



I found it hard to locate anything that clearly shows where the money comes from and goes, for a lottery. This is the best I've located so far.

M E M O R A N D U M

The bottom line is at the bottom.

Date: June 27, 2013

To: California State Lottery Commission

From: Robert T. O'Neill
Director

Prepared By: Nicholas Buchen, Deputy Director
Finance Division

Subject: Item 10(d) – Fiscal Year 2013-14 Budget

ISSUE

Should the California State Lottery Commission (Commission) approve the proposed budget that presents a sales goal of \$5.1 billion and is expected to provide \$1.3 billion to public education for Fiscal Year (FY) 2013-14?

RECOMMENDATION

Staff recommends the Commission approve the Lottery budget for FY 2013-14 as presented in the attached documents. Both the level of sales and the contribution to education projected in the FY 2013-14 Budget are the highest in California State Lottery (Lottery) history.

BACKGROUND

As included in the draft proposed budget provided to the Commissioners in May 2013, the proposed FY 2013-14 Budget reflects the Lottery's goal of \$5.1 billion in sales and is estimated to result in \$1.3 billion in profits to California public education. This budget includes resources necessary to deliver objectives of the FY 2013-14 Business Plan, as presented at the April 2013 Commission meeting. These business initiatives, in conjunction with proposed operational growth requirements, balance tactics to continue growing sales in the upcoming fiscal year as well as provide investments that set the foundation for continued growth in contributions to public education in future years.

DISCUSSION

Development of the Lottery's FY 2013-14 Budget began by generating preliminary sales projections by product, determining prize funding levels for each product type, and calculating associated fixed costs. Using the preliminary sales projections, a base budget was developed to determine the availability of resources to fund initiatives and address operational improvements to drive increased sales and contributions to public education.

The Business Plan initiatives were developed by reviewing our business operations as well as trends in the Lottery industry. Broad objectives and strategies were developed and prioritized. Tactics to implement these strategies were developed by staff and evaluated by senior management based on the availability of Lottery resources and the expected benefits those tactics would deliver.

The result of this process is the FY 2013-14 Business Plan that was discussed at the April 2013 Commission meeting, and is presented today for approval. A summary of the Business Plan initiatives with their associated costs as well as the required resources for operational growth and changes are included in this issue memo as Attachment I. Funding for the cost of the initiatives and other revisions reflected on Attachment I is included in the proposed FY 2013-14 Budget.

In order to achieve the significant growth in sales and profits over the next three years to become one of the largest lotteries in the nation, a foundation for the Lottery's Strategic Direction was formed based on four key themes. All goals and major initiatives tie back to one or more these four essential elements:

- Increasing sales not only in the Scratchers category but also in the jackpot games and other Lottery products.
- Building the playership of Lottery products so more California adults participate in our games.
- Growing the network of Lottery retailers and concentrating our best service to our most productive retailers and those with that potential.
- Improving the Lottery's infrastructure to handle the sales growth and build a more efficient and effective operation, and to cultivate an internal culture that is more collaborative and performance-driven with an eye towards the common, overall Lottery goal.

The result of this comprehensive assessment of sales goals and the funding needed to deliver those goals is the budget being proposed for the upcoming fiscal year. Attachment II to this memo presents the Lottery's proposed FY 2013-14 Budget.

A summary of the elements of the proposed FY 2013-14 Budget is presented below:

Sales

Total sales for all Lottery products are projected to be \$5.1 billion for FY 2013-14. This represents a \$668 million, or 15.1 percent, increase over estimated year-end sales levels for FY 2012-13.

The chart below compares estimated FY 2012-13 year-end sales with proposed sales goals for the FY 2013-14 Budget. Following the chart is background information for the sales goals for each product type.

