



M E M O R A N D U M

Date: May 24, 2012

To: California State Lottery Commission

From: Robert T. O' Neill
Director

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Subject: Item 8(a) – Fiscal Year (FY) 2012-13 Business Plan

ISSUE

Should the California Lottery Commission (Commission) approve the 2012-2013 Business Plan?

RECOMMENDATION

California State Lottery (Lottery) staff recommends that the Commission approve the FY 2012-2013 Business Plan (Plan).

BACKGROUND

The Commission approved the Lottery 2010-2013 Business Plan at the meeting held on May 20, 2010.

While the FY 2012-2013 business planning process used the 3 Year Business Plan as a foundation, the initiatives for the upcoming year were, again, developed through a team effort of key Lottery staff consulting with key business partners. It started with a review of our business with strategic opportunities to further grow sales being identified. From this, key objectives and strategies were laid out and prioritized. Then, tactics to implement this vision were proposed by staff and evaluated by senior management based on the Lottery resources available and the benefits those programs would deliver.

DISCUSSION

The Plan for FY 2012-13 blends the implementation of programs to create immediate sales gains during the year with other initiatives where the payoff is really in subsequent years. With this mix, the Lottery will be able to not only grow sales in the upcoming year on top of the record sales and profits achieved in FY 2011-12, but also continue to provide greater sales and contributions to public education for many years to come.

Product Development

Enhancements to our current line of products and development of new offerings for our players are the foundation for long-term sales growth. Highlights include:

In the area of Scratchers®, FY 2012-13 will continue growth of the \$5 and \$10 games. There will be more new products launched at these price points with a combined total of at least 11 during the year compared to just seven this current fiscal year. And, retailers will be asked to simultaneously display more \$5 and \$10 games for sale compared to their current offering.

In FY 2012-13, a plan to reinvigorate Hot Spot® will be implemented. A key component will be the permanent increase in the game's prize payout. With the Lottery's restrictions on prize payout being removed, recent Hot Spot promotions that temporarily boost prizes have provided significant sales gains. With an improved product, efforts to recruit additional Hot Spot specific retailers in social venues will be part of our Retail Initiatives.

The Lottery is also developing plans to launch its first new Draw Game since 2008. Powerball is a game played in 42 states plus the District of Columbia and the U.S. Virgin Islands. It is differentiated from MEGA Millions® with a much higher starting jackpot at \$40 million and the ability to grow the jackpots more quickly. It is also now priced at \$2 per play.

Research and Development efforts have also been funded in the year's Plan to ensure that there is a pipeline of new products for the future.

Advertising and Promoting the Lottery

For long-term sales growth, marketing efforts should not only increase interest among current players but also try to attract new players. These initiatives will use everything from traditional TV and radio advertising to promotions and the internet to reach these audiences. To deliver greater sales, these projects are aimed at increasing brand or game awareness, the product's image, the frequency in which people play a game and/or the number of adults actually playing Lottery games.

The major advertising efforts this year will be focused against three product lines – Scratchers, MEGA Millions and the introduction of Powerball.

For Scratchers, there will be quarterly advertising campaigns primarily concentrating on our \$5 games. However, a couple of the efforts will be featured around a series of similarly themed Scratchers games at the \$1, \$2 and \$5 price points. The first example of this will be a series of MONOPOLY-themed games slated for introduction in the second quarter.

In FY 2012-13, the Lottery will begin to utilize its own digital media to promote other games to its loyal players. This will allow the next \$10 Scratchers game, the Holiday Scratchers product line and SuperLOTTO Plus® to be marketed without going to the expense of a major television and radio advertising campaign. Communications via our new website, social media and e-mail to our 2nd Chance registrants can promote these products in a very cost-effective manner.

To counter slower Scratchers sales during the summer months, a consumer and retailer promotion is slated to begin in July aimed at encouraging purchases of \$5 games throughout the summer period.

As a long-term strategy, the Lottery will begin work on developing a Player Loyalty Club in FY 2012-13. Much like rewards programs in other industries, consumers will receive points for their purchases that can be used for prizes, free plays and/or special drawings.

Retail Initiatives

Lottery products are sold to consumers at over 21,000 retail locations where the stores are not owned or controlled by the Lottery. To maximize success, the Lottery must devote significant resources towards having motivated retailers with product knowledge and the ability to properly display and merchandise the games.

