



eLOT, Inc. ELOT

Initial Report

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Symbol (NASDAQ):	ELOT	Fiscal Year Ending: December 31				
Recent Price:	\$.34	Year	EPS ³	PE	REVS ³	PSR
Price Range:	\$.31-\$8.50	1998A	\$(0.51)	---	\$ ----	---
Avg. Daily Vol. (30 day):	404,272	1999A	\$(0.21)	---	\$.012	---
Industry:	Internet-Lotteries	2000E	\$(0.23)	---	\$1.00	24.0x
12 Month Target Price:	\$1.30	2001E	\$(0.10)	---	\$3.74	6.4x
Market Capitalization (000):	\$24,062	2002E	\$.01	34x	\$16.00	1.5x
Capitalization: 9/30/00 – 10Q (000 omitted)		Estimated 2000- 2003 Annualized				
Shares O/S ¹ :	70,000	Growth Rate:	200%			
Cash & Equiv ² :	\$ 10,176	Dividend:	Nil			
Net Working Capital:	\$ 13,019	Yield:	Nil			
Long-Term Debt:	\$ 13,301	Inside Ownership:	12% fully diluted; 1.6% actual			
Shareholders Equity	\$ 28,345					

1. As of January 31, 2001.
2. \$3.5 million restricted cash settled December 2000 for \$2 million free cash.
3. Continuing Operations.

Recommendation: Speculative Buy

BASIS FOR RECOMMENDATION

eLOT, Inc. is positioned to be the leader in the web-based sale of lottery tickets and ticket subscriptions as the state and international lotteries adopt the Internet as an alternative marketing and distribution channel. Considering the extraordinary historic and prospective growth of Internet gambling, the US state lotteries, if only for defensive reasons, will provide Internet purchase access to lottery players. The Company has applied a number of strategies that are beginning to demonstrate that eLOT should achieve an important share of the commission income to be available for lottery ticket sales transacted over the Internet. We assign the stock a Speculative Buy rating and recommend its purchase by aggressive investors for potential significant appreciation.

- eLOT has divested itself of a substantial conventional telephony asset base for investment in its lottery service business. It expects to receive additional cash through the sale of all or part of its final legacy asset later in 2001.
- It has positioned itself as the first Internet company working with states, initially by Internet marketing initiatives, and then for lottery subscriptions and ticket sales by Internet. The December 2000 Maryland Lottery contract with eLOT for Internet subscription sales was the first in the US.
- \$45.9 billion was spent in North America in 2000 on state lottery products, none via the Internet. The population is, we believe, ready for lottery participation via the Internet.
- People increasingly are gambling via the Internet. By 2004, \$123 billion is expected to be wagered worldwide in all venues on the Internet. Lotteries must migrate to Internet marketing

and sales to protect their markets and grow. Over 150 million people in the US are considered lottery players, and over 50% of those are on the Internet.

- A state's rights shift in the new Congress suggests that if any Internet gambling prohibition were passed, it would exempt states' lotteries.
- State legislatures need the increased funds that can be provided by higher lottery sales, and early eLOT programs demonstrate that the Internet can stimulate sales.
- eLOT has partnerships with the key players worldwide, including PlasmaNet (FreeLotto), Autotote Corporation (TTE), and MDI Entertainment (LTRY).
- The potential for the desisting of eLOT shares from NASDAQ exists. This has been a depressant on its share price, with the result that its current price is not reflective of the Company's progress towards its business objective.
- We expect that these shares will be upgraded this year as more contracts are announced.

Overview

By 2004, over US\$123 billion is expected to be wagered via the Internet, with at least half coming from North Americans. The sites receiving this wagering are offshore. The forms of Internet gambling primarily included are sports books, pari mutual, and casino games. Lotteries, on which US\$130.0 billion was wagered worldwide in 2000, are one of the most popular forms of gaming, but are mostly controlled by governments. Hence, forecasters have taken a conservative near term view towards their migration to the Internet, particularly in North America. Forecasters have viewed the political debates on prohibition of Internet gaming in the last Congress as impediments to a US state making a political decision to employ the Internet for sales.

Conditions are now rapidly changing. States are beginning to migrate marketing functions and some subscription sales to the Internet. This trend should accelerate. In the last Congress, Kyl's Senate bill passed, while the proposed Goodlatte House bill was not enacted. While the battle over this legislation was underway, states lacked the political will to make the right business decision. Goodlatte, if it had passed in its amended form, would have prohibited lotteries from selling tickets via the Internet. If Goodlatte's sponsored legislation is reintroduced in this session, it is probable that it would be in its original form that exempted state lotteries. In our view, the Internet will remain open to state lotteries for marketing and subscription sales, and will be used increasingly. eLOT is uniquely and exceptionally well positioned to lead and benefit from this migration. We view the primary business drivers for eLOT as:

1. The Congressional debate should shift to a state's rights position, and this is reflected in the new Leach Bill in the House that defines illegal Internet gaming as that Internet gaming activity as defined by the individual state(s). States can define what is legal Internet gaming within their borders.
2. In January, in New Jersey, and soon, in Nevada, legislation has been introduced that will legalize and regulate Internet casino and other forms of gaming via the Internet. Most lotteries are already state controlled, so approval for use of the Internet in most of these states would appear likely. All but two states have some form of legalized gambling.
3. Annual lottery sales in North America have stagnated around \$40 billion, with competition for the gaming dollar rapidly intensifying. The industry needs new players and increased player frequency. Forward thinking lottery managers such as in Indiana, Maryland, and Idaho recognize the benefits of incremental business and increased frequency of play that can be attributed to the Internet.

