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Hoosier Lottery Integrated Services Provider (ISP): Selection Team Briefing Document

August 28, 2012

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MARSH & McLENNAN COMPANIES

Introduction and purpose for today's discussion

Timeline:

August 1	• Interested Parties (IPs) submit initial probity
August 31	• IPs submit Business Plans and Bid Net Income commitments
Sept 1-14	• Offers reviewed, clarification meetings held
Sept 17-18	• Selection Team meets to determine and document consensus rating
Sept 21	• Final recommendation & notification to Selected Offeror
Sept 26	• Lottery Commission votes on recommendation

Purpose for today's meeting:

- To reinforce the importance of confidentiality and integrity to this process
- To discuss the structure of the ISA and how this translates to evaluation principles
- Review purpose, requirements and likely components of the Business Plans, which will be the Selection Team's primary focus
- Familiarize the Selection Team with the evaluation tool

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Agenda

- **Confidentiality**
- Selection process
- Concepts overview
- Evaluation Tool(example walkthrough)

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Confidentiality | Process Integrity

- It is of utmost importance that information about the selection process, evaluation, Offerors and your participation be kept confidential and treated with discretion even among co-workers. At this point in this competitive process, Offerors do not know:
  - The identity of the Selection Team;
  - The specific criteria being used to evaluate Offers; or
  - The identity of the other Offerors.
- Throughout the process there has been careful attention to creating a level playing field and treating Offerors objectively. The evaluation process must be free of external influence, including past experiences and/or opinions you may have formed concerning any of the bidders. You should consider the BNI proposal, business plan and probity findings and apply your own unbiased judgment in coming to a consensus decision with the rest of the Selection Team on which Offer represents the best opportunity for the State of Indiana.
- If at any point you have a question about confidentiality or concern that the process has been compromised, please contact **Jeff Cramer** and **Lisa Silverman** directly:

Jeff Cramer	Lisa Silverman
312-213-5764	312-345-2763
jcramer@kroll.com	lsilverman@kroll.com

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Evaluation Process Objectives and General Guidelines

Process Objectives

We want to walk away with confidence that:

1. We have selected a "good deal" for the State

   - Belief that the State will be in a better position for outsourcing and the risks of outsourcing are less than risks of the status quo

2. We are confident that the selected business plan is rational and achievable
3. We have examined the detailed budgets and are confident that they are internally consistent
4. We can articulate the inherent risks and how we propose to manage them

General Guidelines

- Key questions to keep in mind:
  - Which Offeror provides the **strongest business case for its ability to grow** the Lottery responsibly and offers the State a **significant guarantee of revenue**?
  - Is the business plan **credible** in explaining “how” and “why” in addition to what the Offeror will do grow lottery income?
  - Will the Offeror engage in a **good working relationship** with the Lottery in upholding the integrity of the games and the brand?
  - Is there **sufficient detail** to support and defend the Bid Net Income levels?
- There will be a chance to interact with Offerors and ask questions during the Clarification Meetings on Sept 13-14
- As you read through the Offers, please note any questions you have regarding the Business Plan, management team background and experiences, etc.

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Selection Process

- **Response Discussions** – September 5 and 6
  Purpose: Preliminary assessment of business plans. Ask clarifying question of the Transaction Advisors and, if necessary, Lottery staff
- **Briefings** – September 7
  Purpose: Discussion of analysis of each Offeror's budget and financial projections, legal advisors comment on the compliance of each bid; Kroll provides a briefing on initial background investigations, and clarification meeting invitees and agendas – including any requests for revised offers – finalized
- **Clarification Meetings** – September 13 and 14
  Purpose: Meet with selected Offeror Key Personnel for a brief presentation of their business plans and to question elements of the response that need clarification
- **Consensus Determination** – September 17 and 18
  Purpose: Review Bid Net Income proposals, complete Evaluation Tool for each Offer, and rate responses based on overall best value
- **Final Recommendation** – September 21
  Purpose: Recommend an Offer to present to the Commission

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Evaluation Criteria

You will be asked to evaluate and rate each Offer for the following criteria

Probity & Financial Stability

- Probity
- Financial viability

Bid Commitment

- Bid Net Income Year 1-5

Business Plan

- Business Plan Strategy
- Credibility of Business Plan Activities & Initiatives
    - Marketing
    - Brand Management
    - Customer Engagement
    - Product Development
    - Sales Effectiveness
    - Retail Distribution
- Experience
- Financial Plan
- Resource Plan
- Compliance

Business Plan

- Credibility of the Transition Plan
- Credibility of the Ramp Up Plan
- Approach to Disentanglement of Operations
- Brand Integrity
- Diversity
- Responsible Gaming
- References
- Key Considerations

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  - **ISA concepts**
  - Deal structure
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Integrated Services Agreement (ISA) Key Concepts