Comparison of Revenues				
FY 2012-13 Estimated Year-End Sales and Proposed FY 2013-14 Budget				
<i>(Dollars In Thousands)</i>				
Sales:	Proposed Budget FY 2013-14	Estimated Year-End FY 2012-13	Difference	
SuperLotto Plus®	\$ 310,000	\$ 375,000	\$ -65,000	
Daily Games	340,000	344,000	-4,000	
Hot Spot®	170,000	153,000	17,000	
MEGA Millions®	350,000	386,000	-36,000	
Powerball®	520,000	199,000	321,000	
Scratchers®	3,410,000	2,975,000	435,000	
Total Sales	\$ 5,100,000	\$ 4,432,000	\$ 668,000	

SuperLotto Plus

Sales for SuperLotto Plus are projected to be \$310 million. This reflects a \$65 million decrease (17.3 percent) from projected year-end sales levels of \$375 million for FY 2012-13.

The goal set for SuperLotto Plus next fiscal year is considered conservative since SuperLotto Plus sales have declined only 10% with the launch of Powerball and the proposed sales of \$310 million for FY 2013-14 assumes close to a 20% loss in sales due to Powerball. Additionally, this sales figure is supported by FY 2013-14 Business Plan initiatives (i.e., the launch of a second chance draw feature for SuperLotto Plus and expansion of the Lottery retailer sales network through retail recruitment), that are expected to provide approximately \$7 million in sales gains for SuperLotto Plus.

Daily Games

The proposed sales goal for Daily Games (Fantasy 5, Daily Derby, Daily 3 and Daily 4) is \$340 million. This forecast is essentially unchanged from projected year-end sales level of \$344 million for FY 2012-13. The goal of \$340 million is primarily based on sustained sales trends in Fantasy 5 and Daily 3 over the past several years.

Hot Spot

A sales goal of \$170 million is proposed for Hot Spot, an increase of \$17 million (11.1 percent) over estimated year-end sales for FY 2012-13. The projected increase in sales is primarily attributed to a full year of the increased prize payout of 63 percent (the prize payout was increased from 56 percent to 63 percent in October 2012), plus Business Plan initiatives that increase the number of retailers in social venues (e.g., bars, restaurants, and bowling centers) and implementing retailer events at Hot Spot locations to promote the game.

MEGA Millions

The \$350 million sales goal proposed for MEGA Millions represents a decline of \$36 million (9.3 percent) from estimated year-end sales for FY 2012-13. This decline reflects a full year of cannibalization from the Powerball game as there are now two choices in multi-state lotto games for players.

With the changes to the matrix that are being proposed by the MEGA Millions Consortium, this sales goal reflects three draws during the FY 2013-14 with jackpots in excess of \$200 million.

Powerball

Sales goal of \$520 million is proposed for this game to reflect a full year of the recently-launched game. Although this is an increase of \$321 million (161 percent) over FY 2012-13 sales, the sales goal is still considered somewhat conservative based on the following factors and assumptions:

- Assumes a slightly slower rise in jackpot progression than was seen in the first two months (April-May time period) following Powerball's launch.
- Assumes a decline in the sales level at all jackpot levels from what was experienced in the first two months of the game despite the planned marketing initiatives to keep Powerball in front of the consumers and boost trial of the new game.
- Assumes just two draws with a jackpot of \$300 million or higher, which is lower than the historical and statistical averages for this game.

Scratchers

The largest increase in projected sales is in the Scratchers product line with sales expected to grow \$435 million to a total of \$3.41 billion. This sales goal represents a 14.6 percent increase over estimated sales for FY 2012-13.

The Business Plan initiatives are focused on higher price point games and various retail-related tactics. An increase in the number of \$10 games sold simultaneously will occur during the year as well as the launch of the Lottery's first \$20 Scratchers game in the fall of 2013. Additionally, there are initiatives aimed at improving the Scratchers inventory levels and mix of games at retail locations as well as promotions designed to enhance the visibility and merchandising of Scratchers in many stores.

