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# **Pennsylvania Lottery Profit Report**

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As Required by Act 53 of 2008

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June 2010

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## ANALYSIS

The Pennsylvania Lottery remains the only state lottery that designates all its proceeds to programs that benefit older residents. Since its inception 38 years ago, the Pennsylvania Lottery has contributed more than \$19.2 billion to programs that include property tax and rent rebates; free and reduced-fare transit; the low-cost prescription drug programs PACE and PACENET; long-term living services; and the 52 Area Agencies on Aging, including more than 600 full- and part-time senior centers throughout the state.

Act 53 of 2008 passed in July 2008 and 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 has been given the latitude to return a minimum of 27 percent through fiscal year 2010-11.

This change was granted with the understanding that it will give the Lottery the capability to grow sales and net revenues for programs even though the return percentage may be lower.

## PROGRESS THROUGH WEEK 49 of FISCAL YEAR 2009-2010

After 49 weeks of fiscal year 2009-10 sales, the Lottery projects to end the fiscal year on June 30 with game sales totaling \$3.072 billion. This would represent a decrease of \$16.3 million or 0.53 percent less than fiscal year 2008-09 sales. Lottery sales would, however, exceed the \$3.028 billion estimate for fiscal year 2009-10 by \$43.6 million or 1.44 percent.

The Lottery estimates it will return \$918.4 million to the Lottery Fund in proceeds in fiscal year 2009-10. This would be an increase of \$7.9 million or 0.87 percent in net proceeds as compared to the fiscal year 2008-09 net return of \$910.5 million. The net return percentage for fiscal year 2009-10 is projected to be 29.90 percent.

### **How will the Lottery generate more net revenue on fewer sales in fiscal year 2009-10?**

Interest earnings during fiscal year 2008-09 were negative \$27.5 million. Interest earnings for fiscal year 2009-10 are projected to end at \$757,000.

The Lottery also realized savings from a full year of reduced vendor commissions that began in January 2009. Retailer commissions and prize liabilities have remained relatively stable over the last three years as shown in Table 1.

<b><i>Thru May</i></b>	<b>Vendor Comm.</b>	<b>Rtr Comm</b>	<b>Prize Liab.</b>
FY0708	2.41%	5.54%	60.48%
FY0809	1.93%	5.37%	61.16%
FY0910	1.53%	5.24%	60.69%

*Table 1: Vendor and retailer commissions, prize liability percentage*

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## CONTRIBUTING FACTORS

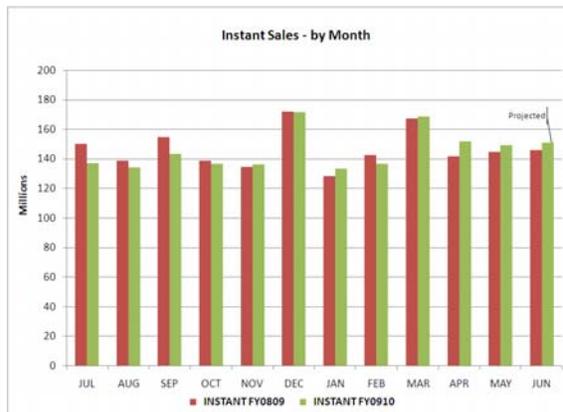
Fiscal year 2009-10 sales have made a remarkable recovery from the downward sales trend in the first and second quarters that precipitated a mid-year revision of the 2009-10 sales estimate.

On November 30, 2009, fiscal year sales for terminal-based games were down \$8.53 million (-1.6 percent) over the same period in fiscal year 2008-09. At the same time, instant year-to-date sales were down \$29.03 million (-4.1 percent). Altogether, game sales were down \$37.56 million (-3.0 percent).

A prolonged softened economy contributed to a reduction in spending per player and also to an increase in business failures; hence negative growth in the Lottery's retailer network. The Lottery's own focus group study, fielded in January 2010, indicated one in 10 players had increased their spending on Lottery tickets, but one in four players reduced their spending or stopped playing altogether. The report found that the Lottery retained its players better than all other leisure activities measured. This is likely a contributing factor in the Lottery's ability to bounce back in the last two quarters of fiscal year 2009-10 as players' attitudes about the economy improved.

Graph 1 shows that for the first six months of fiscal year 2009-10, sales were down for all months except November. Instant sales have beaten last year's sales for four of the last five months and are expected to beat last year's sales in June as well.

