



A Private Management Agreement for the Pennsylvania Lottery

***\$3.0-\$4.5 billion of New Funding for
Senior Programs over Twenty Years***

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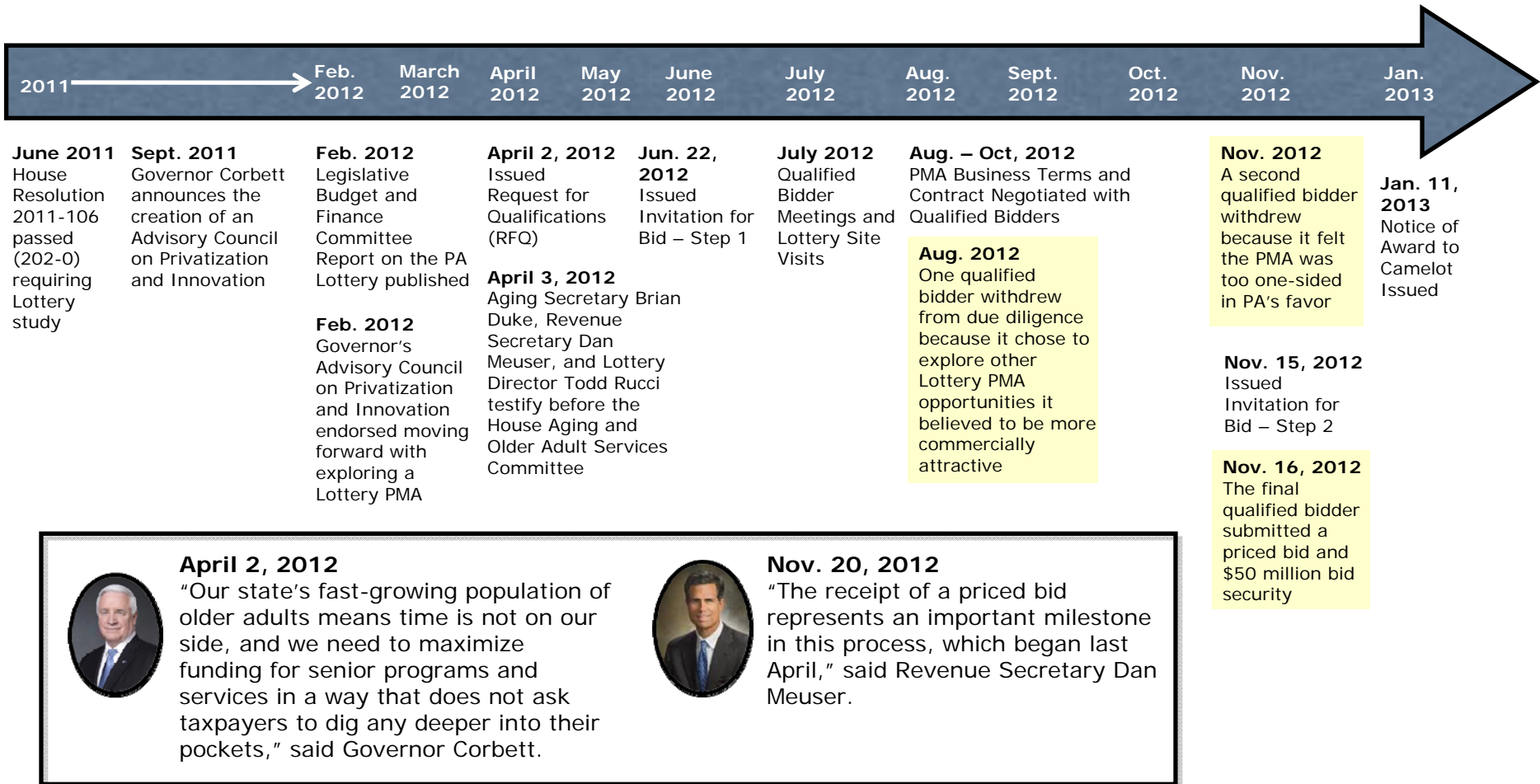
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Bottom Line

▶ A Private Management Agreement for the PA Lottery

- Governor Corbett has evaluated a private management agreement (PMA) for the Pennsylvania Lottery as a way to provide more reliable and predictable revenue to ensure the continued strength and viability of programs supporting a dramatically growing population of older Pennsylvanians.
- On Nov. 20, 2012, the Commonwealth of Pennsylvania announced it received a bid on its PMA for the Pennsylvania Lottery from Camelot Global Services PA, LLC.
- Camelot's bid offers \$34.6 billion in Lottery profit and 20 consecutive years of positive growth.
- The commonwealth evaluated the bid against historic and projected Pennsylvania Lottery performance data and the analysis shows that the PMA will result in at least \$3.0-\$4.5 billion of new funding for senior programs over twenty years.

