \$154,000 ahead of budget at this time but all of our other expenses are below budget so that's a very good sign. Moving on to lines 73-75, these are the mandatory payments to the chronic gamblers' fund as well as to OPM for our regulatory costs to DCP, and then what we've been able to return to the General Fund. I have mentioned before, at the end of March we were \$400,000 or so ahead of budget at that time, obviously we have slipped below that after the end of the quarter but for reporting purposes we were ahead of budget by \$400,000 and we have returned \$266.6 million to the General Fund.

There are no other prepared comments, but I do have a summary of our quarterly annuity ratings report to go over unless there are questions.

(P. Maroney): This is Patti. The office costs that are above budget, are they things like the cleaning that was required?

(P. Granato): Those costs have not been recognized yet, most of those occurred after the end of March. I believe we had a very small impact in the last two weeks of March, where we had started to see some of those costs increase. However, most of those costs will be in the fourth quarter.

(P. Maroney): Do you have any idea how many people are taking advantage of the extension of the claim period for claiming prizes?

(G. Smith): This is Greg. Paul and I looked at that to determine the bringing the additional extension forward yesterday we saw that even though we've been giving extra time for the claims that would expire in March and April, and now May, the balance that would expire if we did not do the extension was slightly below our expired ticket amounts in a normal month. We are not seeing a difference, we are seeing what would be a normal claiming or lapse in claiming, even now. We felt it was a good thing to do based on waiting on the economy to open up better. For the purposes of this having any impact on the nine months, it is insignificant, if any.

(P. Maroney): Thank you.

(P. Granato): If that is all, I will move on to the Quarterly Ratings Report. There really are no changes so we will refer back to the prior minutes which pertain to the current situation as well. The Mutual of America Insurance Company still has a negative outlook but they remain with an A+ rating, and Monarch continues to be under regulatory supervision. There are no new policies with either vendor. That is our update for the Committee. Are there any questions?

b. Review of Keno Sales Analysis for the period ended March 31, 2020:

(P. Granato): If not, I will move on to the Keno Sales Analysis for March 31st. This was a very good quarter for the lottery in comparison to the prior quarter. We saw about \$2.4 million in growth in Keno sales for quarter-over-quarter, 9%, and the interesting part about this is it was equally divided between our two groups, our Keno monitor locations grew about \$1.2 million, and all other locations also grew by \$1.2 million. Obviously we have less Keno monitors out in the field so they have consumed a much greater portion of that growth; they grew 73% and the other group 27%. It's great to see that overall, across the board, we are seeing growth, not just at our monitor locations. The group that did the best were our convenience store locations, they accounted for about 99%. So all of the growth has been in the convenience locations, whether with a monitor or without a monitor. Looking at the sales going into February and March, right before the pandemic hit, we were at such an unbelievable upward trend, it truly was pointing in the right direction for a record year. I think we've seen the bottom right about at the end of March and beginning of April, and we have grown back in excess of 20% of those totals back. We are starting to see things turn around in a positive way.

(G. Smith): As you look at this spreadsheet, Keno sales are notably different quarter by quarter and one of the things that I have found looking at this compared the same quarter from a year ago, the growth in a quarter from the prior year is quite good and it also gives you a chance to see how many locations were in each group a year ago. Last year we had 665 Keno monitor

locations and this year we have almost 800. That is a nice indicator of how that group grew by almost \$4 million from a year ago.

(P. Maroney): Thank you. Any questions?

(P. Birney): None.

(M. Langella): No questions. This has been very helpful.

c. Review of Draft FY21 Budget:

(P. Granato): Let's continue on with the Draft of the Fiscal Year 2021 Budget. The best way to go through this document is to go through the detail. If you look at the two right-hand comments in blue, my comments are going to follow along with those comments. If you have questions with regard to any other line items please stop me and I will go through those as well.

The very first comment is that this proposed budget was prepared around the same time that the pandemic hit, so our estimate for 2020 was done right at the worst time. Our sales were at the lowest point, they've improved since then and that has not been reflected yet in our estimate. Other expenses have been incurred which were not anticipated and they are not in this projection as well.

One line 14 we have highlighted the Lucky for Life game, and we are still planning to move that game to a daily game at some point in fiscal 2021, sometime after the end of the calendar year, maybe as late as March 2021. That will hopefully have a positive impact as has the other similar game offered in other states called Cash for Life where they saw about 20-30% increase in sales based on moving that game to a daily draw. As you've heard from many of the other groups in the lottery, FastPlay is getting ready to launch. We anticipate that will launch in June or July and will bring in \$15 million of revenue for the next fiscal year. You will also note that we do not have anything budgeted for Lucky Links as that game is due to end on June 30, 2020. The prizes that we have budgeted are all done to statistical payouts, which is the best way for us to budget for those. Anything to the positive will be paid out less and go right to the bottom line. On lines 57-73 are the unclaimed prizes that we anticipate. There are about \$11.5 million in unclaimed prizes. We anticipate that based on historical averages and hopefully we can anticipate some of that to return as well.

