Pat McHugh

President,
North America Lottery Systems,
Scientific Games Corporation

PGRI Introduction: Industry changes are being driven by the consumer. Lottery operators and their commercial partners are adapting to new consumer trends towards self-serve, multi-channel buying, longer-play games, loyalty programs and all new interactive products. But operators and their commercial partners can also play a role in shaping the evolution of consumer behavior. "Technology changes everything" but only insofar as it is applied to our industry and converted into benefits that truly add value to the consumer experience. As Pat McHugh explains, the process of deciding what to do and when to do it is part science and part art.

Scientific Games is in the business of innovating ahead of consumer trends and positioning its customers to meet the needs of changing markets. In the end, combing the science and art of visionary strategic planning depends on execution of those plans. With over 20 years of lottery experience directing large-scale projects and operations for leading gaming and government service providers, Mr. McHugh leads Scientific Games' Lottery Systems business unit serving their customers in North America and the Caribbean. His responsibilities include sales, business development, game design, marketing, project implementations and operational services.

Paul Jason, Public Gaming: *Congratulations on your promotion to president of North America Lottery Systems. You're assuming this pivotal role in a period of rapid change and innovation.*

Pat McHugh: Thank you. It's really formalizing a role that's evolved over time. I see my position within our Lottery Systems business as not just the technology operator, but as a business partner who helps our customers maximize proceeds to good causes. The diversity of our products and services makes Scientific Games very unique. I'm fortunate to be in a position to leverage creative solutions from all of our business units to help our systems' customers grow their business. The results have been very positive – the sales growth of our systems customers has generally outpaced the industry. It's an exciting time in the lottery industry with so many products converging, and that's certainly true within Scientific Games.

Is lottery a consumer product that is purchased or is it a game that is played? It would seem that Poker and Zynga® social games function more like actual games. Lotto is about purchasing the "hope and dream" and as such seems to function more like a consumer product than an actual game. Instants might be somewhere in between, but more like a consumer product than an actual game. Insofar as the goal is to deliver the optimal consumer experience, wouldn't traditional lottery products perform better if we could integrate an element of play, or an element of social experience, into the fabric of the game? And isn't Scientific Games' Zynga partnership an important move in this direction?

P. McHugh: Your reference to instants being "somewhere in between" is very appropriate. Think about the popularity of extended play instants. It can take 10 minutes to play a bingo or crossword

game. Yet, there is a large group of players who will scratch every bit of the scratch-off coating before turning in a game ticket for the winnings or tossing the non-winning ticket – even though they could have cashed the ticket immediately and never even had to "play" the game. Extending the game element to a new generation of digitally savvy consumers is what our Zynga partnership is about. Converting Zynga players who play for fun, and may or may not purchase virtual goods, will be one of the keys to the success of this partnership. We are working with lotteries to build a robust lottery game play based on the play inherent in the Zynga brands like Farmville™, Zynga Poker™ and Words With Friends™. Leveraging the social experience and virtual goods and combining that with a "hope and dream" should solidly position the Zynga brands as a key lottery category in the middle ground that you mentioned. This can be applied to instant or draw games whether purchased at retail or on the internet. In this way, it becomes a game and a consumer product worth dreaming about.

What accounts for the incredible longevity of lotto? There is much talk about the need to refresh the traditional games to make them more appealing for the next generation of consumers. But the fact remains that sales of traditional lottery products have weathered the economic recession much better than other gaming sectors and the category appears to be bouncing back faster than others in the recovery period. What are some of the fundamental attributes of the traditional lottery products that we can expect to have enduring consumer appeal and so we should leverage them and not attempt to change them? And what are some attributes that may be more malleable and subject to change and updating as with the Zynga model?

P. McHugh: You're correct, the longevity of lottery products – and the performance through these tough economic times compared to that of other consumer products – has been outstanding. Many of our customers saw record sales in 2012. However, consumer purchasing habits have been changing dramatically with the proliferation of ecommerce in all industries. As well, they now have many more entertainment choices. Clearly, lottery needs to adapt to stay relevant to consum-

ers while maintaining the core attributes that have made the product appealing.