A number of retail programs for the year are focused around educating and training retailers to display and sell the Scratchers games in our Ideal Mix. These are composed of the new games plus other top sellers. Many tactics will be employed against this initiative from having quarterly retailer promotions to creating new quantitative tools that will aid the sales force in tracking retailer performance and identifying remedial actions.

The Plan also includes acquiring and installing new equipment at certain retailers to expand the number of Scratchers games that can be carried.

A major effort to recruit new retail locations will start in FY 2012-13. To successfully grow the retail network with locations having a high potential, a new unit within the

Sales & Marketing Division will be devoted specifically for this purpose. They will recruit, train and develop new locations to sell Lottery products.

This will be a long-term effort since the Lottery must add about 4,000 locations in order to be at the national average in terms of retailer density. Also, the benefits of this program will have just marginal impact on FY 2012-13 sales but will contribute greatly in subsequent years.

Focus on Lottery Efficiency and Effectiveness

In order to provide solid service to our retailers and players and ensure that resources are being used to maximize profits to education, the Lottery must run as efficiently and effectively as possible. As the Lottery operates more efficiently, then more dollars can be devoted towards sales building programs with more money going to education.

A major study looking at the entire Scratchers supply chain will determine the optimal way to create ticket orders, ship tickets to retailers, have retailers activate and display tickets for sale and process unused or unwanted tickets physically and financially. The goal will be a streamlined process so retailers can quickly get and return tickets so that they are selling the correct mix of games to maximize sales.

The Lottery also plans to enhance the way it handles incoming inquiries from the public. With the public contacting the Lottery via phone, e-mail and/or written correspondence, new technology can be employed to better handle the work flow as well as have the potential to provide better customer service with a quicker response time.

A major initiative that will begin in FY 2012-13 involves an upgrade to the Lottery's internal financial back-office system. The current version has been in place for 14 years and handles accounting, procurement, financial and asset management. It is outdated and there are many manual processes in place because the current system no longer matches our business requirements.

Other projects as part of this area include: implementing recommendations from Contract Management and Risk Management studies being conducted in the current fiscal year; completing a comprehensive update to the Lottery's Operating Manual; and developing the technology requirements for the Business Continuity Plan.

Building the Capacity Within the Lottery

For the Lottery to maximize sales, it must have the internal capacity to implement many simultaneous projects and to handle more retail locations. Initiatives in this section are designed to increase the productivity of the Lottery through new technologies, training and a combination of the two.

Plan Highlights in this area include:

FY 2012-13 will see the further development of the Lottery's Business Intelligence and Business Analytics system. Currently, the system provides valuable information geared to headquarters staff. One of the major efforts for the upcoming year is to provide the field sales force with tools to aid their analysis and decision-making as they help retailers grow their Lottery sales.

Enabling Sales & Marketing staff to develop retailer promotions and incentives that can be created to meet changing sales trends and issues is sorely needed. This has been hindered in the past by the system used to pay retailers as a result of the promotion. This year, a new programming solution will be designed to make the process more flexible.

The year will also see the development and installation of software for the Human Resources Division at the Lottery to automate many activities that are currently done manually. This transition will provide many benefits such as reducing manual entry into the State Controller's Office (SCO) payroll system, being able to measure the staff time spent on specific projects and reducing the manual entry and potential errors when the SCO's new payroll system – MyCalPAYS deploys later in the fiscal year.

Financial Results

This Business Plan will allow the Lottery to attain many important financial milestones during FY 2012 – 2013.

- ***Sales will again be record-breaking at around \$4.8 billion***
- ***Profits will surpass \$1.3 billion and become the highest amount in the Lottery's 27 year history***

Through this Business Plan, the Lottery will see solid growth in the upcoming year particularly in the sales of Scratchers and Hot Spot. And, sales across all products will be poised for even larger gains in the subsequent year.

Profits will increase for the fourth consecutive year and again set a record for the most dollars provided to public schools in the Lottery's history.

Approval of the Business Plan will allow the Lottery to begin the process of committing resources and developing a budget aligned with this Plan. The details of this will be presented at the next Commission Meeting on June 21, 2012.



