Pennsylvania Lottery Profit Report

As Required by Act 53 of 2008

2014

# END OF FISCAL YEAR 2013-14 ANALYSIS

The Pennsylvania Lottery set a new sales record for fiscal year 2013-14 of $3.8 billion, surpassing the $3.1 billion record set in fiscal year 2012-13 by $100 million, or 2.7 percent. This is the fourth year in a row that the Lottery has set a record in total sales.

The Lottery also achieved record profits of $1.081 billion for fiscal year 2013-14, which represents a $14.1 million, or 1.2 percent, increase over fiscal year 2012-13 total profits of $1.067 billion. This is the third year in a row that the Lottery has set a new profit record and the fifth consecutive year the Lottery has seen an increase in year-over-year total profits.

The Pennsylvania Lottery remains the only state lottery that designates all its proceeds to programs that benefit older residents. Since its inception in 1971, the Pennsylvania Lottery has contributed more than $24.7 billion to programs that include property tax and rent rebates; free and reduced-fare transit; the low-cost prescription drug programs PACE and PACENET; care services; and the 52 Area Agencies on Aging, including full- and part-time senior centers throughout the state.

Act 53 of 2008 granted the Pennsylvania Lottery temporary relief from the mandated 30 percent minimum return that had been in place since the Lottery’s inception. The Lottery was given the latitude to return a minimum of 27 percent through fiscal year 2010-11. Act 23 of 2011 extended the 27 percent minimum return through fiscal year 2014-15.

Using this reduction of the minimum rate of return from 30 percent to 27 percent, the Lottery was once again able to execute a marketing plan that generated record sales and net revenues for these important programs. The lottery ended fiscal year 2013-14 with a net profit percentage of 28.46 percent. Contributing to the record profit was a reduction in the Lottery’s operating cost from 2.07 percent in fiscal year 2012-13, to 2.04 percent in fiscal year 2013-14.

The Pennsylvania Lottery remains one of the best performing lotteries of the 43 U.S. Lotteries, ranking in profits in fiscal year 2012-13.

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# State of the Lottery Game Portfolio

The Lottery maintains a diverse product portfolio, providing lottery games that meet an equally diverse consumer population. The Lottery’s 2.7 percent sales growth was largely driven by a 6.1 percent growth in the instant games category. Fiscal year 2013-14 marks the fourth year in a row that instant sales have grown by 6 percent or more. Terminal-based games' sales fell by 2.9 percent in fiscal year 2013-14, primarily due to shorter Powerball jackpot runs, which produced smaller jackpots.

**Product Mix**

To a large extent, consumer demand drives Lottery sales and its product mix. Lottery sales for fiscal year 2013-14 continue to reflect the industry trend of increased consumer demand for higher price point instant games. Since the Lottery’s instant games return approximately half the profit per sales dollar as the terminal-based portion of the portfolio, increased consumer demand for the instant games reinforces the necessity of the relief from the 30 percent mandate to grow sales and profits.

Instant sales as a percentage of total traditional sales



In an effort to boost sales of higher-margin terminal-based games, the Lottery is planning a number of improvements to its terminal-based games portfolio.

**Instant Games**

For the fourth year in a row, the Lottery set a new instant games sales record. Instant sales of $2.45 billion easily surpassed the record of $2.31 billion set in fiscal year 2012-13. The growth in instant sales amounted to an increase of $140 million, or 6.1 percent. An impressive 18 of the top 40 instant game sales weeks in the entire 42-year history of the Lottery occurred in fiscal year 2013-14.

The category accounted for 64.3 percent of total sales.

As with most lotteries, the sales mix is shifting toward the higher price point instant tickets. The table below shows the sales migration toward the higher price point instant games over the last four fiscal years. As a result, the average selling price has risen as well.



**Multi-State Lotto: Powerball and Mega Millions**

The multi-state lotto category suffered a 7.7 percent decline in fiscal year 2013-14 largely as a result of a 25 percent decline in Powerball/Power Play sales. Mega Millions/Megaplier sales increased 74 percent. While Mega Millions sales grew significantly, the increase was not enough to offset the decline in Powerball, as Mega Millions is a much smaller portion of multi-state lotto category sales.

As always, sales in this category are largely driven by the length of jackpot runs and the size of jackpots. Since Powerball saw fewer jackpots above $300 million in fiscal year 2013-14, the sales for the category suffered.