4. Over US\$1 billion is spent worldwide by lotteries on marketing and advertising. eLOT provides a highly cost effective VIP Club opt in email program to stimulate sales. Further, the aggregation by eLOT of a frequent player database by state is made available to the state lotteries. These players are attractive advertising targets.
5. We expect ongoing studies will demonstrate that Internet lottery subscription or ticket sales are not cannibalizing existing ticket sales via a state's current land based sales organization. These outlets are primarily independent merchants and convenience stores chains. As a group, they have been politically active in discouraging Internet encroachment into their lottery sales market. In passing, it should be mentioned that lottery ticket sales have become a mixed blessing for this land-based group. (Big well-publicized jackpots create bottlenecks at the register). At stake are commissions on lottery sales of \$2.5 billion domestically and a world wide total of \$8.5 billion.
6. The lack of an Internet sales channel for the states will likely result in decreased sales as existing players migrate to more convenient interactive Internet sales channels for competing products.
7. States face an increasingly large backlog of capital expenditures for critical infrastructure projects. Increased lottery proceeds will provide much needed revenues for several of these infrastructure project classes (e.g., education), freeing up resources for the remainder. This is an attractive proposition for state legislatures.
8. eLOT has demonstrated both the technical and marketing expertise to migrate lotteries to the Internet. The Company has also formed alliances with key players in the lottery industry. There are cross equity positions with eLOT and these key industry participants. With its partners, eLOT has designed and implemented programs and alliances for states that have increased player frequency and attracted new players.
9. In Europe, \$63 billion of lottery products were sold in 2000. Several of eLOT's partners are either in Europe or are opening European marketing campaigns. The Company has also launched a direct sales initiative in the UK, and other large volume jurisdictions.
10. eLOT has first position today in moving lotteries to the Internet, a major competitive advantage. It economically wins with subscription sales, which are politically less complicated than the sale of individual tickets. Maryland and eLOT are pioneering the sale of subscription sales over the Internet.
11. A portion of the North American \$40 billion annual ticket sales will be pre-sold by subscription. Average transaction amounts for subscription sales should be substantially higher than for sales of individual tickets. The subscription is for advance purchase of certain games and/or numbers for up to a year in advance, or can be for any combination of a state's lottery games. A player could subscribe to 10 numbers weekly for 52 weeks, resulting in a \$520 transaction. Conceptually, a balance remaining during the period can be reallocated to a large jackpot that develops, including in the multi-state games such as Power Ball. Subscription sales are a pre-payment system with the potential of creating a significant float for the states. Historically, subscription sales have been a small percentage of overall lottery sales because the process was labor intensive and therefore subscriptions were not aggressively promoted by the states. The Internet is the ideal application to reduce the labor component providing the incentive to promote subscriptions and stimulate sales.

12. There are three investment caveats:

a. Timing of lottery migration to the Internet – We believe Internet access to state lotteries is when not if” proposition. However, the “when” is hard to forecast due to the vicissitudes of dealing with governments. And of course, Congress is a wildcard. A reintroduction of the Goodlatte bill in its final amended form prior to the adjournment of the last Congress could further slow the process of Internet adaptation.

b. eLOT cash resources – Current cash balances, a pending asset sale, potential additional financing and existing revenue sources should provide sufficient liquidity until eLOT reaches a cash flow breakeven level. However, the timing of certain events is out of the Company's control. Ed McGuinn, a highly skilled and experienced investment banker, leads management and its fund raising strategies.

c. Competition – The sheer size of the market will attract competition. However, companies that dominate land based infrastructure services have not yet developed clear Internet strategies.

Corporate Background

eLOT, Inc, then Executone Information Systems, Inc., began a metamorphosis in 1995, evolving through several stages into a business today that is unrecognizable from the telephony company of the past. Successive managements have transformed the company from one that generated \$150 million dollars of profitable revenues but as a second tier player with little potential for growth, into a business with only nominal revenues but extraordinary growth prospects.

The transition began with the acquisition of Unistar Gaming Corporation in 1995, which was renamed eLottery, Inc. in 1999. Unistar had an exclusive five-year contract with the Coeur d’Alene Indian Tribe of Idaho to design, develop, finance, and manage the National Indian Lottery (the NIL). The NIL (later known as the U.S. Lottery) was a national telephone lottery believed authorized under the federal Indian Gaming Regulatory Act of 1988. Operationally, lottery participants would purchase tickets via an 800 number line, with the purchase processed by interactive voice response systems or by a live agent located on the Coeur d’Alene Indian Reservation. The NIL required an extensive and sophisticated telephone network to handle the anticipated call volume. This was the historical forte of Executone. In return for the telephone system and management services, Unistar was to receive 30% of the profits of the NIL.

The economic potential of such a national lottery was enormous and threatened the existing state sponsored lotteries. Consequently, AT&T (joined by several of these states) challenged the legality of the NIL in Tribunal, State, and Federal courts. In December 1998, nearly three years after the Company’s Unistar Gaming acquisition, a Federal District Court ruled that the NIL was not protected under federal law. Subsequently, eLOT and the Coeur d’Alene Indian Tribe terminated operations of the NIL. eLOT had expended over \$30.0 million during the three years of the NIL.

As a hedge against potential adverse legal and political decisions, eLOT in early 1998 began investigating alternative applications and markets for its lottery fulfillment technology. It concluded that it possessed unique experience and technical skills, which would be required to effect the electronic distribution of lottery tickets over the Internet, intranets or via telephone. For the NIL, it had developed a state-of-the-art Internet and telephone-based system that provided both instant and draw lottery games, full player accounting and tracking, as well as an automatic credit or debit card clearance capability. It had acquired marketing experience in generating lottery customers. Its program before termination had sold approximately ten million electronic lottery “tickets”, generating monthly revenues of \$1 million. It was almost at break-even volume.

Further, the company realized that it must either work with the States or Indian initiatives. The Company established a new business plan. It has as its objective become a web-based retailer of lottery tickets and services for state and international lottery sponsors. The Company concluded that Internet marketing and distribution of lottery tickets made purchasing more accessible and would, with its marketing programs, result in significant incremental lottery sales. Such a program should be of great interest to domestic and international lotteries, which were suffering from stagnating sales as increasing and diverse competition intensified for the available gaming dollar. A background on the Lottery industry provides a useful context to position eLOT.

