

Senate Finance Committee – Camelot written testimony

Introduction

In response to the request from Matt Azeles of Senator Brubaker's office, the purpose of this document is to provide Camelot's written evidence for the hearing of 14th January 2013. It will cover the following points:

- Who Camelot is
- What Camelot does
- What Camelot has done elsewhere
- What Camelot will bring to the table in Pennsylvania

Camelot welcomes this opportunity to provide the parties attending the hearing with further insight into Camelot's background, track record and why we believe Camelot's potential appointment as the Private Manager of the Pennsylvania Lottery would serve to maximise returns to seniors over the term of the contract.

1. Who Camelot is

Camelot is one of the world's leading lottery operators. Camelot has been the operator of the UK Lottery since its launch in 1994, and holds the Licence to operate the UK National Lottery until 2023.

As operator of the UK National Lottery, Camelot is responsible for all aspects of the day-to-day operations of the lottery including management of the retail network (over [36,000] terminals), the National Lottery website (the world's largest interactive lottery website), commercial operations (including sales, marketing, contact centres and new game development) and business operations (including distribution, corporate assurance, human resources,, legal and finance). Under this contract, Camelot complies with a complex and strict regulatory regime which, first and foremost, seeks to protect players of the National Lottery.

Camelot applies two key business principles in all its lottery operations. First, it adopts 'consumer goods industry' best practices to the development, marketing and management of all lottery products so that the lottery is treated like a true consumer products business, Secondly, Camelot sees its primary mission being the delivery of a popular and mass participation lottery.

These principles have proved highly effective. Despite fierce and increasing competition from over 9000 bookmakers and adverse economic conditions, the UK National Lottery achieved record sales in FY2012 of over \$10 billion, with profits to the government of over \$4 billion.

Camelot also has a wide range of international experience, including North America. It currently has consulting operations with the California and Massachusetts State Lotteries. In 2011/12, it provided consulting services to the Interprovincial Lottery Corporation in Canada. Camelot has also operated in South Africa as a founding member of the Uthingo consortium, which launched the first South African Lottery in 2000.

Camelot has been owned by the Ontario Teachers' Pension Plan ("OTPP") since 2010. OTPP is a major pension fund with net assets under management of over \$100 billion. For Camelot's potential agreement with the State of Pennsylvania, OTPP's presence brings significant financial resources, a willingness to invest for the long-term and a clear focus on corporate social responsibility.

2. What Camelot does

Camelot runs lotteries. In contrast to the major vendors in the lottery industry, Camelot sees itself as a sales and marketing organization enabled by technology. Camelot has a number of key principles which define the way it does business, including

- A strong desire to **align incentives among all stakeholders**
- **A vendor neutral approach** in procuring technology (since Camelot has no vested interest or loyalty to any one technology)
- A belief that lotteries should have the **widest participation of play** where many people play a little bit rather than a few demographics playing a lot and hardly anyone else playing at all (in other words, a progressive lottery, rather than a regressive lottery)
- The incorporation of **social responsibility** considerations which underpins all aspects of lottery operations
- The application of a **‘consumer goods industry’** mind-set in managing lottery products
- The importance of investing in our **people**

We believe these principles present a unique proposition in the lottery industry and would serve to maximize the long-term value of the Pennsylvania Lottery.

2.1. Aligned incentives and shared risk

While Camelot is a ‘for profit’ operator of lotteries, it and seeks to share in the commercial risks of operating the lottery with its beneficiaries. Currently, most lottery vendors are incentivized by producing gross sales, regardless of its impact on net revenues. Camelot believes its incentives should be aligned with what’s most important for the state – increased net revenue for its beneficiaries.

This structure has provided an excellent framework for encouraging investment and strong performance. In the UK, Camelot is on track to achieve another record year in sales, and in 2011, California became the fastest growing lottery in the US, with sales growth of +13.1% and continued robust growth of +30.1% in the first three quarters of 2012.

The terms of the Pennsylvania Private Management Agreement are consistent with this approach – Camelot is only positioned to earn profits if the Annual Profit Commitment (APC) is exceeded, assuring the state of increased revenue year after year.

2.2. An absence of vested interest

Most of the major participants in the lottery industry are technology providers. In bidding for lottery operations contracts, these organizations have a significant vested interest in supplying their own legacy technology solutions as part of any contract. Camelot believes

that such an outcome is likely to be sub-optimal for lotteries, both in terms of the cost and quality of the technology solution.

In contrast, Camelot is a pure lottery operator. This gives Camelot the commercial freedom to procure and integrate the technology solution most appropriate to the needs of the client lottery. This approach brings two benefits. First, it provides a framework for greater speed-to-market and a more responsive technology platform, which is both critical to meeting the specific challenges of offering lottery products across multiple channels. Second, this approach is likely to reduce costs, since Camelot can create a competitive bidding process and generate bids from technology providers other than the usual established participants in the lottery market.