Business Plan

FY 2012-13

Presentation to
California State Lottery Commission
May 24, 2012

Item 8a

Outline of Today's Presentation

- Review Process and Timeline of Developing the Plan
- Outline Key Strategies
- Describe of Major Plan Elements and Tactics
- Provide High-Level Financial Results from Plan



Plan Development Process

- 3-Year Strategic Plan is a foundation
- Review of Lottery Industry plus our sales trends, performance measures
- Strategic Opportunities for growth identified
- Objectives, Strategies & Plan Tactics developed
- Plan elements reviewed, analyzed, prioritized based on projected benefits and resource requirements
- The results is this Proposed Plan



Strategic Imperatives from 3-Year Plan

1. Focus on turning around draw game sales
2. Ensure we are getting the most out of Scratchers®
3. Get the most out of our retailer network
4. Get the most for our marketing dollar
5. Allocate our Resources to maximize profit
6. Foster a performance management culture
7. Focus on building productive stakeholder relationships

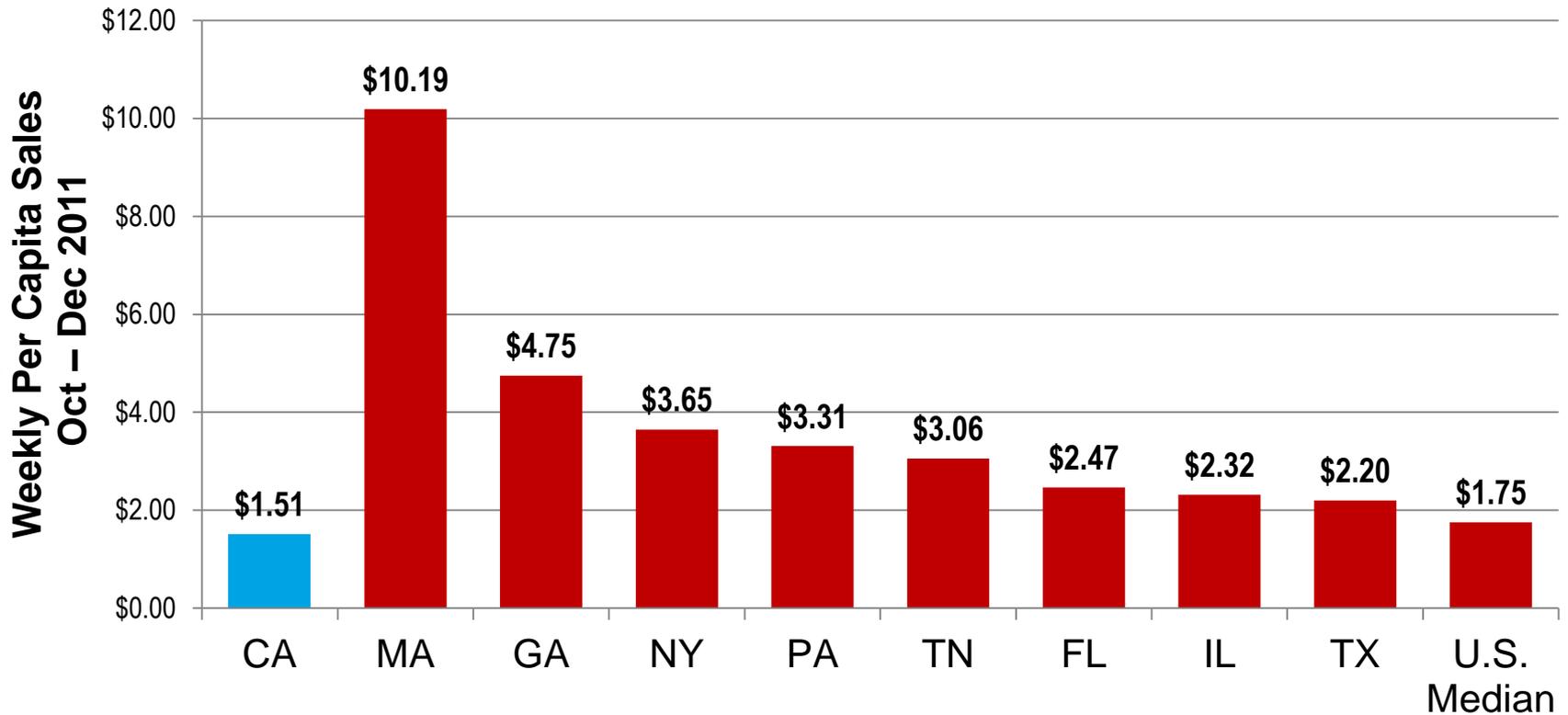


Strategies for FY 2012-13

- Mix of initiatives having immediate sales impact for FY 2012-13 PLUS efforts that deliver sales growth in subsequent years
- Scratchers continue to be Focus for growth
- 5 Areas for the Business Plan Strategies:
 - Product Innovations
 - Advertising and Promoting the Lottery
 - Retail Initiatives
 - Focus on Efficiency and Effectiveness
 - Building the Capacity Within the Lottery