Industry Background

The Lottery is as old as gambling and is now well entrenched as an institution in most societies. The pragmatism of governments and the desire of the population to be entertained have proved to be intractable forces. Today, almost all states (38 of 50) plus Washington D.C. have a lottery. Last year fifty two million lottery players spent over \$40.0 billion in North America on state lottery games. To promote last year's lottery sales, state sponsors spent over \$1.0 billion on advertising to bring purchasers to over 200,000 US retail ticket vendors, predominately convenience stores. These ticket retailers are paid commissions of 5% to 8% of ticket sales, which last year totaled \$2.5 billion domestically and \$8.5 billion worldwide. The individual and chain convenience stores, fearful of any commission reduction or revenue diversion, have become a powerful lottery lobbying force in North America.

In the US, the state sponsored lottery was revived in the mid sixties after a hiatus of about one hundred years. First to establish a lottery was Rhode Island in 1964, which was followed by New York in 1966. During the 1970s and the 1980s, another 12 and 18 states, respectively, established lotteries to benefit from non-tax revenues. Today, the US count is thirty-eight states and Washington, D.C.. The US accounts for approximately 30% of worldwide lottery sales. The worldwide lottery market is shown in the following table. The following table suggests a maturing or flattening of the North American and international lottery markets, and in particular in comparison to the estimated growth in wagering via the Internet.

<u>Lottery Sales By Area (\$ Billion)</u>					
Area	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
North America	42.4	42.6	42.8	43.8	45.9
Europe	56.3	55	61.2	63.5	64.0
Asia/Australia	17.8	16.9	15.7	17.0	16.5
All Other	2.4	4.5	4.5	3.9	4.1
World Total	118.9	119.0	124.2	128.1	130.5

Source: LotteryInsider and Investrend Research, Inc.

Lotteries are a different gaming product. In a lottery, a player typically risks a small amount of money against very long odds to win a large prize, with the game's net proceeds going to the public good. Compared to other gaming venues, on a purely odds basis, a lottery provides the least attractive prospect for individual players to win money. The lottery prize pool or payout is only 50% of lottery tickets purchased while total game expenses including payouts runs to 60%-63%. Statistically, the odds of picking a winning lotto number in a large multi-state game generally run 80 million to 1. In smaller pools, odds range from the Florida Lotto at approximately 1 in 23 million, New York at 1 in 18 million, while the UK National Lottery is down to 1 in 14 million. In land based casino gaming, for example, the payout exceeds 90% of the aggregate wagers, with the house taking the equivalent of 4% - 6% percent off the top.

Increasing competition from other legalized gambling formats and venues, are causing lotteries to lose market share of the growing gaming dollar. Competition for the gaming dollar comes from land-based

casinos, Indian reservation gaming, riverboat gambling, sports books, and charity gambling. A recent threatening development for lotteries is the approximately 2,000 worldwide Internet casino and sports book gambling sites. Players are estimated to have wagered over \$6.0 billion worldwide via the Internet ("online") in 2000. We consider wagering projections of \$123 billion online (predominately casino and sports book) in 2004 to be reasonable. That is an amount, which is just slightly less than worldwide lottery sales in 2000. Five years ago, there were virtually no Internet gaming sites. State Lotteries have to take the Internet gambling encroachment seriously. The best defense may be an offensive move with the states initiating online ticket sales.

Internet and the Lottery

Lottery proceeds are addictive to state legislators. Lottery net proceeds in either real or gross terms are only growing in Europe, albeit at a low rate. State lotteries in the US need new players and new games to stimulate growth. Cogent and politically benign plans that bring in new players or games are likely to be seriously considered and adopted by lottery officials.

In our opinion, state lottery managers are ready to solicit new players, or allow others to solicit new players on their behalf, from among those 168 million adults who frequent the Internet. They are also ready, based on anecdotal evidence of effectiveness, to use the Internet to increase the frequency of play of the "occasional player". However, adoption of the Internet for sales and distribution is not as simple as the introduction of a new lottery game. The technology or method to screen out the under-aged, the non-state resident, and the problem gambler must be demonstrated. The technology does exist to accomplish these goals. The image or politics of gaming in cyberspace must not be risky to elected government officials. This latter issue has been exacerbated by the uncertainty of potentially adverse federal legislation and the hyperbole surrounding the debate. Last year, an impediment was Senate bill S-692 (aka the Kyl Bill) passed by voice vote in the Senate. Its companion House bill, HR 3125, referred to as the Goodlatte Bill, subsequently failed to pass in a hard fought battle. The Goodlatte legislation, in particular with its amendments, sought to prohibit US citizens from virtually all gambling online. With the failure of Goodlatte to pass, we believe the issue of a full federal prohibition passing both houses is low.

Early in this new Congress, Rep. James Leach introduced House Resolution 556, a bill entitled the "Unlawful Internet Gambling Funding Prohibition Act". It is a bill that seeks to halt defined Internet gambling in the United States by making it nearly impossible for Americans to use US bank instruments to pay for their online gambling activities. This bill only prohibits Federally what an individual state defines as illegal, following an increased emphasis on "states rights". For state lotteries, the first bill out this year would not prohibit their migration to the Internet. While Goodlatte continues to talk about reintroducing a bill in this Congress, we note certain points that mitigate any probable negative effect for state lotteries:

1. The states rights tenor of the new administration.
2. The attachment of the Pease Amendment outlawing states lotteries is the main cause of the failure of Goodlatte to achieve passage of his bill. An earlier version exempted state-sponsored lotteries and was likely to pass, in the opinion of those close to the legislative process.
3. Land based gambling interests now inclined to favor state licensed Internet gambling.
4. The introduction of bills in New Jersey, and probably shortly in Nevada, authorizing state regulated Internet gambling.
5. The potential economic slowdown suggesting states are looking at additional revenue sources.

