MINUTES OF THE JANUARY 14, 2014, FINANCE COMMITTEE MEETING

The Finance Committee ("the Committee") of the Board of Regents of the Smithsonian Institution held a meeting on January 14, 2014, in the Smithsonian Castle in Washington, D.C. Participating were Committee Chair David Rubenstein* and Committee members Representative Xavier Becerra*, Senator Thad Cochran*, France A. Córdova, Roger W. Sant*, and David Silfen*.

Staff participating for all or part of the meeting included Secretary G. Wayne Clough; Chief of Staff to the Secretary Patricia Bartlett; Acting Inspector General Epin Christensen*; Smithsonian Enterprises Vice President of Finance and Administration Bruce Dauer; Under Secretary for Finance and Administration/ Chief Financial Officer Albert Horvath; Deputy Under Secretary for Finance and Administration John Lapiana; Associate Director, Office of Finance and Accounting Albert Lee; General Counsel Judith Leonard; Smithsonian Enterprises President Christopher Liedel; Director, Office of Planning, Management and Budget Director David Voyles; and Chief of Staff to the Board of Regents Porter N. Wilkinson.

CALL TO ORDER

The Chair called the meeting to order at 11:03 a.m.

APPROVAL OF MINUTES

Upon motion duly made and seconded, the draft minutes of the August 26, 2013, meeting were approved.

FISCAL YEAR 2014 FINANCIAL BUDGET

Mr. Horvath said there likely would be a short continuing resolution (CR) to finish the appropriations process. He thought the omnibus appropriations bill would pass within the next few days.

Fiscal Year 2014 Federal Funding. The Smithsonian received $775 million in Federal appropriations in fiscal year 2013. The fiscal year 2014 funding level will be $805 million. Mr. Rubenstein noted that, while this level is above fiscal year 2013 appropriations, it is still below the fiscal year 2014 request. Mr. Horvath said the number is better than what he anticipated six or seven months ago. The Salaries and Expenses number will bring the Smithsonian above the fiscal years 2012 and 2013 pre-sequester levels. The basic Facilities Capital program will be funded at $103 million. Funding levels for overall facilities maintenance and capital renewal, however, remain below industry standards.

The Smithsonian will receive $55 million in fiscal year 2014 to continue the construction of the National Museum of African American History and Culture (NMAAHC). Anticipated construction costs for NMAAHC total $540 million, which will be evenly split between Federal and private monies. Federal funding received to date totals $246 million. The remainder of the Federal

** participated by telephone*

commitment for NMAAHC construction will be included in the fiscal year 2015 Federal budget request. To date, private fundraising for NMAAHC totals $140–$145 million, including close to $90 million in cash. Secretary Clough noted that the Smithsonian achieved a total of $13 million in overall commitments in December 2013. Mr. Rubenstein thanked the Congressional Regents for their advocacy on behalf of the Smithsonian.

Issuance of Bonds. Mr. Rubenstein reminded the Committee that in late summer 2013 the Board of Regents authorized the Smithsonian to borrow money to address funding shortfalls for NMAAHC. In November 2013 the Smithsonian responded to the low interest rate environment and completed two transactions totaling $100 million: (1) a $50 million taxable 10-year fixed-rate bond issuance and (2) a $50 million five-year variable-rate bond issuance. The variable rate bond can be retired at any time, and the fixed rate for the 10-year bond is extremely low. Private funding will repay the debt. The Smithsonian has maintained its AAA rating with Moody's and Standard & Poor's.

Consequences of the Fiscal Year 2014 Appropriation. If the appropriation goes through, the Smithsonian will be able to avoid layoffs, furloughs, and reduced visiting hours at its museums. Ongoing consolidations and efficiencies have contributed to the management of costs. In addition, approximately 200 employees took advantage of the early retirement program.

SMITHSONIAN ENTERPRISES' INITIATIVES

Mr. Liedel stated that Smithsonian Enterprises (SE) has embarked on its most ambitious and broadest expansion in over a decade. SE is faced with two significant shifts: a rise in digital platforms and an increase in globalization based on those digital platforms. SE wants to continue to develop new products and grow in these two important areas. He also noted that SE's net gain increased from $27 million in 2009 to $32.6 million in 2013.

Two key areas of reinvestment in the core SE business include remodeling the specialty retail stores and retooling media properties into digital (which includes advertising in support of this effort). The remodeled specialty retail stores have been successful. Despite being closed for 16 days during the Federal shutdown, the remodeled stores in the National Museum of African Art (NMAfA), the Freer and Sackler Galleries (FSG), and the Castle saw increases in their growth rate over the prior year. NMAfA had a 2 percent increase, FSG had a 31 percent increase (and is projected to earn over $1 million for the first time), and the Castle was up 10 percent.

Direct mail in fiscal year 2013 grew 10 percent with an 8 percent increase in profits over fiscal year 2012. The average order value for the catalog sales grew by 5 percent over the same time frame.

Mr. Liedel noted that, after he first arrived in 2012, he refocused SE's advertising sales force towards digital development and away from print. Although SE's print advertising market share has increased to almost 20 percent in comparison to its competitors, the overall print advertising market is down. SE cannot look to print advertising as a significant source of income for the long term and must continue to invest in its digital transformation. Web advertising for fiscal year 2013 increased 18 percent from fiscal year 2012; the second half of fiscal year 2013 increased over 100 percent versus the first half. However, digital advertising only represents 10 percent of SE's total advertising intake.