With the gains in \$5 and \$10 games sales and the introduction of a \$20 game, the aggregate prize payout for Scratchers is projected to rise to 67.4 percent in FY 2013-14. This compares with an estimated year-end payout of 65.6 percent in FY 2012-13.

Expenses

Prize Expenses

The proposed sales goals in the FY 2013-14 Budget are supported by higher prize payouts, primarily for the SuperLotto Plus game and the Scratchers product line that includes the introduction of the Lottery's first ever \$20 Scratchers game. Prize Expenses are budgeted at \$3.2 billion, which is \$486.5 million (18.3 percent) above the expected prize level for FY 2012-13.

Continuation of the Lottery's strategy of utilizing higher prize payouts to increase sales is reflected in the aggregate change in prize payouts from 60.1 percent of sales in FY 2012-13 to 61.8 percent of sales in FY 2013-14. This increase in prize payout is one of the key drivers for the projected sales growth in FY 2013-14.

Administrative Expenses

The Administrative Expense budget is comprised of retailer compensation, gaming costs, and operating costs. Per the Lottery Act, Administrative Expenses are capped at 13 percent of total annual revenues.

Total budgeted Administrative Expenses for FY 2013-14 are \$663 million, an increase of \$86.8 million (15.1 percent) over expected FY 2012-13 expenses. This increase is directly proportional to the expected increase in sales for FY 2013-14. It is important to note the lion's share of this increase results from the cost of selling Lottery products, i.e., retailer compensation costs and game operating costs.

Retailer compensation costs of \$351.2 million account for 53 percent of the Administrative Expense budget for FY 2013-14. This amount represents an increase of \$46 million (15.1 percent) over expected FY 2012-13 retailer compensation costs and is directly attributable to the higher sales goals in the upcoming year.

Gaming costs are budgeted at \$102 million for FY 2013-14. This budget category includes the cost of operating the gaming system, acquisition of gaming equipment along with installation and maintenance, and production and distribution of Scratchers tickets. The increase of \$16.5 million (19.3 percent) from FY 2012-13 is primarily due to higher projected sales for FY 2013-14 and the anticipated acquisition of gaming equipment to support retailer expansion.

The remaining elements of the Administrative Expense budget are grouped as operating costs, which are comprised of personnel costs, advertising/marketing costs, and base operating costs. Operating costs also include the funding and resources required to execute the FY 2013-14 Business Plan initiatives as well as funding for operational improvements. The proposed budget includes establishment of 61.0 new positions and \$19.2 million allocated to meet the Business Plan and program expansion needs.

Also included within Administrative Expenses for FY 2013-14 is a \$5 million reserve for insurable risk. As a result of an assessment of the organization's risk exposures along with a comprehensive analysis to determine the most appropriate management of our insurable risks, we believe that a mix of insurance and self-insurance will allow the Lottery to continue operation with the most efficient and effective means. To cover our probable fiscal exposures for the areas we are electing to self-insure, we recommend including a \$5 million reserve in the Lottery's annual budget. Any unspent funds within this reserve will be transferred in their entirety to education at the end of each fiscal year.

This budget also continues the long-standing practice of providing an administrative spending reserve as a safeguard against future uncertainties and to provide the Commission and the Lottery the flexibility to take advantage of sales growing opportunities that may emerge over the course of the upcoming year. The proposed Administrative Spending Reserve is set at a \$15.1 million for FY 2013-14. The Administrative Spending Reserve is an element of the 13 percent of total revenues specified for Administrative Expenses, and the entire amount of the reserve remaining at the end of the fiscal year will be transferred directly to public education.

Summary

The proposed FY 2013-14 Budget contains sales goals of \$5.1 billion, a 15.1 percent increase over expected sales for FY 2012-13. This level of sales, combined with the other elements in the budget, is estimated to generate \$1.3 billion in contributions to California public schools, an increase of more than \$105 million over the contribution level projected for FY 2012-13. Both the projected sales level and the estimated contribution to education for FY 2013-14 are the highest in the Lottery's 28-year history. In addition, FY 2013-14 will mark the 14th consecutive year the Lottery will surpass a billion dollars in contributions to public education.

