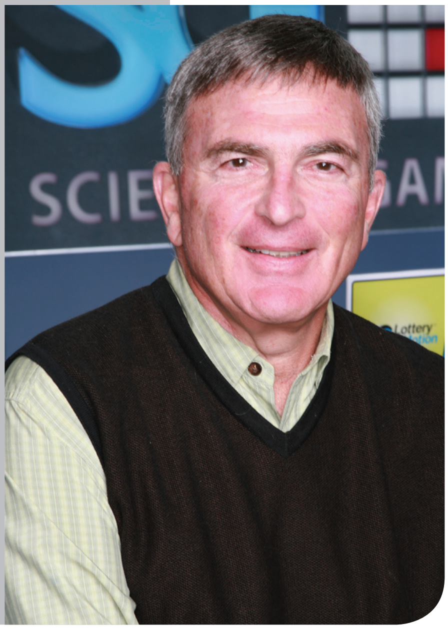

SCIENTIFIC GAMES®

Steve SAFERIN

President, Properties and Chief Creative Officer, Scientific Games

PGRI Introduction: *As all the various gaming categories become available and accessible to everyone, the consumer is driving change on the supply side of the industry. As founder of MDI Entertainment, which became a fully owned subsidiary of Scientific Games in 2003, Steve Saferin has been the creative impetus behind many innovations in the lottery industry. He shares his vision for how and why convergence will be the catalyst for ongoing Lottery innovation, growth and prosperity.*

Paul Jason, PGRI: *Twenty years ago, or even three years ago, it was commonly thought among lottery professionals that playing the lottery is different from "gambling." Lottery players do not go to casinos and vice-versa. Is that changing?*

Steve Saferin: Of course that is changing, and it has big implications for the entire games of chance industry, including Lottery. Twenty years ago, the only casinos were located in Nevada and New Jersey and on a number of Native American reservations. So the U.S. consumer had to incur the time and cost of getting on a plane to go to a casino. In a jurisdiction that had a lottery, tickets were ubiquitous. Lottery was sold, and is still sold, in retail stores everywhere—many of the very stores where the consumer is already shopping. The change over the past 20 years is based not so much on shifting consumer preferences, rather on the shifting marketplace and the availability of casino gaming to nearly all Americans. I would suggest that although people wanted to migrate across game categories, they did not because it was simply inconvenient for them to do so. All forms of gaming and gambling are now readily available and accessible to consumers no matter where they live. Well over half of the U.S. population resides within a half-hour drive from a casino. And the internet has spawned the creation of whole new categories of gaming, from entertainment games like Angry Birds™ or Candy Crush, to social casinos, fantasy sports and, in the U.S., the very beginnings of online real money gaming.

I'm not sure how useful it is to ponder the definition of gambling and whether playing the lottery is gambling. I have little doubt that casino and online gaming is more dynamic than lottery play. There are sound and motion and special effects. By the same token, no form of gaming provides the same opportunity to secure a life-changing prize than the lottery. I have no doubt that there are hardcore gamblers—a small percentage with gambling problems and the majority without—and that there are some games that appeal to this segment of the player base more than others. However, the broader marketplace enjoys games of chance as a perfectly healthy entertainment activity that happens to include the possibility of winning something. This broad segment of recreational players does not get on a plane to travel long distances and stay in hotels for the purpose of gambling. Players of lottery games fall into this gamer category. These same players may enjoy other games of chance to be played either at casinos or online. The point being, with the convergence of gaming the vast majority of recreational players are happy to find their gaming opportunities at lottery retailers, online or at brick-and-mortar casinos. This presents an opportunity for us to provide them with a uniform and consistent experience across all types of gaming.

Lottery has always thought of itself as a monopoly or just competing for the "entertainment dollar." Insofar as consumers are migrating across multiple game categories, doesn't that change this picture in an important way? What implications do these trendlines have for Lottery?

S. Saferin: The widespread availability of options that exists today is continuing to evolve in ways that represent both an opportunity and a competitive challenge for Lottery and for all operators of games of chance. On the one hand, lotteries are now in a competitive environment. They are not just competing for the gaming dollar, rather for a broader "entertainment dollar." The recreational gamer is migrating across categories, and so Lottery is competing not only with operators that offer games of chance but also with other forms of entertainment. And the variety and quality of options in the games of chance industry are increasing. So the challenge to attract and hold the attention of the customer is increasing. Customer acquisition and retention will be the biggest challenges for lotteries in the future just as they will be for all gaming operators. It's clear that the way to prosper in this type of an environment is to make all of the experiences as robust and integrated as possible. Lottery must look at the broader spectrum of gaming to discern what appeals to the consumer and try to integrate fresh and exciting new game attributes into their game designs and concepts. Although Lottery games may not be as dynamic as slot machines, we can still look at trends in player behavior that are being revealed in these other sectors and see things that we can do to enhance the lottery playing experience. If we want to attract casino players, we should look at what appeals to casino players and, within the limitations of lottery game mechanics, try to integrate some of the game attributes that are popular in casinos. Or we can make lottery play complementary to casino play—or both.

