



MEMORANDUM

To: California State Lottery Commission

Date: June 25, 2008

From: Joan M. Borucki
Director

Subject: Item 9(b) – Approval of Fiscal Year 2008-09 Budget

ISSUE

Should the California State Lottery Commission (Commission) approve the budget for Fiscal Year 2008-09 for an annual education contribution of \$1.134 billion from sales of \$3.2 billion.

RECOMENDATION

Staff recommends that the Commission approve the budget for Fiscal Year 2008-09 as presented in the attached document.

BACKGROUND

The Commission approved the 2007-2010 Business Plan at its June 27, 2007 meeting. This provided the California State Lottery (Lottery) with a clear long-term direction and outlined a number of multi-year initiatives. It delineated four major strategic components:

1. Focus on long-term planning
2. Improve brand image
3. Shift the jackpot paradigm
4. Modernize operations.

At the May 20, 2008 Commission meeting, the Commission approved the FY 2008-09 business strategies to form the foundation for the development of the FY 2008-09 Business Plan and Budget. The Commission also approved the Marketing Plan Strategies for further development and allocation of funding. With this direction, Budget staff developed the baseline operating expenses and equipment budget with

input from each Lottery division, reviewed new budget proposals, and identified the funds available for continuing and new programs.

DISCUSSION

The development of the Lottery's budget begins by projecting sales performance by game and determining prize funding levels by game. Remaining revenues are allocated to administrative expenses and contributions to education. Sales performance is projected by the Lottery's Budget Department using sophisticated modeling and simulations based on recent sales trend data. In reality, sales are affected by many things, including prize payout levels, jackpot levels, marketing efforts, new games, promotions, and the economy. As a result, modeling and simulations can never predict future sales with absolute certainty. As a result, budget projections and actual sales always differ, sometimes significantly.

For Fiscal Year 2008-09, a key element in the Lottery's Business Plan is to produce \$3.2 billion in sales and to provide public education with \$1.134 billion. This represents a turnaround of sales from the current year projected level of \$3.075 billion. This would be the ninth consecutive year that over \$1 billion has been provided for public education. Prior to the first year in the current streak (2000-01 fiscal year), the \$1 billion mark had only been reached once.

For the Lotto games, including SuperLOTTO Plus® and MEGA Millions®, a combined sales target of \$1.1 billion is projected. This represents an increase of \$80 million over the current year's performance, or about an eight percent growth. This increase is a predicted result of the Business Plan goal to shift the jackpot paradigm away from the emphasis on very large jackpots and encourage increased play at lower jackpot levels.

For Hot Spot, the sales goal for next year will be \$140 million. This figure is slightly higher than the estimated sales for the current fiscal year and \$10 million below the current year budget. This is a reasonable goal that is consistent with the recent sales trends for this product.

For the Daily Games, a \$360 million sales goal is planned for the upcoming fiscal year. This figure is \$40 million more than the estimated sales for the current year and \$50 million higher than the current year budget. Almost all of this sales growth is the result of the strong performance of the new Daily 4 game.

For the Scratchers product line, a \$1.6 billion sales goal is projected. This is \$200 million less than the current year budget and about even with the estimated sales for the current year. The overall level of Scratchers® sales that can be supported is influenced by the aggregate payout for the Scratchers product, other prize funding available to be used for Scratchers prizes, and the administrative savings that can be diverted to Scratchers prizes. As other product sales decline, Scratchers sales

goals must also decline. Enthusiasm for Scratchers declines with players experiencing fewer wins of significant prizes due to low prize payouts.

The Fiscal Year 2008-09 Annual Budget is estimated to produce \$3.2 billion in sales with a budget that is estimated at 13.1% of sales. The main categories within the budget are retailer compensation, game operations, communications, general administrative expenses, and the administrative spending reserve. The total administrative budget proposed for next year is about \$418 million.

There are no major funding changes being proposed. There are two important features of this budget that should be noted. First, continuing costs associated with the Action Plans approved last year have been included in this budget. For the most part, these costs represent the second cost of multi year projects started last fiscal year. Second, this budget includes spending levels for the Marketing Communications budget (advertising, point-of-sale, consumer and retailer promotions) for three quarters of the fiscal year. However, Lottery staff will meet with the Commission's Budget Liaison periodically to determine if adjustments to the annual budget are warranted, and the budget will be modified as conditions warrant. If warranted, staff will return for Commission approval in December 2008 with a modified budget for modified fourth quarter spending authority.

The budget contains an administrative spending reserve as a safeguard against future uncertainties. The spending reserve is set at a modest \$10 million. This level of reserve provides protection against a sales shortfall and/or for unanticipated expenses.

Attachment

CALIFORNIA STATE LOTTERY
FY 2008-09 BUDGET
(Dollars in Millions)

	<u>Dollars</u>	<u>% of Sales</u>
SALES		
o Estimated Sales	\$3,200	100.0%
PRIZES		
o Prize Expense	\$1,600	50.0%
Promotional Prizes	<u>\$95</u>	<u>3.0%</u>
Total Prizes	\$1,695	53.0%
ADMINISTRATIVE EXPENSES		
o Retailer Compensation	\$226	7.1%
o Game Operations	\$55	1.7%
o Communications	\$44	1.4%
o General Administration	\$86	2.7%
o Administrative Reserve	<u>\$6</u>	<u>0.2%</u>
Total Administrative Expenses	\$417	13.1%
EDUCATION REVENUE		
o Statutory Requirement	\$1,088	34.0%
o Interest and Other Income	\$20	0.6%
o Unclaimed Prizes	<u>\$26</u>	<u>0.8%</u>
Total Revenues for Education	\$1,134	35.4%