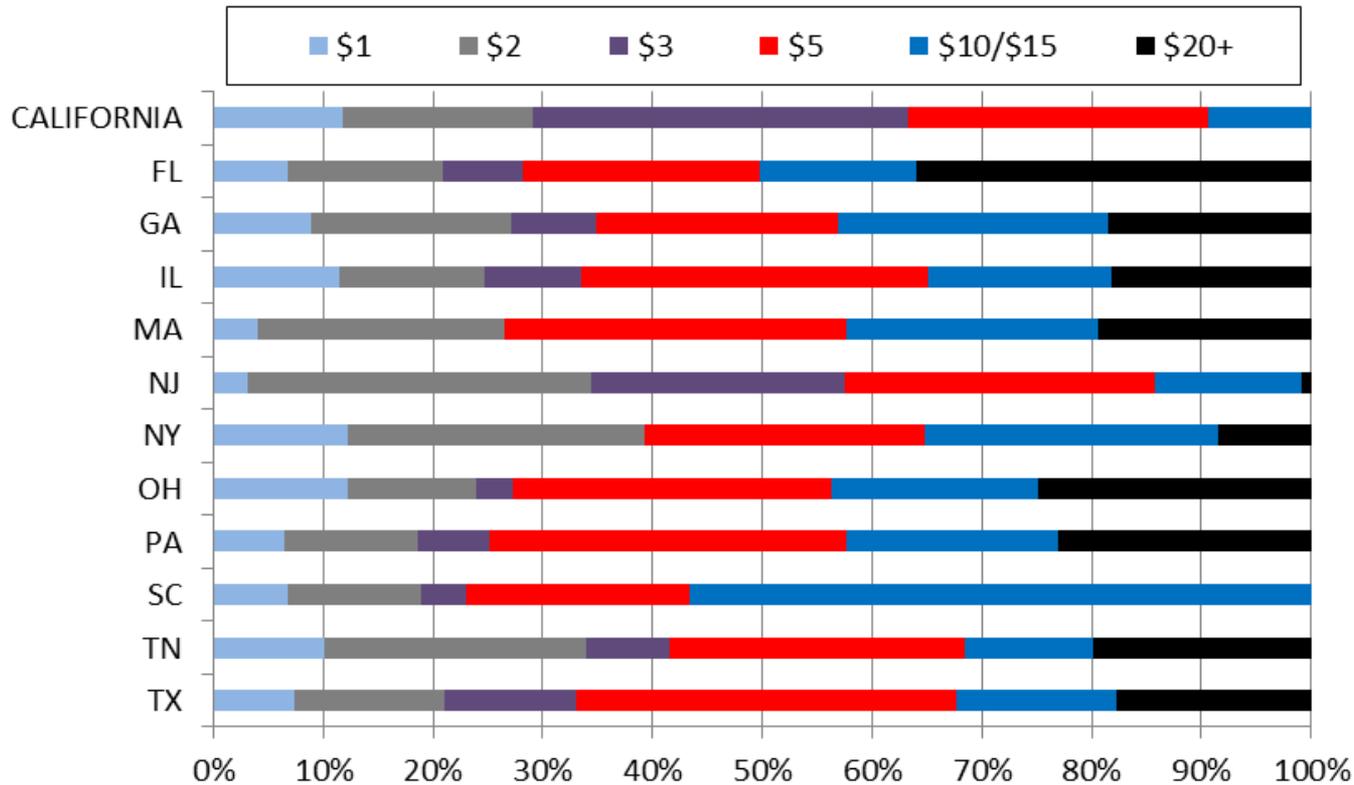


Per Capita Scratchers Sales Much Higher in other States



\$5 Game: Dominant Price Point in Most Large Selling States

Scratchers Sales by Price Point - CY 2011



Product Development - Scratchers

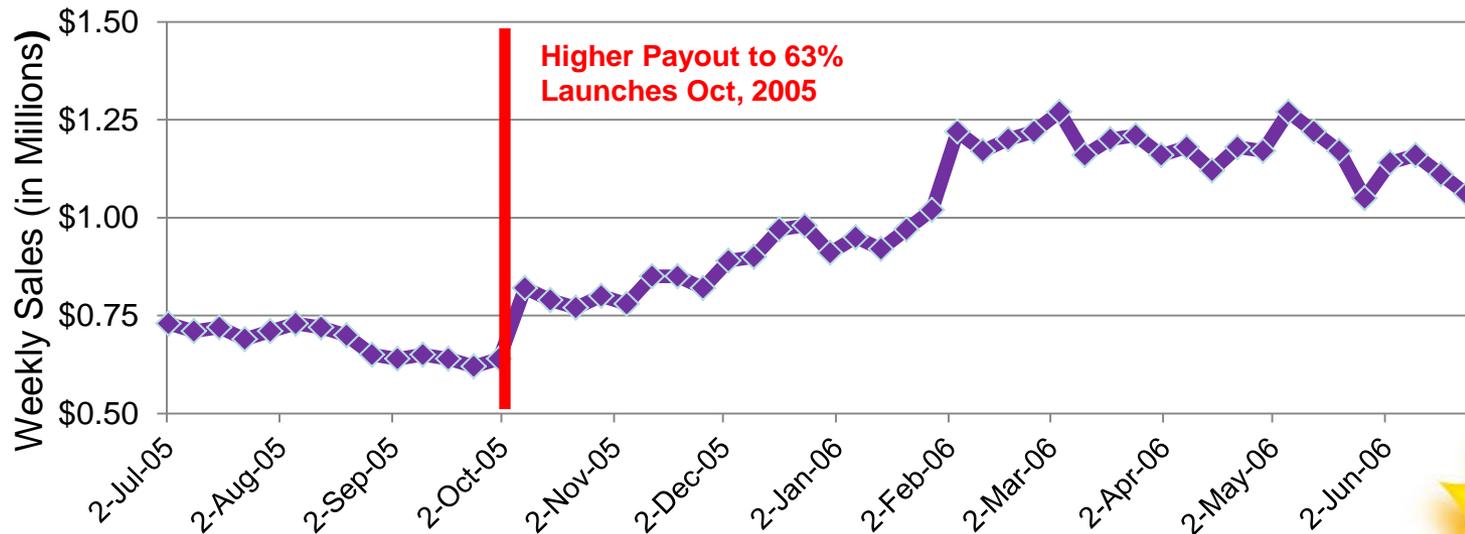
- More \$5 & \$10 Games introduced in FY 2012-13
 - 9 new \$5 games launched (vs. 6 this year)
 - 3 new \$10 games launched (vs. 1 this year)
- There will be two \$10 games sold simultaneously starting in September
- And, six \$5 games available starting in July