Thus, an absence of prohibiting Federal legislation regarding Internet gambling should provide political cover for states. State lottery officials are not oblivious to the benefits of the Internet, and they generally

have taken small steps forward. These consist of maintaining a web site for the convenience of its players and the promotion of its games on their sites. While states are not likely themselves to sell subscriptions or lottery tickets directly on their sites, the state sites can be linked to lottery ticket retailers. With respect to effecting subscription or ticket sales over the Internet, it was observed that no state wanted to be the first, but neither did any state wish to be third.

The State of Maryland resolved the question of who would be first. It recently announced selection of eLOT to facilitate its lottery subscription sales over the Internet. We think, as does Maryland, that the choice of eLOT was a logical one. First eLOT, Inc. has over five years of lottery technical expertise and marketing experience. Secondly, eLOT, through its Internet Marketing, Analysis, Research & Communications Systems (IMARCS) initiative, had a client relationship with the Maryland Lottery that began in May of last year. Third, through its own free play site and its purchase of player names from PlasmaNet (FreeLotto), it is able to seed the state's VIP Club with a significant number of email addresses of interested Maryland lottery players.

eLOT: Marketing Strategy and Tactics

The goal of eLOT is simply to be the leading Internet retailer of lottery subscription and ticket sales for the individual state and international lotteries. It is a simple goal but requires complex strategy and tactics for its achievement. Widespread adoption of online lottery ticket sales is still some time in the future. eLOT has laid out an interim business strategy to build a base business that generates revenues and provide it with the necessary relationships that afford a competitive advantage over the few existing participants and any new entrants into this lucrative market. The strategy calls for the Company to establish a strong industry presence with the state lottery decision-makers and with lottery players. The early position of eLOT led to its first lottery subscription contract with the Maryland State Lottery, which is perhaps the ideal prototype service for eLOT. When the online purchase of lottery subscription and ticket sales is commonplace, eLOT should be well entrenched as a major, if not the dominant Internet lottery retailer and information/communication source. This building of an Internet lottery infrastructure is conceptually similar to GTECH, who grew by providing equipment and telecommunications infrastructure for the lottery industry.

In the last six months, the Company has continued to assemble additional necessary initiatives, alliances, and relationships that will allow it to be a unique one-stop shop. The Company has implemented a four step tactical program for state lotteries that would lead a state to lottery Internet ticket retailing. The four steps are 1) web site development and enhancement, 2) VIP Clubs, 3) opt-in email marketing, and 4) offering lottery subscription sales. This fourth function, lottery subscription sales via the Internet, may in fact be the ultimate economic activity. In each of these steps, the Company has created an alliance with one or more companies possessing a missing expertise or experience, or who can assist eLOT in establishing lottery management contacts and relationships. In most cases, a cross equity ownership stake has been taken. A future contract with a state lottery will very likely include the sequential adoption of at least the last three steps of the eLOT four-step program.

The Company's primary vehicle for initiating a business relationship with the lotteries is called IMARCS (Internet Marketing, Analysis, Research & Communications Systems). This is closely followed by the contractual and marketing relationships it has with MDI Entertainment and FreeLotto. Further, the Company's web sites, eLotteryFreeway.com and eLottoNet.com are tactical vehicles to build a database of lottery players that can be integrated into the IMARCS program.

IMARCS Program

eLOT's IMARCS program was created by the exclusive agreement for the lottery market between eLOT and the IMARCS Group, Inc., a privately held company based a Florida. IMARCS Group has an Internet

software platform that enables state lotteries to enroll online lottery players into a VIP Club (Very Important Player) and then to regularly communicate with those players by way of opt-in email. VIP membership benefits are designed to be of interest to regular lottery players, including notification of winning numbers, special promotion notices, newsletters, Jackpot reminders, and new game announcements. eLOT markets this service as its IMARCS program.

The benefits of IMARCS to state lotteries are considerable. First, by a state starting an eLOT VIP Club, it facilitates the assemblage of a large database of frequent lottery players. The club registration provides demographics that are invaluable in the design and implementation of marketing campaigns. The club's audience becomes the target of highly focused, low cost, opt-in email marketing programs that are designed to stimulate incremental ticket sales. A selling proposition of eLOT is that new incremental players who are Internet enabled can be attracted to the lottery pastime. Furthermore, the play frequency of existing players can be increased. It is believed that the Internet lottery sales will be from new players or that existing players will increase their frequency. If analysis demonstrates this to be the case, then states will have less political concern with its existing land based retail network, and the pace of online migration would accelerate.

North American lotteries spend, in the aggregate, \$1.0 billion annually on traditional advertising - TV, radio, and print advertising. This advertising is costly and scattered when compared to a highly focused permission email campaign. The acceptance by the states of the Internet as an important marketing medium is critical step to accelerating lottery sales. Permission email provides marketing precision, and is becoming the Internet marketing tool of choice. A Jupiter Research survey concluded that response rates to opt in email are about 10%-15% while the response to traditional advertising is random, and are too uncertain to measure its efficacy. Forrester Research forecasts an increase to \$4.8 billion in 2004 in marketing expenditures for permission email compared to \$156 million in 1999. The IMARCS initiative is positioned to capture a leading share of the opt in email expenditures of the lottery industry.

The lottery playing Internet public has responded to VIP Clubs. Indiana's new VIP Club obtained 12,000 enrollments. Maryland has generated 10,000 enrollments. The first IMARCS client, Idaho has over 35,000 VIP members. This calendar year, the Company expects to add an additional 10 to 11 IMARCS customers to the four now signed and announced.

eLOT provides another benefit to the state lotteries with its IMARCS relationship - the seeding and building of enrollees into the state's VIP Clubs. eLOT generates its own lottery player names on its two lottery related web sites. It also purchases large blocks of names from PlasmaNet. It specifically markets to names in the state from these proprietary lists the benefits of joining the VIP Club in their state. Also, its alliance with MDI Entertainment provide branded state lottery ticket programs that generates large volume of potential VIP Club names as part of second and third chance drawings with non-winning tickets.