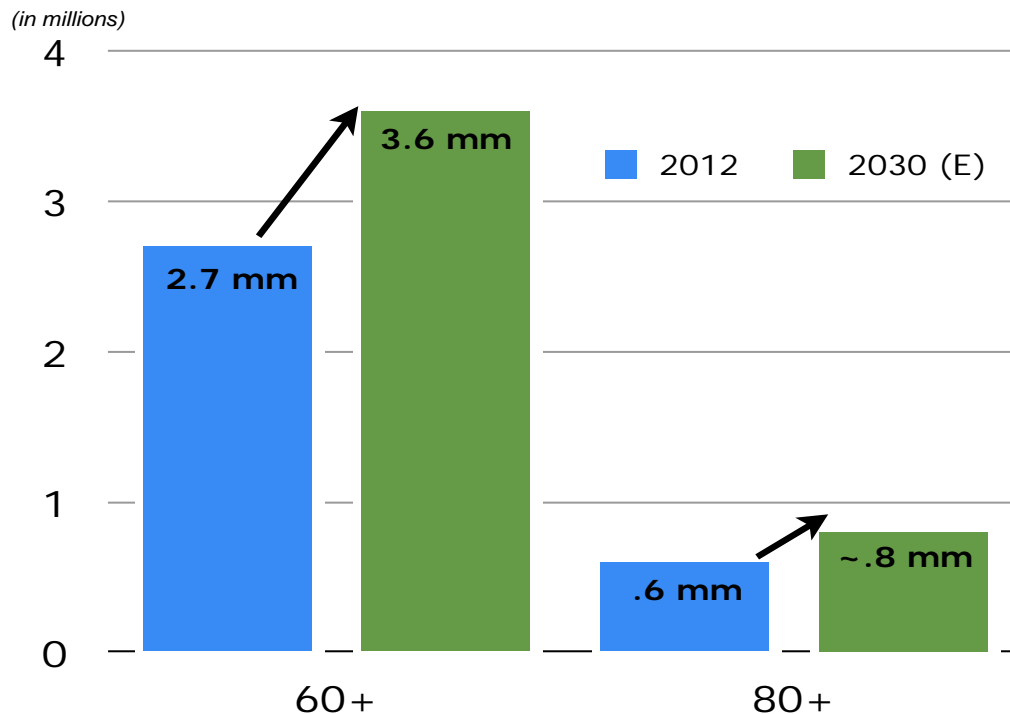
Process Timeline



The Challenge: More Revenue is Needed

By 2030, Pennsylvania's population of residents age 60 and older is expected to grow by 900,000.