- Reduction in \$1 and \$3 games typically carried



Reinvigorate Hot Spot

- Much like Scratchers, higher prize payout can grow sales and profits
 - Hot Spot Prize Payout to go to 63%
- In GA, sales up more than 60% after 6 months

Georgia Lottery Case Study



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Product Development

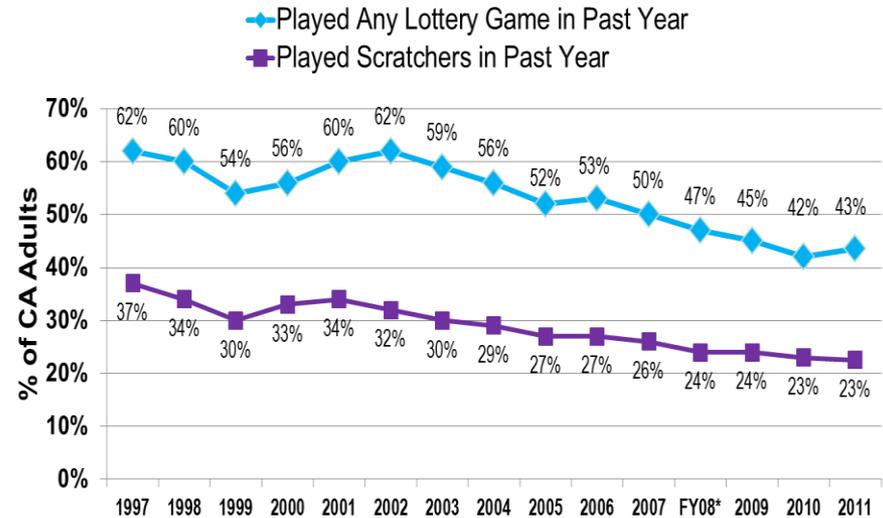
- Develop plans to launch first new game since 2008: \$2 Powerball
- R & D efforts for future games and improvements to existing products



