MEMORANDUM

Date: March 25, 2009

To: California State Lottery Commission

From: Joan M. Borucki
Director

Prepared By: Michael Ota
Deputy Director of Finance

Subject: Item 9(a) – Revised FY 2008-09 Sales Goal and Revised FY 2008-09 Budget

ISSUE

Should the California State Lottery Commission (Commission) approve the proposed revisions to the Fiscal Year 2008-09 sales goal and the related adjustments to the Fiscal Year 2008-09 budget?

RECOMMENDATION

California State Lottery (Lottery) staff recommends that the Commission approve the proposed revisions to the Fiscal Year 2008-09 sales goal and the related adjustments to the Fiscal Year 2008-09 budget.

BACKGROUND

At the June 25, 2008 meeting, the Commission approved the Business Plan and budget for the current fiscal year. At that time, sales were budgeted at $3.2 billion, with $1.134 billion projected profits going to education.

In Fiscal Year (FY) 2008-09, we continued implementing innovative and groundbreaking strategies as outlined in our Business Plan and have achieved some very significant milestones. We replaced “The Big Spin®” television show, which the Lottery had sponsored for the past 23 years, with a fast-paced and exciting new game show, “Make Me a Millionaire®” and have made significant efforts in

promoting the show. We successfully launched our new and improved brand image and recruited new retailers in non-traditional trade styles. We have also continued to improve our consumer protection efforts.

Despite the positive sales trends since January resulting from our key business strategies, sales for the full fiscal year will fall short of the original goal of $3.2 billion. Faced with the worst recession in over a quarter of a century, all businesses are dealing with declining sales.

DISCUSSION

The Lottery projects that it will not meet the $3.2 billion in sales it projected for this fiscal year. Sales for this fiscal year are now projected to be $2.89 billion. The original sales forecasts did not anticipate the worst recession in a quarter century.

The Lottery took action and made the necessary reductions and adjustments in administrative spending to bring the budget in balance and to ensure that education will receive its 34 percent of Lottery sales. These reductions include keeping 32 vacant positions unfilled for at least the balance of the fiscal year and deferring contractual services and procurements.

Sales are down in our draw games due primarily to the recession and poor rollover luck (i.e. low jackpot levels) in SuperLOTTO Plus and MEGA Millions. A series of lower level jackpots were won more frequently than statistically expected. This resulted in no instances of “Lotto Fever,” wherein a large jackpot brings in significantly greater sales. With lower sales in these games, the Lottery took the necessary step of slightly reducing the Scratchers prize payouts. This negatively impacted Scratchers sales.

However, since January, Scratchers sales are significantly higher. For example, sales of “Make Me a Millionaire” tickets are averaging 40 percent above the sales rate of the prior “Big Spin” tickets. And, the marketing activity against this product has lifted sales for the entire Scratchers product line by about $2.5 million per week. As a result, Scratchers sales will be higher than the figures for the prior year.

Despite the improvement in Scratchers ticket sales, the decline in our draw game sales point to a revised sales goal of $2.85 billion, rather than the $3.2 billion originally budgeted.

On January 28, 2009, the Commission approved changing the Lottery’s current investment policy to expand the financing vehicles to include municipal and agency bonds for the payment of long-term or annuity prizes. As a result of this policy

change, the Lottery is pursuing opportunities to utilize its current investment portfolio in order to realize $40 million of additional revenue for FY 2008-09.

The majority of the added revenue is proposed to be dedicated to a rejuvenated marketing effort with a small investment to initiate contractual services that will improve business operations. The additional revenues will also allow the introduction of a new $5 Scratchers game which will boost sales by $40 million.

As a result, the Lottery proposes a revised FY 2008-09 budget with total projected revenue of $2.93 billion. This will still result in $1.027 billion for education. This will be the 9th consecutive year that Lottery has provided over $1 billion to education.

Total sales through June 30th are projected to be behind last year's figures by only 5%. Earlier in the year, sales were pacing behind last year's figures by 10%. Compared to most other businesses, this 5% decline is a strong showing given this economy. For the entire year of 2008, gaming revenue on the Las Vegas Strip is down by nearly 11% compared to 2007 figures.

Attachment

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

	Original Budget FY 2008-09	Change	Revised Budget FY 2008-09	Change	Adjusted Budget with $40 M FY 2008-09	% of Sales
SALES						
o Estimated Sales	$3,200	($310)	$2,850	$40	$2,890	
o Additional Revenue				$40	$40	
Total Revenue	$3,200	($310)	$2,850	$80	$2,930	100.0%
PRIZES						
o Prize Expense	$1,600	($175)	$1,425	$40	$1,465	50.0%
Promotional Prizes	$94	($13)	$81	($11)	$70	2.4%
Total Prizes	$1,694	($188)	$1,506	$29	$1,535	52.4%
ADMINISTRATIVE EXPENSES						
o Retailer Compensation	$226	($24)	$202	$3	$205	7.1%
o Game Operations	$55	($7)	$48	$1	$49	1.7%
o Communications	$45	($3)	$42	$14	$56	1.9%
o General Administration	$85	($4)	$81	$6	$87	3.0%
o Administrative Reserve	$6	($4)	$2	($0)	$2	0.1%
Total Administrative Expenses	$418	($43)	$375	$24	$399	13.6%
EDUCATION REVENUE						
o Statutory Requirement	$1,088	($119)	$969	$27	$996	34.0%
o Interest and Other Income	$20	($10)	$10	$0	$10	
o Unclaimed Prizes	$26	($5)	$21	$0	$21	
Total Revenues for Education	$1,134	($134)	$1,000	$27	$1,027	35.5%