- **Term of agreement:** The ISA is a 15-year contract, until June 20, 2028
- **Contract extension:** Beginning in the sixth year of the ISA, the Term may be extended by one year for each year in which the Provider Net Income is at least 110 percent of the Bid Net Income, up to a maximum of 10 years
- **Governance:**
  - Engagement of Provider to provide Services to increase sales and Net Income
  - Provider must conduct its business in a manner sensitive to the nature of a state-conducted lottery including public image, social implications, and perform with the Highest Standards
  - Commission must exercise actual control over all significant business decisions at all times
  - Commission has veto/countermand power over any and all decisions
- **Annual Business Plan:** The Provider is expected to submit a proposal of strategies, activities and their associated revenues and costs, for a rolling 5-year period
  - The Annual Business Plan set the direction and tone for the relationship between the Lottery Commission and the Provider
  - The Lottery Commission will approve (or not) the business plan based on information provided – with the understanding that the first two years will be substantially more detailed than the latter three years
  - Approved business plan "locks" the Provider into the 5-year budget in the approved plan
  - The Annual Business Plan will serve as a basis for any upward / downward adjustment requests
- **Adverse Action:** Should the Commission "countermand" a previously approved strategy or action and the Provider believes there will be a material impact on Net Income, an adjustment to Bid Net Income can be requested
- **Existing employees:** Provider is expected to retain current Lottery employees for at least one year and offer substantially similar compensation terms
- **Procurement:** The Provider will identify initial subcontractors in their Offer, and follow the Operating Standard on procurement in the future, including Commission approval for Major Procurements (defined term)
- **Termination:** The ISA may be terminated for lack of performance by the Provider or at the Commission's convenience given reimbursement of certain costs

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Overview of the transition

Provider is entitled to a management fee, reimbursement of lottery expenses and incentive compensation at various stages

Nov 1, 2012

Agreement Signed

Nov 1 – Jan 1, 2013 (approx.)

Transition Phase

- Administrative organization

- No Management Fee
- No reimbursement of costs

Jan 1 – Jun 30, 2013

Ramp Up

- Assumption of lottery operations
- Prepare to Implement Business Plan

- Management Fee
- Reimbursement of lottery expenses
- No incentive opportunity

July 1, 2013

Base Services

- Execution of business plan

- Management Fee
- Reimbursement of lottery expenses
- Incentive compensation:
  - No incentive compensation until Bid Net Income (BNI) is achieved
  - Incentive payment equal to the difference between BNI and Provider Net Income (PNI), limited to 5% of PNI
  - If BNI is not achieved, shortfall payment is the difference between BNI and PNI, capped at 5% of BNI

Note: Timing is subject to change by the Lottery in its discretion.

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Incentive structure

The selection process and incentive structure encourage Offers that propose aggressive, but achievable, Bid Net Income

Incentive Structure

- **Bid Net Income (BNI)** – Set by the Provider for each year of its Business Plan. (Offer sets first 5 years.)
- **Provider Net Income (PNI) =** Actual sales minus prizes, commissions and operating expenses
- **Upside Cap = 5% of PNI + any previous shortfall payments**
- **Downside Cap = 5% of BNI**
- **Incentive Illustrations:**
  - Case 1: ISP receives 100% of each $1 over BNI until Upside Cap is reached, then 5¢ of each incremental $1.
  - Case 2: ISP pays Lottery 100% of each $1 under BNI until Downside Cap is reached, then no more.

