

EXPERT OPINION ON THE PROPOSED IGT DEAL

(BY ALAN ELAND)

Introduction

The State of RI is considering extending its exclusive relationship with IGT for the online lottery services contract and the video monitoring systems contract. In order to properly value the premium IGT is proposing the State pay for these services a reliable method of comparing the price IGT is proposing in RI to the rest of the domestic lottery market is necessary.

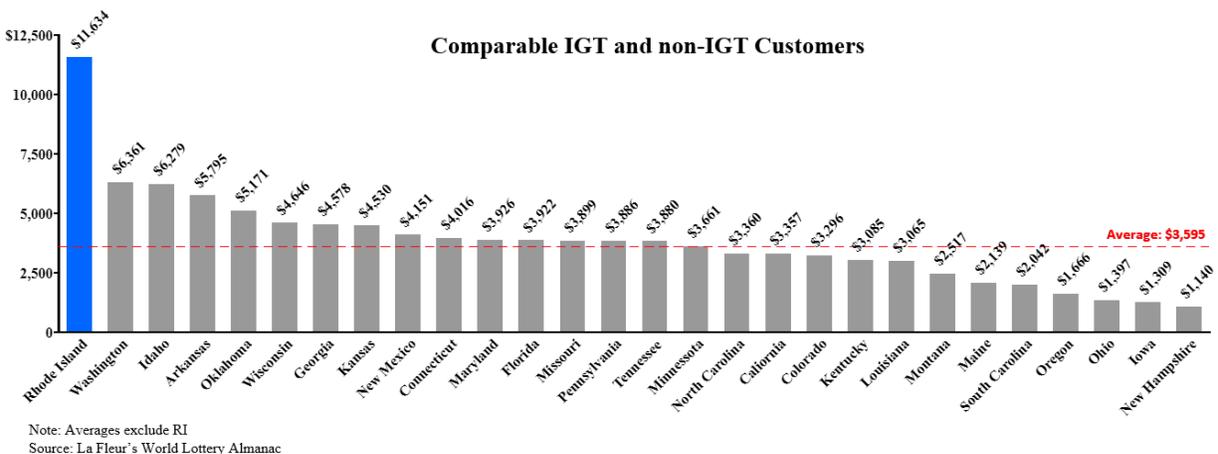
The RI Lottery online contract was last competed in 1997. The new proposed 20-year agreement will extend the exclusive relationship between IGT and the RI Lottery to 46 years representing a 350% increase over the 13-year average length of contracts in the domestic lottery market. In its proposal to the State IGT is raising its price.

The RI Lottery pays IGT for its online lottery contract more than 300% above the average rates in the domestic lottery market. Even when differences in contracts are factored in the RI Lottery pays IGT more than 300% above what it pays Massachusetts and Pennsylvania for the same video monitoring system.

Online Lottery Contract Price Comparison

When RI is compared to 27 other state lotteries with similar services a tight average market rate emerges with the 27 lotteries and RI stands out as the exception with the highest price. The average for 30 other customers is \$3,595 per retailer. IGT charges RI \$11,634 per retailer.