While the \$5.1 billion sales goal and the \$1.3 billion estimated contribution to education for FY 2013-14 represent unprecedented levels, they are based on execution of a vast array of Business Plan initiatives designed to result in sustainable growth of future revenues. The proposed budget includes a balanced approach between actions that will increase sales above the record setting levels of FY 2012-13 as well as prudent investments that will provide greater sales and contributions to public education in years to come.

Attachments

ATTACHMENT I

FISCAL YEAR 2013-14

**SUMMARY OF FUNDING NEEDS BY GOAL
(Dollars in Thousands)**

Initiatives/Goal	Positions	Cost
• Products		
✚ Continue Scratchers Enhancements		\$1,250
✚ Optimize the Draw Game Product Mix		\$230
• Players		
✚ Grow Playership of Lottery Games	1.0	\$3,814
✚ Improve the Lottery's Overall Image with Consumers and Stakeholders	1.0	\$1,035
✚ Expand the Lottery's Corporate Social Responsibility Program		
✚ Maximize Return-of-Investment of Advertising and Promotions	1.0	\$3,325
• Retailers		
✚ Expand the Network of Lottery Retailers	10.0	\$1,610
✚ Optimize the Support Provided to Lottery Retailers	31.0	\$3,870
• Infrastructure		
✚ Improve the Lottery's Infrastructure	17.0	\$3,678
✚ Build a One Lottery Culture within the Organization		\$393
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TOTAL, FY 2013-14 INITIATIVES AND OTHER REVISIONS	<u>61.0</u>	<u>\$19,205</u>



ATTACHMENT II
FISCAL YEAR 2013-14
PROPOSED BUDGET
(Dollars in Thousands)