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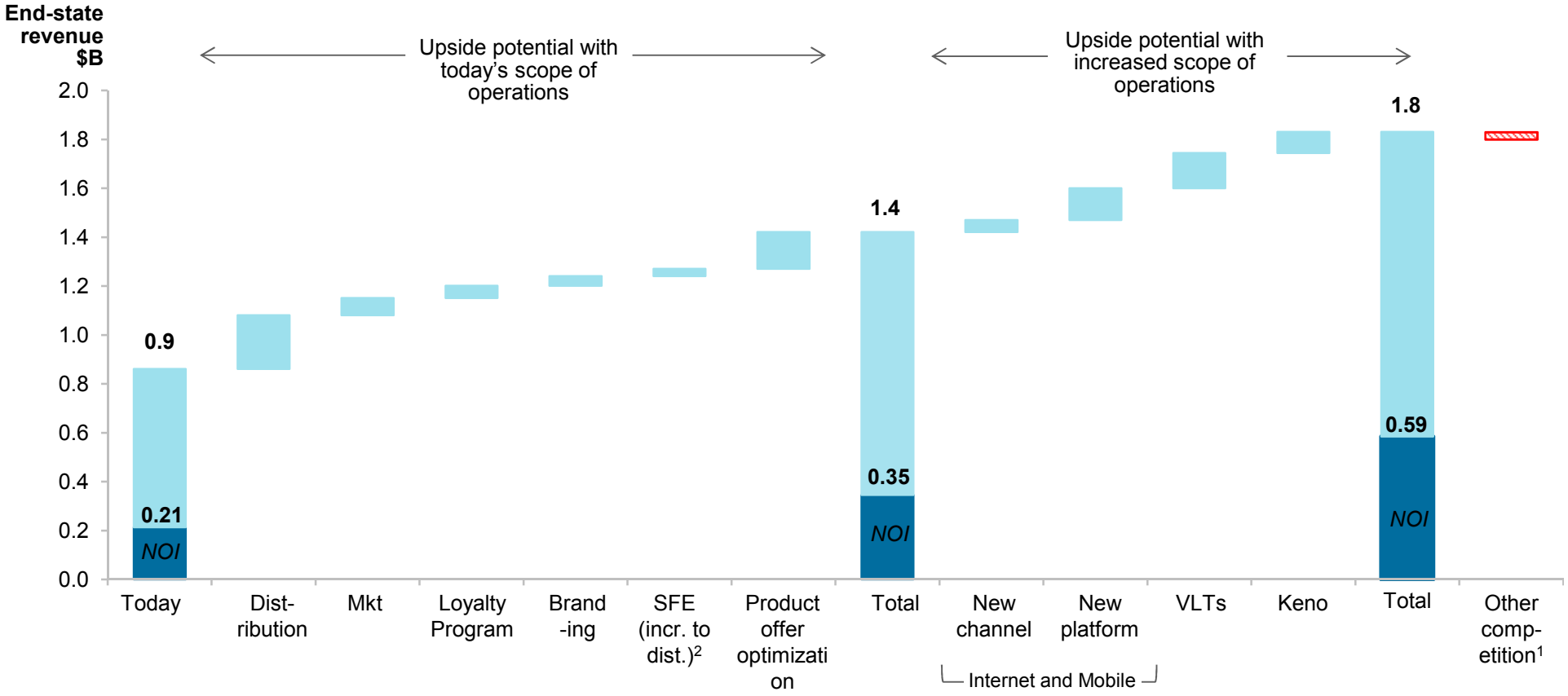
Key Lever Optimization: Potential Impact on Revenue (Sales)

Potential upside in the Hoosier Lottery (Today vs potential future 'end-state')

Not adjusted for population growth or inflation



Note: All numbers are net of cannibalization

1 Includes competition from potential Racino entry into market, as well as still TBD competitive forces. 2 There is large overlap between the network density/quality driver and the SFE driver, thus only a moderate revenue uplift is recognized as pure incremental from SFE.

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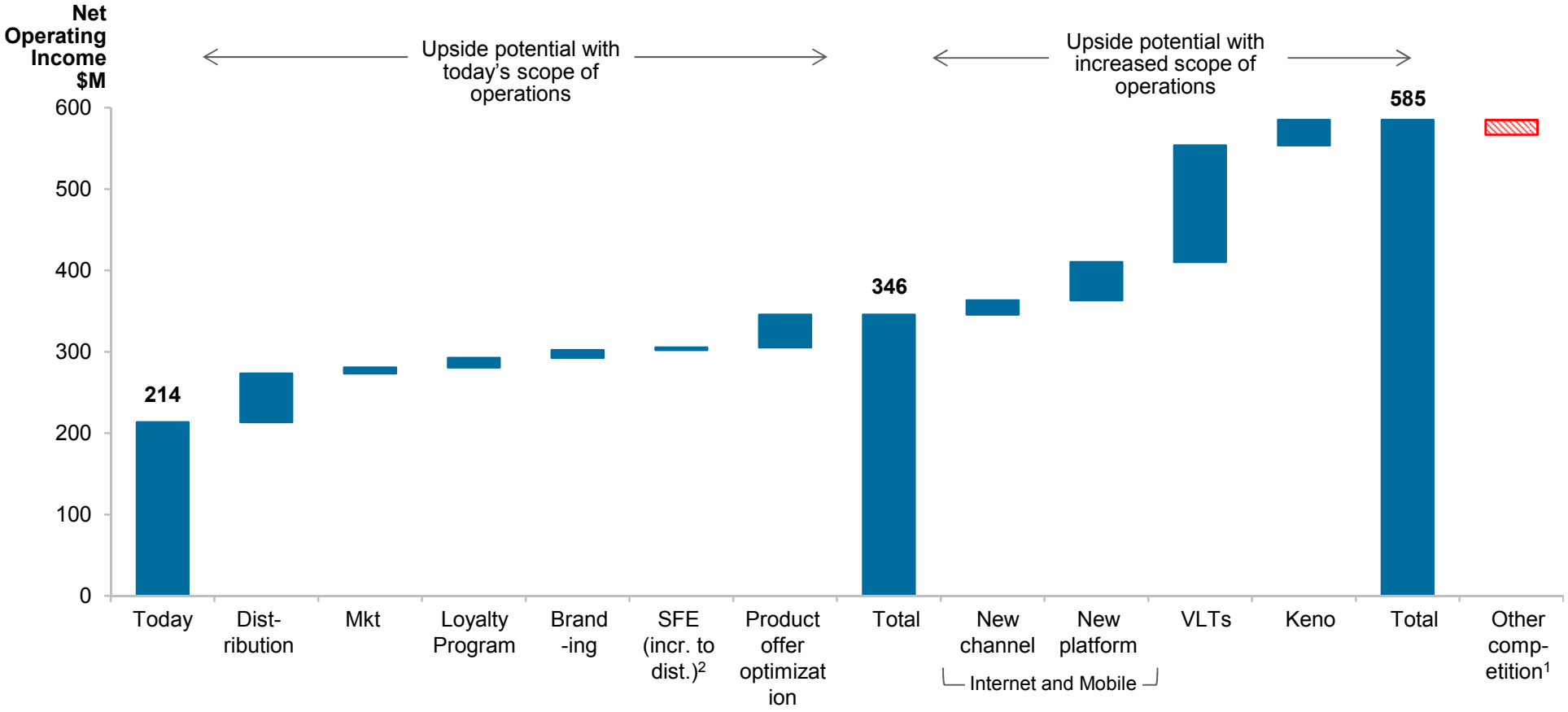
Key Lever Optimization: Potential Impact on Income