2.3. Mass participation

Camelot sees its mission as being the operator of popular, *mass participation* lotteries that raise as much money as possible for the State. In a number of US jurisdictions, lotteries are seeing ever narrowing participation in lottery games, where a few demographic groups play at high levels and many groups play hardly at all. Camelot has an entirely different approach – have a lot of people play a little, rather than a subset of the population playing a lot, a far less regressive approach. To illustrate the success of this strategy, in the UK, more than 70% of adults play the lottery, but they typically spend the equivalent of a few dollars every week.

2.4. Social responsibility

Consistent with its aim of operating popular and mass participation lotteries, corporate Social responsibility is an integral part of the way Camelot does business, informing any decision Camelot makes around its game, channel and marketing plans.

Camelot's social responsibility leadership in the lottery industry has been evidenced by winning a number of prestigious industry awards, most recently the World Lottery Association's Responsible Gaming Award in 2012.

2.5. 'Consumer goods industry' mind-set.

Camelot believes that lottery products are analogous in many regards to other mass-market consumer goods. It also believes the capabilities required for success in the consumer goods industry (such as consumer research, brand management and retail account management etc) are equally necessary in the lottery industry.

It is important to note that the application of consumer goods industry disciplines in Pennsylvania (which Camelot sees as an essential part of delivering the business plan) is likely to require additional investment above current resource levels.

By adopting such a 'consumer first' philosophy, Camelot's approach is not only materially different than other participants in the lottery industry, it is also an approach most likely to maximise returns to state and its seniors over the long-term.

2.6. People

A key component in Camelot's success has been its people. Camelot's success in the UK and elsewhere has stemmed from its commitment to innovation, excellence, teamwork, integrity and responsibility. In recognition of the significant investment that Camelot has continued to make in its people, it was featured in *The Sunday Times* list of the top 100 companies to work for in the UK.

Having considered these critical features of the way in which Camelot does business, the following section will provide some case studies of Camelot's achievements in the UK and elsewhere.

3. What Camelot has done elsewhere

This section provides examples of how Camelot's operating principles have translated into responsible commercial success, both in the UK and other markets. It will consider five aspects of Camelot's commercial performance, which illustrate the success of this approach:

- 5-year performance in the UK
- Operator of the largest interactive lottery in the world
- Strong track record in draw-based and multi-jurisdiction games
- Program management
- Camelot's California consulting contract

3.1. 5-year performance in the UK

An analysis of Camelot's sales performance in the UK over the past 5 years illustrates how the application of Camelot's lottery operation principles has resulted in significant commercial success. As shown in Table 1, total sales have increased from just under £5 billion in 2008 to £6.5 billion in 2012, a Compound Annual Growth Rate ("CAGR") of 7.1%. Over the same period, returns to the UK government have increased from £2.0 billion to £2.6 billion, a CAGR of 7.43%. Rarely does a lottery have greater return in net revenues that it does in increasing sales over an extended period of time, which re-enforces our last focus on returns to the state.

Table 1 UK sales history 2008-2012 (\$m)

	2008	2009	2010	2011	2012	4-yr CAGR
DBGs						
Retail	5,638	5,584	5,737	5,970	6,344	3.0%
Internet	531	701	858	1,048	1,336	25.9%
Total	6,169	6,285	6,595	7,018	7,680	5.6%
Instants						
Retail	1,603	1730	1,882	2,029	2,434	11.0%
Internet	173	224	246	269	328	17.4%
Total	1,776	1,954	2,128	2,298	2,762	11.7%
Total Sales						
Retail	7,241	7,314	7,619	7,999	8,778	4.9%
Internet	704	925	1,104	1,317	1,664	24.0%
Total	7,945	8,239	8,723	9,316	10,442	7.1%
Returns to UK government (tax and Good Causes)	3,194	3,278	3,581	3,838	4,230	7.3%

- The growth obtained over the past five years has been against a background of significant adverse economic conditions (the global recession) and significant competition from other gaming companies (the UK is the world's most competitive gaming market)
- The highly profitable Draw-based games category have seen significant growth over the five-year period growing by over £900m
- The retail instant ticket category has seen a CAGR of 11% over the five-year period
- Although internet sales have increased by £1 billion over the period, this has not been at the expense of retail sales, which have also increased during the same period.

3.2. Operator of the largest interactive lottery in the world

As operator of the UK National Lottery website, Camelot manages the world largest interactive lottery in the world. Camelot launched its first interactive games in 2003. The National Lottery website now generates sales of over £1 billion per annum with over [7] million registered players. In 2012, Camelot launched a mobile optimised version of the website, further enhancing its digital presence.

Camelot believes the extensive experience it has acquired in operating the National Lottery website will be valuable in the context of Pennsylvania.

3.3. Strong track record in draw-based and multi-jurisdiction games

The draw-based game category is problematic for many lotteries. It is typically the highest margin category (with net sales of typically 45-50% of gross sales vs 25% to 35% for instant tickets), but also the category most susceptible to long-term decline. As noted above, in the UK, Camelot has seen sustained growth in its draw-based game category over the past five years, achieving a Compound Annual Growth Rate of 5.6%.