Smithsonian Channel had another strong year and reached 30.2 million subscribers by January 2014, which allows SE to be Neilsen-rated and increases SE's access to more advertisers, including key corporate advertisers. 2014 is the first year the Smithsonian has the option to sell its ownership interest in the Channel, either in part or in whole, with the next opportunities coming in 2016 and 2018. Mr. Liedel expects revenues in the Channel to almost double from $56.5 million at the end of fiscal year 2013 to $103.7 million in 2016, with advertising revenue going from $4 million to $20 million during that same time period. This would increase the profits the Smithsonian could achieve from selling its ownership interest in the Channel. Mr. Rubenstein asked how much the Smithsonian invested at the beginning of the Channel's launch, what the valuation was at that time, and what the valuation is now for the Channel. Mr. Liedel said the Smithsonian originally invested $9 million for 30 percent equity, so the valuation was about $27 million at the time of investment. The Smithsonian's ownership interest is now $55 million.

To reach younger audiences, SE has invested in educational gaming with E-line Media in September 2013. Revenue growth for that company shows an increase from $2.1 million in 2012 to $8 million in 2014. SE will be involved in the Historia and Mind Craft games. Another key SE focus is online learning. SE has partnered with edX, Great Courses, and Deltak to offer courses and certified and degree programs. These projects are under development. One of the classes SE is creating with Great Courses is focused on art and art education. In addition, SE wants to tie such courses with the Smithsonian Journeys trip to Italy, as well as other trips associated with the arts.

In 2013, SE also launched its partnership with Gale Cengage to digitize Smithsonian manuscripts, archive materials, and other documents to make available to researchers, scholars, and academics around the world. The digitization plan goes through 2017, and will continue beyond that time. SE hopes to build royalties from this product line that, once fully implemented, will total $1.5 to $2 million annually.

Mr. Liedel updated the Committee on SE international initiatives. SE and PBS are discussing the development of four–six hours of programming for PBS's UK and European audiences. SE is also looking into working with Bertelsmann's publishing division, Gruner and Jahr, to bring a successful millennial magazine called *Quest* to the Smithsonian. The magazine is currently offered in 14 languages. SE would issue English and Spanish editions of the magazine in the United States, as well as offer it as a digital product.

Mr. Liedel discussed the relationship of SE business initiatives to the mission of the Smithsonian, including its collaborations with other Smithsonian units. He said SE has had great success with building relationships with the museums. For example, SE, with support from Under Secretary for History, Art, and Culture Richard Kurin, worked with the National Museum of American History to develop a new music initiative with Smithsonian Radio. This will support a pan-institutional digital musical archive effort and create retail products. SE and Smithsonian Radio have formed a partnership with the Grammy Museum and the Rock and Roll Hall of Fame. SE hired a new person to focus on Internet2 and the Channel, and work with museum curators to develop programming that reaches younger audiences. SE is also looking into online education platforms to create courses that focus on Smithsonian research; the program will rely upon collaborations with the museums. SE has offered Internet2 as an outlet for education for the Smithsonian Astrophysical Observatory, the Smithsonian Environmental Research Center, and the Smithsonian Tropical Research Institute. All SE programming and products go through a curatorial review to ensure they meet Smithsonian standards. Secretary Clough added that SE works with Assistant Secretary for Education and Access Claudine Brown to ensure potential products are educational, instead of just entertaining.

Representative Becerra asked if Mr. Liedel could comment on SE's efforts to reach "aware" moms and Latino audiences. As previously noted, SE is working with Bertelsmann to acquire the rights to distribute English and Spanish editions of *Quest* magazine in the United States. SE also is looking into investing in a new project—a classroom magazine in both Spanish and English—with its equity fund. SE is working to reach "aware" moms through a publishing plan with Capstone that is designed to help parents of reluctant readers. SE also is working with new digital platforms to develop map and science tools to help "aware" moms' children who would otherwise be reluctant to explore these subjects.

Representative Becerra questioned why SE might close the Union Station Smithsonian store. SE has transportation hub stores in Reagan National Airport, Dulles International Airport, and Union Station. Mr. Liedel said the Union Station store is away from commuter traffic, experiences low circulation, and has high rent, making the site economically unfeasible. Applying those resources to online stores would be more profitable.

Mr. Rubenstein asked what SE's single biggest challenge is. Mr. Liedel said the biggest challenge is getting SE up and running on the digital platform to offset drops in the print advertising business, as well as broadening product lines by continuing to build relationships with the museums. Another challenge is developing Smithsonian Radio and building enough quality content for required airtimes.

Mr. Rubenstein asked about the Made in American effort. SE is getting close to the 60 percent threshold. However, it is having trouble finding American sources for two of the biggest-selling items: gemstones and toys. Made in America cost SE about $3 million in product costs, a loss that cannot be passed on to consumers. Increased consumer sales volume must make up for the shortfall.

EXECUTIVE SESSION AND ADJOURNMENT

The Committee conducted an executive session and adjourned the meeting at 12:03 p.m.

Respectfully submitted,

David Rubenstein, Chair