Potential NOI upside in the Hoosier Lottery (Today vs potential future 'end-state')
Not adjusted for population growth or inflation



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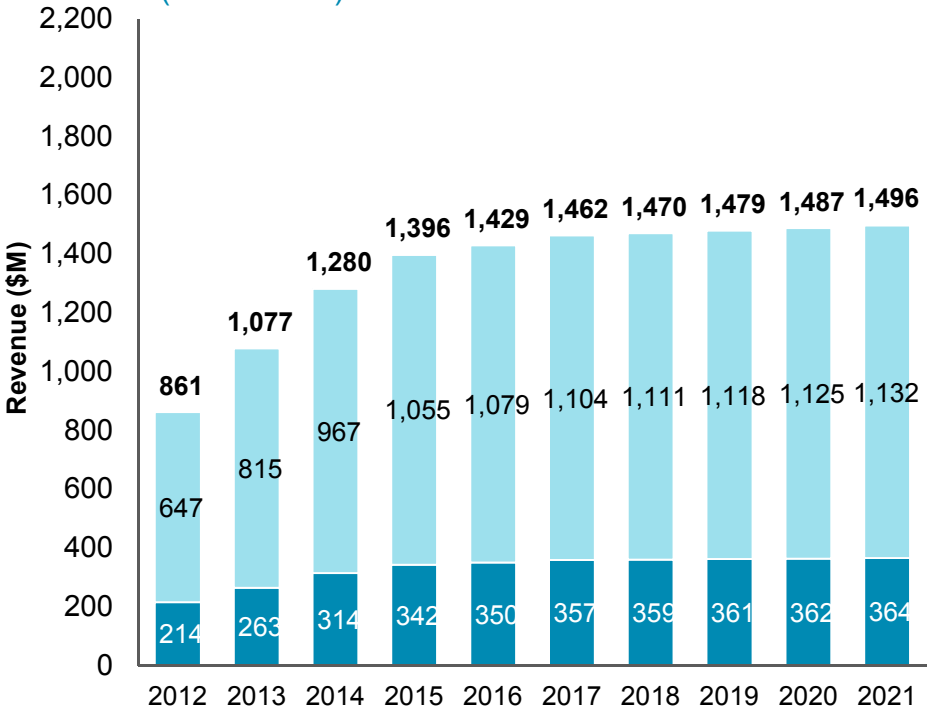
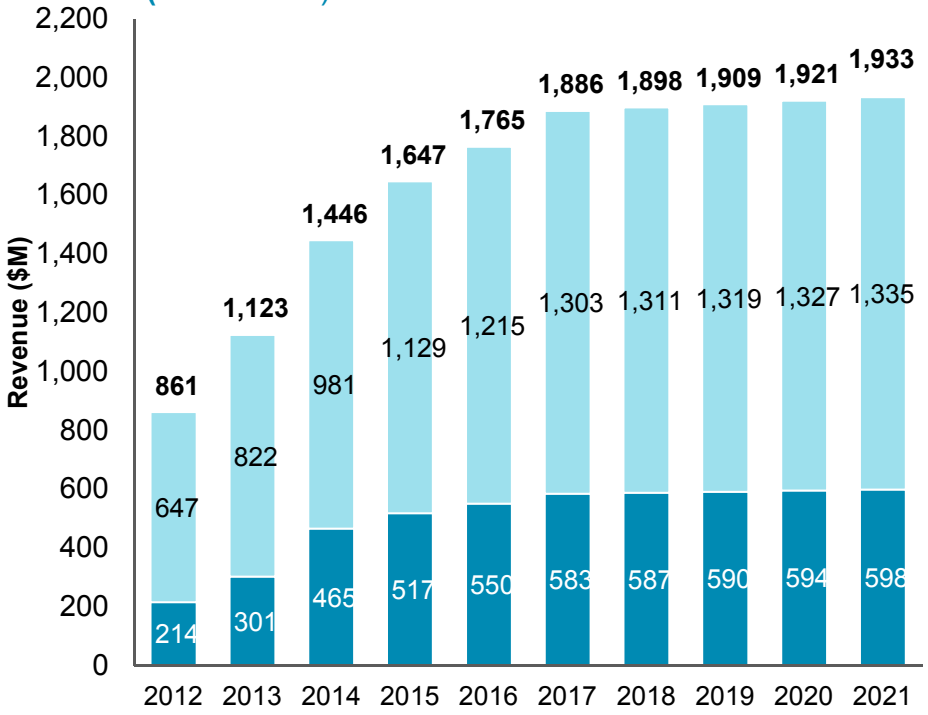
Annualized view of growth potential