Third, the installation of the IMARCS VIP platform for a state lottery is simple and low cost. There is no fixed operating cost increase for the state, as the IMARCS cost is almost entirely variable. Costs are transaction based, and are a function of the number of emails sent. State lottery personnel design the marketing campaigns and compose the email messages. They have discretion over the number of email messages that are transmitted although a minimum annual charge motivates the lottery marketing departments to make a commitment to the program. These low installation and operating costs are due to IMARCS functioning as an Application Service Provider (ASP). The scalable software and databases reside on the IMARCS Group's data center in Florida. The VIP Club icon displayed on the state lottery web site is a hyper-link to the IMARCS server. IMARCS Group computers carry out all of the functions, from the data collection of the registration process to the fulfillment of email messaging. The state lotteries do not have capital costs nor is there any expansion required in their IT departments. The ASP

structure explains why the state lottery can be in the VIP Club business in just a few weeks and a very low price of entry.

The sales cycle of IMARCS has been running six to nine months, while an IMARCS state program can be operational in a matter of a few weeks. The long decision process includes the lottery director and staff, and the state governor and attorney general generally review a recommendation. Over the intermediate term, any Internet based program is likely to be met with scrutiny and caution because of political considerations. However, the reappearance of states' rights in gaming determination within a state's borders, the compelling argument for using the Internet to generate incremental lottery revenues, and demonstration that the Internet does not cannibalize existing land based sales, will all lead to future rapid adoption of these programs.

The early US adopters of the IMARCS program are the states of Maryland, Idaho, Indiana, and, internationally, Jamaica. With management expecting to add an additional ten to twelve states in 2001, total states in IMARCS would then be fifteen to seventeen. The IMARC contract terms provide for a payment for each email sent to its VIP members. The rate per email for the initial state contracts is \$0.022 per email, which is significantly under the prevailing opt-in email rates. The VIP program goal for each state is to sign up 25% of the state's lottery player base, and then to communicate to them on a regular basis. The theoretical market for email marketing to VIP Clubs members is small relative to the sales commission opportunity. However, it is more immediate over the short term. In quantifying the market, we assume the following. The gross adult population within the 39 US jurisdictions that have lotteries is about 200 million. Approximately 70% or 140.0 million are regarded as regular lottery players and 25% or 35.0 million of these regular players are expected to be enrollees in the VIP Clubs. Assuming the price per email will remain at \$0.022 and that the annual emailings will be 150 messages per VIP members, then the theoretical market would be approximately \$115.0 million. This level of email marketing costs could readily be absorbed within the current collective marketing budgets of the state lotteries.

The VIP Club initiative is an attractive business in its own right. However, it is but an interim step towards the goal of online subscription and ticket sales. The VIP Club is the door opener to Internet sales, with the Maryland State Lottery a first proof of concept. Maryland entered into a VIP Club agreement in May 2000. In December, Maryland awarded eLOT with a contract to provide the Internet interface to its lottery subscription system. A short-term impediment to broad Internet utilization is the payment mechanism. Maryland does not have enabling legislation allowing credit cards to be used for lottery subscription of ticket sales. Consequently, the process requires an interim step. Absent the payment methodology, this milestone subscription sales arrangement is, in many respects, indistinguishable from a retail agency agreement. eLOT is now in the business of effecting Internet lottery subscription sales.

The IMARCS platform is a communication infrastructure – an Internet pipeline to be filled with lottery players who are expected to have a high propensity to buy Internet lottery subscriptions and, potentially, tickets. The states generate players by promoting their web sites, attracting visitors who in turn register in the VIP Clubs. As noted, eLOT is also building a database of web enabled lottery players who can be integrated into their respective state's VIP Club, building the base of probable Internet buyers of lottery subscriptions/tickets. Two Internet initiatives and three alliances are engaged in this player name recruitment effort.

The Internet initiatives are eLotteryFreeWay.com, the company's reward entertainment site and eLottoNet.com, a lottery email notification service (LENS). The alliances are with MDI Entertainment, Terra Lycos, and Autotote. Each strategic relationship is described below.

MDI Entertainment

MDI specializes in developing and marketing branded specialty scratch or instant games that are sold by the North American lottery industry. The lotteries introduce about forty new games each year in order to maintain player interest. Instant tickets are a growing portion of the new lottery products. They represent nearly \$16.0 billion or 42% of the North American lottery sales. The following table displays a breakdown of the lottery sales mix.

<u>Games</u>	World Wide Lottery Sales By Category (\$Billions)				
	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Lotto	45.2	45.6	46.7	50.4	53.1
Numbers	11.8	13.3	14.0	15.5	16.5
Keno	2.4	2.9	3.0	3.1	3
Other	2.8	4.8	4.4	5.6	6.6
Sports Toto	6.9	6.7	5.6	5.3	4.4
Draw/Passive	19.9	20.4	18.0	17.5	18.3
Instant	<u>24.5</u>	<u>26.9</u>	<u>27.3</u>	<u>26.8</u>	<u>26.3</u>
Total	113.5	120.6	119.0	124.2	128.2

Source: LotteryInsider

MDI has licensed the rights to use over thirty entertainment properties, personalities or cultural icons in the promotion of second chance drawings. By way of example, the specific properties include Harley Davidson, Wheel of Fortune, Elvis Presley, Ray Charles and Spam. In its simplest form, where no merchandise is involved, a lottery may promote an MDI game and pay MDI a fee – typically 2% of sales. MDI then pays a 20% license fee to the property owner. Increasingly, the game includes a second chance opportunity to win prizes, either cash or merchandise. Players participate in these second chance games by mailing or, more recently, conveying via the Internet, their losing lottery ticket to the sponsoring lottery. MDI has provided over 125 second chance promotions to thirty-nine North American lotteries. The Company has conducted surveys that provide persuasive evidence that the MDI branded games are responsible for new players and/or an increased frequency of play among occasional players.

