



M E M O R A N D U M

Date: June 26, 2009

To: California State Lottery Commission

From: Joan M. Borucki
Director

Prepared By: Michael Ota
Deputy Director of Finance

Subject: Item 9(a) - Fiscal Year 2009-10 Budget

ISSUE

Should the California State Lottery Commission (Commission) approve the proposed budget that projects a contribution of \$1.05 billion to public education for Fiscal Year 2009-10?

RECOMMENDATION

Staff recommends that the Commission approve the California State Lottery (Lottery) budget for Fiscal Year 2009-10 as presented in the attached document.

BACKGROUND

The foundation for the proposed Fiscal Year 2009-10 budget is forecasted sales of \$2.96 billion. The proposed budget expects sales revenues to be augmented with \$50 million from continued efforts to restructure the Lottery's investment portfolio for total forecasted revenues of \$3.01 billion.

Fiscal Year 2009-10 revenues will be utilized to fund the 2009-10 Business Plan strategies approved by the Commission at the May 2009 meeting. These strategies represent multi-year initiatives derived from the Lottery's 2007-10 Business Plan, which are delineated in four categories, approved by the Commission in June 2007.

- Focus on Long-Term Planning
- Improve Brand Image

- Shift the Jackpot Paradigm
- Modernize Operations

Also included in the proposed budget is funding to initiate development of the Lottery's next Business Plan.

The proposed budget will result in profits to California public schools of over \$1.05 billion marking the tenth consecutive year the Lottery will surpass the one billion dollar mark in its contributions to public education.

The Fiscal Year 2009-10 budget does not include any assumptions regarding passage of lottery modernization legislation to increase lottery revenues and the resultant increase in contributions to public education. Should the legislature approve such changes, the Lottery will submit a revised budget for Commission approval.

DISCUSSION

Revenues

The development of the Lottery's budget begins by projecting sales performance by game and determining prize funding levels by game. Sales performance is initially projected by using sophisticated modeling as well as recent sales trend data. However, sales of Lottery products are affected by many variables. Some of these variables are influenced by strategic decisions such as prize payout levels, marketing efforts, and introduction of new games. These variables have fiscal constraints directly tied to the budget.

Sales are also heavily influenced by unpredictable factors, most notably jackpot levels, and uncontrollable factors such as the economy. As a result, the Lottery relies on modeling that is heavily dependant on key assumptions to develop sales projections.

Fiscal Year 2009-10 revenue is projected to be at \$3.01 billion or an increase of about \$44 million over the current fiscal year. This revenue will come from \$2.96 billion in product sales, which is about \$10 million higher than this year, and \$50 million in revenue from the restructuring of the Lottery's investment portfolio.

Despite severe economic conditions in the state, several of the Lottery's Business Plan strategies are beginning to show positive results. As such, the sales goal reflects a stemming of the declining sales trends of the past two years and begins to reverse those trends.

For the Scratchers product line, a sales goal of \$1.70 billion is being proposed. This will represent an approximate 5 percent increase over the current year's sales. This

goal was based on the growth in Scratchers sales since mid-January from the very successful launch of the “Make Me a Millionaire” game and television show, a full year of the Scratchers second-chance “Replay Program” and exciting new games designed to expand the player base.

For the SuperLotto Plus and MEGA Millions jackpot games, the sales goals reflects how the Lottery’s initiatives have begun to show signs of stabilizing the decline in sales for these games. As such, SuperLotto Plus and MEGA Millions have a combined sales goal of \$805 million. While this represents an approximate 8 percent decline from this year’s sales, this amount is substantially lower than the 14 percent decline experienced during the current fiscal year.

In terms of the other Lottery products, Daily Games and Hot Spot will have sales goals that are somewhat close to the levels being achieved this fiscal year. A goal of \$120 million is being proposed for Hot Spot. This is about \$7 million lower than current year sales and follows the trend of slightly declining sales in this product line. For the Daily Games category, a sales goal of \$335 million is proposed. This represents an increase of about \$7 million compared to the current year’s sales level.

Total sales for Fiscal Year 2009-10 are projected to be \$2.96 billion. The projected sales goals do not include any assumptions regarding passage of lottery modernization legislation to increase revenues. Consequently, the sales goals are constrained by the amount of administrative dollars that can be redirected to supplement the prize payouts for the Scratchers product line. Without the lifting of current prize payout restrictions, sales of Lottery products will continue to be limited.

