




## MEMORANDUM

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**Date:** June 26, 2014

**To:** California State Lottery Commission

**From:** Paula D. LaBrie  
Acting Director 

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Deputy Director, Finance Division

**Subject:** Item 10(h) – Fiscal Year 2014-15 Budget

### **ISSUE**

Should the California State Lottery Commission (Commission) approve the proposed budget that presents a sales goal of \$5.4 billion and is estimated to provide \$1.35 billion to public education for Fiscal Year (FY) 2014-15?

### **RECOMMENDATION**

Staff recommends the Commission approve the California State Lottery (Lottery) budget for FY 2014-15 as reflected in the attached documents. Both the level of sales and the contribution to education projected in the FY 2014-15 Budget are the highest in Lottery history.

### **BACKGROUND**

As included in the draft budget presented at the May 2014 Commission meeting, the proposed FY 2014-15 Budget reflects the Lottery's goal of \$5.4 billion in sales and is estimated to result in \$1.35 billion in profits to California public education. This proposed budget includes resources necessary to implement objectives of the FY 2014-15 Business Plan, which was also presented at the May 2014 Commission meeting. These business initiatives, in conjunction with proposed operational growth requirements, balance tactics in delivering sales growth as well as providing investments for continued growth in contributions to public education in future years.

## **DISCUSSION**

Development of the Lottery's FY 2014-15 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 industry trends. 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 2014-15 Business Plan that was approved at the May 2014 Commission meeting and the proposed FY 2014-15 Budget that 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 2014-15 Budget.

In order to achieve the growth in sales and profits 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 of these four essential elements:

- Increasing sales not only in the Scratchers category but also in the jackpot games and other Lottery products.
- Promoting the play of other Lottery games among existing players.
- Growing the network of Lottery retailers and concentrating our best service to retain our most productive retailers.
- Improving the Lottery's infrastructure to handle the sales growth and build a more efficient and effective operation.

This comprehensive assessment of sales goals and the funding needed to deliver those goals culminates in the budget being proposed for the upcoming fiscal year. Attachment II to this memo presents the Lottery's proposed FY 2014-15 Budget.

A summary of the elements of the proposed FY 2014-15 Budget is presented below:

**Sales**

Total sales for all Lottery products are projected to be \$5.4 billion for FY 2014-15. This represents a \$392 million, or 7.8 percent, increase over estimated year-end sales levels for FY 2013-14.

The chart below compares estimated FY 2013-14 year-end sales with proposed sales goals for the FY 2014-15 Budget. Following the chart is background information for the sales goals for each product type.

<b>Comparison of Revenues</b>			
<b>Proposed FY 2014-15 Budget and FY 2013-14 Estimated Year-End Sales</b>			
<i>(Dollars In Thousands)</i>			
<b>Sales:</b>	<b>Proposed Budget FY 2014-15</b>	<b>Estimated Year-End FY 2013-14</b>	<b>Difference</b>
<b>Scratchers®</b>	\$3,615,000	\$3,263,000	\$352,000
<b>Multi-State Jackpot Games</b>	935,000	901,000	34,000
<b>SuperLotto Plus®</b>	330,000	330,000	0
<b>Daily Games</b>	320,000	327,000	-7,000
<b>Hot Spot®</b>	200,000	187,000	13,000
<b>Total Sales</b>	<b>\$5,400,000</b>	<b>\$5,008,000</b>	<b>\$392,000</b>

**Scratchers**

The largest increase in projected sales is in the Scratchers product line with sales expected to grow \$352 million for a total of \$3.615 billion. This sales goal represents a 10.8 percent increase over estimated year-end sales for FY 2013-14.

The increase in sales is supported by Business Plan initiatives focused on higher price point games and the marketing plan campaign to enhance summer promotion/advertisement and mitigate sales declines experienced in summer months. The increase in sales is also attributed to a full year of sales for the \$20 Scratchers game, additional \$10 games (starting September 2014), and an additional \$20 game (starting March 2015). Additionally, there are initiatives aimed at improving the Scratchers inventory levels and game mix at retail locations as well as promotions designed to enhance the visibility and merchandising of Scratchers in many stores.

With the additional \$10 games and a full year of two \$20 games, the aggregate prize payout for Scratchers is projected to rise to 68.1 percent in FY 2014-15. This compares with an estimated year-end payout of 67.5 percent in FY 2013-14.

### **Multi-State Jackpot Games**

The \$935 million sales goal proposed for the Multi-State Jackpot games represents an increase of \$34 million (3.8 percent) over estimated year-end sales for FY 2013-14. This sales figure assumes that jackpots exceed \$500 million twice within the fiscal year as well as implementation of options to increase sales, such as adding another multi-state game or enhancing and expanding our existing games through the FY 2014-15 Business Plan Initiatives.