Graph 2 shows that terminal-based games were down for seven of the first eight months of fiscal year 2009-10. Already down by \$25 million at the end of January, terminal-based games took another major hit when two snow storms cost the Lottery an estimated \$20 million in total sales. Thanks in large part to the February launch of Mega Millions and the larger population/player base of Powerball, terminal-based games have gone from down 3.1 percent in February to down 1.3 percent in May, and are projected to only be down about 0.6 percent by the end of the fiscal year.



Graph 1: Instant Game Sales by Month



Graph 2: Terminal-based Game Sales by Month

**Instant versus terminal-based product mix is relatively unchanged from fiscal year 2008-09.**

Through May, product category mix remains relatively unchanged from last year. Instant products accounted for 56.97 percent of sales in fiscal year 2009-10 versus 56.69 percent of

sales in fiscal year 2008-09. Price point mix within the instant category did see some shifting in fiscal year 2009-10 toward the \$5 and to a lesser extent to the \$2 price points as shown in Table 2.

Price Point	\$1	\$2	\$3	\$5	\$10	\$20/\$25	Overall
Change from FY 2009-10	-17.5%	2.4%	-5.0%	14.1%	-6.6%	-2.9%	-0.1%

Table 2: Percentage of instant sales by price point.

### Multi-state lotto: Powerball and Mega Millions

Multi-state lotto games account for 11.7 percent of sales.

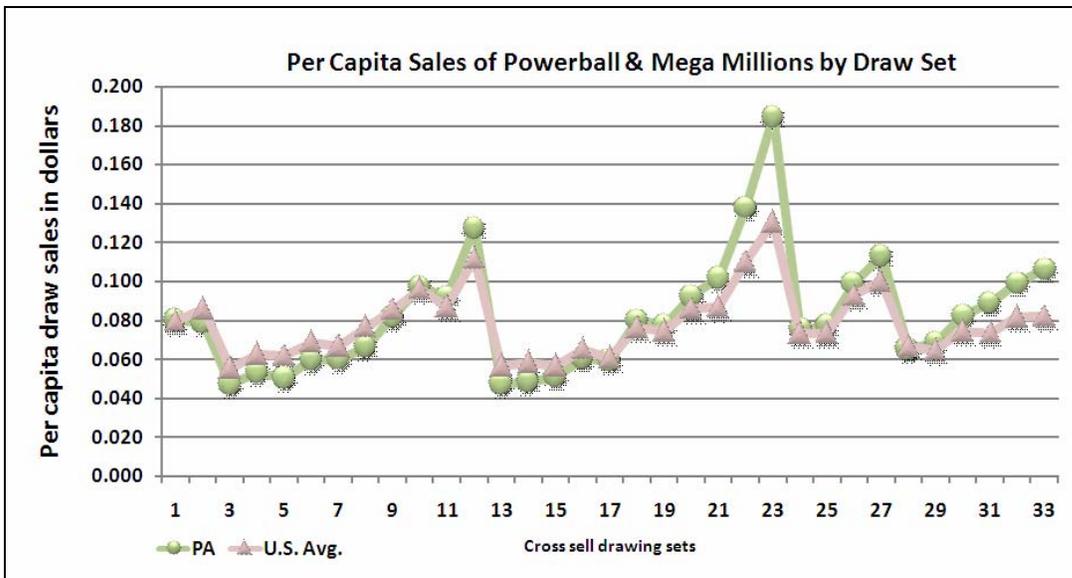
Game Category	Sales (\$MM) FY 2009-10	Sales (\$MM) FY 2008-09	Change (\$MM)	Change (%)
Multi-state	335.8	295.6	40.20	13.6%

Table 3: Multi-state lotto games sales.

In week 31, Powerball was down \$10 million dollars over week 31 in fiscal year 2008-09. Mega Millions was launched in Pennsylvania the next day. As of week 49, the multi-state category which includes Powerball and Mega Millions, was up \$40.2 million dollars over the same period in fiscal year 2008-09.

Pennsylvania has done particularly well in the combined cross-selling of Powerball and Mega Millions. Pennsylvania ranks sixth in population among the U.S. lotteries selling Powerball and/or Mega Millions. After 17 weeks, Pennsylvania ranks fourth in total sales and seventh in per capita sales.