In November of last year, eLOT and MDI entered into a joint venture, which provides for eLOT to facilitate the partial migration of the MDI second chance players to the Internet. Until the recent Indiana Spam promotion, the second chance players, even those who are web enabled, have had to rely on the US mail to send their losing ticket to the lottery for a “second chance”. Interestingly, of the 35,000 players in the February, Indiana Spam second chance game, 34% participated over the Internet. MDI will benefit from the alliance by being able to offer eLOT’s Internet experience and core technology as an enhancement to its instant ticket promotions. eLOT’s motivation for the joint venture is the potential to add state lottery IMARCS clients and to increase the membership in the IMARCS VIP Clubs. Second chance players who submit online the ID number of their losing ticket are very likely to join the VIP Clubs. The relationship with MDI should also lead to opportunities of mutual interest with another of MDI’s strategic partners, Scientific Games, Inc. SCI is the world’s leading supplier of instant lottery tickets. Scientific Games was recently acquired for \$308.0 million by Autotote Corporation, another major player in the gaming industry. eLOT’s Internet expertise is the basis for a symbiotic relationship with those companies more entrenched in the worldwide lottery industry.

eLottoNet.com

The Company’s eLottoNet web site’s function is to collect names and email addresses of visitors predisposed to play the lottery. The site offers its over 1.6 million registered lottery players an opt-in email notification service (referred to as the LENS program). Enrollees receive regular reports of lottery results for their respective state. eLOT acquired the site, previously called LottoNet, in May of 2000 from

PlasmaNet, Inc. as part of an overall strategic partnership agreement. PlasmaNet, a leading online database marketing company providing targeted advertising and marketing services, also owns and operates the web site FreeLotto. This site receives over 13 million unique users each month. As part of the strategic agreement, PlasmaNet provides branded links on its home page to eLOT's two web sites – eLottoNet.com and eLotteryFreeway.com. PlasmaNet also gave eLOT the right to market products and services to the FreeLotto user base.

Most importantly, the Company purchased up to 5.0 million lottery player names and email addresses with up to 375,000 deliverable quarterly over the life of the five-year agreement, with no obligation to pay for unsubscribed names. eLOT has issued to PlasmaNet 1.6 million eLOT common shares valued at \$4.3 million, in consideration for the purchase of the LottoNet web site and as payment for the first 500,000 names.

eLotteryFreeway.com

This site is a rewards-entertainment lottery portal that collects Internet lottery players. The site attracts approximately 750,000 unique visitors per month. It is also intended to establish the eLOT brand. Revenues are also being generated from advertisements and merchandise sales. It is currently uncertain whether the goals of eLotteryFreeway are being met relative to the expenses in maintaining the site.

Virtgame.com

Virtgame is an Application Service Provider (ASP) specializing in eBorderControl technology for the gaming and lottery industries. E-BorderControl limits e-commerce to one jurisdiction or restricts access of users from a specific jurisdiction over a proprietary State Wide Web technology. eLOT has acquired a license, which gives the Company the right to include the proprietary eBorder Control technology in all of its lottery e-commerce solutions. The Virtgame software compliments eLOT's existing border control techniques. It allows the states lotteries to demonstrate a good faith effort in maintaining the integrity of an intra-state business.

Competition

eLOT's long-term goal is to be the leader in Internet ticket sales. At this time, there are just a few contenders that may compete in this market with the Company. GTECH is the dominant international vendor of lottery products and services. It does not retail tickets, but provides the lotteries and land based retailers with terminals and a communication infrastructure. Gtech has 29 domestic and 53 international lottery customers. Uwin!, the Company's Internet-gaming subsidiary formed in May 1998, has secured two international contracts – Ireland and Denmark which are due to go live later this year. Gtech, through Uwin!, may move more aggressively in Europe where the attitude toward gambling and the Internet is less restrictive than in the US.

Another potential contestant for lottery ticket sales is Automated Wagering International, Inc.. AWI is a subsidiary of Anchor Gaming, a vendor of casino gaming equipment and a casino property owner and operator. AWI designs, manufactures, markets and operates on-line (not Internet) lottery systems worldwide. AWI has no announced strategy for directly selling lottery tickets over the Internet.

Autotote Corporation also has a major position in the lottery industry, which was recently strengthened with the acquisition of Scientific Games. SGI offers a portfolio of integrated lottery products, systems and services to lotteries in more than 60 countries, including the majority of the North American lottery organizations. Autotote markets central processing and a land based online communications networks. It is more likely that eLOT will have a cooperative rather than a competitive relationship with both Autotote and SGI. eLOT already does business with Autotote and MDI Entertainment, an eLOT strategic partner, has a good business relationship with SGI.

There is little visibility as to who else might emerge as a major player. The land-based retailers could provide online access terminals on their premises although it is not likely that they would take such an initiative independently. In fact, eLOT has discussed with a retail chain the possibility of installing freestanding lottery ticket kiosks in retail establishments.

While competition will undoubtedly develop, eLOT is well positioned as the first mover in the Internet lottery ticket sales space. The leverage of an entrenched IMARCS program and the strategic alliances with MDI, Autotote, and PlasmaNet should give eLOT a distinct advantage in capturing a significant share of the future Internet lottery sales commission market.

Financial Background

Since 1996, the Company has raised approximately \$108.0 million of cash principally by selling the Executone telephony assets. The timing of the transactions and the amounts realized are as follows:

- (a) On May 31, 1996, eLOT, then Executone, sold the Company's direct sales and service organization to a newly formed private company. The purchase price was \$61.5 million in cash plus a note and warrant for \$5.9 million.
- (b) On January 1, 2000, the Company sold its computer telephony division to Inter-Tel, Incorporated for \$42.8 million in cash plus the assumption of certain liabilities.
- (c) On July 21, 2000, the Company completed the sale of its Healthcare Communications division to the Grinnell Corporation for \$5.0 million in cash plus assumption of certain liabilities.

