



CT Lottery

MEETING TRANSCRIPTION

Finance Committee

Special Meeting

June 10, 2021 at 10:30 a.m.

via teleconference

Committee Members: Patti Maroney, Chair of the Finance Committee; Manny Langella; Robert Simmelkjaer, Board Chair (all via teleconference).

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

I. Welcome:

(P. Maroney): Good morning, I'd like to welcome everyone to the Special Meeting of the Finance Committee on Thursday, June 10, 2021. I'd like to call the meeting to order at 10:32 a.m. I'll turn it over to Matt to give us the instructions for the meeting.

(M. Stone): Thank you, this is Matt Stone, General Counsel for the Lottery and I just wanted to remind everyone that we are still operating under Governor Lamont's Executive Order regarding public meetings. The primary reminder I want to give is that each speaker should identify themselves by name before speaking; that is all, back to you Madam Chair.

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

(P. Maroney): Thank you, Matt. This is Patti Maroney. At this point we'll go into our agenda. The first item we'll postpone until Manny is on the line.

[Later in the meeting]

(P. Maroney): Manny could you make a motion to approve the minutes?

(M. Langella): Yes, Manny Langella, motion to approve.

(P. Maroney): I will second. Any questions? All those in favor?

(Ms. Maroney and Mr. Langella): Aye.

(R. Simmelkjaer): I will abstain.

(P. Maroney): Thank you, the minutes pass.

III. Approval of the May 19, 2021 Finance Committee Meeting Minutes:

(P. Maroney): The second item is the approval of the May 19, 2021 meeting minutes. May I have a motion to approve?

(R. Simmelkjaer): So moved.

(P. Maroney): I will second. Any questions? All in favor?

(All): Aye.

(P. Maroney): The minutes are approved.

IV. New Business:

a. Review and Possible Action: Draft Budget for Fiscal Year 2022:

(P. Maroney): Next is item is under New Business: Review and Possible Action on the Draft Budget for Fiscal Year 2022. To go over any issues on the budget, I'll turn it over to Paul.

(P. Granato): Thank you Madam Chair. This is Paul Granato, Chief Financial Officer. I'm going to be going over our next version of the fiscal 2022 budget with the Committee this morning. We've made a few more fine-tunings since we last met on May 19th and I'll go over those today with you. We are still looking at very positive results not only for fiscal 2021 but for fiscal 2022 as well. When we look at our budget to budget comparison we're looking at nearly a ten percent increase in sales from \$1.322 billion to \$1.457 billion. That is a nice increase year-over-year. Prize expense is going to be going up modestly from 62.8% in the prior budget year to 63.0% and that increase is due to the mix of games that we are going to be expecting in next year's budget. The instant ticket portfolio and the Fast Play games are a higher payout than the 63%, while the other games have a lower payout, so the mix comes out to a blended rate of 63%. Our retailer commissions are at 5.6% in the prior budget year as well as the current budget year.

[Mr. Langella joined the meeting at 10:34 a.m.]

(G. Smith): Hi Manny. We've started with Paul reviewing the draft budget, thanks for joining us.

