

MEMORANDUM

Date: May 13, 2009

To: California State Lottery Commission

From: Joan M. Borucki

Director

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Marketing Division

Subject: Item 9(f) – Amendment to Extend the Term of Pollard Banknote Ltd.

Instant Ticket Printing Contract

<u>ISSUE</u>

Should the California State Lottery Commission (Commission) approve an amendment to the Pollard Banknote Ltd. Instant Ticket Printing contract to extend the contract term for four years with an additional expenditure authority of \$15 million for a total contract expenditure authority of \$35 million for Contract #10868?

RECOMMENDATION

Staff recommends that the Commission approve an amendment to the Pollard Banknote Ltd. Instant Ticket Printing contract to extend this contract for four years. To accommodate this extension, staff recommends that the Commission approve an additional expenditure authority of \$15 million for a total contract expenditure authority of \$35 million for Contract #10868. This extension deal will result in ticket printing cost savings to the California State Lottery (Lottery) over the next four years.

BACKGROUND

A key component of the Lottery's product line is its instant games, known as Scratchers®. Each year, the Lottery introduces between 40 and 45 new Scratchers games. Each game is comprised of millions of tickets that sell for between \$1 and \$5 each. There are only three North American manufacturers of Scratchers games: Scientific Games International Inc. (SGI), GTECH Printing Corporation (GTECH), and Pollard Banknote Ltd. (Pollard). All of the lotteries in North America rely on these three companies to provide them with their instant games.

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In the past, the Lottery, as well as most US lotteries, generally depended on just one company to print all of its games. However, in recent years, the industry trend has been to contract with more than one of these three companies to reduce costs by encouraging competition and to fully leverage the proprietary printing technologies and game features that the individual vendors can provide. Accordingly, on June 29, 2005, the Commission awarded four contracts for the production of Scratchers games. The principal contract was awarded to Scientific Games International Inc. and three supplemental printing contracts were awarded to Creative Games International, Oberthur Gaming Technologies and Pollard. Pollard was awarded a four-year contract and the option to extend up to four additional years with an initial expenditure authority of \$4 million and subsequent additions of expenditure authority of \$6 million and \$10 million for a current total expenditure authority of \$20 million. In May 2007, Scientific Games Inc. acquired Oberthur Gaming Technologies and their contracts with the Lottery. In August 2007, GTECH acquired the assets of CGI along with its contracts with the Lottery.

DISCUSSION

As a result of the acquisitions noted above, the Lottery currently has a primary contract with SGI and supplemental contracts with GTECH and Pollard. For games not printed by SGI, the Lottery requests bids from GTECH and Pollard, unless the game is proprietary to one vendor. These three companies have been producing all of the Lottery's Scratchers games since 2007. The Lottery has been very pleased with the ability of these vendors to deliver innovative high quality games that have met our sales expectations.

The Lottery gauges the success of Scratchers games not only by weekly sales, but also by retailer feedback and consumer surveys. Some recent examples of innovative and successful games produced by Pollard include the constantly evolving crossword and bingo games like *Tripling Crossword* and *Greenline Bingo*, which provide a higher entertainment value and opportunities to reach a variety of players

In assessing the overall performance of its ticket printing vendors, the Lottery also considers such factors as the overall quality of the tickets produced, the vendor's ability to meet the lottery's timelines to launch new Scratchers games and how responsive the vendor is in resolving any problems that may arise related to production, distribution, security and ticket accounting.

Pollard is very professional and makes very few errors. Pollard has produced high performing bingo themed Scratchers and holds a patent on the bingo marking system using a transparent latex.

In preparation for the impending expiration of these contracts on June 30, 2009, the Lottery invited its supplemental printing contractors, Pollard and GTECH, to propose

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a cost per thousand pricing model (CPM) that would reduce printing costs in exchange for a four year contract extension.

Pollard responded with a CPM pricing proposal that will result in reduced costs. Pollard's proposed pricing model gives the Lottery a discount depending on the number of our games printed by Pollard. The more games they print for us the more we will save. Based on the number of games that Pollard has produced for us in the past, the Lottery estimates that the proposed rates will save us 7 percent over current costs. However, Pollard's proposal differs from GTECH's in that Pollard will give the Lottery a rebate by retroactively discounting prior games if and when we reach a certain number of tickets. In addition, the 7 percent discount likely represents more bottom line dollars in savings than the GTECH extension because we currently do more games with Pollard.

Based on Pollard's favorable pricing proposal and their satisfactory performance to date, staff recommends that the Lottery exercise the full four-year contract extension option. This extension will require an additional expenditure authority of \$15 million to cover future Scratchers ticket printing costs. With the four-year extension, the new contract expiration date will June 30, 2013 and the total contract expenditure authority will be \$35 million. The increase from the previous four years from \$20 million to \$35 million in expenditure authority will allow the lottery maximum flexibility to take advantage of any current and new proprietary technology or game designs that Pollard may develop in the next four years.