Leading up to the record-breaking jackpots in March and December, it seemed like everyone was playing the game – including the under-30s, non-players and even the skeptics! The excitement of chasing a big jackpot will continue to have appeal but lotteries need to find ways to bring those infrequent players back more often. Our survey responses from all U.S. lotteries last year indicated the 'Numbers' products produce consistent sales and represent approximately 37% of draw sales. And the diversity of instant games and price points has continued to grow instant sales. I believe these product categories and their fundamental attributes will maintain a prominent position in lottery product portfolios for the foreseeable future. However, all lotteries are facing the challenge to expand their player base and attract a younger demographic, particularly within the draw product category.

At Scientific Games, we believe there's considerable opportunity for growth in draw games by applying the strengths of other game categories without changing the fundamental attributes. Some examples include applying licensed properties to draw games, the expanded use of loyalty and social media programs, extended play through the internet or mobile, and hybrid games that feature an instant win and draw component to give players more value for the game. Not to mention maximizing the opportunities that new distribution channels can provide.

Let's talk about distribution. Insofar as much of the fundamental game design of the traditional products has enduring consumer appeal, it would seem that expansion and innovation of distribution would be key to increasing sales. Giving the consumer internet access is on the top of everyone's radar. But what other ways is Scientific Games innovating for the distribution aspect of the business?

P. McHugh: As lotteries have matured, it's become more challenging to expand distribution to create greater product exposure to players. This has remained a strategic focus at Scientific Games. A great success story is our work with the Pennsylvania Lottery in recruiting the Wawa convenience store chain back to the lottery industry. Wawa just reached the $126 million

mark in Pennsylvania Lottery game sales – all through our PlayCentral™ full-service vending terminals that were integrated into Wawa's in-store and back-office systems and processes. Our PlayCentral is one of the tools lotteries in the U.S. are turning to as a way to gain entry into new trade styles and retailers. This month, we are installing the first units in Wal-Mart super-centers in Puerto Rico. We were ahead of the curve with touchscreen technology. Now, the market is catching up with us. To accommodate non-traditional street vendors in Puerto Rico, we have recently launched our mobile retail devices that we deployed so successfully in China. Another great success is our work with the Minnesota Lottery and Linq3 to launch sales at ATMs and gas pumps through our Sciplay™ platform. This NFL season, we supported the Delaware Lottery's initiative to leverage their position as one of four states grandfathered to allow sports betting by expanding our point of sale beyond casinos and into social establishments such as restaurants and taverns. The expanded distribution brought in additional revenue and also saw year-over-year increases for the casinos' sports wagering – we believe, by attracting new players through broader exposure to the product. This month, we'll launch Keno in many of these same locations that are now new lottery retailers. Our systems are designed to easily integrate new products from our various business units, or from third-parties, to expand distribution as the marketplace evolves.

Where does Scientific Games stand on land-based retail? I just reviewed an RFP from a major North American lottery that states: "BCLC is investigating the potential to fundamentally transform its lottery business and is considering all aspects of the business such as players, retailers and our central gaming system. BCLC's lottery division is positioning the retail environment as the main distribution channel and driver of sustainable growth for the next 15 to 20+ years." The irony of this focus

on land-based retail for the next 20 years is that BCLC has the most advanced and developed internet gaming division in the western hemisphere. They told me that while iGaming will have a faster growth rate; it will never really impinge on the key-driver role that land-based retail has always played. (The internet as a communications and customer relationship management (CRM) hub and customer acquisition tool will be vital. It's just that the internet will not be the game-changing channel for distributing the traditional games as they may have projected a couple years ago).

P. McHugh: Scientific Games remains incredibly bullish on the land-based retail channel. We fully expect the retail channel to always serve as our industry's primary sales outlet. With that said, the most successful lotteries in the world – indeed the most successful businesses in the world – watch what their customers are doing, help shape behaviors and ultimately adapt to the consumer's choice. Today, consumers are choosing the internet in addition to traditional retail stores to make their purchases. We also see the internet, along with other advanced sales channels, as a critical component to engaging in a different way with existing players, reaching new players and driving incremental business growth. A digital channel at its core is a fantastic promotional tool and a great way to extend brand awareness for the lottery. Our industry will stagnate if we don't pursue these new channels, albeit in a way that remains complementary to our industry's retail-based roots. The rapid adoption of our rewards platform, Properties Plus®, with over 760,000 members as of January 1 – all who purchased tickets at retail – demonstrates the power of this combination.