### **SuperLotto Plus**

Sales for SuperLotto Plus are projected to be \$330 million, which is the same level projected for year-end sales in FY 2013-14. The goal set for SuperLotto Plus next fiscal year is supported by FY 2014-15 Business Plan initiatives to provide periodic promotions and an advertising campaign during the fiscal year.

### **Daily Games**

The proposed sales goal for Daily Games (Fantasy 5, Daily 3, Daily 4 and Daily Derby) is \$320 million, which is a \$7 million (2.1 percent) decrease from the projected year-end sales level for FY 2013-14. The goal of \$320 million is primarily based on sales trends within these games.

### **Hot Spot**

A sales goal of \$200 million is proposed for Hot Spot, an increase of \$13 million (7.0 percent) over estimated year-end sales for FY 2013-14. The projected increase in sales is due primarily to 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.

## **Expenses**

### **Prize Expenses**

The proposed sales goals in the FY 2014-15 Budget are supported by higher prize payouts. This is primarily a result of the higher sales projection as well as a full year of the \$20 Scratchers game and additional \$10 and \$20 Scratchers games. Prize Expenses are budgeted at \$3.38 billion, which is \$297 million (9.6 percent) above the expected prize level for FY 2013-14.

Continuation of the Lottery's strategy of utilizing higher prize payouts to increase sales is reflected in the aggregate change in prize payouts from 61.6 percent of sales in FY 2013-14 to 62.6 percent of sales in FY 2014-15.

### **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 2014-15 are \$702 million, an increase of \$51 million (7.8 percent) over expected FY 2013-14 expenses. This increase is directly proportional to the expected increase in sales for FY 2014-15. It is important to note the majority of this increase results from the cost of selling Lottery products, i.e., retailer compensation costs and game operating costs.

Retailer compensation costs of \$375 million account for more than 53 percent of the Administrative Expense budget for FY 2014-15. This amount represents an increase of \$27.6 million (8.0 percent) over expected FY 2013-14 retailer compensation costs and is directly attributable to the higher sales goals in the upcoming year.

Gaming costs are budgeted at \$117.2 million for FY 2014-15. 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 \$12.6 million (12.0 percent) over FY 2013-14 is due primarily to higher projected sales for FY 2014-15 and Scratchers ticket use tax and licensing fees.

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 expenses. Operating costs also include the funding and resources required to execute the FY 2014-15 Business Plan initiatives as well as funding for operational improvements. As shown on Attachment I, the proposed budget includes establishment of 32.0 new positions and \$16.6 million allocated to meet the Business Plan and program expansion needs.

Also included within Administrative Expenses for FY 2014-15 is a \$5 million reserve for insurable risk to cover fiscal exposures for the areas of our organization that we are continuing to self insure. In addition, a \$4.8 million administrative spending reserve is included 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 administrative spending reserve is an element of the 13 percent of total revenues specified for Administrative Expenses, and the entire unspent amount within both the administrative spending reserve and the reserve for insurable risk will be transferred directly to public education at the end of the fiscal year.

### **Summary**

The proposed FY 2014-15 Budget contains sales goals of \$5.4 billion, a 7.8 percent increase over expected sales for FY 2013-14. This level of sales, combined with the other elements in the budget, is estimated to generate \$1.35 billion in contributions to California public schools, an increase of approximately \$42 million over the contribution level projected for FY 2013-14. Both the projected sales level and the estimated contribution to education for FY 2014-15 are the highest in the Lottery's 29-year history. In addition, FY 2014-15 will mark the 15<sup>th</sup> consecutive year the Lottery will surpass a billion dollars in contributions to public education.

While the \$5.4 billion sales goal and the \$1.35 billion estimated contribution to education for FY 2014-15 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 2013-14 as well as prudent investments that will enable us to continue laying the foundation to sustain growth in sales and contributions to public education in years to come.

Attachments

**FISCAL YEAR 2014-15**

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

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Initiatives/Goal	Positions	Cost
• <b><u>Products</u></b>		
✚ Continue Scratchers Enhancements		\$140
✚ Optimize the Draw Game Product Mix		\$9,117
• <b><u>Players</u></b>		
✚ Improve the Lottery's Overall Image with Consumers and Stakeholders		\$3,350
✚ Maximize Return-on-Investment of Advertising and Promotions		\$1,588
• <b><u>Retailers</u></b>		
✚ Expand the Network of Lottery Retailers	1.0	\$105
✚ Optimize the Support Provided to Lottery Retailers	23.0	\$1,101
• <b><u>Infrastructure</u></b>		
✚ Improve the Lottery's Infrastructure	8.0	\$1,173
<b>TOTAL, FY 2014-15 INITIATIVES AND OTHER REVISIONS</b>	<b><u>32.0</u></b>	<b><u>\$16,574</u></b>



