
Pennsylvania Lottery Profit Report

As Required by Act 53 of 2008

July 2012

END OF FISCAL YEAR 2011-12 ANALYSIS

The Pennsylvania Lottery ended fiscal year 2011-12 with an all-time sales record of \$3.481 billion, surpassing the \$3.208 billion record set in fiscal year 2010-11 by \$273 million or 8.5 percent.

In addition to record sales, the Pennsylvania Lottery posted record profits for fiscal year 2011-12. The Lottery ended the fiscal year with a profit of \$1.061 billion, which represents a \$100 million or 10.4 percent increase over fiscal year 2010-11.

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 \$22.5 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 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 able to execute a marketing plan that resulted in increased sales and net revenues for programs ending the 2011-12 fiscal year with a net profit percentage of 30.5 percent.

The Lottery achieved a record sales year and a record profit year in fiscal year 2011-12 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. Despite suspending or terminating dozens of retailers pursuant to the Lottery's zero-tolerance illegal substance sale policy, the Lottery grew by 156 retailers, or 1.7 percent, in fiscal year 2011-12. At the same time, retailer equipment grew by 3.5 percent, meaning not only has the number of Lottery outlets grown, but the Lottery presence within outlets has grown as well. The increase in instant vending equipment, in particular, addresses the growing consumer preference for instant ticket products.

The Pennsylvania Lottery remains one of the best performing of the 43 U.S. Lotteries, ranking sixth in population and fifth in profits in fiscal year 2010-11.

State of the Lottery Game Portfolio

The Lottery maintains a diverse product portfolio, providing lottery games that meet various consumer demands. Although certain categories of the portfolio are in decline due to decreasing consumer demand, others categories are thriving, reporting double-digit annual growth for fiscal year 2011-12.

The table below summarizes the Lottery's fiscal year sales by category versus fiscal year 2010-11 and versus the estimate for fiscal year 2011-12.

FY 2011-2012 Sales Summary (Figures in dollars)

	FY 11-12	vs. Estimate	vs. Estimate	vs. FY 10-11	vs. FY 10-11
Total	3,480,900,688	180,891,651	5.5%	272,992,637	8.5%
Instant	2,134,578,653	141,608,698	7.1%	212,466,198	11.1%
Terminal-based	1,346,322,035	39,282,953	3.0%	60,526,439	4.7%
Numbers Games	646,275,177	(35,646,441)	-5.2%	(27,881,576)	-4.1%
TDN Nite	247,264,451	(16,489,018)	-6.3%	(15,042,147)	-5.7%
TDN Noon	112,659,964	(7,379,490)	-6.1%	(4,707,474)	-4.0%
Big 4 Nite	167,492,852	(8,121,446)	-4.6%	(7,324,653)	-4.2%
Big 4 Noon	78,107,969	(3,328,390)	-4.1%	(1,568,567)	-2.0%
Quinto Nite	25,744,576	(490,992)	-1.9%	235,695	0.9%
Quinto Noon	15,005,366	162,894	1.1%	525,569	3.6%
Cash 5	159,853,249	(12,832,518)	-7.4%	(12,396,083)	-7.2%
InState Lotto	90,321,740	8,489,568	10.4%	11,293,679	14.3%
Treasure Hunt	24,313,690	1,210,354	5.2%	1,609,969	7.1%
Match 6	66,008,050	7,279,214	12.4%	9,683,710	17.2%
Multi-State Lotto	428,925,549	78,326,024	22.3%	88,529,459	26.0%
Powerball	244,345,588	65,156,437	36.4%	66,181,832	37.1%
Power Play	33,346,262	(2,959,197)	-8.2%	(2,665,226)	-7.4%
Mega Millions	131,589,844	15,962,245	13.8%	23,661,285	21.9%
Megaplier	19,643,855	166,539	0.9%	1,351,568	7.4%
Raffle	20,946,320	946,320	4.7%	980,960	4.9%

Product Mix

Consumer demand drives Lottery sales. Lottery sales for fiscal year 2011-12 continue to reflect the industry trend of increased consumer demand for instant products. Since the Lottery's instant products return approximately half the profit per sales dollar as the terminal-based portion of the product portfolio, increased consumer demand for the instant product reinforces the necessity of the relief from the 30 percent mandate to grow sales.