The use of the \$108.0 cash proceeds has been for:

- (a) The funding of the Unistar/NIL venture (\$30.0 million).
- (c) The funding of the operating losses of the divested operations prior to their sale (\$35.0 million).
- (d) Working capital (\$43.0 million) of eLOT over the past three years.

The Company has announced its intention to sell its 51% ownership position in Dialogic Communications (DCC), a privately held vendor of telephony products and systems. Executone acquired a 46% stock position in 1995, with the final portion of 51% acquired in January 2000. Dialogic is said to be the leading provider of high-speed notification and corporate messaging systems. DCC has developed an enterprise messaging system named Reciprix™ that is built on the Microsoft® BackOffice platform and integrates the Microsoft's Outlook® 2000, Microsoft® Exchange and Microsoft® SQL Server. DCC recently announced that Microsoft Corporation has awarded Business Partner status to the company. Microsoft also provided a \$4.0 million financing to support the company's expansion. eLOT management believes, based on the valuation of the Microsoft investment, that the Company's 51% interest in DCC has a value in the range of \$15.0 million to \$20.0 million. eLOT and DCC have retained the services of an investment-banking firm to raise new money for DCC and sell all or a portion of eLOT's holdings of DCC.

On December 31, 2000, the Company had approximately \$3.7 to \$4 million cash and prospects of raising \$5.0 to \$10.0 million in the next four to eight months from the DCC stock sale. Operationally, there are projected revenues of \$ 6.0 to \$7.0 million over the next twelve months that should produce an EBITDA loss of \$6-8 million. The Company's monthly net cash expenditures were approximately \$1,000,000 (inclusive of operating expenses, lobbying and consulting services and capital expenditures). We are projecting, based on management's comments, that these monthly costs are being reduced to \$900,000 and should decline to \$800,000 by the second quarter with additional cost cutting. If the Company is able to make or exceed our projected results, it should be able to finance operations over the twelve to eighteen

months without having to resort to an equity offering. The ability of eLOT to self-finance, at least over the next twelve months, is a very important investment consideration. A primary stock offering at the current depressed market price would be excessively dilutive.

Financial Projections

The following discussion is intended to provide additional information on the assumptions used for the projections. It will, as well, point out the areas where significant variance in actual future operations may occur due to external events.

At the end of the 2000 fiscal year, the Company adopted a new FASB proposal to account for its Advertising Revenues net of advertising commissions. Accordingly, the forecast of Cost of Sales does not contain any advertising commission expenses for 2001 and 2002.

Lottery result notifications (LENS) and eLotteryFreeWay are the major sources of projected 2001 revenues, and together account for most of the projected fiscal 2001 revenue gain over fiscal 2000. The lottery notification source of revenues (its LENS and LottoNet site) is sensitive to a number of factors. Economically, the primary factor is advertising rates. Advertising rates (CPM) for highly focused emailings have remained strong. The CPM rates for less focused lists are declining, and advertisers have increasingly deferred this less focused advertising expenditure. Consequently, its LENS program generates a per email revenue of only 25% - 35% of the VIP Club rate of 2.2¢ (approximately 50% of the IMARCS revenues are paid to IMARCS Partners). At the end of December, the Company had 1.65 million names, and adds 375,000 purchased names quarterly. The eLottoNet site had 472,000 unique visitors in January, compared to 498,000 in December. Many of these visitors become new registrants for the LENS program, adding to its name database.

Unlike most other name purchase agreements, the FreeLotto undertaking provides eLOT with a continuously growing number of active names during the three-year contract period. Each quarter, FreeLotto must first replace those prior names that have become nonexistent for whatever reason (e.g. unsubscription, email account termination, or change), prior to receiving credit for any additional quarterly delivered names. This new name delivery continues during the three-year life of the sales agreement.

From a net revenue perspective, management expects the rate of increase of total names (from quarterly name purchases and its other visitors) to mitigate partially the decrease in the CPM advertising rate. The LENS program had 1.65 million names as of December 31, and by year-end 2001, we estimate it will have between 2.5 and 3 million names. Our revenues estimates for its LENS program are based on assumptions as to average names during the quarter, the average quarterly emails per name, and the effective advertising rate translated at a CPM of between \$7.5 and \$8. The LENS emails are also generating between \$0.30-\$0.45 for CPC deals. Amortization expenses of the name cost are taken over three years, their estimated useful life. Advertising commissions average 35% - 40% and have been deducted from report revenues.

eLotteryFreeWay generates revenues from site advertising, and has a substantial cost of prize fulfillment. Advertising rates on the FreeWay are those for banner advertising. The low banner advertising rates coupled with the FreeWay's cost of e-point rewards fulfillment has resulted in the FreeWay site not being profitable. Cost reductions have been made, ranging from elimination of sports games to staff reduction. Significant reductions are to be made in Q1 and Q2, such that it is profitable. We expect that with a change to net revenue accounting, its cost of sales can be brought to 40% - 50%. With the Company's other newer name generation initiatives, e.g. LENS, FreeLotto purchases, and the MDI Entertainment joint venture, the necessity to maintain the FreeWay remains under review.

The timing and levels of revenues from other potential revenue streams, such as the IMARCS VIP Club program, suggest that they will become increasingly important in the latter half of the current year. In addition to IMARCS, the other revenues include a joint venture with Terra Lycos for a site with lottery notification, and its Jamaica contract. The transactional fees from the sale of subscriptions, a primary goal of the Company's business strategy, should begin in the current year and become significant in 2002. Although its initial state, Maryland, is without credit card authorization for lottery sales, it will be an example of interest in Internet enabled subscription purchases. It permits the Company's infrastructure to be fine tuned, and allows the Company to send the equivalent volume of VIP Club emails to yield a 3% - 3.5% commission rate on Maryland's subscription sales. Actual processing of the subscription purchase with credit or debit card would be expected to yield a typical retail commission of 5.5%.