(P. Granato): Continuing on with the retailer commissions, they were at 5.6%, that includes a 5% selling commission as well as a 1% cashing commission and retailers are also included for receiving selling bonuses; so when they sell winning tickets of \$10,000 or more, they are also incentivized and they receive a bonus for that as well. Gaming system is modestly down a slight percent. It was 1.3% in the fiscal 2021 budget to 1.10% in the fiscal 2022 budget. That is a blended rate again; we pay .84% on all of our lottery sales other than Keno. Our Keno sales, we pay 1.57%, again that blended rate comes to 1.1%. Included in the gaming system are other fees as well for additional Keno monitors and our Player Activated Terminals which are our self-serve vending machines out in the field. Moving on to marketing and advertising, it was 1% of sales in fiscal 2021 budget and that dropped to .9% in the fiscal 2022 budget. There was a slight change in the category so in marketing and advertising in the prior fiscal year, we had included the loyalty program that we had started with a vendor. The reason it was in marketing and advertising is that we felt that the interaction with the players and consumers was going to be the primary role of that. We have now switched that program to be more of a second-chance drawing, building a platform that will be reusable over time to reward our players and give them additional chances to win prizes and cash. So that has been moved into production expenses, it is now considered a production expense instead of a marketing expense. That is really all that I have for the cost of sales components. Salaries and benefits are modestly up on a comparison basis from the fiscal 2021 budget to the fiscal 2022 budget. There is a 2% increase -- which we mentioned at the first meeting -- for managers included in the fiscal 2022 budget. There are no increases at this time for union members as the union contracts are on hold at this point. Other operating expenses are projected to increase about \$1 million in fiscal 2022, the greatest portion of that increase is going to be associated with our gaming system vendor and our project management office, so we will be using a consultant to help us and assist us with the gaming system vendor and all of the attributes that go with changing to a new gaming system. Depreciation and amortization is modestly down as our equipment becomes older and there is less impact on the financial statements, so that expense is going to be modestly down as well. So

our total operating expense is up approximately \$1.7 million from a comparative basis budget year to budget year and jumping all the way down to the general fund, we are looking at transferring \$385 million in the fiscal 2022 budget compared to the \$350 million that we had anticipated in fiscal 2021. So about a \$35 million increase budget to budget year which is again, 10% up from the prior year. We can go through in detail if the Committee feels you need more information, I'm prepared to go line by line – we did do that at the first meeting and I'm ready to do it again if you'd like that level of detail or I can answer any specific questions that you may have.

(P. Maroney): Are there any questions?

(R. Simmelkjaer): My only question is: changes from the last meeting, what are they?

(P. Granato): Sure, I can walk you through that Rob, that's a great idea. So if you begin on page 3 at the detail level, the very first change is on page 7 under the gaming system, line 252. That number went down slightly again, it was a lower rate that our President & CEO negotiated with the current vendor. And then on the retailer equipment lease on line 257 we increased that just slightly, this includes additional equipment above and beyond the contract as well as additional Keno equipment above and beyond the contract. Next on page 8, there was a decline on line 273, media production and then the digital menu boards which is a major component of the marketing point of sale, includes digital menu boards as well as additional jackpot signs. Some of these are not necessarily value changes but changes to some of the comments. Moving on to page 10 there is a small change here on the scratch ticket production cost, you'll see that we included the 50th Anniversary, we're going to have additional costs for that family of games, we're going to have a suite of games coming out and we anticipate that they are going to be additional costs for the printing of those. And then as I mentioned on the second chance platform, the \$900,000 on line 255

(P. Maroney): Quick question, sorry I'm going back to the cost for the scratch ticket production for the 50th Anniversary, is that because there are additional game or because the tickets are more expensive?

(G. Smith): This is Greg. Not necessarily additional games but we are doing some special printing treatments on those tickets which is where the additional cost comes from.

(P. Granato): Once again, the second chance platform is going to be in production expenses as we'll have the ability to reuse this platform hopefully over a number of campaigns supporting our instant ticket portfolio. Moving on to page 11, there were no changes from our May 19th meeting. The next change is on page 13 under data processing costs. This number went up to \$401,000, licensing costs for multi-year software costs. And that is it, I believe in the previous version we reviewed with the Committee, we had \$385 million going to the general fund so it is really unchanged from that, very modest changes.

(G. Smith): I had asked Paul to change one line about prize claim expiration expenses, I asked him to take it up by \$20,000 due to some of the regulation requirements and another one about office cleaning supplies that we added another \$10,000 to it just to make sure we are prepared in case there is any uptick in pandemic effects on purchasing for next year. They'd be unrecognizable because they did not change the outcome for the total proceeds.

(P. Maroney): Any other questions?

(M. Langella): Manny here, no questions on my end.

(P. Maroney): Than if we are all set, I'd like to read the resolution regarding the budget.

