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# **Pennsylvania Lottery Profit Report**

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As Required by Act 53 of 2008

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June 2011

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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 39 years ago, the Pennsylvania Lottery has contributed more than \$20 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 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 was 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. The Lottery's plans for growth in 2011-12 and beyond are built on the expectations that relief from the 30 percent minimum will be extended.

## PROGRESS THROUGH April 31, 2011

As of April 30, 2011, the Lottery projects to end the 2010-11 fiscal year with game sales totaling \$3.206 billion. This would represent an increase of \$140 million or 4.6 percent from 2009-10. The projected \$3.206 billion in sales would set a new record surpassing the fiscal year 2007-08 sales record of \$3.089 billion.

The Lottery projects it will return \$963 million to the Lottery Fund in proceeds for 2010-11. This would be an increase of \$48 million or nearly 5.3 percent over last year's net return of \$915 million. This year's net profit percentage is projected to be about 30.0 percent. The projected fiscal year 2010-11 profit of \$963 million would rank second in profits, surpassed only by the fiscal year 2005-06 record profit of \$967 million.

### Pennsylvania Lottery ranking in the industry for fiscal year 2009-10

For the most recently completed fiscal year (fiscal 2009-10) the Pennsylvania Lottery rankings out of 43 U.S. lotteries:

	<u>FY-0809</u>	<u>FY-0910</u>	<u>Change</u>
Population	6	6	-
Total Sales	6	6	-
Instant Sales	6	6	-
Terminal Based Game Sales	5	6	-
Profits	6	5	+1

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# State of the Lottery Game Portfolio

## Product Mix

An increase in consumer appetite for the instant game products not only in Pennsylvania but in the entire lottery industry is causing a shift in the product mix toward the less profitable instant product. Instant products return approximately half the profit per sales dollar as the terminal-based side of the product portfolio.

<b>Product Mix (Instant sales as a percentage of total traditional sales)</b>					
	FY0506	FY0607	FY0708	FY0809	FY0910
Pennsylvania	49.2%	51.7%	55.4%	55.3%	56.9%
Other U.S. Lotteries	55.2%	55.1%	56.8%	57.3%	57.2%

The Lottery is able to predict a record sales year and the possibility of a record profit year in fiscal year 2010-11 because in addition to executing an efficient and effective marketing program, and managing one of the most diverse game portfolios in the country, it continues to grow the retailer base. The increase in instant vending equipment in particular addresses the increase in consumer preference for the instant ticket products.

The Lottery has grown by 442 retailers, or 5.2 percent, in the 16 months between January 2010 and April 2011. At the same time retailer equipment has grown by 9 percent meaning not only has the number of Lottery outlets grown, but the Lottery presence within outlets has grown as well.

## Instant Games

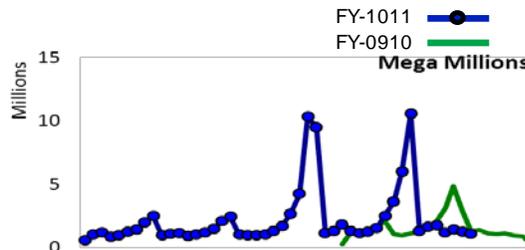
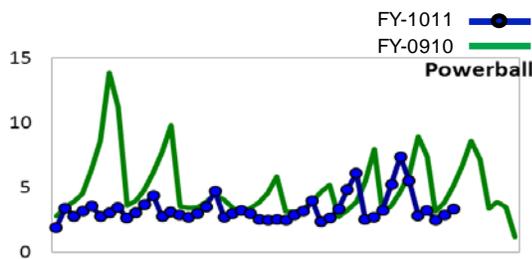
The Lottery is projecting a new instant product sales record for fiscal year 2010-11. The projected \$1.91 billion will easily surpass the record of \$1.76 billion set in fiscal year 2008-09.

Through week 46 of fiscal year 2010-11, instant games account for 59.8 percent of total game sales, up from the 57.1 percent at week 46 of fiscal year 2009-10. Total sales for this category at week 46 are up \$148 million, or 9.7 percent, compared to the same period last year. Seventeen of the top 30 instant game sales weeks in the entire 39 year history of the Lottery have occurred in the first 46 weeks of fiscal year 2010-11.

## Multi-State Lottos: Powerball and Mega Millions

Through week 46 of fiscal year 2010-11, multi-state lotto games account for 10.7 percent of total game sales, down from 11.4 percent at week 46 of fiscal year 2009-10. Total sales for this category are down \$3.5 million, or -1.2 percent, compared to week 46 last year.

The overwhelming cause for the drop in multi-state game sales is smaller Powerball jackpots caused by shorter Powerball jackpot runs in the current fiscal year. Powerball is down \$88 million from the same 46 weeks in fiscal year 2009-10. Fortunately, Mega Millions offered two significant jackpot runs in fiscal year 2010-11 and added \$84 million in sales to offset most of the losses in Powerball sales. The week-by-week sales trends compared to last year for each game are depicted in the following graphs.