This quarterly names purchase from FreeLotto, its LENS program growth, and the FreeWay all generate a fast growing list of lottery playing names that become the seed names for building VIP Club in the individual states. The MDI second chance site encourages Internet registrants to also register for the VIP Club, but it is not mandatory. Out of the growing VIP Clubs, revenues are generated by a state's email marketing, and then by the opportunity for VIP Club members to become subscription purchasers.

To support this business model, the initiatives of management are to:

1. Maximize available cash resources by the sale of legacy non core assets.
2. Reduce fixed overhead (the burn rate) and improve operational efficiencies.
3. Develop a stream of profitable interim revenues, primarily its lottery notification and base IMARCS programs.
4. Leverage the IMARCS relationships, which are then combined with the lottery names acquired, to provide states with an established Internet enabled customer base from which subscription ticket sales and focused marketing campaigns can be initiated.
5. Add the actual ticket sales function to a states subscription program.
6. Extend the business model internationally.

In fiscal 2001, the Company will be actively engaged in the first four steps above. Our net revenue estimate in the current year is \$3.7 to \$4 million. As we look into 2002, the major focus will be on steps three and four, and its international expansion. We assume 2002 could see subscription purchase programs by 2002-year end of 10 to 20, yielding an average of 5-10 states on line for the full year. Subscription revenues to eLOT could range from \$9 million to \$16 million, with, we expect, at least 70% gross margins.

Thus, there are significant variations of outcome in 2001 and 2002 for revenues and expenses, which are dependent upon:

1. Timing and number of states migrating to VIP Clubs in 2001.
2. Direction of the FreeWay and LENS advertising rates.
3. Timing and number of states migrating to a subscription sales model in 2001 and 2002.
4. Any introduction of blocking Federal legislation.
5. Expansion of credit card sale authority for state lotteries by their state legislatures.
6. The Company's cash resources.

eLOT, Inc.

 Statement of Continuing Operations and Forecast Thousands of Dollars

	FY 2000		As %	FY 2001					As %	FY 2002	As %
	Nine Months A	Year E		Q1 E	Q2 E	Q3 E	Q4 E	Year E		Year E	
Revenues											
LENS - LottoNet (net)				\$ 156.9	\$ 412.8	\$ 715.0	\$ 865.0	\$ 2,149.7	57%	\$ 3,617.7	23%
Freeway				100.0	204.0	325.0	390.0	1,019.0	27%	1,387.3	9%
IMARCS					50.0	125.0	250.0	425.0	11%	2,000.0	12%
Subscription/Ticket Sales				-	-	-	150.0	150.0	4%	9,000.0	56%
Total	\$ 558.0	\$ 1,000.0	100%	\$ 256.9	\$ 666.8	\$ 1,165.0	\$ 1,655.0	3,743.7	100%	\$ 16,004.9	100%
Cost of Revenues											
LENS - LottoNet				-	-	-	-	-	0%	-	0%
Freeway				75.0	122.4	162.5	175.5	535.4	53%	554.9	40%
IMARCS					25.0	62.5	125.0	212.5	50%	1,000.0	50%
Subscription/Ticket Sales							45.0	45.0	30%	2,700.0	30%
	2,017.0	2,717.0	272%	75.0	147.4	225.0	345.5	792.9	21%	4,254.9	27%
Gross Profit	(1,459.0)	(1,717.0)	-172%	181.9	519.4	940.0	1,309.5	2,950.8	79%	11,750.03	73%
Operating Costs											
Operations				450	500	500	500	1,950.0	52%	2,600.0	16%
Marketing				300	300	350	400	1,350.0	36%	1,950.0	12%
Lobbying Expenses				100	50	50	50	250.0	7%	200.0	1%
General & Administrative				1650	1600	1500	1500	6,250.0	167%	6,600.0	41%
	7,129.0	9,050.0	905%	2500	2450	2400	2450	9,800.0	262%	11,350.0	71%
EBITDA	(8,588.0)	(10,767.0)	-1077%	(2,318)	(1,931)	(1,460)	(1,141)	(6,849)	-183%	400.03	2%
Interest and Depreciation Expenses											
Amortization of customer Names		900.0		500.0	650.0	750.0	900.0	2,800.0	75%	4,680.0	29%
Depreciation		1,600.0		700.0	800.0	900.0	950.0	3,350.0	89%	3,685.0	23%
Interest Expense (Income)		1,600.0		400.0	400.0	400.0	400.0	1,600.0	43%	1,250.0	8%
	1,522.0	4,100.0	410%	1,600.0	1,850.0	2,050.0	2,250.0	7,750.0	207%	9,615.0	60%
Income Before Gain on Sale	(10,110.0)	(14,867.0)		(3,918.1)	(3,780.6)	(3,510.0)	(3,390.5)	(14,599.2)		(9,215.0)	
Net Gain on Sale of DCC Shares						6,000.0		6,000.0		10,000.0	
Pre Tax Income (Loss)	(10,110.0)	(14,867.0)		(3,918.1)	(3,780.6)	2,490.0	(5,208.7)	(8,599.2)		785.0	
Taxes on Income				-	-	-	-	-		-	
Net Income (continuing operations)	\$ (10,110.0)	\$ (14,867.0)	-1487%	\$ (3,918.1)	\$ (3,780.6)	\$ 2,490.0	\$ (3,390.5)	\$ (8,599.2)	-230%	\$ 785.0	5%
Earnings per Share (cont. ops)											
Primary	\$ (0.16)	\$ (0.23)		\$ (0.06)	\$ (0.05)	\$ 0.03	\$ (0.05)	\$ (0.11)		\$ 0.01	
Fully Diluted											
Shares Outstanding (000)											
Primary	64,682.0	66,000.0		70,000.0	73,000.0	75,000.0	75,000.0	75,000.0		77,000.0	
Fully Diluted	N/a	N/a		N/a	N/a	N/a	N/a	N/a		N/a	

Forecast by Investrend Research

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