Chart 1: Online lottery contract fee charged per retailer

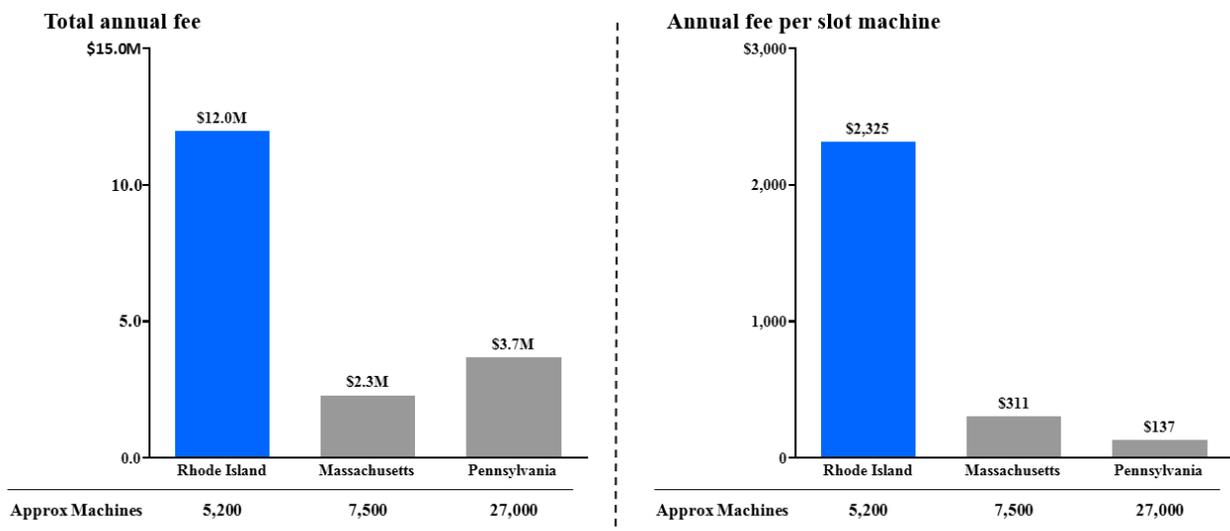


Video Monitoring System

The Video Monitoring system provided by IGT in RI provides basic monitoring of sales and other events, requires cabling and connectivity of the machines and machine service. The rate charged by IGT is well above market norms. When compared with Massachusetts and Pennsylvania where IGT supplies the same system, RI pays IGT a material premium.

The RI contract requires IGT to supply about 40 technicians to service the machines. Including supervisors and a manager this requirement conservatively adds about \$2,500,000 of annual costs to IGT. *Adjusting for requirements still leaves gaps of more than \$7 million and \$6 million annually between Massachusetts and Pennsylvania respectively.* IGT uses a single group to operate the central computer systems in the online lottery contract and the video monitoring contract offsetting a material amount of the cost of the service technicians. IGT's capability to leverage staff across both contracts produces efficiencies that should result in lower pricing.

Chart 2: Annual central monitoring system fee comparison



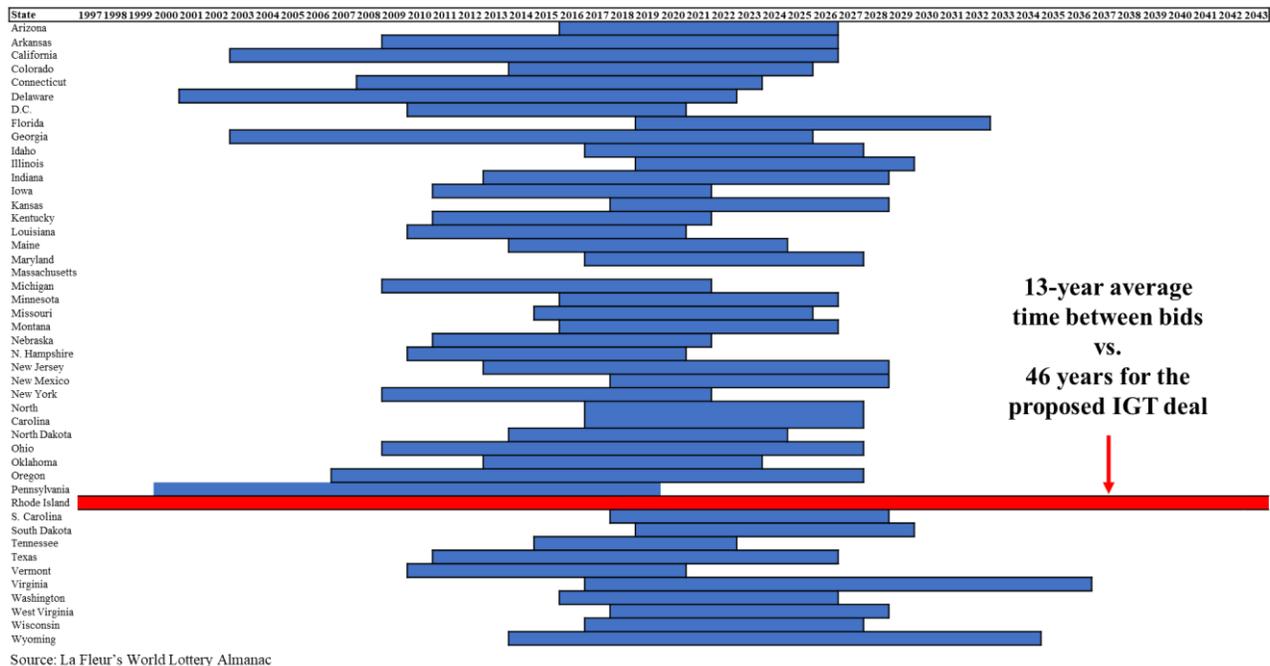
Source: – Public Contracts and Documents from Massachusetts and Pennsylvania