Advertising and Promoting the Lottery

Major Ad Campaigns

- Quarterly Scratchers efforts for key \$5 game
- MEGA Millions ads run if jackpot above \$70 MM
- Introduction of Powerball
- Accounts for most of marketing funds



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Other Advertising and Promotion Efforts

- Summer Promotion to offset seasonal declines
- Marketing to current players via our owned Digital Media for other products
 - Next \$10 Scratchers Game, Holiday, Super Lotto Plus
 - Via Website, Social Media, e-mail to our registrants
 - Development of an integrated i-strategy
- Begin development of Loyalty Program
 - To be launched in FY 2013-14
- Renew relationships with stakeholders



Retail Initiatives

- Multiple tactics aimed at increasing retail display of key Scratchers games
 - Sales Reps to concentrate Visitation Schedule on A, B and C accounts; reducing calls to D & E locations
 - Field staff to get Business Intelligence Tools
 - Quarterly Retailer Promotions
- Purchase and installation of new equipment allowing retailers to expand number of games



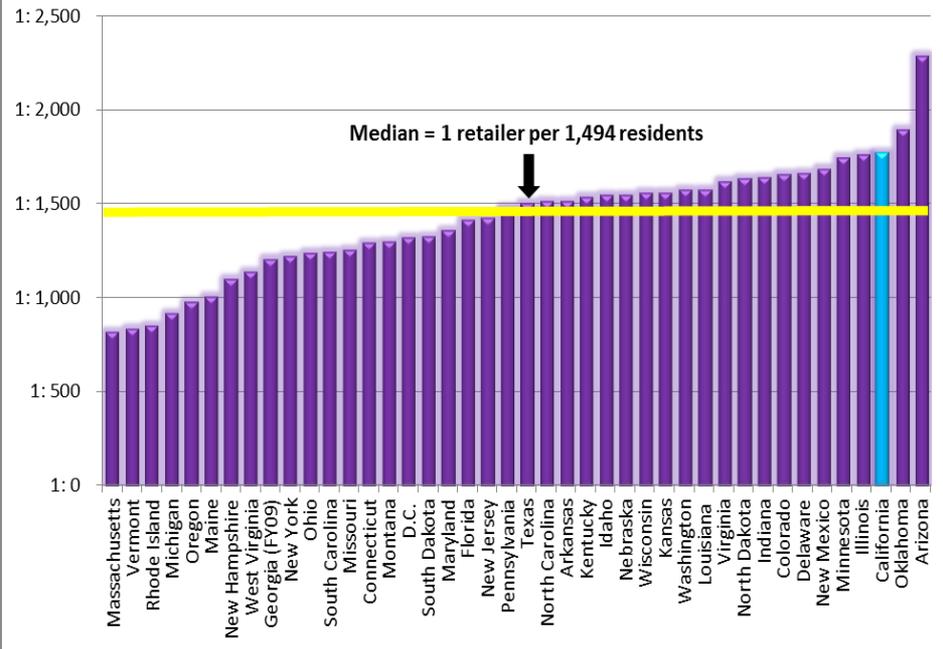
Retail Display KPI's and Sales Impact

- April, 2012: In displaying \$5 games, average retailer selling 3.5 out of 5
- April, 2012: In displaying the new games, average retailer selling 2.2 out of 3 launched
- Tens of millions of dollars in Scratchers sales generated if more of the Ideal Games were at retail



Need to Increase Retailer Network

Residents per Total Retailers - 2010



- Scratchers are “impulse” purchases
- More places = higher sales
- CA has fewer retailers for its population
- To be at U.S. average, 4,000 new stores needed
- Long-term initiative; greater sales impact in future years



Focus on Efficiency and Effectiveness

- Scratchers Ticket Supply Chain Review
- Upgrade to the Lottery's current Epicor System
- Improvements in Contact Center Management System to better handle public inquires
- Technology requirements for Business Continuity Plan
- Complete Update of Lottery Operating Manual