	<u>FY 2013-14 Proposed Budget</u>	<u>% of Sales</u>	<u>Estimated Year-End FY 2012-13</u>	<u>% of Sales</u>	<u>Difference</u>
SALES:					
SuperLotto Plus	\$310,000	6.1%	\$375,000	8.5%	(\$65,000)
Fantasy 5	\$163,500	3.2%	\$166,000	3.7%	(\$2,500)
Daily 3	\$135,000	2.6%	\$137,000	3.1%	(\$2,000)
Hotspot	\$170,000	3.3%	\$153,000	3.5%	\$17,000
Daily Derby	\$12,500	0.2%	\$13,000	0.3%	(\$500)
Daily 4	\$29,000	0.6%	\$28,000	0.6%	\$1,000
MEGA Millions	\$350,000	6.9%	\$386,000	8.7%	(\$36,000)
Powerball	\$520,000	10.2%	\$199,000	4.5%	\$321,000
Scratchers	\$3,410,000	66.9%	\$2,975,000	67.1%	\$435,000
TOTAL, ESTIMATED SALES	\$5,100,000	100.0%	\$4,432,000	100.0%	\$668,000
	PaidIn				
PRIZE EXPENSE:					
SuperLotto Plus	\$161,200	52.0%	\$181,875	48.5%	(\$20,675)
Fantasy 5	\$75,210	46.0%	\$76,360	46.0%	(\$1,150)
Fantasy 5 Reserve Fund/ Bonus Bucks	\$6,540		\$5,000		\$1,540
Other Draw Games	\$87,897	49.8%	\$88,644	49.8%	(\$747)
Hot Spot	\$107,100	63.0%	\$93,804	61.3%	\$13,296
MEGA Millions	\$175,000	50.0%	\$190,999	49.5%	(\$15,999)
Powerball	\$260,000	50.0%	\$98,471	49.5%	\$161,529
Scratchers	\$2,298,340	67.4%	\$1,950,113	65.6%	\$348,228
Prize Expense Savings	(\$25,000)		(\$25,000)		\$0
Cal Replay	\$5,000		\$4,550		\$450
TOTAL, PRIZE EXPENSE	\$3,151,287	61.8%	\$2,664,816	60.1%	\$486,471
NET SALES AFTER PRIZE EXPENSE	\$1,948,713		\$1,767,184		\$181,529
	PaidBackTaxable				
ADMINISTRATIVE EXPENSES:					
Retailer Compensation:					
Commission	\$300,900	5.9%	\$261,488	5.9%	\$39,412
Special Handling	\$18,090	0.4%	\$15,931	0.4%	\$2,159
Incentives	\$4,443	0.1%	\$3,168	0.1%	\$1,275
Cashing Bonus	\$27,805	0.5%	\$24,629	0.6%	\$3,176
Gaming Costs:					
Gaming Contract (GTECH)	\$92,025	1.8%	\$76,324	1.7%	\$15,701
Gaming Monitor Fees	(\$621)		(\$577)		(\$44)
Administrative Retailer Fees	(\$21,100)		(\$21,579)		\$479
Scratchers Ticket Costs	\$26,862	0.5%	\$27,332	0.6%	(\$470)
Scratchers Tickets Delivery and Support Costs	\$4,803	0.1%	\$4,000	0.1%	\$803
TOTAL, RETAILER & GAMING COSTS	\$453,207	8.9%	\$390,717	8.8%	\$62,490
Operating Costs:					
Personal Services	\$71,686	1.4%	\$60,000	1.4%	\$11,686
Marketing Plan	\$80,686	1.6%	\$70,344	1.6%	\$10,342
Contractual Services	\$13,913	0.3%	\$16,372	0.4%	(\$2,459)
Operating Expense	\$16,695	0.3%	\$17,877	0.4%	(\$1,182)
Depreciation: Gaming Equipment	\$346	0.0%	\$463	0.0%	(\$117)
Office Furniture and Equipment	\$4,496	0.1%	\$3,954	0.1%	\$542
Building and Leasehold Improvements	\$1,899	0.0%	\$2,589	0.1%	(\$690)
Reserve for Insurable Risk	\$5,000	0.1%	\$0	0.0%	\$5,000
Administrative Spending Reserve	\$15,070	0.3%	\$13,844	0.3%	\$1,226
Subtotal, Operating Costs	\$209,793	4.1%	\$185,443	4.2%	\$24,350
TOTAL, ADMINISTRATIVE EXPENSES	\$663,000	13.0%	\$576,160	13.0%	\$86,840
	ToAdmin				
CONTRIBUTION TO EDUCATION					
Interest Income	\$1,500	0.0%	\$1,400	0.0%	\$100
Unclaimed Prizes	\$25,000	0.5%	\$21,000	0.5%	\$4,000
TOTAL AVAILABLE FOR EDUCATION	\$1,312,213		\$1,213,424		\$98,789
TOTAL CONTRIBUTION TO EDUCATION WITH RESERVES	\$1,332,283		\$1,227,267		\$105,016

PaidIn = 5,100,000

PaidBackTaxable = 3,151,287

ToAdmin = 66,3000

ToEducate = 1,312,213

$((\text{PaidIn} - \text{PaidBackTaxable}) / \text{PaidIn} * 100) = ((5100000 - 3151287) / 5100000 * 100) = 38.2\%$ so players ALWAYS loose more than half their money. Before Taxes.

$\text{So } (((\text{PaidIn} - \text{PaidBackTaxable}) * 0.60) / \text{PaidIn} * 100) = (((5100000 - 3151287)) * 0.60) / 5100000 * 100) = 22.9\%$ so players ALWAYS loose 3/4 of their money if they pay taxes.

But $((\text{ToEducate} / \text{PaidIn}) * 100) = ((1312213 / 5100000) * 100) = 25.7\%$ of what's paid in goes to a good cause.

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