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

Through week 46 of fiscal year 2010-11, numbers games account for 21.2 percent of total game sales, down from 22.3 percent versus fiscal year 2009-10. Total sales for this category are down \$4.6 million, or -1.9 percent, compared to last year.

Four of the six games increased (TDN mid-day, Big 4 mid-day, Quinto evening and Quinto mid-day), while the two largest and longest-running games decreased (TDN evening and Big 4 evening).

Quinto sales and profits have been particularly strong in fiscal year 2010-11, thanks to a very successful single-day Quinto Doubler promotion that has run eight times to date.

Comparative numbers game sales are likely to take a downturn for the remainder of fiscal year 2010-11, considering the unusually strong sales during the second half of fiscal year 2009-10 that resulted from an uncommonly large number of triple and quadruple number combinations being drawn for TDN and Big 4.

### **In-State Lottos: Match 6, Treasure Hunt**

In-state lotto accounts for about 2.5 percent of sales, down slightly from the 2.8 percent in fiscal year 2009-10. This category is down 7.8 percent compared to last year. As is the case in most U.S. lotteries, the in-state lotto category in Pennsylvania is being negatively impacted by player migration to the multi-state games and instant products.

The Lottery retired its Super 7 game 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 Lottery also retired Mix & Match last year.

The Lottery brought back Match 6 because it delivers something that no other terminal-based game in the current lineup offers – a large number of winning experiences. At week 46, Match 6 sales are exceeding the Lottery's fiscal year estimate by 44.7 percent.

Treasure Hunt continues to perform admirably for its position in the portfolio and provides mid-day players with a daily jackpot game. Treasure Hunt sales are up 17.4 percent over the same period last year.

### **Cash 5**

At week 46, Cash 5 is accounting for about 5.3 percent of sales, down from 6 percent in fiscal year 2010-11. The Lottery is taking a careful look at Cash 5. After seeing Cash 5 sales continue to decline, the Lottery changed the Cash 5 matrix in February 2008. The matrix change achieved the goal of generating higher jackpots, which in turn generated higher sales. Cash 5 sales are once again declining due to jackpot fatigue. The Lottery is faced with the choice of again

changing the matrix or trying to reverse the sales decline through sustained game promotion. The hesitation in changing the matrix is due to the fact that each matrix change alters the nature of the game, making Cash 5 less of a daily jackpot game and more of a “play only when the jackpot is high” game. Cash 5 is featured prominently in the fiscal year 2011-12 marketing plan.

### **Millionaire Raffle**

Millionaire Raffle accounts for less than 0.7 percent of sales. Pennsylvania sold out its eleventh Millionaire Raffle games in December 2010, and the Pennsylvania Lottery remains the only U.S. lottery to have sold out every raffle without extending the drawing date. The Lottery is currently running its twelfth Millionaire Raffle with the drawing planned for July 9, 2011. The Lottery plans to again offer Millionaire Raffle for New Year’s and for the Fourth of July in fiscal year 2011-12.

## **PLANNING FISCAL YEAR 2011-12 AND BEYOND**

**The Lottery has set specific goals in order to fulfill its fiscal commitments for 2011 and beyond.**

### **1. Increase benefits awareness among stakeholders.**

The Lottery returns approximately 30 cents of each dollar spent on ticket sales to programs benefiting older Pennsylvanians, every day. In fiscal 2009-10 that amounted to \$915 million dedicated entirely to programs that help protect older Pennsylvanians’ independence, preserve their health and help improve the quality of their lives. The Lottery believes that increased awareness of these benefits will lead directly to an increase in Lottery sales. The Lottery has set a goal of increasing general program awareness to 75 percent among non-players in Pennsylvania.

### **2. Increase the retailer network and equipment density.**

Growth in Lottery sales and profits is positively correlated with growth in the size of the retailer and equipment network. In fiscal year 2010-11, the Lottery’s retailer network is growing faster than in any year since fiscal year 2004-05. Much of the recent growth has come from the addition of long sought-after retail partners. The highly successful incorporation of these key accounts is spurring talks with other potential key accounts and is the primary reason the Lottery is confident it can achieve the goal of 9,200 retailers by Jan. 1, 2012.

Month	Time Frame	# Retailers	Growth (#)	Annual Growth Rate
Jun'03		7170		
Jun'04	12 Months	7249	79	1.1%
Jun'05	12 Months	7987	738	10.2%
Jun'06	12 Months	8448	461	5.8%
Jun'07	12 Months	8511	63	0.7%
Jun'08	12 Months	8545	34	0.4%
Jun'09	12 Months	8340	-205	-2.4%
Jun'10	12 Months	8443	103	1.2%
May'11	11 Months	8924	481	6.2%
Proj. Jan'12	7 Months	9200	276	5.3%

While the retailer network has grown at an impressive annual rate of 6.2 percent over the past 12 months, equipment has grown at an even faster rate of 8.2 percent. The increase in WAVE terminals and Play Central Terminals (PCT) is primarily due to the increase in new retailers. The increase in Instant Ticket Vending Machines (ITVM) also reflect an increase in density per store, as an additional ITVM is added to support both entrances in a large grocery store, for example.