Resolved, that after review and due consideration, the Finance Committee recommends to the CLC Board of Directors that the CLC Board of Directors adopt the Fiscal Year 2022 Budget. Should there be any significant changes resulting from easing of pandemic restrictions, or from a reoccurrence of the pandemic, the Finance Committee may instruct the CLC to reevaluate the budget for potential adjustments.

(R. Simmelkjaer): So moved, Rob Simmelkjaer.

(P. Maroney): Is there a second? I will second. All those in favor?

(All): Aye.

(P. Maroney): Motion is passed. Manny, could we go back to an earlier agenda item which is the approval of the minutes from November?

b. Quarterly Insurance Company Rating Report:

(P. Maroney): Back to the agenda, the quarterly insurance company ratings report.

(P. Granato): This is Paul Granato again, thank you Madam Chair. The quarterly insurance ratings report is in your package today, there are really no changes to inform the Committee of. Monarch Life Insurance remains as an "under review" by AM Best, they have been in receivership since the early 1990s, they continue to pay us as agreed. Just as a reminder these are insurance company annuity products that we purchase to fund our annuitized prizes for our winners. We have 156 current contracts, 47 of those contracts are past their expected life expectancy, so we continue to receive payments on those and we continue to make payments to the winners. So 47 out of 156 have lived longer than we anticipated.

(P. Maroney): Wow, good for them.

(P. Granato): Yes, that is very good news.

(G. Smith): But no impact on us, because we've already purchased the annuity.

(R. Simmelkjaer): So the downside is really on the insurance company when that happens, interesting.

(G. Smith): Yes.

(P. Granato): And as I mentioned Monarch Life is continuing to pay us as agreed, there are six contracts left with them.

c. Keno Sales Analysis for the Period ended March 31, 2021:

(P. Granato): And if there are no questions I'll move on to the next agenda item which is the Keno Sales Analysis. This is our quarterly report for the fiscal quarter ended March 31 of this fiscal year, compared to the same period in the prior year. You can see we've done a fantastic job, nice growth over time. One thing that I want to point out though if you look under Keno monitor sales at the top portion of this report and scroll down to restaurants with alcohol – that's the primary place that we're going to be looking for Keno sales – and you'll see the impact that has happened since the pandemic, sales were down, down, down and now we will see that build up again as things reopen. And I only point that one out because it is the most noticeable, we saw the most significant impact there, quite a big drop. The

locations that don't have Keno monitors are performing just as well as the ones that do have Keno monitors so we are seeing Keno sales continue to grow, again over a 14% over that same period a year ago. Again, part of that is impacted by the pandemic but that growth is nice to see for this fiscal year. Any comments or questions on the Keno monitors?

(M. Langella): No questions.

(G. Smith): Just a comment from me on this, we haven't done any real initiatives in placing Keno monitors in stores that don't have them, and mostly that's been in the convenience stores. We were on a hold during pandemic times for doing that and for doing additional installations even though there were a few. We will get back to doing that because this report makes it clear that 75% of our Keno sales come from the stores with monitors, a quarter of the locations provide three quarters of the sales. And it's been that way, as sales grow it still remains a quarter of the stores. We'll pick that effort up again and that supports one of the budget items where we say we've got almost a quarter million dollars investing in Keno monitors and media servers so that we can continue that growth of the locations.

(P. Maroney): No questions?

d. Update: Collections Process:

(P. Maroney): Ok, then we'll move on to the next item which is an update on the collections process.

(P. Granato): This discussion is really in regard to the regulations and the update to the regulations that DCP has recently come out with. Prior to that period, Greg and I, and the finance manager for collections have been working on making some modifications to our internal policies. The way our retailers work – it's really easy to become a Connecticut Lottery retailer, there is literally no financial component that the retailers have to come up with – there's not an application fee, they just put their name on an application, fill it all out and here you go and we give them the product for free, we give it to them on consignment. We say, here's the tickets, when you sell them we are going to bill you and then you're going to remit that on a weekly basis, that's our process. Some of those retailers don't pay us timely and they become delinquent and that's why we have a collections department. It's a modest amount, somewhere between ten to twenty retailers on a weekly basis fail to meet their financial obligation and then we must go back and try to collect that.