A key contributor to the success of the draw-based games category has been Camelot's management of EuroMillions, the world's largest multinational, draw-based game. Camelot was a founding member of the EuroMillions lottery game and has since driven the game's success through the addition of a second weekly draw, a price change and the use of a special event draws.

Camelot believes that this experience is transferable to driving growth within the draw-based game category for the Pennsylvania Lottery.

3.4. Strong program management capability

Camelot has a strong track record in the delivery of complex programs. As an example of this, in 2008/9, Camelot undertook a major technology transition program in preparation for

the implementing its third license from the British government. As part of this program, Camelot successfully managed the deployment of a new host platform, installed 27,500 new terminals connected by a new communications network (supplied by Hughes systems), and also implemented a new business systems and management information platform provided by SAP, integrated into the GTECH host. This program was the largest lottery transition in the world, and was recognized by the UK government as being one of the most successful IT programs ever undertaken in the UK.

More recently, Camelot has nearly completed the process of selecting and installing 8,000 new terminals across the retail estate.

Camelot believes the experience acquired in delivering these programs would be directly applicable in successful implementation of the initiatives within its Pennsylvania business plan.

3.5. California

Camelot has had a presence in the United States since 2009, providing consulting services to the California State Lottery as part of a four-year contract. By providing expertise on business planning and sales and marketing support, Camelot developed a business plan together with the California Lottery that projected an additional \$2.25 billion in incremental sales and \$780 million in new funds for education over the following three years. To date, even those projections are being exceeded, and in Fiscal Year 2012, California was the fastest growing lottery in the US for the second year running

4. What Camelot will bring to the table in Pennsylvania

The previous sections have demonstrated that Camelot has both a significant range of capabilities and a strong track record of success. We believe that these capabilities will be of direct relevance to the Pennsylvania Lottery, and will play a central role in maximizing revenues to seniors over the coming years. This section will consider the key benefits of Camelot's potential appointment as Private Manager of the Pennsylvania Lottery. They include:

- Annual Profit Commitments: Shared risk and aligned incentives
- Investment
- Track record
- Consumer-first approach
- Interactive

4.1. Annual Profit Commitments: Shared risk and Aligned Incentives

A critical benefit of appointing Camelot as Private Manager of the Pennsylvania Lottery is of its commitment to a responsible yet aggressive series of Annual Profit Commitments, underwritten both by Cash Collateral and a Letter of Credit with a combined value of \$200 million. At a time when there are increasing funding demands for seniors, this commitment of new money provides a significant degree of certainty to the Commonwealth in preparing its long-term plans, transferring the risk of performance from the taxpayers to the private sector.

The structure of the Private Manager's compensation (with Shortfall obligations in the event of underperformance versus forecast and a revenue share for outperformance versus forecast) also provides compelling incentives for excellent commercial performance over the term of the contract. Camelot only receives incentive compensation and only makes a profit if it exceeds the annual profit commitments. If Camelot does not exceed its Annual Profit Commitments, it will not make a single dollar of profit. Camelot is therefore solely incentivized to maximise returns to seniors.

4.2. Investment

Camelot has committed in its business plan to conduct a major program of investment across a range of areas:

- People – the business plan anticipates an expansion of the Pennsylvania Lottery's headcount to support its commercial plans
- Marketing—Significant additional investments to re-brand the lottery so as to widen player participation and attraction

- Retail channel – Camelot’s business plan includes significant expenditures to refresh the retail environment, to associated back office systems and to implement a new Keno offering
- Interactive – an important part of Camelot’s business plan is the introduction of an interactive channel in 2015

This investment program will play an important role in increasing revenues to seniors over the duration of the contract.

4.3. Track record

In considering Camelot’s bid for the Private Management Agreement, the Commonwealth should be assured by Camelot’s history and track record. Camelot’s experience in the UK shows a track record of sustained responsible growth and successful delivery of complex programs. Camelot would be an equally responsible steward for the Pennsylvania Lottery.

4.4. Consumer-first approach

As discussed in the previous section, Camelot believes that its approach of placing the consumer first in the development and execution of its commercial plans is a critical part of the Camelot ‘offer’, making it distinct from other more technology-focused participants in the lottery industry. By ensuring that all critical business decisions are informed by in-depth consumer insight and research, Camelot maximizes the probability of increasing returns to seniors over the long-term.

4.5. Interactive

The launch of an Interactive channel in Pennsylvania in 2015 represents an exciting opportunity for the Commonwealth to increase significantly revenues for Seniors. However, the successful launch and operation of an interactive channel requires a significant degree of specialist lottery expertise, experience Camelot has gained as the operator of the world’s largest interactive lottery.

Camelot believes that the expertise it has acquired in operating the UK National Lottery website since 2003 would enable Pennsylvania to achieve the maximum benefit from launching its own online offering.

5. Conclusion

We trust this paper has provided a helpful insight into Camelot's background, its core capabilities and track record. We also trust that it has demonstrated that there is a clear role for a specialist private sector lottery operator to work in partnership with the Commonwealth to provide improved certainty of revenues to seniors and to grow revenues over the long-term.

We look forward to presenting our position on 14th January.