One of the primary reasons that Pennsylvania ranks high in cross-selling sales is described in Graph 3 below. As jackpots grow toward the end of a Powerball or Mega Millions run, the per capita play in Pennsylvania increases at a much higher rate as compared to the average lottery.



Graph 3: Per capita sales by draw: Pennsylvania versus U.S. Lottery average.

### **Numbers Games: TDN, Big 4, Quinto**

Numbers games represent 22.3 percent of sales.

Game Category	Sales (\$MM)	Sales (\$MM)	Change (\$MM)	Change (%)
	FY 2009-10	FY 2008-09		
Numbers	638.9	651.3	-12.38	-1.9%

Table 3: Numbers games sales.

Although down for the year after 49 weeks, there is room for optimism with regards to the numbers category. Three of the six games are actually ahead of the same period last year (Big 4 day, Quinto evening, Quinto day), and the other three games have made up considerable ground since week 31 of the fiscal year.

Pennsylvania remains the only U.S. lottery to include a five-digit game (Quinto) in its numbers games portfolio. Quinto will account for \$35 million dollars in fiscal year 2009-10 sales.

### **In-state lotto: Match 6, Treasure Hunt, Super 7, Mix and Match**

In-state lotto accounts for about 2.7 percent of sales.

Game Category	Sales (\$MM)	Sales (\$MM)	Change (\$MM)	Change (%)
	FY 2009-10	FY 2008-09		
In state Lotto	77.7	114.7	-37.05	-32.3%

Table 4: In-state lotto games sales.

The in-state lotto category has seen its share of the terminal-based game shrinkage ever since Powerball was introduced in Pennsylvania in 2002. Several attempts at adding new games in this category have experienced varying degrees of success. The Lottery retired its Mix and Match and Super 7 games in fiscal year 2009-10. Super 7's retirement was not planned, but it became apparent to the Lottery that there was less of a market for a game with a jackpot between Cash 5 and the multi-state games than anticipated.

The re-launch of the Match 6 game is in part due to the Lottery's recognition that this category can provide something that cannot be obtained from the rest of the terminal-based game portfolio, namely, a lot of winning experiences.

Treasure Hunt continues to perform admirably for its size and provides daytime players with a daily jackpot game for their time slot.

### **Cash 5**

Cash 5 accounts for about 5.9 percent of sales.

Game Category	Sales (\$MM)	Sales (\$MM)	Change (\$MM)	Change (%)
	FY 2009-10	FY 2008-09		
Cash 5	169.6	176.3	-6.64	-3.8%

Table 5: Cash 5 sales.

In the second half of fiscal year 2009-10, Cash 5 has been a victim of bad luck in terms of the jackpot getting hit more often early in the jackpot roll sequences. Up by \$5.2 million after 20 weeks, sales have fallen \$6.6 million below last year after 49 weeks.

Table 5 compares average jackpot levels for weeks one through 30 against average jackpot levels for weeks 31 through 47. Average jackpots were down 17.7 percent, while sales were only down 12.9 percent. This suggests that the fall in sales was a result of fewer jackpot rolls than a game cannibalization problem. The Lottery will continue to monitor Cash 5 and the rest of the portfolio with respect to cannibalization from the multi-state games and will react accordingly.

Cash 5 jackpot vs, sales

Period	Avg Jackpot	Avg Drw \$	Sales to JP ratio
Week 1-30	\$ 314,283	\$ 520,780	1.66
Week 31-47	\$ 258,630	\$ 453,585	1.75
Difference	-17.7%	-12.9%	5.4%

Table 5: Cash 5 sales versus jackpot levels.

### **Millionaire Raffle**

Millionaire Raffle accounts for less than 0.7 percent of sales.

Pennsylvania sold out its ninth Millionaire Raffle game in January. Pennsylvania remains the only U.S. lottery to have sold out every raffle without extending the drawing date.

Although selling out the Millionaire Raffle has become more difficult with each new offering; raffles are profitable after 60 percent of the tickets are sold. The Lottery plans to offer again a Millionaire Raffle for New Year's and one for the Fourth of July.