Revenue and NOI forecast within the current scope of operations
(FY12-FY21)



Revenue and NOI forecast with additional scope of operations
(FY12-FY21)



- **Assume all revenue uplift will be realized in the next 3-5 years, and HL revenue will only grow at the population growth rate beyond that**
- **Cost inflation has been incorporated into the future forecast**

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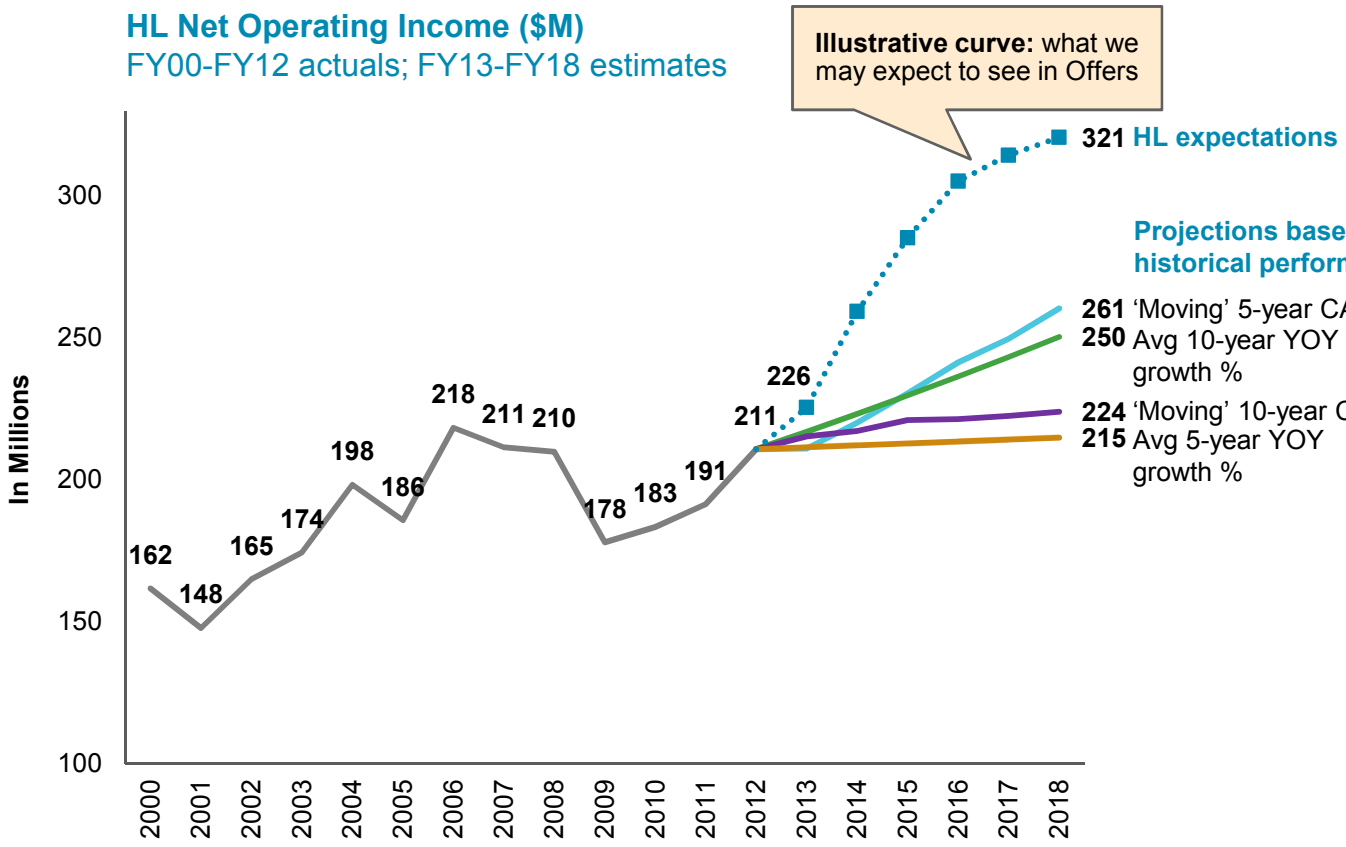
Source: Population projections taken from US Census Bureau Future Population Projections for Indiana .