(R. Simmelkjaer): This is all for scratch tickets?

(P. Granato): This is for all lottery products.

(R. Simmelkjaer): For all lottery sales, ok, because they collect cash for draw tickets and everything, nothing comes directly to us.

(P. Granato): And that is a little different, on the draw side, someone buys a Powerball ticket, they give the clerk two dollars – scratch ticket are a little different because of the consignment aspect, I'm getting a little too far into it – just know they're getting them and they don't have to pay for them until after, that's the important part. We do require some of our retailers to become bonded – they have to provide us with a surety bond, to ensure that if they do not pay us we have some sort of mechanism, an asset to go after, some insurance

policy basically that the retailer has to provide to us so that if they fail to meet their requirement we will be able to collect against that bond.

(R. Simmelkjaer): Which ones would we require, the ones who are delinquent, the ones who are doing large sales?

(P. Granato): That's a great question. It's based on our own credit evaluation of those retailers. At the credit application process, when they first apply, we evaluate them, we run a credit report and we look at their history from a credit perspective as well as their other endeavors. So if they have multiple locations, maybe they have two or three gas stations and they are adding a fourth, that may require an additional surety bond. They could have missed a payment six months ago, that would be a black mark against them and that would be a reason for them to have the bond as well. So what we have planned to do is make these financial policies a little bit tighter. We have a three strike guideline, meaning the retailers are allowed to have three chances to not pay us without any repercussions, that's what the three strikes are for and after looking at our retailer environment we decided that we wanted to close some of that gap and take swift action against retailers who do not pay us in a timely manner. So close that gap, make quick action, because the faster we can reach out to these retailers, the more likely it is that we are going to collect from them. The longer you wait, the less likely it is you're going to collect that money. We have updated our three strike policy and we are planning to present this information to DCP, we actually had a few conversation with DCP already about this, they have been supportive of our efforts in terms of closing this gap and making a swift financial decision against the retailers if needed. What we are planning to do with all applications going forward, for new retailers, they will all be required to provide a surety bond, rather than just ones that meet a certain credit criteria and that is going to be universal for any new applications that come in, provide a surety bond at the time of application, and provide that for two years. If you have a clean record for two years then you can apply to the Lottery and request a waiver and you will no longer be providing that surety bond. Now a surety bond costs the retailer a little bit of money, so there is a little bit of financial cost that is not there now that will be there in the future, and it's based on their own credit profile. If they have a poor credit profile then they are going to pay more for that insurance policy. That is one of the changes that we are going to do. All of the retailers that we currently have in place are not affected by this, unless something happens, if they miss one of their weekly sweeps. Currently, they just have an overdraft fee and they pay us the amount they owe us, now we're going to tell our retailers if you don't pay us you're going to get a surety bond now, if you don't have one already. That's the biggest change.

(P. Maroney): Would this apply if it was a retailer who was adding a location.

(P. Granato): Potentially, depending on the number of locations. So we look at retailers who have four or more as a "chain store" and I'm using quotes because they are obviously not all chains. If they have common ownership of four stores then we want them to be bonded, we want to be sure that we are protecting the Lottery as well as the State's funds and we require that entity to get bonded. So for our chain stores there really won't be any change to the application because they are already getting bonded. And as I mentioned before, retailers who come into this program, if they are clean for two years, apply to the Lottery for a waiver and then you would no longer need to provide that; again unless the situation changes and you miss a payment, then you are required to get the surety bond for a 24-month period.

(P. Maroney): So you have one store and you're adding a second, are you required or are you grandfathered in?

(P. Granato): We are going to look at that on a case-by-case basis, so there still will be a credit evaluation process, we are going to look at the individual credit reports of the applicant again and we will probably look at the sales of the location to see if it would be a riskier location, has it turned over multiple times, are there previous delinquencies at that location, there are a number of factors that we consider, it is a little subjective because we are evaluating.