Pennsylvania Residents - Ages 60+ and 80+

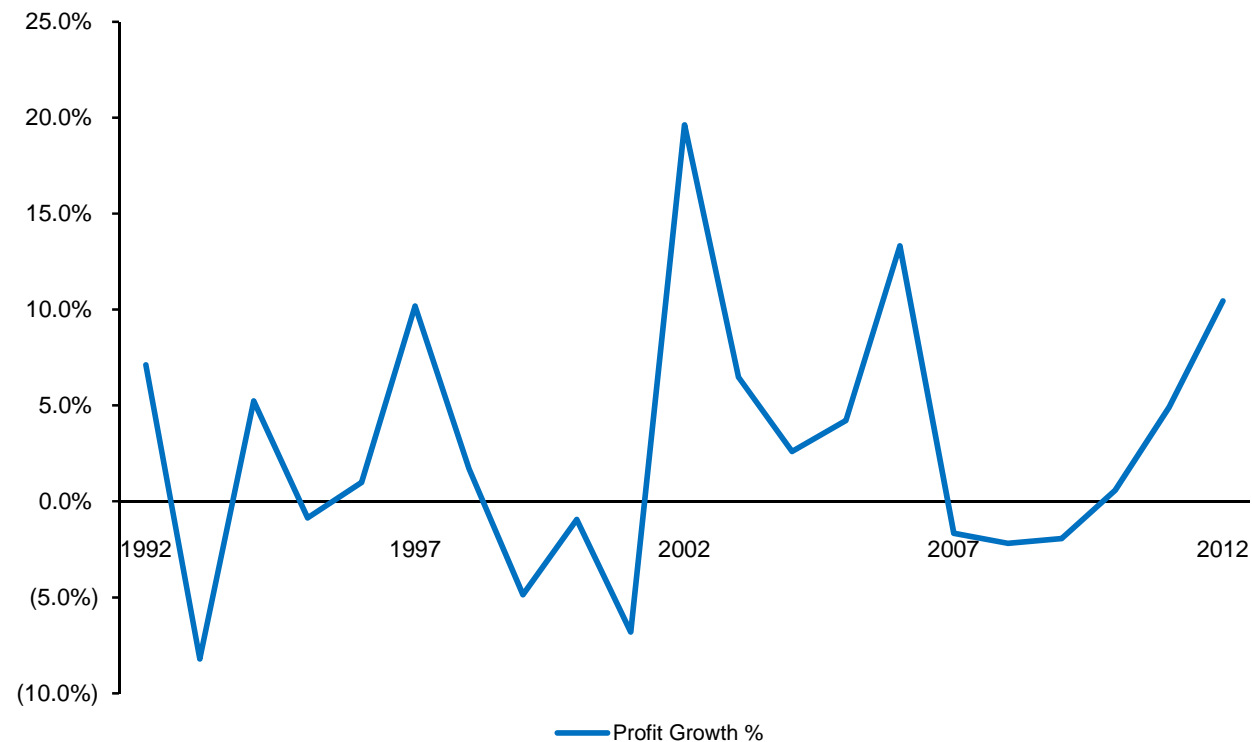


- Pennsylvania ranks fourth nationally in percentage of older residents.
- Pennsylvania is home to nearly 2.7 million people over the age of 60.
- By 2030, nearly 25 percent of Pennsylvanians will be 60 and older.

The Challenge: Lottery Profit Volatility

The Lottery has experienced negative profit growth in eight of the last twenty years.

Lottery Profit Growth Percentage Over 20 Years⁽¹⁾



(1) All financials include interest, miscellaneous and gains or losses on sale of investments.
Source: Commonwealth Bureau of Financial Management

A Solution: Private Management Agreement

Volatility has accompanied Lottery profit growth over the last 20 years. A PMA will provide more stability and predictability for revenue to fund senior programs.

Pennsylvania Lottery Historical Performance

- Negative profit growth in eight of the last 20 years (including two instances in which Lottery's profit declined in three consecutive years)
- According to LB&FC, missed budgeted sales in four of the last eight years
- Five-year historical profit compound annual growth rate: 2.3 percent
- Twenty-year historical profit compound annual growth rate: 2.4 percent⁽¹⁾