The contracts in Massachusetts and Pennsylvania are based on fixed fee pricing. The system is generally an upfront fixed cost with some smaller fixed and variable costs based on the number of machines serviced. Because of its variable cost structure, the RI monitoring contract produces unearned gains for IGT as sales increase. IGT's revenue increases as sales increase while its costs remain the same. *Compound annual growth rate in video sales, since the inception of the video program in RI, has been 4.8%.* This growth has resulted in the material difference between the rate RI pays IGT and the rate IGT charges other customers for the same system.

Bid Frequency

The chart below illustrates the contract duration and time between competitive bids for the domestic lottery market. The frequency of bids ensures states pay competitive market rates and that each supplier constantly produces new innovation to differentiate its offerings. Forgoing a competitive process in RI since 1997 has resulted in the State paying a material premium to IGT in both its Lottery and Video Monitoring Services contracts. *The new proposed master contract with increasing compensation for IGT further increases the gap between RI and the domestic market.*

Chart 3: Bid frequency for US Lotteries



Conclusion

The proposed 46-year exclusive relationship between IGT and the Rhode Island Lottery is unprecedented and has resulted in the RI Lottery paying a material premium that puts its price as the highest per retailer in the country. After already receiving pricing well above the market IGT is proposing price increases for another 20-year term.

There are at least four suppliers for the two contracts that may participate in a competitive process. A bid will produce a market rate against which RI can compare the promised value of jobs from IGT. As suppliers compete for differentiation a bid will produce innovation in solutions that will enable growth, create efficiencies and increase reliability of solutions.

An online lottery contract is unique in its opaque pricing. With a new competitive process, the RI Lottery has a chance to increase cost disclosure requirements. Increased cost detail will allow

greater visibility into the fee suppliers will propose to charge for the wide variety of products and services required by the lottery and will provide the lottery with valuable information to negotiate with IGT or a new supplier. In its most recent RFP, the Texas Lottery requires IGT to disclose its start-up costs as well as its first quarter operating expenses. By adopting a similar approach, the lottery puts itself in a much more informed position to negotiate. A competitive process will produce rates consistent with the market and requiring more transparency will enable the lottery to better analyze the value of the contract.

The State of RI is paying the highest price per lottery retailer in the United States. The premium paid to IGT is predictable and is caused by the exclusive relationship between IGT and RI now in its 22nd year. Extending this contract to almost a half century, as is proposed, with price increases, is unprecedented.

We can safely project that if the RI contract was subject to a competitive process current market averages suggest the \$26 million the State pays IGT annually for combined online lottery services and video monitoring systems would be reduced to \$9 - \$10 million annually, saving the State \$16 million each year and \$320 million over the life of the proposed 20-year contract.

Alan Eland

I worked at GTECH/IGT for 31 years beginning my career there in 1985. I spent most of my career in operations living and working in various locations for the company including Ohio, California, Louisiana, Texas, Malaysia, Puerto Rico and Rhode Island. Prior to retiring from IGT I held the position of Chief Operating Officer for the Americas. Revenue for the Americas exceeded \$1 billion on client turn-over of over \$40 billion.

Considering the average length of a contract in the lottery industry is 13 years and I was in a position to be responsible for bids from 1998 through 2015 I directed the company's bid responses for most of the domestic market as well as bids in Latin America. My tenure overseeing bids included a three-year period beginning in 2010 when some of the company's largest contracts representing a significant share of business were competed including New York, Texas, Michigan and Illinois. We were successful in retaining all of these contracts through bidding while simultaneously growing the value of the contracts for IGT. In Illinois we won the first-ever private operator contract for a US Lottery which included a unique partnership with one of IGT's primary competitors, Scientific Games. In this contract and later in the Indiana private operator contract we proved that large lottery contracts can include solutions from multiple suppliers reducing the client's reliance on a single company for all of its needs.

Beginning with the New York competition we worked with that Lottery to increase transparency in the bidding process. This new approach to bidding was copied by Texas, Nebraska and others.

In 2010 I was given responsibility for IGT's new and struggling instant ticket printing business. We were successful in growing market share 400% and in achieving profitability through, in part, by working with states to modify bidding practices for more open and transparent qualifications of all suppliers.