The Lottery is planning the launch of two additional multi-state games in fiscal year 2014-15. Monopoly Millionaires’ Club’s October 2014 launch will offer players three different ways to win a million-dollar prize with a single ticket. This game is designed to create many million-dollar prizes instead of one huge jackpot. For this reason, cannibalization risk upon Powerball and Mega Millions is expected to be minimal. The Lottery is also planning to join a regional multi-state game with the New Jersey and New York lotteries. This new game will feature a unique top prize, which will differentiate it from other terminal-based games and is slated for an April 2015 launch.

The multi-state lotto category accounted for 11.8 percent of total sales in fiscal year 2013-14.

**In-State Lotto: Cash 5, Match 6, Treasure Hunt**

The in-state lotto game category was up 6.9 percent over fiscal year 2012-13, accounting for 7.3 percent of total sales in fiscal year 2013-14. Although Cash 5 sales were down 9.5 percent, sales for the other two games were up significantly over the prior year. Treasure Hunt was up 11.5 percent, while Match 6 was up 47.3 percent. As with the multi-state category, jackpot size is a major driver of in-state lotto game sales. Players of this category tend to watch jackpots between the games closely and make purchases accordingly. The Lottery is considering a lotto game enhancement for launch in fiscal year 2015-16.

**Numbers Games: The Daily Number, Big 4, Quinto**

Numbers games ended fiscal year 2013-14 down 3.1 percent as compared to the prior year. Although numbers games have a loyal player base, industry-wide trends show that these games have a shrinking player base. The Lottery has plans to bolster the numbers category in fiscal year 2014-15 with the introduction of a new two-digit game in January 2015 and a simultaneous re-branding of all games in this category under a one-umbrella naming convention (Pick 2, Pick 3, Pick 4, and Pick 5). The Lottery expects incremental sales from the new Pick 2 game and that an economy of scale in promoting a family of games will lead to more opportunities to support the category with additional advertising and promotion. Lottery research shows that the numbers games player base will not be dissuaded with the re-branding, provided that there are no other changes to their favorite games.

Numbers games accounted for 16.1 percent of total sales in fiscal year 2013-14.

**Millionaire Raffle**

The Lottery sold out both Millionaire Raffles in fiscal year 2013-14, bringing the total of sold-out raffle games to 18, the same number of raffles the Lottery has offered. The Pennsylvania Lottery remains the only U.S. lottery to have sold out all its Raffle games on schedule.

# PLANNING FISCAL YEAR 2014-15 AND BEYOND

The Lottery continues to look to the future, planning for fiscal year 2014-15 and beyond. In an effort to meet its fiscal goals for the coming years, the Lottery will focus efforts on the following strategies.

**Key Strategy #1 – Modernization**

The Lottery will continue to analyze and adopt leading private-sector practices to modernize its systems, technology, communication and retail environment.

**Key Strategy #2 – Optimization**

By measuring more and more of its business operations, the Lottery will increase efficiency and effectiveness, make it easier for retailers to sell its products and make optimal use of its retail network, human resources and external relationships.

**Key Strategy #3 –Stakeholder Engagement**

In an effort to prepare for long-term success, the Lottery understands that it must continue to expand its engagement of players, retailers, employees and members of the General Assembly. Through these unique perspectives, the Lottery believes it will gain additional insights into its business.

**Key strategy #5 – Focus on Terminal-Based Games**

With the addition of new games to the Lottery’s portfolio of terminal-based games, the Lottery will continue to grow funding for programs benefitting older Pennsylvanians. With their higher profit margins, terminal-based games are an important component to a profitable portfolio. Across the industry, numbers games and in-state lotto games are slowly declining. In an effort to reverse this trend, the Lottery will increase the promotional resources dedicated to these games.

**Key strategy #4 – Continue the Growth of Instant Game Category**

With the addition of the new $30 price point, instant games continue to grow at a remarkable pace. In an effort to facilitate continued growth in this product category, the Lottery will continue its practice of deliberate, best practice and data-based product management.

# Conclusion

The Lottery achieved a record sales year in fiscal year 2013-14 with $3.8 billion in total sales. The Lottery also achieved a record profit year of $1.081 billion.

The Lottery is projecting another strong year of sales growth in fiscal year 2014-15. Total sales are estimated to grow to $3.96 billion, an increase of $161 million or 4.2 percent over fiscal year 2013-14. The Lottery projects strong growth in profit as well. Total profits are projected to grow to $1.107 billion for fiscal year 2014-15, an increase of $26 million or 2.4 percent over fiscal year 2013-14.

The Lottery continues to focus on the future, with the ultimate goal of providing the funding necessary to meet program goals for fiscal year 2014-15 and beyond. By executing the key strategies outlined herein and continuing to operate the business in a manner that allows the Lottery to quickly respond to changing market conditions and consumer demand, the Lottery is confident that it will be able to meet the program funding goals.