Terminal Type	May-10	May-11	1 year Growth
Wave	8,722	9,186	5.3%
PCT	956	1,317	37.8%
ITVM	3,779	4,055	7.3%
Total	13,457	14,558	8.2%

The Lottery has additional equipment on order for the first half of fiscal year 2011-12 including:

- 243 ITVM units
- 300 ITVM refurb kits
- 500 WAVE units
- 312 PCT units
- 1,075 22" PCT monitor upgrade kits
- 1,000 wireless jackpot signs

**3. Increase the promotion of winner awareness.**

It is widely accepted in the industry that increasing winner awareness drives incremental sales. Fiscal year 2011-12 will see a notable increase in winner awareness messaging in the form of television advertisements, digital out-of-home billboards, point-of-sale messaging, social media and various public relations events. The Lottery will include its retailers in the strategy by supplying winner awareness materials and highlighting retailer accomplishments through the Lottery website and social media.

**4. Continue instant games growth.**

As noted earlier, the Lottery is experiencing phenomenal growth in instant sales in fiscal year 2010-11. The Lottery fully expects that the positive growth trend in instant sales will continue in fiscal year 2011-12, provided that relief from the 30 percent minimum return requirement is extended for fiscal year 2011-12.

Presuming relief from 30 percent, the Lottery will likely maintain similar numbers and frequencies in game launches next year. A strategy of increasing ticket quantity for the average instant game will play a significant role in the strategy to grow instant sales in the new year.

**5. Stop the decline in The Daily Number and Big 4 sales.**

One of the specific goals of the Lottery for fiscal year 2011-12 is to grow numbers games (The Daily Number, Big 4 and Quinto) sales. The Lottery will achieve this through tactical use of retailer incentives and through a promotion called "Double Draw". The promotion will involve one free drawing for each of the six numbers games, one day each month. It will be supported through an advertising campaign that includes radio, point-of-sale promotion and social media support. The promotion's return on investment will be monitored, and promotion adjustments will be made as necessary.

The Lottery will also explore add-on features for numbers game products through research and development.

**6. Stop the decline in Cash 5 sales.**

Another prime goal of the Lottery for fiscal year 2011-12 is to reverse the decline in Cash 5 sales. The Lottery will achieve this through tactical use of retailer incentives and a promotion called "Cash 5 Fever". The promotion will run one week out of each month. Each Cash 5 purchase of \$5 will be eligible for an instant win of \$50 for every 40<sup>th</sup> qualifying purchase. The promotion will be supported through radio, online banners, digital out-of-home billboards, point-of-sale promotion and social media. The promotion's return on investment will be monitored, and promotion adjustments will be made as necessary.

#### **7. Grow brand awareness for Mega Millions while maintaining strong support for Powerball.**

In Pennsylvania as well as in other lottery jurisdictions, the new (introduced in February 2010) multi-state lotto game Mega Millions has understandably been slow to achieve jackpot sales similar to the long-established Powerball game. As with virtually every other cross-selling lottery in the U.S., Pennsylvania has promoted the two games together in all facets of advertising. In fiscal year 2011-12, the Lottery will roll out a marketing strategy that will allow Mega Millions to establish its own identity separate from Powerball.

Pennsylvania is also participating in the Multi-State Lottery Association's efforts to optimize the Powerball game to match the new demographics that were established when cross-sell became a reality. The Lottery will continue to support Powerball with jackpot awareness, winner awareness and promotional efforts including couponing, point-of-sale promotions, website marketing and social media.

#### **8. Look for opportunities to grow the in-state lotto and raffle categories.**

At week 46, Treasure Hunt is up 19 percent and Match 6 lotto is up 37 percent over the fiscal year 2010-11 estimate. The Lottery will continue its strong support of these games in fiscal year 2011-12 in the form of couponing, system-driven promotion, website promotion and strategic marketing of the games on the Lottery In Motion System (LIMS) flat-screen monitors at the point-of-sale at retailers.

## **Conclusion**

In spite of a challenging economy and increasing competition for the entertainment dollar, the Lottery is experiencing impressive sales and profit growth in fiscal year 2010-11. The Lottery is projecting to end the fiscal year with record sales of \$3.2 billion, and it may surpass the record profit figure of \$967 million set in fiscal year 2005-06.

The reasons for this impressive growth are many, including new and more vending equipment, more retailers, improved management software and practices and deployment of new marketing tools. Just as important is the continued dedication and ingenuity of the people of the Lottery, from the staff at headquarters and area offices to the vendors, support staff, retail owners, managers and clerks.

Another reason for the Lottery strong year is the continued extension of the relief from the 30 percent return minimum granted by Act 53. The relief provided by the Act allowed the Lottery to continue to offer its players the types of games they want to buy and the prizes they want to win. Without the passing of Act 53, the Lottery would not have been able to realize the impressive growth it experienced this fiscal year and would not be able to plan for future growth.

In fiscal year 2011-12 and beyond, the Lottery will continue to focus on growing its business and the profits dedicated to funding important programs that aid and support older Pennsylvanians.