Camelot's Offer

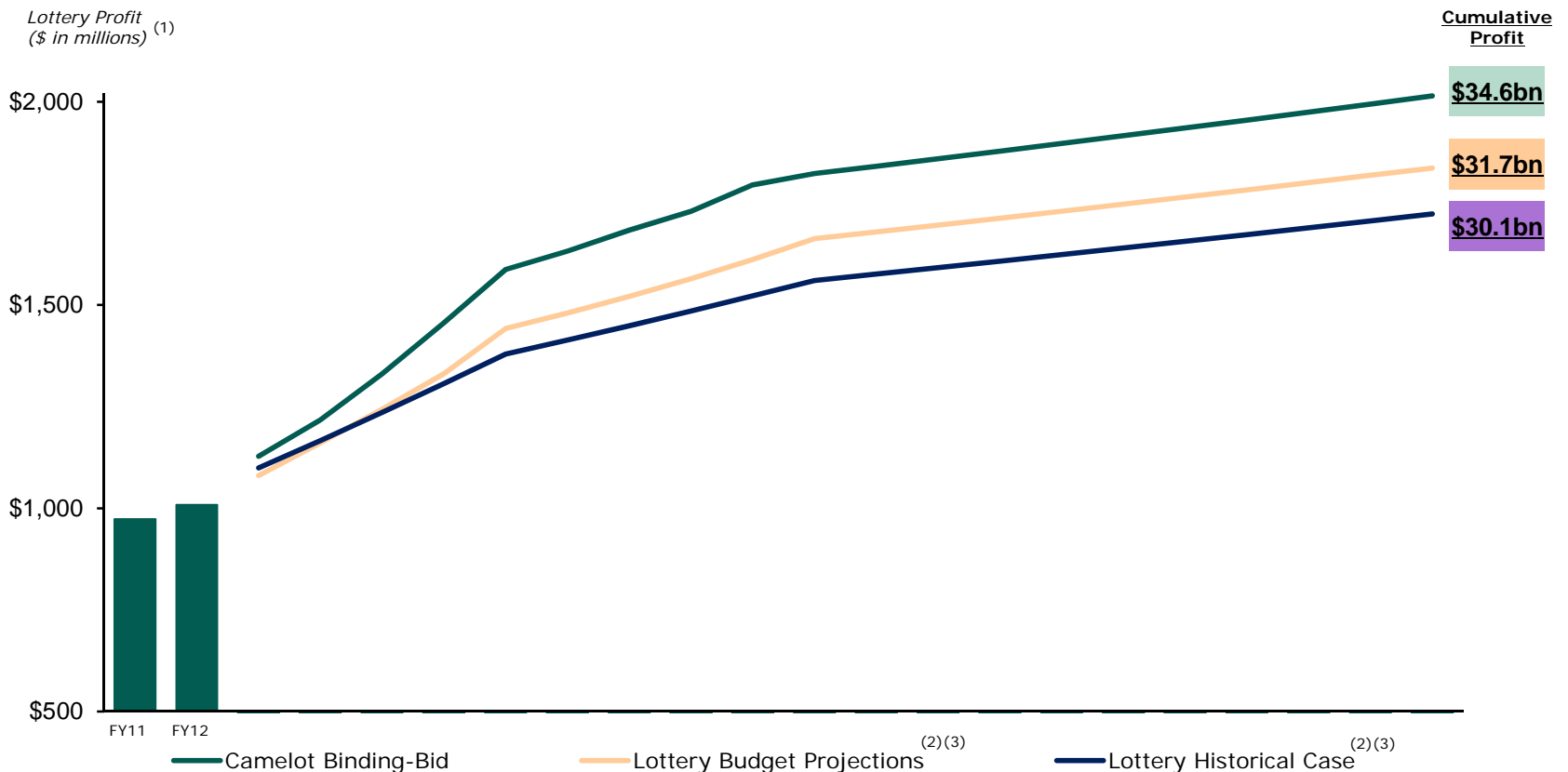
- \$34.6 billion in Lottery profit
- 20 consecutive years of profit growth supported by \$200+ million collateral
- Five-year future profit compound annual growth rate: 9.5 percent⁽²⁾
- Ten-year future profit compound annual growth rate: 6.1 percent⁽²⁾

⁽¹⁾ Cash accounting basis; all other compound annual growth rate figures based on accrual accounting.

⁽²⁾ Five-year and ten-year future profit compound annual growth rates are 9.1 percent and 5.8 percent, respectively, under current law (27% statutorily mandated rate of return through June 30, 2015 and 30% thereafter).

New Funding For Senior Programs

Camelot's priced bid offers the Commonwealth at least \$3.0-\$4.5 billion of incremental profit over 20 years



(1) Profit projections assume statutorily mandated rate of return of 27% through June 30, 2033 (the base 20-year PMA term).

(2) Lottery projections prepared on a cash basis; therefore, adjustment to accrual accounting was applied.

(3) Lottery projections reflect full implementation of value drivers (i.e., Keno and Internet).

Source: Camelot IFB – Step 2 Submission; Department of Revenue



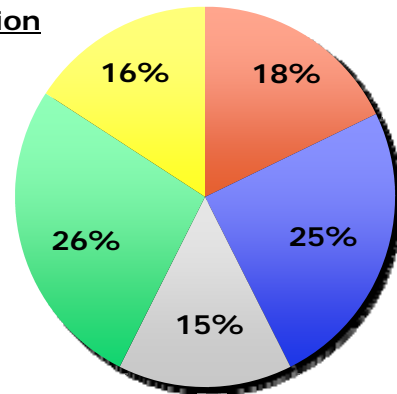
What it Means for Older Pennsylvanians

The Lottery exclusively supports programs benefiting older Pennsylvanians, and a PMA will substantially increase revenue for senior programs.