COMPARISON OF REVENUES
FY 2008-09 ESTIMATED and FY 2009-10 BUDGET
(\$ in Thousands)

SALES:	ESTIMATED YEAR-END FY 2008-09	CHANGE	PROPOSED BUDGET FY 2009-10
Scratchers	\$1,615,000	\$85,000	\$1,700,000
SuperLotto Plus	\$533,000	(\$43,000)	\$490,000
MEGA Millions	\$347,000	(\$32,000)	\$315,000
Daily Games	\$328,000	\$7,000	\$335,000
Hot Spot	\$127,000	(\$7,000)	\$120,000
Total Sales	\$2,950,000	\$10,000	\$2,960,000
Other Revenue	\$16,000	\$34,000	\$50,000
Total Revenue	\$2,966,000	\$44,000	\$3,010,000

The Fiscal Year 2009-10 budget also anticipates \$50 million from the Lottery's continued efforts to restructure its investment portfolio. This effort, which began in the latter portion of Fiscal Year 2008-09, involves taking advantage of financial market conditions to leverage the Lottery's currently held U.S. Treasury bonds by replacing them with other high-credit higher yielding investment instruments. This market condition has created an opportunity to reduce the Lottery's investment costs while generating funds for public education as well as for reinvestment in the Lottery's business.

The projected sales of \$2.96 billion plus the \$50 million augmentation from restructuring of the Lottery's investment portfolio results in total forecasted revenues of \$3.01 billion for Fiscal Year 2009-10.

Expenses

The Lottery Act mandates that fifty percent of the sales of Lottery products are required for prize payments. The Fiscal Year 2009-10 budget continues the Lottery's past strategy of redirecting funds from the administrative budget to enhance prize payouts in order to stimulate sales. The budget proposes allocating \$1.58 billion for prizes. This represents 52.6 percent of total revenues going to prize winners.

The resultant administrative budget is utilized to fund retailer compensation, game operations, communications, general administrative expenses, and a small administrative reserve. Total budgeted administrative expenses of \$403 million are equal to 13.4 percent of total revenues, well below the 16 percent cap on administrative expenses per the Lottery Act.

The Fiscal Year 2009-10 budget includes funds for the following multi-year Business Plan strategies approved at the May Commission meeting. These strategies are listed under the relevant strategic directive:

Focus on Long Term Planning

- Development of the Next 3 Year Business Plan

Improve Brand Image

- Redesign the Lottery's Public Website
- Create more Winners Through Second-Chance Drawings

Shift the Jackpot Paradigm

- Total Review of the Draw Games Product

Modernize Operations

- Conduct Business Intelligence Pilot Project
- Address Financial Policies and Procedures Documentation Needs

- Implement Customer Contact Center Improvements

The administrative budget proposes 640 permanent authorized positions. This reflects an increase of 3 permanent positions above Fiscal Year 2008-09 levels. The additional positions are in headquarters and are necessary to address increased workload in the Human Resources, Legal, and Security and Law Enforcement organizations. The budget also proposes to keep 27 vacant positions unfilled through December 2009 to realize savings in administrative expenses.

This budget continues the longstanding practice of providing an administrative spending reserve as a safeguard against future uncertainties. Given the variables that can negatively affect the sales revenues, the administrative spending reserve is set at a very conservative \$1.9 million. This provides a modest reserve to mitigate potential sales shortfalls and/or unanticipated expenses.

Summary

With this proposed budget, profits to California public schools in Fiscal Year 2009-10 are anticipated to be over \$1.05 billion marking the tenth consecutive year that the Lottery has surpassed the billion dollar mark in contributions to public education.

The proposed Fiscal Year 2009-10 budget does not include any assumptions regarding passage of Lottery modernization legislation to increase revenues. Consequently, the sales goals are limited by the amount of administrative dollars that can be redirected to supplement the prize payouts for the Scratchers product line. Without the lifting of current prize payout restrictions, sales of Lottery products will continue to be constrained.

Should the legislature approve actions to modernize Lottery operations by lifting prize payout restrictions, the Lottery will submit a revised budget for Commission approval. The sooner that such legislation takes effect, the sooner the Lottery will be able to implement strategies that will result in greater profits to public education in the coming fiscal year.

Attachment