Moving on to the next page, Daily Numbers Game Promotion, there is \$200,000 budgeted. These are a number of promotions that are scheduled for next year where we will be incentivizing players through the use of cash win vouchers that they can use for any other lottery product. This is geared to our Play3 and Play4 games, both night and day, over a two week period. On to the Lotto game, we have \$1.5 million to continue to augment that as needed, we have that set aside for next fiscal year as well. On line 90, we have \$60,000 set aside for Keno parties, which we have mentioned to this committee previously; we are doing a fantastic job of promoting the game and giving away prizes specifically for that game.

Moving on to page three we have Retailer Sales Commissions. On lines 96 through 114, these are our regular sales commissions at 5%, then lines 129 through 146 represent the cashes that are estimated on those prizes at 1%. No changes there; that is our standard budgeting process for those games.

On lines 215 through 229 are Selling Bonuses. When a retailer sells a winning ticket greater than \$10,000, they are entitled to 1% of that prize. That is a standard policy for the Lottery. These are our estimates for those prizes and those bonuses to go to the retailers, \$733,000.

Moving on to Gaming Systems Fees, no changes here. Our Gaming System Fees are .84% of all sales, except for Keno sales. Keno sales are on the next line, we pay 1.57% for all of our Keno sales. For the budget-to-budget comparison, the Player Loyalty Program has been suspended, so it is not in the fiscal 2021 budget. Next, in summary of our discussion on the Keno monitors, on line 252, we are looking to purchase additional Keno equipment. We have utilized the full amount that is allocated under our contract, and we have set aside additional funds for additional servers and monitors for next fiscal year.

Moving on to Marketing and Advertising, we are continuing to supplement our advertising program, we have about \$11 million set aside for various media programs. We continue to focus on digital marketing wherever we can. Total Marketing and Advertising for the year is budgeted at \$12.6 million, about \$1 million below last year's budget of \$13.6 million.

On page 8, Production Expenses, we have \$3.9 million budgeted for scratch ticket production. That estimate is a bit higher than fiscal year 2020 and I am looking into that with the Director of Instant Games. We do have a change in process that will affect the financials slightly. We are moving from a prepaid ticket, where we purchase and hold tickets in inventory, to paying for tickets on a consignment basis. We will now pay for tickets as they are sold. We will no longer have inventory of tickets at some point in the future for our primary vendor, Scientific Games. The other two scratch ticket providers, IGT and Pollard, will continue with the current structure. So there will be changes to the accounting structure; that is where the \$3.9 million comes from. Next is the dispensers on line 385, we continue to lower that cost with a worker who has been cleaning and refurbishing many of our dispensers and we have seen a significant savings in this area. Our plan is to continue to do that in fiscal 2021 as well. Those costs will be absorbed by the additional costs needed for ball sets. During our time at Alumni Road and through our disaster recovery experiences, we identified that we need to purchase a significant amount of additional ball sets. This is a requirement from DCP, we need to have a number of ball sets available at the backup site. I believe the plan would be to purchase new ball sets and to move the old ball sets to the backup facility. That cost is significant for next year at \$103,000.

Moving on to page 9, Salaries and Benefits. We have \$11.1 million in the budget for fiscal 2021 which includes a 3.5% general wage increase for union and management staff. Fringe benefits of \$11.4 million, as of now is the same number as the prior fiscal year until we get the updated comptroller's memo indicating the new fringe benefit rates. We have a small amount budgeted for incentive compensation; this is specific to the sales field staff, small promotions are done throughout the year, often gift cards if they reach certain sales targets. Other Operating Expenses on page 10, you will see a fairly significant increase in the property tax on the building, a 30% increase. We were notified by the landlord, it was included in our assessment, a combination of the assessed value and the building. One thing for the Committee to consider is that if we purchase the building we would be tax-exempt and would not have to pay the property tax, versus if we continue to lease.

(P. Birney): This is Patrick Birney. What is the annual real estate tax bill?

(P. Granato): \$290,000. Moving on to page 11, Software Licenses and Maintenance. We have additional finance software package tools and website support expense there. It is higher than

our estimate for fiscal 2020 but in line with where we were in 2019 and what we had budgeted for fiscal 2020. We anticipate the use of a consultant for the network security testing. Moving to travel costs, these are the vehicles that we rent through DAS fleet services. We have a significant amount of cars that are nearing their end of life, as determined by DAS. We will then need to return them and get newer cars at a higher premium. The gasoline and out of state travel are still under evaluation, we are not sure how long the decrease in the gas prices will last so we will fine tune that again when it's time to approve the budget. All of that, the travel, is subject to what is happening in the current environment with many delays or postponements of conferences.