Senior Programs Funded by the Lottery FY 11-12

- Pharmaceutical Assistance
- AAAs, Senior Centers & In-Home Services
- Shared & Free Ride Programs
- Property Tax & Rent Rebates*
- Long-Term Living Services

Total: \$1.1 Billion



**Includes slot revenues*

- Currently, more than 5,300 older Pennsylvanians are on wait lists to receive program benefits.⁽¹⁾
- Over the last two years, the numbers of older Pennsylvanians on wait lists have grown by 52 percent.

The PMA will result in a substantial and sustained increase in revenues is expected to be available to fund senior programs.



(1) Waitlists include Personal Care/Home Support (4,102), Additional Units (1,094) and Meals/Transportation Assistance (191).

Legal Authority for Entering into the PMA

Pennsylvania Law and Regulations Grant The Revenue Secretary Broad Authority

- **72 P.S. § 3761-303(a)** The State Lottery Law vests the Secretary of Revenue with the authority and “duty to operate and administer the Lottery, and to promulgate rules and regulations governing the establishment and operation” of the Lottery.
- **72 P.S. § 3761-303(a)(1)-(11.1)** The commonwealth’s statute provides a non-exhaustive list of areas within the operation and control of the Lottery, including: the type of lottery conducted, the price of lottery tickets, the numbers and sizes of prizes for the winning tickets, the method of selecting winning tickets, the manner of payment of prizes, the types of locations where tickets may be sold, the method of ticket sales, the amount and type of compensation to be paid to licensed sales agents where appropriate, the apportionment of revenues realized from sales of lottery tickets, and the production and merchandising of promotional items for the Lottery.
- **72 P.S. § 3761-303(a)(12)** Extends the Secretary’s authority over “[s]uch other matters necessary or desirable for the efficient and economical operation and administration of the lottery...” The relevant section of the Pennsylvania Code sets forth the Secretary’s “power and duty to operate the lottery” in a substantially identical manner.
- **61 Pa. Code § 803.11** Provides for regulatory authority regarding the powers and duties of the Revenue Secretary pertaining to operating and administering the Lottery.

▶ Bottom Line

- New revenue is necessary for the commonwealth to keep its commitment to a growing senior population.
- The PMA will result in at least \$3.0-\$4.5 billion of new funding for senior programs over twenty years and minimize the volatility that Lottery profits have historically experienced.
- Camelot's bid represents the culmination of a long, concerted effort by the Administration to engage the private sector through a robust process.
- Camelot does not seek growth through personnel attrition, but rather would like to expand the current Lottery workforce in Pennsylvania.

Addendum



Details of the Private Management Agreement

Lottery Employment

Pennsylvania's PMA Compares Favorably

Legal Authority for Monitor-Based Games

Fact Check – Refuting Alleged Secrets

Addendum: PMA Details

Length of Contract	<ul style="list-style-type: none">• 20 years plus performance-based extensions that could take the term to 30 years.
Annual Profit Commitments (APC)	<ul style="list-style-type: none">• Profit thresholds that must be achieved by the manager in order for the manager to earn any incentive compensation.• If a private manager fails to meet these annual profit commitments, the commonwealth will draw shortfall payments down from the \$150 million cash collateral provided by the manager to secure its performance, in order to preserve funding for programs benefitting older Pennsylvanians.• Such funding protections are not available today to the same extent.
Financial Security	<ul style="list-style-type: none">• \$150 million in up-front cash.• \$50 million letter of credit, replenishable annually.
Oversight	<ul style="list-style-type: none">• Commonwealth retains ownership of and control over the Lottery.• Pennsylvania has right to veto and direct actions of the private manager.
Incentive Compensation	<ul style="list-style-type: none">• Manager will only be paid incentive compensation when it exceeds its annual profit commitment.• Incentive compensation is limited to 5 percent of profit.

For comprehensive details on the PMA, review the contract itself or a Summary of PMA Terms and Conditions, both available at www.revenue.state.pa.us/LotteryPMA.



➤ Addendum: Lottery Employment

Camelot recognizes the tremendous asset the Lottery's workforce is to its success, and it has expressed interest in hiring Lottery employees

What happens to the existing Lottery workforce?