Bid Net Income (BNI) Evaluation: NOI Historical Performances

The Hoosier Lottery has set a cumulative Bid Net Income 'expectation' for the bidders that highly exceeds the lottery's historical performances

HL Net Operating Income ($M)
FY00-FY12 actuals; FY13-FY18 estimates



	Cumulative BNI ($B)	% Improvement @ $1.49B	FY14-FY18 CAGR
321 HL expectations	$1.49B	0%	
Projections based on historical performance			
261 'Moving' 5-year CAGR	$1.20B	+24%	4.3%
250 Avg 10-year YOY growth %	$1.18B	+26%	2.9%
224 'Moving' 10-year CAGR	$1.11B	+34%	0.8%
215 Avg 5-year YOY growth %	$1.07B	+39%	0.3%

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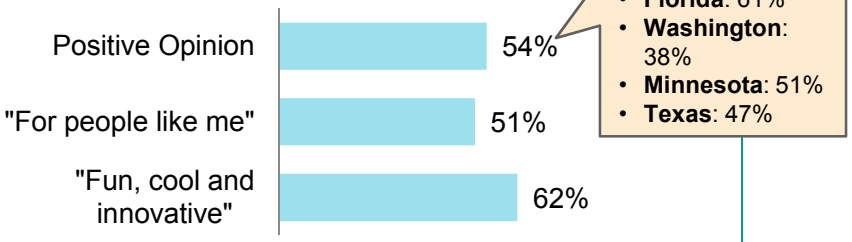
HL Quarterly Tracking – Player participation and awareness (FY12 Q3)

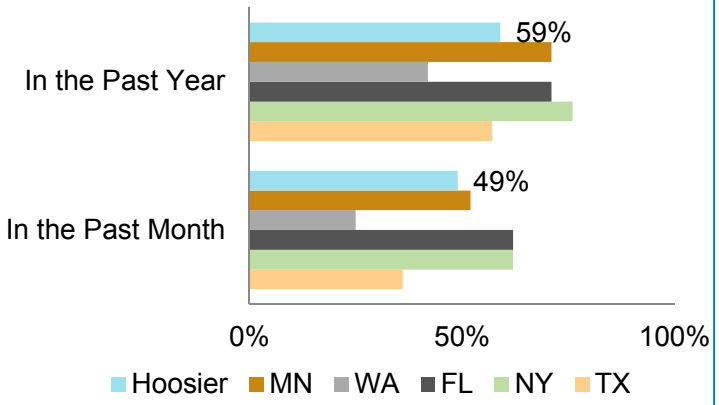
Participation and promotions awareness has mostly ranged between 50-60%; participation in on-site events have been relatively low

Public Image & Game Participation

Perception of the Lottery:

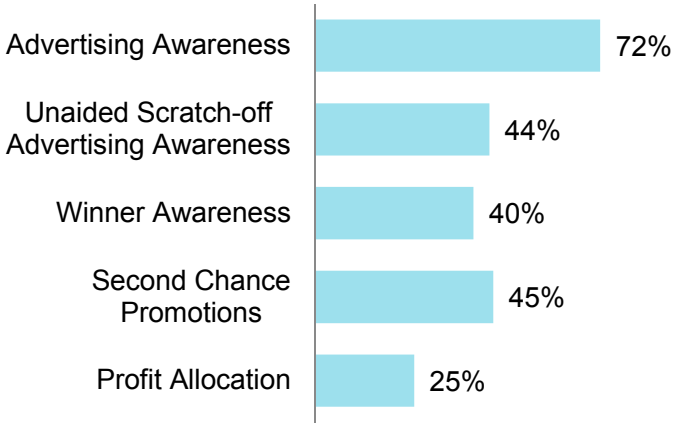


Participation in Lottery games:



Promotions – Awareness & Participation

Promotions Awareness:



Participation in On-Site Events:

Source: Marketing Ipsos dashboard (FY12 Q3)

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Business Plan Components
Marketing