(R. Simmelkjaer): This is Rob Simmelkjaer. How many applications for new retailers do we typically get in a month, what's the incoming?

(P. Granato): That's a great question. In the last fiscal year we had over 500 new applications and out of those 500 new applications approximately 50% get bonded based on their credit profile, so we're only talking about 250 who would be impacted, because the other 250 were already going to get bonded, the population is pretty small on the impact. But I think having it as universal and eliminating that subjectiveness will make it a little easier for my department to handle as well as protect the Lottery from any future financial losses.

(R. Simmelkjaer): This is Rob Simmelkjaer again; have there been any instances where you get an application in and you tell them they have to get bonded in the current situation, and they say "no thanks", what's the frequency of people declining becoming a retailer because of the bonding?

(P. Granato): There is a number, it depends because there could be a number of other factors. Our normal surety bond value that we require is \$15,000; that's two times the average weekly amount of what we would sweep, so that's where that number comes from. And that's because there is typically a two-week lag from when we find out about the delinquency and the time we actually collect it. I know that sounds like a long time, it actually is, but that notification from Bank of America, they have to check their correspondent bank. So if you're the retailer and you deposit at Webster Bank, Bank of America has to go to Webster Bank, then notify us so there is a pretty long lag time there.

(R. Simmelkjaer): Is this fairly standard practice to ask for bonds across the board in other states?

(G. Smith): It becomes state-by-state; I've seen some where it's all and I've seen some only done when you miss a payment. The challenge becomes if you wait until you miss a payment then you're losing the retailer and the money, it's the stronger outcome.

(R. Simmelkjaer): Yes, I get that, I could see how this will have a dampening effect on our acquisition of new retailers. It's a risk benefit analysis, of is the benefit you're getting from decreasing your risk and your delinquencies greater than whatever downward pressure you may put on your retailers and the sales that come from them.

(P. Maroney): So how many tickets on average would a retailer have to sell to pay for the bond, the \$700 dollars?

(G. Smith): So they get a 5% commission, so 700 x 20, so \$14,000 worth of tickets. That amount of annual sales is tiny, our low performing sales retailers are at about \$50,000 per year.

(P. Maroney): I was thinking more of a new store, who's building it's business, what do they have to sell to get that bond money back. If they have the retail business already, \$700 may not feel like such a big hit but if they're opening a new location, does this make sense?

(P. Granato): This is Paul Granato again, I'd like to mention that \$15,000 is our typical amount but we could take that amount down even lower to \$7,500. As you mentioned, some of the stores who are just starting up, this is one of the ways to get new Keno retailers, we lowered that down based on your sales not being at \$15,000 when you first start out, we will look at it and monitor it and adjust it as we go forward, so it gives them the chance to grow and it gives us the same level of protection at the same time.

(G. Smith): And if their store performs well, that cost goes away after two years.

(P. Granato): Again, we wanted to bring these financial policies to the Committee for review because these are changes that we are proposing. Our next plan is to bring this to DCP for their approval and then I'll work with Greg and our marketing group to get this message out to the retailers if there are no questions from this Committee or from DCP.

(R. Simmelkjaer): One last question that I wanted to ask, how many retailers do we typically lose in a year?

(G. Smith): The churn? Think of what Paul said about 500 applications – we constantly have about 2,900 retailers, so these are not really new buildings, they are new operators. So the churn is about one-sixth, or fifteen percent.

(R. Simmelkjaer): Got it; so it will be worth keeping an eye on, does churn go up because of this policy, does new approved retailers go down because of this policy.

V. Adjournment:

(P. Maroney): Any other questions or discussion? If not I'll take a motion to adjourn.

(R. Simmelkjaer): So moved.

(M. Langella): Second, Manny Langella.

(P. Maroney): Thank you, I'll second. All in favor?

(All): Aye.

(P. Maroney): Thank you everyone, we are adjourned at 11:15 a.m.

Respectfully submitted,

Paul Granato
Chief Financial Officer