- The commonwealth expects to maintain a complement of about 70 Lottery employees to perform the commonwealth-retained responsibilities. These employees will occupy a combination of management and unionized positions.
- Current Lottery employees beyond the 70 retained by the commonwealth will be invited to apply for job opportunities and interview with Camelot during an employment transition period.
- PMA includes an employee transition period from public to private management of up to a year. For those Lottery employees who are not interested in transitioning to Camelot, the commonwealth will make a concerted effort to redeploy them within the commonwealth workforce.

Camelot wants to expand local workforce

- Camelot has made it clear it does not seek growth through personnel attrition, but rather is looking to grow by expanding the Lottery workforce.
- Camelot has signaled its intention to add employees in the state over time.
- Camelot was one of the U.K.'s "Top 100 Best Companies to Work For" in 2011.



Addendum: Pennsylvania's PMA Compares Favorably

	 Pennsylvania	 New Jersey	 Illinois	 Indiana
Bid Date / Transaction Date	November 16, 2012	December 27, 2012	January 2011	October 2012
Cumulative Binding-Bid APCs / Net Income Levels	\$34.6 billion (20 Years Bid)	Not Yet Disclosed	\$4.7 billion (5 Years Bid)	\$1.8 billion (5 Years Bid)
Term (years)	20 plus extensions (max term: 30)	15	10	15 plus extensions (max term: 25)
Process Timing (RFQ to Bid)	8 months	5 months	3 months	4 months
Upfront Cash Collateral / Letter of Credit or Performance Bond	\$200 million (\$150 million upfront with \$50 million springing LOC obligation)	\$120 million / Limited ⁽¹⁾	\$50 million (\$100 million initial LOC or performance bond reduces 50% by Year 7) ⁽²⁾	\$20 million LOC
Liability Protection⁽³⁾	\$100 million / year increasing to \$500 million	\$100 million / year increasing to \$500 million	\$100 million / year increasing to \$500 million	\$50 million / year increasing to \$200 million
Bid Security	\$50 million Cash	\$2.4 million LOC, Cash or Bid Bond	\$20 million LOC or Cash	\$1.5 million LOC or Cash
Total Revenue ⁽⁴⁾	\$3,476 million (FY 6/30/2012)	\$2,795 million (FY 6/30/12)	\$2,196 million (FY 6/30/2010)	\$856 million (FY 6/30/2012)
Profit ⁽⁴⁾	\$1,008 million	\$948 million	\$652 million	\$212 million

Key PA Features

- Pennsylvania's PMA includes upfront cash collateral that provides dollar-for-dollar downside protection, subject to federal law.
- The PMA was carefully structured to ensure realistic annual profit commitments.
- Performance-based extension options incentivize profit performance.

(1) Manager is required to furnish and maintain a \$100 million LOC or performance bond only if certain credit rating metrics are not met
 (2) The obligation reduces to \$50 million after the earlier of (a) manager exceeding Net Income Targets in any three consecutive contract years and (b) the end of the sixth contract year
 (3) Gross negligence, fraud and certain other liabilities are uncapped / unlimited
 (4) For the last available fiscal year prior to the PMA transaction

Source: State Lottery PMA Documents

➤ Addendum: Legal Authority for Monitor-Based Games

- In examining existing Lottery regulations as well as the Race Horse Development and Gaming Act and corresponding regulations, it is readily apparent that any monitor-based games that would be implemented by the Lottery fall clearly within the scope of the Lottery's existing terminal-based game regulation, rather than the more restrictive definition of "slot machine," contained within the Gaming Act.
- The Lottery's terminal-based lottery game regulation establishes procedures for the creation of a terminal-based lottery game, sales of tickets, validation of winners and the payment of prizes concerning said games. 61 Pa. Code § 875.1. A "terminal-based lottery game" is defined by the regulation as "[a]ny Lottery game . . . for which a terminal-based lottery game ticket is generated through a computer connected to a Lottery central computer system." 61 Pa. Code § 875.3.
- The key distinction between a proposed terminal-based or monitor-based game and a game played through a slot machine is that a terminal-based game must be played through a Lottery central computer system with only bets being registered through a retail location. *Id.* In essence, a monitor-based game as has been discussed allows for a player to compete against multiple players from various locations within the Commonwealth for each drawing.
- Contrast that method of gameplay with a traditional slot machine where a player essentially competes against the machine the player is located at. This view is supported by the unique nature of the Gaming Control Board's regulations that govern slot machine specifications which clearly show that the regulations have no applicability to the monitor-based games under discussion. 58 Pa. Code § 461a et seq. These regulations set rules on issues such as payment vouchers, coupons, venue seating requirements, and slot machine progressive capabilities – all issues that have no bearing on the monitor-based games under discussion. In short, the Department does not believe that the Gaming Control Board's regulations have any applicability to the discussion at hand. However, the Department reiterates its commitment to ensuring that any future gaming opportunities comply with all existing state and federal law and that said games will only be implemented to the extent authorized by law.