= Yes
~ Somewhat
≠ No

Concept	Industry Best Practice	Does HL currently practice?	Hoosier Lottery – current plan
Marketing	▪ Targeted marketing campaigns to raise awareness, engagement, and/or customer conversion		▪ Quarterly Hoosier Lottery Tracking presentation and dashboard – surveys on public overall opinion, participation rates, and awareness
	– Improves shoppers' experience with attractive POS / in-store merchandising	=	▪ Create standardized winner awareness policies & procedures
	– Consistent marketing events and activities to reinforce engagement and awareness	=	▪ Custom Media Buys
	– High winner awareness	=	– Convert brand advertising $$ to more productive jackpot alert - print, TV
	▪ Conducts various types of consumer insight research to stay in touch with consumers and to drive engagement, including segmentation and tracking studies, focus groups, mail / phone / internet surveys, etc.	=	– Refine jackpot alert strategies & creative to maximize ROI
	▪ Differentiates each product with customized media plans	=	▪ HoosierLottery.com
	▪ Understands the media landscape and appropriately allocates marketing budget to different media types based on objectives and expected return on investments (ROI)	=	– Improved winner awareness & brand areas of site
	– If applicable, Advertising Agency has demonstrated past successes in the lottery or other industries	=	– Improve coverage and promotion of drawing & drawing events
	▪ Leverages the Internet and other new media platforms and strategies, particularly to attract the new and younger players	~	▪ Test Initiatives - Nozzle Talkers - Player-activated Terminals - POS Displays

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Business Plan Components
Brand Management

= Yes
~ Somewhat
≠ No

Concept	Industry Best Practice	Does HL currently practice?	Hoosier Lottery – current plan
Brand Management	▪ Solicits positive public opinion and resonates with lottery's customer base – fun, innovative, entertaining and relevant while maintaining the integrity and values of the State	=	▪ Consumer testing, pre-product intro of all games ▪ Creating more big news events around product launches and other organization initiatives
	▪ Grounded in consumer insights and analytics to increase penetration rates, player registration and frequency of play	=	▪ Reduce reliance on Big Jack Pot Games through additional local draw games
	▪ Consistent umbrella brand concept permeates: – Logo / communication materials, – Product design, – Promotional and advertising activities – Sales force and retailer network management – Technology deployment	≠	▪ Develop new store and digital communication materials – Improved in-store merchandising – Digital jackpot sign roll-out ▪ Sponsorship focus on brand ▪ Most recent brand / logo update was in 2009
	▪ Positioning is well understood internally and externally	≠	

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Business Plan Components
Customer Engagement

= Yes
~ Somewhat
≠ No

Concept	Industry Best Practice	Does HL currently practice?	Hoosier Lottery – current plan
Customer Engagement	▪ Loyalty program fully leverages direct touch points with individual consumers:		▪ mylottery – launched in 2010; sends registered users newsletters, jackpot alerts, winning numbers, surveys & research and second chance promotions
	– Reinforces traditional sales at retail locations with promotional offers	≠	– Launch interactive section of mylottery (myGames)
	– Enables subscription-based purchases and/or easy repeat of past transactions	≠	– Launch regular schedule of polling, survey and communications
	– Rewards play frequency	≠	– Launch lifecycle communication plans
	▪ Provides customers a more relevant experience based on individual customer knowledge (past purchases, spend profile, demographics, etc.)		▪ Events – generate consumer enthusiasm – on-the-spot "specials"
	– Targeted direct promotions and offers that encourage additional product engagement	≠	▪ Mascots support events, promote fun
	– Better optimize marketing budgets and efforts	≠	▪ State fair – engage with a broad base of Hoosiers. Lottery Day events
	▪ Leverages the Internet and other new media platforms and strategies to "humanize" the brand and to continue to engage them in the lottery brand experience		
	– Engage in dialogues with customers and "fans"	≠	
	– Encourages user-driven content	≠	

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Business Plan Components
Product Development

= Yes
~ Somewhat
≠ No

Concept	Industry Best Practice	Does HL currently practice?	Hoosier Lottery – current plan
Product Development	▪ Understand the consumer segments and design different products to target them, including: – Develop a diverse and balanced offering of various price points, prize payout structure and marketing messages – Optimize the life of products ▪ Calculate a prize structure and game design that maximizes entertainment value and winning experience ▪ Through rigorous analytics, customer insights and market research, identify and understand segments that may not have been fulfilled and define new games, considering: – Targeted game mechanics that appeal to light and lapsed players (game features, win frequency, etc.) – Enhances games with added-on components to differentiate similar products ▪ Continually innovate and stay up-to-date with technology and offerings in the gaming environment	~ = = = = ≠	▪ Increase frequency and spend among existing players: – Continued evolution & improvements of game strategies (tested games, benchmarking & analysis, use of player segmentation data) – Expansion of $3 price point – Refinement of $10 and $20 strategy – Recapture portion of pull-tab business ▪ Develop game concepts specifically to appeal to 18 - 34; include non players in opti-mix tests ▪ New draw games plan for FY13 (to reduce reliance on Big Jackpot Games): – Launch little lotto game (removing Lucky 5) reflecting best in class industry prize structures and product strategy – 2nd half new game (possibly Poker Lotto - or other type of game with new or interesting style of play) – Roll-out Tag 6 on Quick Draw, Daily 3 & Daily 4