## **PLANNING FISCAL YEAR 2010-11 AND BEYOND**

**To meet its fiscal commitment in fiscal year 2010-11 and beyond the Lottery will maintain a strong presence in the higher margin terminal-based games.**

### **Multi-state games - Powerball and Mega Millions**

The addition of cross-sales for Powerball and Mega Million is important to the Lottery's fiscal future in several ways. First, the Lottery now offers a big jackpot drawing on four nights a week rather than just two. Secondly, sales grow exponentially after \$100 million jackpots are advertised, and the chance that Pennsylvania will have at least one game with a \$100 million jackpot has more than doubled thanks to the addition of Mega Millions and to the increase in population supporting the growth of Powerball jackpots. As a bonus, the increased traffic has a residual positive effect on the rest of the game portfolio.

The fiscal year 2010-11 plan will support both games on many levels. Television advertising for jackpots at \$100 million and over will be shared between the two games. Electronic out-of-home (OOH), digital OOH, online banners, website/VIP Players Club, radio and sport stadium advertising will also support both games throughout the year. The new flat panel, point-of-sale monitors will play a vital role in jackpot awareness at the point of purchase by featuring short clips with large typeset jackpot numbers and will be rotated in sequence with other game and promotional messages on a continual basis. Consumer system promotions will feature Mega Millions in August and January and Powerball in January. Consumer mailing coupons will feature Powerball in September and Mega Millions in September and December.

## **Cash 5**

Pennsylvania has one of the strongest cash lotto games in the country in Cash 5. Understanding that higher jackpots drive higher sales the Lottery decided to increase the matrix size of Cash 5 in January 2008 in order to increase the length of the average jackpot run. In spite of the run of bad luck in recent jackpot runs, the move has proved successful overall. Given the long history of Cash 5 and its loyal playership, the Lottery is hesitant to make additional changes to the game in fiscal year 2010-11. Nevertheless, the Lottery will continue to monitor Cash 5 and its position in the portfolio of games.

Cash 5 will be supported throughout the year through jackpot awareness and television advertising for large jackpots. It will also be supported daily by Cash 5 jackpot electronic OOH and radio throughout the year. Cash 5 system promotions will be featured in October and March. Cash 5 mailer promotions will likely be featured for a month in the spring 2011. A retailer promotion in the form of a second-chance drawing is planned for Cash 5 in October.

## **In-state lotto – Match 6 and Treasure Hunt**

As noted earlier, this category has shrunk in terms of percentage of sales revenue and in the number of games offered. The Lottery recognizes that is difficult to design an in-state lotto game with a jackpot that can compete with the mega-sized jackpots of the multi-state games and the frequency of significant jackpot wins that Cash 5 offers. The Lottery has concluded that, at least in the near term, there is only room for a smaller version of Cash 5 for daytime lotto players (Treasure Hunt) and a game that offers many more winners of smaller prizes that satisfies the player who values a winning experience more than the longer odds of winning larger jackpots (Match 6).

In fiscal year 2010-11, the lottery will support Match 6 and Treasure Hunt by including them in the winner awareness promotional campaign. Match 6 will be featured in a “buy one, get one free” consumer promotion in July and a volume discount promotion in January. Match 6 will also be featured in a retailer “ask for the sale” second-chance drawing promotion in July.

## **Numbers games – TDN, Big 4, Quinto**

As was noted earlier, numbers games account for nearly 23 percent of overall sales. They are nearly twice as profitable as instant games for the same sales dollar. The Lottery will include numbers games in several promotional vehicles throughout the year including winner awareness announcements and messages on the new flat panel, point-of-sale monitors.

Consumer promotion featuring numbers games will include a Quinto “doubler” promotion on the fifth of every month where Quinto tickets will be valid for a second drawing for both Quinto games. A numbers holiday weekend promotion is planned for Labor Day, Columbus Day, Martin Luther King Day, President’s Day and Memorial Day. All six numbers games are eligible. Every 200<sup>th</sup> numbers ticket sold will generate a \$5 instant win.

## **Instant Sales**

Many of the initiatives instituted in fiscal year 2009-10 remain relevant to spurring growth in instant sales in fiscal year 2010-11:

Media and new games - Delivery of new instant tickets to retailers will be timed closely to match the launch of the television commercials that feature the new games.

Emphasis on core games - There are marketing initiatives in place for fiscal year 2010-11 to boost the awareness of the instant games that have a continuous presence (i.e. Win for Life, Bingo, Crossword).

Improved ticket callouts - The Lottery continues to refine the optimal design of callouts on tickets in order to attract players.

The Lottery along with its vendor partner, Scientific Games, continues to monitor the deployment of the predictive ordering system and is making adjustments and improvements to the process as needed.