**FISCAL YEAR 2014-15  
PROPOSED BUDGET**

Attachment II  
June 26, 2014

(Dollars in Thousands)

	<b>FY 2014-15 Proposed Budget</b>	<b>% of Sales</b>	<b>FY 2013-14 Estimated Year-End</b>	<b>% of Sales</b>	<b>Difference</b>
<b>SALES:</b>					
Scratchers	\$3,615,000	66.9%	\$3,263,000	65.2%	\$352,000
Multi-State Jackpot Games	935,000	17.3%	901,000	18.0%	34,000
SuperLotto Plus	330,000	6.1%	330,000	6.6%	0
Daily Games	320,000	5.9%	327,000	6.5%	(7,000)
Hotspot	200,000	3.7%	187,000	3.7%	13,000
<b>TOTAL, ESTIMATED SALES</b>	<b>\$5,400,000</b>		<b>\$5,008,000</b>		<b>\$392,000</b>
<b>PRIZE EXPENSE:</b>					
		<b>Prize Payout %</b>		<b>Prize Payout %</b>	
Scratchers	\$2,461,815	68.1%	\$2,203,830	67.5%	\$257,985
Multi-State Jackpot Games	467,836	50.0%	450,500	50.0%	\$17,336
SuperLotto Plus	172,102	52.2%	171,600	52.0%	502
Daily Games	159,642	49.9%	163,132	49.9%	(3,490)
Hot Spot	126,000	63.0%	117,810	63.0%	8,190
2nd Chance	24,435	0.5%	7,400	0.1%	17,035
Prize Expense Savings	(30,000)		(29,000)		(1,000)
<b>TOTAL, PRIZE EXPENSE</b>	<b>\$3,381,830</b>	<b>62.6%</b>	<b>\$3,085,272</b>	<b>61.6%</b>	<b>\$296,558</b>
<b>NET SALES AFTER PRIZE EXPENSE</b>	<b>\$2,018,170</b>		<b>\$1,922,728</b>		<b>\$95,442</b>
<b>ADMINISTRATIVE EXPENSES:</b>					
		<b>% of Sales</b>		<b>% of Sales</b>	
<b>Retailer Compensation:</b>					
Commission	\$318,600	5.9%	\$295,472	5.9%	\$23,128
Cashing Bonus	30,034	0.6%	25,500	0.5%	4,534
Special Handling	20,537	0.4%	19,670	0.4%	867
Incentives	5,797	0.1%	6,700	0.1%	(903)
<b>Gaming Costs:</b>					
Gaming Contract (GTECH)	104,265	1.9%	97,514	1.9%	6,751
Administrative Retailer Fees	(22,105)		(19,900)		(2,205)
Gaming Monitor Fees	(628)		(520)		(108)
Scratchers Ticket Costs	30,528	0.6%	22,750	0.5%	7,778
Scratchers Delivery and Support Costs	5,135	0.1%	4,800	0.1%	335
<b>TOTAL, RETAILER &amp; GAMING COSTS</b>	<b>\$492,163</b>	<b>9.1%</b>	<b>\$451,986</b>	<b>9.0%</b>	<b>\$40,177</b>
<b>Operating Costs:</b>					
Personal Services	\$76,253	1.4%	\$67,000	1.3%	\$9,253
Marketing Plan	83,104	1.5%	81,186	1.6%	1,918
Contractual Services	14,683	0.3%	13,120	0.3%	1,563
Depreciation	6,201	0.1%	6,100	0.1%	101
Operating Expense	19,812	0.4%	16,082	0.3%	3,730
Reserve for Insurable Risk	5,000	0.1%	5,000	0.1%	0
Administrative Spending Reserve	4,784	0.1%	10,566	0.2%	(5,783)
<b>Subtotal, Operating Costs</b>	<b>\$209,837</b>	<b>3.9%</b>	<b>\$199,054</b>	<b>4.0%</b>	<b>\$10,783</b>
<b>TOTAL, ADMINISTRATIVE EXPENSES</b>	<b>\$702,000</b>	<b>13.0%</b>	<b>\$651,040</b>	<b>13.0%</b>	<b>\$50,960</b>
<b>CONTRIBUTION TO EDUCATION</b>					
Unclaimed Prizes	\$1,316,170	24.4%	\$1,271,688	25.4%	\$44,482
Interest Income	25,200	0.5%	22,000	0.4%	3,200
Interest Income	1,300		1,300		0
<b>TOTAL AVAILABLE FOR EDUCATION</b>	<b>\$1,342,670</b>		<b>\$1,294,988</b>		<b>\$47,682</b>
<b>TOTAL CONTRIBUTION TO EDUCATION WITH RESERVES</b>	<b>\$1,352,454</b>		<b>\$1,310,554</b>		<b>\$41,900</b>