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Business Plan Components
Sales Force Effectiveness

= Yes
~ Somewhat
≠ No

Concept	Industry Best Practice	Does HL currently practice?	Hoosier Lottery – current plan
Sales Force Effectiveness	▪ Best-in-class sales force training and resourcing to support effective retailer network management. Sales force should:		▪ Convert sales force to managed sales process ▪ Shift from service-orientation to selling orientation ▪ Implementing Tell-sell to 4th quartile retailers. Free time of LSRs to focus on in-store improvements. ▪ Incentive plan aligned with growth objectives. Pays only after achieving target growth
	– Have complete knowledge of game features and retailer incentivization plan(s) and be able to recommend portfolio strategies to retailers	=	
	– Educate retail personnel on merchandising and promotional plans and best practices	=	
	– Provide retailers with necessary technology supports	=	
	– Have up-to-date information regarding sales goals and marketing activities	=	
	▪ Hosts regular (weekly, biweekly, monthly) statewide communication to discuss sales / marketing activities and goal updates	~	
	▪ Performance management metrics and incentive packages align with overall sales goals	=	
	▪ Dedicated corporate account managers for large accounts	=	

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Business Plan Components
Retail Distribution

= Yes
~ Somewhat
≠ No

Concept	Industry Best Practice	Does HL currently practice?	Hoosier Lottery – current plan
Retail Distribution	▪ Optimize retail network to increase penetration rates and to increase the average sales productivity by focusing on most productive and growing channels	= (new)	▪ Retailer incentives program: – Scratch-off and pull-tabs tickets: 5.5% commission – Draw tickets: 6% commission – 1% cash bonus for each valid, winning tickets paid at its location ▪ Increase bin counts at retailers – $6.3M annualized opportunity ▪ Increase custom selling platform at retailers ("Play Your Way") – $8M annual opportunity ▪ Increase retailer count – 1,561 potential additions, $23M annualized opportunity ▪ Increase sales in corporate accounts; top 15 presents $22M annualized opportunity
	▪ Evaluate new, innovative servicing models (e.g. terminals, self-service vending machines)	= (slowly)	
	▪ Increase retailer loyalty through effective training and communication models with retailers, for example:	≠	
	– Retail advisory board – feedback mechanism for effectiveness of games, merchandising and promotional plans and incentive programs;	≠	
	– Newsletter – information updates to retailers, with spotlights / profiles of retailers;	≠	
	– Web portal / email – Internet-based communication tools for lottery to retailers and between retailers;	≠	
	▪ Competitive retailer incentive programs align with quarterly (or shorter period) targets	=	
	– Defined performance metrics around sales, service levels, and specific campaign objectives	~	
	▪ Retailer-friendly payment terms that does not jeopardize lottery cash flow	=	

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- **Evaluation Tool (example walkthrough)**

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Marketing Evaluation Tool (example)

Evaluation Criteria: Credibility of Business Plan Activities & Initiatives - Marketing

What are we looking for:

- A holistic approach to increasing awareness of lottery products, communicating a value proposition and motivating consistent purchase in keeping with core values of the Hoosier Lottery; evidence of marketing execution capabilities materially different than current efforts

Key considerations:

- Completeness - addresses a range of marketing activities: advertising across various types of media, winner awareness, jackpot awareness, point-of-sale, promotions, events, sponsorships, in order to create awareness, communicate value and motivate purchase
- Credibility – offers a clear rationale based on prior experience, industry insight or research indicating that the activities are effective; marketing budget aligns with scope of the plan
- Customization – rational demonstrates specific insights into customer demographics and Indiana marketplace
- Consistency - financial projections are based on a methodology and assumptions that are realistic/feasible
- Balance - recognition of risks, especially as related to responsible gaming, accompanied by mitigation strategies

Advanced considerations:

- Innovation – the Plan brings genuinely new approaches to Indiana
- Credibility – a demonstration of return on investment and/or yield in terms of sales per dollar spent
- Integration – clear demonstration of how elements in the strategy support/reinforce one another

Rating criteria:

☐ Unacceptable: a poor response with respect to specificity and/or credibility of plans and objectives, sparse discussion of the effectiveness of marketing initiatives; essentially devoid of merit and covering only some of the key categories and lacking in detail

☐ Acceptable: a solid response with respect to specificity and credibility of strategies, activities and objectives; covers key categories with adequate, relevant detail; and some mention of more advanced categories. Generally, details an approach that is agreeable and will enhance the reputation & integrity of the lottery.

☐ Exceptional: an outstanding response with respect to their plans and objectives, where all categories are covered in high detail, with clear thresholds and credible, achievable strategies; track record demonstrates a high degree of effectiveness (and greater than current capabilities); bidder will engage in a strong working relationship, representing the state well in the assigned role

Notes on Rating:

Summarize specific observations or points from the Business Plan that support the Rating.

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