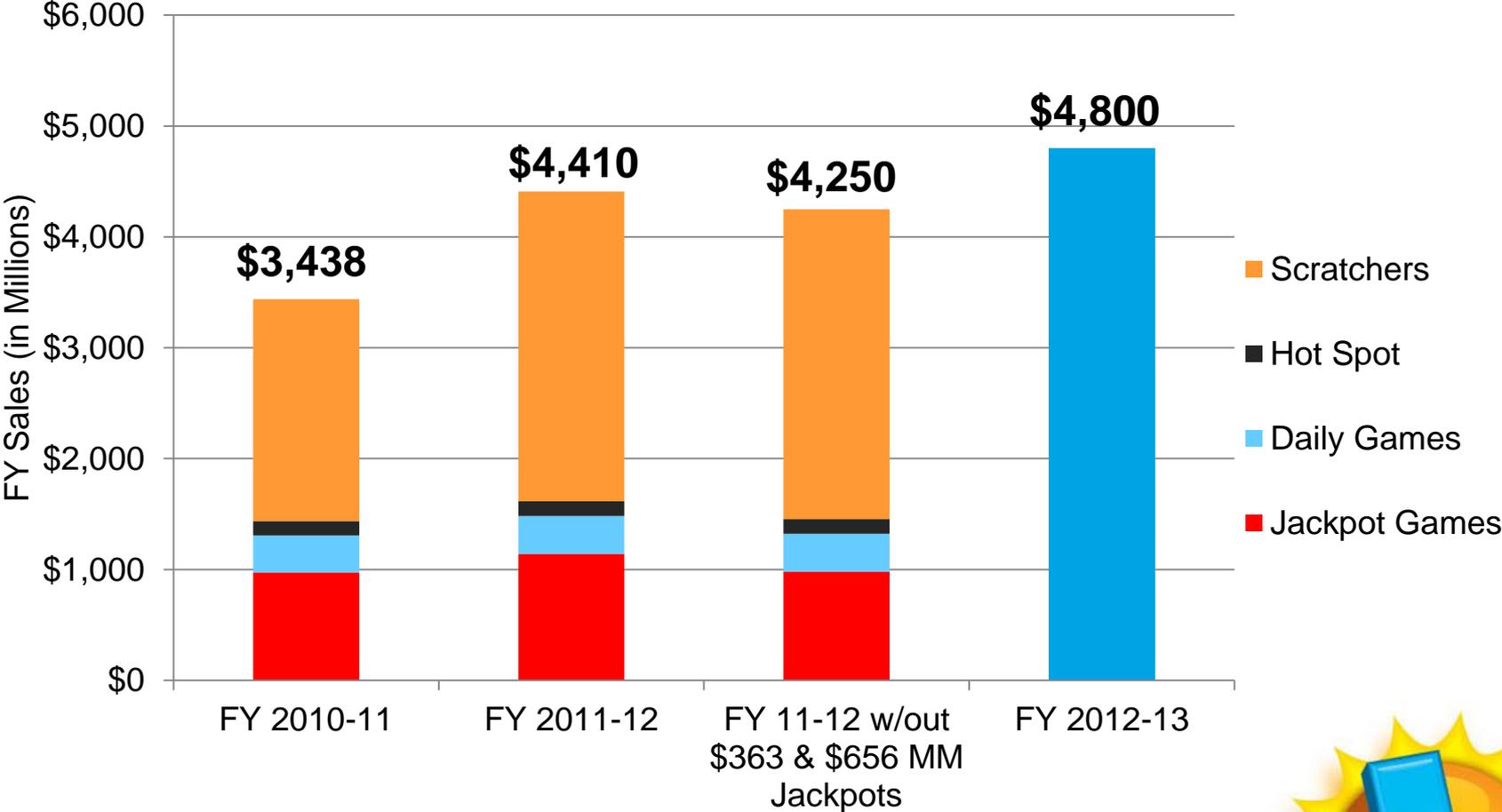


Building the Capacity Within the Lottery

- Business Intelligence to provide information to field sales staff
- Training and Development in how to use data for decision-making
- Flexible Programming for Retail Incentives
- Automation of Personnel-related activities
- Complete Technology Enhancements at District Offices and Distribution Centers



Financial Highlights – Sales



Financial Highlights - Profits

- FY 2012-13 will provide over \$1.3 billion in profits for California public schools
- Contributions will increase for the fourth consecutive fiscal year
- FY 2012-13 will provide the highest total amount to schools in the Lottery's 27 year history



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