



M E M O R A N D U M

Date: May 13, 2009

To: California State Lottery Commission

From: Joan M. Borucki
Director

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Subject: Item 9(g) – Amendment to Extend the Term of GTECH Printing Corporation Instant Ticket Printing Contract

ISSUE

Should the California State Lottery Commission (Commission) approve an amendment to the GTECH Printing Corporation Instant Ticket Printing contract to extend the contract term for four years with an additional expenditure authority of \$10 million for a total contract expenditure authority of \$12 million for Contract #10870?

RECOMMENDATION

Staff recommends that the Commission approve an amendment to the GTECH Printing Corporation Instant Ticket Printing contract to extend this contract for four years and add an additional \$10 million in expenditure authority for a total contract expenditure authority of \$12 million for Contract #10870. 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.

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 (SGI) and three supplemental printing contracts were awarded to (Pollard), Oberthur Gaming Technologies and Creative Games International (CGI). (CGI) was awarded a four-year contract with a total expenditure authority of \$2 million and the option to extend up to four additional years. In May 2007, (SGI) 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 GTECH include games that provide opportunities to reach a variety of players like *Let it Dough Doubler* and *In the Line of Duty*.

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.

GTECH has excellent customer service and a willingness to work with us to try unique games and promotions. Their presses have the ability to print higher detail than other vendors and they have the ability to implement cross-over Scratchers games. Cross-over Scratchers games are games that have free draw game plays as prizes. This encourages Scratchers players to try draw games.

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

GTECH responded with a CPM pricing proposal that will result in reduced costs over the extension period. GTECH's proposed pricing model gives the Lottery a discount depending on the number of games printed by GTECH. The more games they print for us the more we will save. Based on the number of games that GTECH has produced for us in the past, the Lottery estimates that the proposed rates will save us 11 percent over current costs.

Currently, the Lottery bids out printing by our supplemental vendors on a game-by-game basis so rates are not guaranteed. Operational and manufacturing costs are likely to increase. Locking in this extension will guarantee a discount over the next four years. In addition to the savings, locking in these rates will be more efficient and save time because there will no longer be game-by-game bidding.

Based on GTECH'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 \$10 million to cover future Scratchers ticket printing costs. With the four-year extension, the new contract expiration date will be June 30, 2013 and the total contract expenditure authority will be \$12 million. The increase from the previous four years from \$2 million to \$12 million in expenditure authority will allow the Lottery maximum flexibility to take advantage of any current and new proprietary technology or game designs that GTECH may develop in the next four years.