Another source of ideas—mobile and internet games that are strictly for entertainment are incredibly popular. For example, playership in social casinos is increasing at a huge rate. It seems clear that this growth stems from the entertainment value of social casinos. And these players might be potential consumers of lottery or other gaming opportunities that offered a chance to win something. If we want to attract consumers who love the experience of non-money games, let's analyze those games, get creative and think of ways that we can loop some of the attributes of those non-money games into the lottery playing experiences because they have such incredible consumer appeal.

I would think that the consumer will be attracted to a one-stop-shop gaming destination. Look at the success of Walmart and supermarkets over retail stores that specialize in a limited selection. Look at the success of Amazon, which now sells everything under the sun. Won't the consumer be attracted to the operator which makes it super easy to access the whole variety of games, whether that is online or in a retail store?

S. Saferin: In the long run, operators of games of chance that offer the largest variety of playing experiences will likely have an advantage over those that stick with a limited portfolio of games. It's the game content, the quality and appeal of the games themselves that will attract the consumer to play. And it is taking that same content and offering it to players in a variety of different formats and environments. That is what convergence is all about.

And good game content may well be the catalyst that causes players to migrate from one category to another. More to the point, it would be a mistake for lottery operators to think that good game content being offered online or at a casino would not cause lottery players to channel their spend over to the hottest new game in town. As the variety and excitement of games increase, Lottery really has to up its own game to keep its appeal, even with the proverbial "core" lottery players.

S. Saferin: I think so. I don't think there is a bright line that separates a gambler from a non-gambler. There's more of a continuum with people having varying degrees of willingness to risk a little bit of money for some entertainment and chance of reward. Look at the popularity of social casinos, where people spend money with no chance of winning anything. How much different is that from people putting quarters in a pinball machine just for the fun of it with no hope of winning a monetary reward other than a free game? There is a huge consumer group that places a high value on the entertainment experience. So would this group be averse to winning a reward for good performance in the games they enjoy playing? Conversely, there is a huge consumer group that plays in casinos and plays as much for the fun of playing than for the objective of winning money. They sit down at a slot machine with a set amount of money expecting a lengthy entertainment experience but not really with the expectation of walking away with a profit. These players are, of course, much different than the hardcore gambler who really cares little about the entertainment experience of the game and who only plays for the chance to win. For the most part, hardcore gamblers are not the target of lotteries, although there are harder-core lottery players who are more interested in winning than the experience.

Lottery can do a lot to expand its reach by creating more entertaining games that will appeal to non-money gamers and casual casino gamers. The more entertaining player experience may also appeal to the core players and go a long way toward retaining the traditional lottery players. And if we do not enhance and vary the entertainment value of the games, I would be concerned that lottery playership could diminish. We do not need to target the hardcore gamblers. We do need to expand our view of Lottery to include those consumers in the broad midsection of the continuum that value both entertainment and the chance to win a reward or money.

How can the entertainment attributes of social casinos and other new forms of entertainment gaming be applied to Lottery? Are there fundamental limitations to our ability to jazz up the lottery games, to apply new *game concepts to lottery, given some of the immutable attributes and limitations of lottery gaming?*

S. Saferin: That's the question. We are certainly working hard on developing fresh, new and exciting game content for lottery players. As you point out, there are limitations to what can be done with the lottery products. Innovation is happening, and it needs to happen. The payout percentage in casino games is so much higher than it is in Lottery. That does not mean that Lottery can't compete with casino gaming. There are lots of reasons to play a game. We just need to think more expansively about the value proposition. We won't ever be able to compete on prize payout percentage, so how can we compete? We are working on ways to integrate social gaming into Lottery. The challenge with that is that the "freemium" model is what the consumer has come to expect: free play to attract players and then charges for premium content. Lotteries are presently not quite geared for that kind of revenue stream. In fact, this is an example of what Lottery needs to be more receptive to doing. Without a non-gaming revenue stream, it is not clear what the path to social gaming for lotteries could be. Casino operators are moving aggressively in that direction because it is a good business on its own and because it generates players for their more traditional business. So it is a good time for Lottery to imagine new approaches and try to think differently.

It does not cost much to give away free online product. So what would be the obstacle? Is there regulatory or perhaps underlying political resistance?

S. Saferin: Lotteries already give away free product on occasion. They do have couponing for free games or BOGOs (buy one, get one free). However, it's much more limited than the freemium model practiced by the big online operators today.

It is a mistake to think that it does not cost much to give away free mobile and internet product and game content. The purpose of giving away free product is to acquire new customers who are then more likely to pay for premium product. So you're basically talking about the cost of player acquisition, which can be high when you consider the advertising required to gain awareness for your online offer. It is the highest line item cost for social casinos, fantasy and other forms of non-gambling internet and mobile gaming. If the cost of player acquisition is amortized over the entire player base, then it might not seem too high. When amortized over the pool of players who actually migrate to the pay-to-play options, it is much higher. The solution for lotteries is likely to be something different than the freemium model. While lotteries may never function like a social casino, they should try to think bigger and more openly about how to take full advantage of the assets they do have and try to be flexible to explore options and models that have never before been considered.