When considering the internet as a sales channel, we think it's important to continue to make the distinction between iLottery and iGaming. Today, it is best to look to Europe for examples of lotteries that are truly leveraging the iLottery segment. In these cases we see 15-20% (internet sales as a percent of total sales) as the benchmark of a successful program. In these instances, internet sales represent incremental growth. A lottery benchmarking study from Media & Entertainment Consulting Network (MECN) in late 2012 indicated that traditional retail sales growth in these

jurisdictions is outpacing the industry as a whole. We believe this is because an effective internet program will attract new players who will also buy at retail.

For some of our U.S. customers, the internet has provided new ways to drive retail lottery sales through promotions and 2nd Chance games. But for all lotteries, an internet platform can offer CRM tools that provide rich opportunities for lotteries to communicate with their players one-on-one and manage the player relationship more directly and responsively.

Will Scientific Games continue to take a data driven approach to driving lottery performance? A recent article in The Harvard Business Review talks about the limitations of data and research to drive strategic planning and decisions. "Leaders rarely succeed in marrying empirical rigor and creative thinking … For all its emphasis on data and number crunching, conventional strategic planning is not actually scientific. It lacks the genuine inquiry that's at the heart of the scientific method." How is the application of analytics bridging that gap? How does Scientific Games bridge that gap?

P. McHugh: We believe it's vital to maintain a creative culture that analyzes data in terms of consumer behavior to shape our strategic decisions. As far as pure analytics go, there is an abundance of data available. The key to making analytics work for our organization is in knowing which part is science and which part is art. We have developed many proprietary systems to synthesize disparate data sets (i.e. game sales, retail location, prize redemption, etc.) to provide comprehensive and accurate views of the marketplace. We work with our customers to build real empirical evidence into strategic planning. And, we continuously conduct consumer and retailer research. But that alone is only the science component.

The art part is in the insight – the people who can look at the analytics and tease out results to fuel product and service development. It takes experts to analyze the data and turn it into information that can be applied to a business initiative. Finally, it takes leadership that values creativity and is committed to taking calculated risks to further the business. Lorne Weil, our CEO, continually challenges our organization to be creative leaders in the industry.

I believe the diversity of our product and service offerings is unmatched in the industry and is a reflection of that leadership. The results prove it. Scientific Games' customers generally outpace the rest of the industry in sales performance.

What about managing channel conflict? How can lotteries convince their channel partners (especially small land-based retailers) to embrace the need to implement the multi-channel approach so vital to the future of our industry?

P. McHugh: We need to prove it by engaging directly with key retailers and their associations to implement solutions that provide tangible value to them – either through addressing operational challenges with selling our products, or increasing profit. This has been a strategic focus at Scientific Games. However, it must be executed without losing focus on the consumer's needs, or we all lose. Lottery games are consumer products. And lottery brands are consumer brands. And like all consumer products and brands, they must adapt to the changing needs and lifestyles of the consumer from generation to generation. Today's consumers apply a multi-channel purchasing approach to many products in their lives and lottery games should be no different. Consumers today want to have a relationship with the brands that are important in their life. The opportunity to play games on a mobile device does not mean sales will decline at the neighborhood store that's been part of a consumer's life for years.

In fact, adding additional distribution channels to traditional brick and mortar lottery retail distribution can actually increase brick and mortar sales. The 2012 MECN study I mentioned found internet sales in the U.K. represent nearly 16% of total lottery sales. While the National Lottery has successfully created an important sales channel with the internet, it has done so in conjunction with the continued success of its traditional retail sales channel. The latter grew more than 7% in 2011 alone. We believe additional channels support retail growth and can serve as a promotional tool to drive players back to retail. Our research indicates that a significant percentage of frequent players, infrequent players, and non-players would purchase more often and spend more if the current games were offered on the inter-

net. And there was significant appeal to loyalty programs that included coupons for local retailers.