(G. Smith): This is Greg. One comment about that for the Committee, we know that most of the conferences that were scheduled through 2020 have been cancelled but we also don't know if and when they will be rescheduled. While we generally expect the costs will go down, we don't know that for sure in the idea that something we had scheduled in September or October may happen in the last half of next fiscal year. We are monitoring that and will bring forward a more refined number when we can.

(P. Granato): On to page 12, Office Supplies. After the recent move over to Alumni Road, we found that we need to improve some of the work stations over there, especially for the packing of tickets and additional safety supplies. We have put money in the 2021 budget to appropriately address those concerns. Training will mirror Greg's comments on travel; as we know more of what is available, we can take advantage of online training opportunities and situations here where people may not be traveling but still incurring training costs.

On to page 13, where we have additional costs for fixed assets and capital improvements, there will be an additional cost for depreciation. We are still discussing what the plan is for next year for capital improvements. We will be ready to have that conversation with the Committee at our next meeting.

That is all I have for comments. When all is said and done we expect to return \$350 million to the General Fund and that is hopefully higher than where we will end up this fiscal year. Things are starting to improve and depending how quickly they improve to get us back to normal, hopefully we can receive the benefit of increasing General Fund Transfers as well.

Are there any additional questions?

(P. Maroney): I had asked some general questions of Paul earlier in the week and Paul had got back to me but I was wondering about the postage? Had you looking into that? Also, a list of vacancies?

(P. Granato): Yes, Patti, thank you. I could not find a rationale for the postage expense on what was submitted. I will be going back to all the department heads and meeting with them, especially where we have a significant variance. More than likely we will have a reduction in the postage expense. As far as the position vacancies, as I mentioned in my email back to you, Greg and I are working on the open positions and we're not really at a point where we can fully discuss that. I think at this point we have identified the open positions that we have.

(G. Smith): This is Greg. Yes we have had a number of transfers or promotions from within one department to another over the last 12 months. In the fiscal 2020 budget and in prior budgets there were positions which were open and unfilled and were not clear when or if that those positions were going to be filled. We've had a variety of changes of people from one department to another or promotions from one position to another so it's caused a busyness in the count of

employees and how many do we actually need in a specific department, etc. and where were the prior open positions relative to those departments. We have gone through and identified the positions that we have filled, the positions that we want to maintain as open as we are interviewing for them now or anticipate the use of them, and we also have a couple positions that we have let go of and are not carrying forward in fiscal 2021. With Paul's staff doing that and getting ready for this meeting and closing the books, I was not satisfied with the view of that and being able to accurately say what was our open positions, what was our new one and what is our descriptions for the Committee members. We will have that very shortly but the picture we wanted to present was changing quite a bit based on the promotions and transfers that we've done.

(P. Maroney): Thank you.

(M. Langella): Manny Langella here, I had a quick question about the unclaimed prizes. Given the recent decision we made as a Board as far as extending the period terms, does there need to be some consideration to that, even small, that we need to add?

(G. Smith): This is Greg. We expect some impact; albeit very small in fiscal 2020 through the end of June. I expect the difference based on the extensions to be a five figure difference, certainly not a six or seven figure difference. I expect that because we will begin to start rescinding those extensions, my guess is that will start this summer, there is probably, if any, a small or very insignificant impact on the 2021 budget.

(M. Langella): Thank you. That was my understanding as well. And you've already factored that in, so I appreciate that.

(G. Smith): Patti, this is Greg, for all the Committee members' awareness, as we take any questions or comments that you give us earlier or now as far as bringing an updated version of the budget to you, the sales projections that we did were in the month of March, some before COVID-19 and some of them after. This week we will be very close to full recovery of revenue compared to normal. We knew we needed to bring forward numbers and will be reviewing those again and updating as we feel appropriate for fiscal 2021. I know Paul would look to bring forward projections for revenue for fiscal 2020, that will be interesting to see, but it's really how will we use those projections to drive the numbers for fiscal 2021. You can expect that we will be updating some of those numbers for some of the games and that will certainly drive some of the impact for prize expense, retailer commissions and all those directly related, percent-of-revenue expense lines. We also, as mentioned, will be looking very closely at the details that will drive our vehicle expense. Also, as you may recall, in March we began a retailer incentive program and we had to suspend that; we will be factoring an expense for that program to start again in fiscal 2021 and that will put a few hundred thousand dollar expense in but we will have revenue growth to offset that. That is something that is not present in this draft, but that you will see in the next one. Also as Paul had mentioned relative to the equipment for Keno monitors and servers, we had money in fiscal 2020 to take on some of that expense because we had utilized all of the gaming system vendors allotment for us, we are seeing success in revenue growth for that and we may add additional expense in anticipation of buying more monitors and media servers so that we can continue to grow Keno revenue. There could be also additional expense on that line, we are going to be looking at that in the coming weeks and we should have any impact that will come from that in the next pass of the budget that we bring forward to you.