From a public policy point of view, why couldn't Lottery be the one to operate social casinos?

S. Saferin: That's entirely possible. I think that the next great frontier in lottery offerings may be sports betting. The new commissioner of the National Basketball Association (NBA) has said several times that he sees nothing wrong with sports betting, and in fact he thinks proper regulation of sports betting is inevitable. He believes that the leagues can profit from sports betting in a variety of different ways, including higher television ratings. Think about what that could mean to Lottery. The first public policy question would be: Who is going to operate and sell sports betting in the US? And what is a more trusted and secure sales environment than Lottery? This is a template that already exists in many jurisdictions around the world. Governments elsewhere have entrusted their lotteries with the business of offering sports betting for good reason, and hopefully they will apply this model in the U.S.

Bringing together the IP, research and development, and underlying brain-trusts of Scientific Games, WMS and Bally would seem to deliver great synergies that will result in fantastic game content.

S. Saferin: Exactly. Our CEO, Gavin Isaacs, points out that it's all about game content. Content is what attracts the consumer. Content is what retains the player. And content is what we all need to focus on. Cross-pollination of creative is already yielding dividends, and that will only increase over time. The lowest-hanging fruit is to take what has been successful house brands in slot machine gaming and license those brands for lottery instant games. It is an easy fit that has already been done for years. Even before our acquisition of WMS, MDI had a licensing deal with IGT for many of their house brands. MDI licenses many of the same third-party pop culture brands for instant games that are used in slot machines. Sharing brand licenses is one of the main synergies between Scientific Games, WMS and Bally. Applying the licenses to new game styles like social gaming is another form of content cross-pollination.

The main idea is that more resources can go toward game development because the potential payoff is much higher. Scientific Games is now involved in all game categories, which means that any successful concept can potentially now be quickly applied across the entire universe of gaming. A successful concept will have a higher ROI if it can be leveraged across multiple game categories. Higher ROI will drive the development of more and better game content, which will drive sales. This will in turn free up even more resources for R&D, which will further the positive feedback cycle.

Scientific Games is also in a better position to understand player behavior as it manifests in all game categories. The consumer experience is about much more than buying a lottery game. Having a looking glass into all forms of consumer behavior as it relates to gaming and gambling in all its forms will enhance our understanding of the lottery player. What attracts players' attention to the game in the first place? How do they feel after they buy a lottery game? How can we dig deep to understand their entire range of thoughts, feelings and motivations to increase the appeal of the entire consumer experience? Working closely with our colleagues across the combined company has opened our eyes to many insights that will inform our creative production for our lottery customers.

Insofar as the markets are converging, doesn't that mean that Lottery is competing with the casino sector? As a supplier to both sectors now, does Lottery need to be concerned that your best ideas and product and service may migrate to the highest bidder?

S. Saferin: No. It's about applying the best ideas and products in the way that will work best in the consumer marketplace. It is the consumer who is driving convergence, not Scientific Games, not casino operators and not Lottery. The convergence of the supply side and operator side of the business is simply to align with consumer demand. This alignment will create a much more rational and efficient allocation of resources to develop the brightest ideas and best products and bring them to the marketplace in the ways that best serve the consumer. I will point this out: Lottery has instant access to what is by far the most massive consumer marketplace of any gaming category. Lottery's network of retailers and advertising and promotional infrastructure is far more powerful than online gaming and land-based casino operators. Products that can work at this very large scale will be launched with Lottery. On the other hand, casinos and online operators are a more efficient channel to test and develop really innovative game concepts. Exhibit A might be social casinos. As the supply side of the business fine tunes its understanding of how to optimize the performance of an innovative new game concept, the concept can then be overlaid onto the Lottery model. Lottery does not want to be the proving ground where higher risk, lower predictability, and ongoing test and revision of the concept are the norms. Ideas can be tested on a small scale, assessing the reaction of varying psychographic profiles and demographics, and then scaled larger amidst continued testing and analyzing until we fully understand how to make sure it will work on the grand scale that is Lottery. Our lottery customers will absolutely benefit by our ability to integrate idea and product testing and development under all varieties of gaming marketplaces and conditions.

Lottery's brand image and network of retailers really can't be replicated.

S. Saferin: Casinos and online gaming will never have the quality and quantity of Lottery's consumer connection. It's not just about the number of consumer touch points, although this is a mission-critical differentiator. It also involves the quality of the brand image and the scope of Lottery's reach across all consumer groups. There is a platform there that positions Lottery to be the singularly most powerful operator of very-large-scale gaming products. And what is so different about Lottery is that there is often only one lottery per jurisdiction, with the exception of some international jurisdictions where there may actually be a few lotteries. We are able to take proven content and customize it for each lottery customer rather than launch games into a crowded, competitive field. ■