We have been implementing internet-based players clubs, 2nd Chance games, loyalty and rewards programs for more than a decade. And these programs have proven to increase sales. Now more than ever with eCoupons and promotions, lotteries have the opportunity to work with their retailers to heighten brand awareness, reach new customers, drive traffic to brick and mortar locations, and enhance the player's overall experience. We see the internet as fully complementary to retail. And this could also be said for the new play at the pump and ATM channels. We believe that the technology behind multi-channel play and the CRM tools other channels offer, deepens the customer relationship and will take our industry into a new era of growth.

As the number and variety of ways for the consumer to interact with lottery increases, doesn't this create a challenge on at least two fronts? First, how do you keep it simple and easy for the consumer to understand the games, how to purchase them, how to migrate from one type of POS to another – internet, in-lane self-serve, ITVMs, land-based stores, kiosks in casinos or other age-controlled venues, buy at pump, etc. Can multiple channels be integrated to form a simple consumer-friendly user interface? Thirdly, how do you leverage the different media, POS and venues to cross-sell, to gather consumer information, to inform game design innovation, to create better CRM tools, etc.?

P. McHugh: I agree. It's very easy to over-engineer solutions if you focus primarily on the technology. We really focus on the player experience as the 'user interface' because, as you said, there can be many touch points as products converge. First, we decide how we want to shape the player experience, and then we design the technology to enable that experience. A primary goal of new channels is to create opportunities to connect with new or infrequent players. So, the experience must always be simple to understand and easy to navigate. The user-flow must take a player quickly from initial engagement, whether that is at retail, via the internet, or mobile, through to game purchase, and other cross-promotional activities, in a quick and efficient manner. This is a common objective

across the ecommerce world today and proven techniques can easily be applied to the lottery space.

The most important consideration is to avoid doing things that create artificial barriers to play. Player drop-off comes very quickly when they are tasked with irrelevant extra steps, required to supply personal data they deem unnecessary, or asked to do anything that they feel over-complicates the process.

Our industry has invested tremendously in the retail POS experience to make the game purchase process as simple as possible for the consumer. This is long-proven to be a core success factor. The same translates to new channels and the associated interfaces.

The whole opportunity is around player choice, being able to connect with players at different times using different channels – but where possible using a single player account and familiar gaming content and brands. We believe that channels such as traditional retail and the internet, across fixed and mobile, are not mutually exclusive. They will co-exist. It's not a simple case of migrating from one POS to another. It's a case of extending the player experience across multiple channels.

Just as there are advantages to giving players seamless access through a single account and familiar content on different channels, the benefits for CRM are obvious. Now we can use business intelligence technology to build a single view of the player. And with integrated player marketing, we can offer vouchers, free games and loyalty points to incentivize play at retail. Establishing a closer relationship with players can only serve to advance innovation in game content and play styles.

As players drive demand for a play anytime, anywhere experience, how important is the technology in being able to offer secure access and transactions, and a personalized one-to-one gaming experience? What about the integration of third party content? And finally, how does responsible gaming fit into players being able to play the games anytime, anywhere?

P. McHugh: Trust and security remain critical components of a successful lottery program as new sales channels emerge. And incorporating all the elements when designing a responsible gaming program is very important. The

World Lottery Association's framework in this area is exemplary.

For secure transaction processing, building on the same technologies that are widely used for internet banking, the security and integrity of core transactional platforms is already in the marketplace and being used by consumers. Lottery players can have trusted, secure access to their account from any device. The player's account, responsible gaming limits and player exclusion mechanisms sit at the very center of the platform. This 'single view' of the player is critical for the internet channel. Usability is greatly improved if the user interfaces are dynamically built based on individual player profiles and preferences. Our interactive team views personalization as just the first step in ensuring that the play experience can be successfully extended across devices. By using 'contextual' knowledge such as the player's location, the size of jackpots, and time of day, player-specific content is prominently placed. We are further refining the playing surface and menus to make the most desirable content the easiest to find.

Content remains king. Having a platform that is open to third-party developers is important. Just look at the mature iGaming marketplace and you'll see the incredible value of having eco-systems of content producers. We believe the real added value comes through the integration of unique, local content and we are designing programs and technologies that support content innovation. Having large volumes of identical game types tends to move gross gaming revenue between titles. New content successfully engages new players and promotes responsible revenue growth. ◆