(P. Maroney): Thank you, that makes sense as that is one area that is growing.

(G. Smith): One last comment relating to the line item for consulting expenses in the office cost area, we maintain the same or similar budgeted amount for fiscal 2021 as we did for fiscal 2020. I am going through with some of the senior staff to specifically identify what our needs will be for different consulting expenses in fiscal 2021 and will have a detailed listing of what that will be; I expect that it might grow a little higher than what we brought forward. The number you are seeing is just a placeholder for now.

Those are more heads-up comments as we anticipate some adjustments from what you are seeing now in this first pass. There is still a little more digging that we need to do, specifically in top line sales as we are pretty comfortable, but we need to be a little cautious on that given the circumstances.

(P. Birney): This is Patrick. I completely agree. As someone who's been following along with the news, and not necessarily fact-based, some of the stimulus money that has trickled down may have created a bump, but the long-term employment figures that keep coming out provides some concern as to whether these numbers are sustainable. I join with your guarded optimism and thoughtful process in planning next year's revenue dollars.

(G. Smith): Yes, it was very satisfying to see our total sales projection number and going through our expenses for the budget and seeing that \$350 million at the bottom, that was satisfying to see but we really are not in a conversation that allows us to compare to fiscal 2019, fiscal 2020, whether it's budget or actual because the things that have changed and the confidence level – are we in control of driving sales or is something else in control of driving sales. I think it's our ability to speak to the expense lines and the revenue lines in a cautious and confident way as opposed to a comparative way, which will be very different for fiscal 2021.

(P. Maroney): Any other questions?

(M. Langella): No questions from my side, I agree.

(P. Birney): No further questions here.

(G. Smith): This is Greg. I know that we're planning on bringing another pass through to the Committee. Last year our path to approval of the budget was we had this meeting, we resolved questions, brought forward adjustments, and had another meeting right before the June Board meeting. At that time the Committee had recommended approval by the Board. I believe we are anticipating that same path forward but before we schedule the next Finance Committee Meeting we may have a draft out to you so that you can be aware of these changes, documenting the changes and see if we need a third meeting or whether we will be on target for a meeting before the June Board Meeting.

(P. Maroney): The June Board Meeting is the 11th, correct?

(G. Smith): Yes.

(P. Maroney): When would you think we'll see another pass?

(G. Smith): Our thought is to look to have a Finance Committee Meeting, if we could, the week before the June Board Meeting, so June 1-5 assuming the calendar works for everyone. We'd look to have this pass to you the week prior, so end of May. I think it's up to the availability of the Committee to have the meeting, we don't have a whole lot of things we need to learn or dig into relevant to different expense and revenue lines. It's really getting back into it and assembling these final totals and getting it back to you. That's the time line we have planned. If

we are delayed in having a Finance Committee Meeting until the week of the Board Meeting, that will still work, we were just trying to have a gap in time in case there were things that came out of the next meeting that needed to be addressed before the Board Meeting.

(P. Maroney): That sounds good, the timing sounds right. I'd like to do the week before just to give us time. If people have their calendars available, could we schedule it now?

(P. Birney): Makes great sense Patti.

(P. Maroney): Is the 31st Memorial Day?

(A. Daigle): No, Memorial Day is the 25th. May 31st is Sunday, so June 1st is next Monday.

(P. Birney): Do we want to shoot for the same time on the 5th of June, a Friday. That gives us almost a full week before the Board. How does that sound on the lottery side?

(All): That works.

(P. Maroney): That is good for me.

(P. Birney): How about for you Manny?

(M. Langella): That works for me. I'll put it on my calendar.

(P. Maroney): Ok. Let's book the 5th.

(G. Smith): I'm going to have Paul send the results to you the week prior but no later than Monday the 1st. We will stay in touch with you and may provide some explanations in advance if we see some particularly interesting results coming out of either our revenue recovery or some of our modeling for next year. I think we have a good foundation to work with, with this budget draft that came out today.

(P. Maroney): I think so too. Is there any other business?

IV. Adjournment:

(P. Maroney): If not I'll take a motion to adjourn.

(P. Birney): So moved.

(M. Langella): Second.

(P. Maroney): All in favor?

(All): Aye.

(P. Maroney): Thank you everyone, we are adjourned at 11:07 a.m.

Respectfully submitted,

Paul Granato
Chief Financial Officer