Addendum: Fact Check – Refuting Alleged Secrets

“Secret” No. 1: The proposed privatization contract with Camelot would require the commonwealth to pay Camelot’s operating expenses – including salaries for private executives. Those payments would be in addition to the company’s management fee – a cut of Pennsylvania Lottery profits, which otherwise would go to senior programs.

- Under a PMA, the commonwealth transitions most of the Lottery’s current operating expenses to the private manager, including the majority of the Lottery’s current personnel costs.
- Operating expenses must be approved by the commonwealth annually, similar to the Lottery’s current budget process.
- Manager expenses are automatic payments totaling 0.75 percent of profit in a year, and will be used to offset indirect costs, such as capital expenses and research and development of managing the Lottery.

“Secret” No. 2: Camelot appears to have low-balled its performance targets for future years to guarantee it will earn more money. In fact, the better the lottery performs, the more seniors would lose because the “incentives” for Camelot are percentage-based to grow incrementally larger with better performance.

- If a PMA is executed, Camelot will have demonstrated its ability to deliver significantly higher, assured profit levels beyond what the Lottery could achieve on its own.
- The PMA only pays incentive compensation when the private manager exceeds its annual profit commitments.
- The terms of the PMA ensure that any incentive compensation Camelot receives will go hand-in-hand with increased funding for senior programs.

➤ Addendum: Fact Check – Refuting Alleged Secrets

“Secret” No. 3: Despite Corbett Administration claims of guaranteed annual profits for the lottery, the proposal does not require Camelot to pay seniors the full difference between actual results and its projections. They may pay a portion of the difference, or they may pay nothing at all. In Illinois, private lottery manager Northstar Lottery Group is challenging that state’s financial penalties for falling short on its projected lottery profits.

- If Camelot fails to meet its annual profit commitments, the commonwealth will draw shortfall payments – up to 5 percent of profit each year – from the \$150 million cash collateral and \$50 million letter of credit provided by the manager to secure its performance.
- Such funding protections are not available today.

“Secret” No. 4: Camelot’s bid front-loaded profit projections in the first few years of the contract, but in the last 10 years Camelot only guarantees lottery growth of 1% per year – at the same time the Corbett Administration acknowledges there will be a spike in the number of seniors needing services through programs funded by the Pennsylvania Lottery.

- Camelot’s assured 1 percent profit growth in out-years must be maintained above the preceding years actual profit levels. This dynamic is after 10 years of consecutive, uninterrupted growth.
- The commonwealth negotiated the PMA to maximize Lottery profit growth and has the right to seek upward adjustments to the annual profit commitments if the business environment changes.

Addendum: Fact Check – Refuting Alleged Secrets

“Secret” No. 5: A clause in the proposed privatization contract would grant automatic contract extensions beyond the stated 20-year term, so Camelot’s profits can continue for up to 30 years without legislative or public input.

- Contract extensions are not automatic – they would only occur if performance objectives are met.
- The PMA provides for contract extensions under two performance-based scenarios, which were designed to further incentivize the private manager to meet and exceed its annual profit commitments (APC).
- The two extension scenarios are as follows:
 - One-year extension – granted for each of the contract years during the first five contract years that profit meets or exceeds the APC (total extensions not to exceed five years).
 - Five-year extension – granted if the average profit in contract years six through 15 exceeds the average APCs for contract years six through 15.

“Secret” No. 6: Unlike the 2004 gaming law, which legalized casino gaming in Pennsylvania, the proposed lottery privatization scheme would allow Camelot, and its executives, to make generous campaign contributions in Pennsylvania.

- Any such contributions would be subject to the reporting requirements of the Ethics Act and the Lobbyist Disclosure Act, as are contributions from most companies contracted to provide services to the commonwealth.