Valassis couponing is planned for every month in fiscal year 2010-11. Instant tickets, especially at the \$1 and \$2 price points, will be featured nearly every month.

Web-based micro-sites will support several licensed properties throughout the year, including Reese's, NFL Eagles and Steelers, Monopoly, and Slingo.

Once again, the double commission for retailers will be a part of the holiday instant games season.

A Monopoly "ask for the sale" second-chance drawing is planned for October.

Another Grand-a-Day holiday promotion is planned for the period between November 8 and December 12. It will feature electronic entry through the VIP Players Club and award a \$1,000 cash prize to 350 winners.

## Recruitment

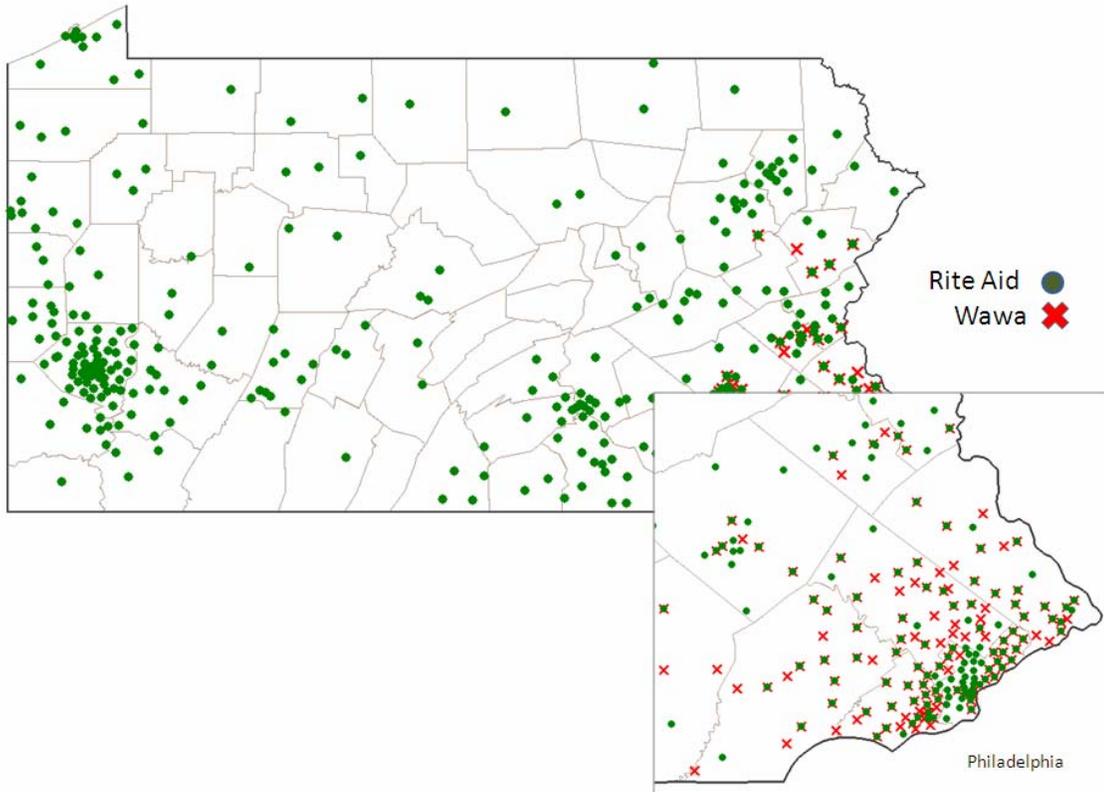
Retailer growth is the life-blood of revenue growth in the lottery industry. The effect of the economy on the Lottery network is evident in Table 6. The Lottery had a net loss of 205 retailers between June 2008 and June 2009. Those numbers continued to decline in the first quarter of fiscal year 2009-10. The second half of fiscal year 2009-10 finally saw enough positive growth that the Lottery expects it will end the fiscal year with a net gain of about 100 retailers.

	# Retailers	Growth (#)	Growth (%)
Jun'03	7170		
Jun'04	7249	79	1.1%
Jun'05	7987	738	10.2%
Jun'06	8448	461	5.8%
Jun'07	8511	63	0.7%
Jun'08	8545	34	0.4%
Jun'09	8340	-205	-2.4%
Jun'10	8443	103	1.2%

Table 6: Retailer counts and growth.

Perhaps even more encouraging than the turnaround in retailer growth in fiscal year 2009-10 is the potential for even greater retailer network growth in fiscal year 2010-11 and beyond. After several years of dialogue, the Lottery has begun pilot programs with the Rite Aid Pharmacy chain and their potential of 572 Pennsylvania stores and the Wawa convenience store chain with its potential of 210 stores. The plan eventually is to sell Lottery in all Pennsylvania stores for both

chains. Rite Aid provides a statewide presence in the drug store business type, a traditionally weak category for the Lottery. Wawa allows the Lottery finally to have a strong convenience store presence in the most populous part of the state, the Philadelphia region.



### Retailer Equipment

Fiscal year 2009-10 began a new era in providing our retailers with the latest in equipment in design and efficiency. July 2009 saw a full implementation of the new contract equipment fulfillments including replacement of 1,000 self-service 16-bin instant player activated terminals (ITVMs) with 1500 new self-service 24-bin ITVMs. Ten-year-old retail terminals were replaced with modern Wave terminals in every one of the 8,443 retail stores throughout the network. All ribbon-based printers were replaced with new thermal printers that eliminate the need to supply and replace ribbons. For the first time player-accessible ticket checkers were added to each location, reducing wait times for purchase and adding an element of confidence for players when checking their tickets.

Also new with the installation of the terminals were the 17-inch-flat-panel monitors that display the current jackpots and winning numbers for each game as well as other promotional and informational messaging at the point of purchase. The Lottery in Motion System (LIMS) will officially launch in July 2010. LIMS provides the Lottery with almost limitless possibilities for delivering timely and pertinent content to the consumer directly at the point of purchase. LIMS will also allow the Lottery to test market special offers and other marketing strategies by sampling in select stores or chains before rolling out marketing campaigns on a larger scale. Just as predicted in last year's profit report, the ease and speed of the new equipment is helping the Lottery in its continuing efforts to grow the retailer base.

Investment in the future continues in June 2010 with the additional purchases of 350 more ITVMs, 375 flat panel upgrades and flat panel inserts for 225 PlayCentral Terminals (PCTs).

## Retailer Incentives

A retailer incentive strategy that began in January 2009 will continue in fiscal year 2010-11. Retailers are more aware of retailer promotions that focus on a single game each month rather than incentives based on overall sales. The new strategy has not only delivered needed focus on particular games, but has limited unnecessary incentive liabilities.

## CONCLUSION

Without question, the single greatest outside influence on Lottery sales and profits during fiscal year 2009-10 was the state of the economy. Despite the ongoing national recession the Lottery has continued to deliver strong sales and profits in very trying economic times. The table below shows that the last five fiscal years rank at the very top of the 38-year history of the Pennsylvania Lottery in terms of total game sales and in overall profit. Relief from the 30 percent return requirement, as granted by Act 53 of 2008, has undoubtedly helped the Lottery maintain its recent history of record sales and profits.

FY	Sales (\$MM)	Rank - PA Historical	Profit (\$MM)	Rank - PA Historical	Return %
FY00-01	\$1,780	10	\$627	10	35.2%
FY01-02	\$1,934	9	\$749	9	38.7%
FY02-03	\$2,133	8	\$788	8	36.9%
FY03-04	\$2,352	7	\$819	7	34.8%
FY04-05	\$2,645	6	\$853	6	32.2%
FY05-06	\$3,070	5	\$968	1	31.5%
FY06-07	\$3,076	3	\$949	2	30.9%
FY07-08	\$3,089	1	\$928	3	30.1%
FY08-09	\$3,088	2	\$910	5	29.5%
FY09-10*	\$3,072	4	\$918	4	29.9%
*Jun'10 Prj					

Table 7: Last 10 fiscal years of sales and profits and their rankings in Lottery history.

Going forward, the aforementioned initiatives - including new and revised games, new equipment, promotions, retailer and consumer incentive programs, retailer growth - will allow the Lottery to continue its recent history of record sales and profits in order to support the many programs that benefit older Pennsylvanians.

As was noted in last year's report, these are still very challenging times for all retailers, not just the Pennsylvania Lottery. The Lottery will continue to focus on maintaining and growing its business. Over the past seven years, under the leadership of Governor Edward G. Rendell, the Pennsylvania Lottery has been one of the fastest growing in the nation. We are now ranked the sixth largest lottery in the country in traditional lottery sales and fifth in proceeds to programs.