Product Mix (Instant sales as a percentage of total traditional sales)

	FY 06-07	FY 07-08	FY 08-09	FY 09-10	FY 10-11	FY 11-12
Pennsylvania	51.7%	55.4%	55.3%	56.9%	59.9%	61.3%
Other U.S. Lotteries	55.1%	56.8%	57.3%	57.2%	58.7%	n/a

Instant Games

The Lottery set a new instant product sales record for fiscal year 2011-12. Instant sales of \$2.13 billion easily surpassed the record of \$1.92 billion set in fiscal year 2010-11.

In fiscal year 2011-12, instant games accounted for 61.3 percent of total game sales, up from the 59.9 percent in fiscal year 2010-11. Total sales for this category were up \$212 million, or 11.1 percent, over fiscal year 2010-11. Twenty-one of the top 30 instant game sales weeks in the entire 40-year history of the Lottery occurred during fiscal year 2011-12.

As with most lotteries, the sales mix is shifting toward the higher price point instant tickets. The table below details growth by price point for Lottery's instant products.

Instant Annual Growth by Price Point

<u>Price Point</u>	<u>FY 10-11</u>	<u>FY 11-12</u>
All	10%	11%
\$20+	0%	32%
\$10	13%	5%
\$5	21%	12%
\$3	-2%	10%
\$2	9%	-6%
\$1	9%	-5%

Multi-State Lottos: Powerball and Mega Millions

Multi-state lotto games accounted for 12.3 percent of total game sales in fiscal year 2011-12. Total sales for this category were up \$88.5 million, or 26.0 percent, compared to last fiscal year.

Powerball was up 30 percent while Mega Millions was up 20 percent. Sales for both games are driven by the size of jackpots. The top 10 jackpots for both games in fiscal year 2011-12 were significantly higher than the top 10 jackpots for the prior fiscal year.

Powerball Jackpots

(comparison in millions)

Mega Millions Jackpot

(comparison in millions)

<u>FY 10-11</u>	<u>FY 11-12</u>	<u>FY 10-11</u>	<u>FY 11-12</u>
\$218	\$325	\$380	\$640
\$200	\$250	\$304	\$363
\$187	\$245	\$244	\$290
\$184	\$240	\$242	\$241
\$171	\$220	\$201	\$206
\$155	\$205	\$200	\$200
\$153	\$203	\$172	\$173
\$144	\$200	\$168	\$171
\$126	\$180	\$151	\$152
\$125	\$177	\$145	\$148

High jackpots drive sales for the two multi-state lotto games. However as jackpots rise, the number of tickets sold with the Power Play and Megaplier option decreases. Not surprisingly, the proportional sales for both Power Play and Megaplier were down for the fiscal year.

Numbers Games: The Daily Number, Big 4, Quinto

Numbers games accounted for 18.6 percent of total game sales, down from 21.0 percent in fiscal year 2010-11. Total sales for this category were down \$28 million, or 4.1 percent, compared to last year. Although numbers games have a loyal player base, industry-wide sales show that it is also a shrinking player base. The Lottery anticipates that the player base will continue to shrink for this category.

The continued decline in numbers games sales is also a byproduct of shifting consumer demand for the large jackpot games and the instant products. Another reason for declining sales is the rigidity of the numbers games. The games offer the same odds of winning and prize amounts as they have since their launch. The top prize for a \$1 straight wager in The Daily Number is \$500, the same as it was in 1975. However, a \$500 prize in 1975 is worth around \$115 in today’s dollars. The Lottery understands that numbers games sales are likely to continue their declining trend, and Lottery is working to replace this lost revenue with revenue from new sources.

Not all numbers games were down in fiscal year 2011-12. Quinto mid-day and Quinto evening drawings saw modest increases in sales. This is likely due to the relative youth of Quinto compared to TDN and Big 4.

Numbers Games Sales

(Percent Increase/Decrease)

Numbers Games	-4.1%
TDN evening	-5.7%
TDN mid-day	-4.0%
Big 4 evening	-4.2%
Big 4 mid-day	-2.0%
Quinto evening	0.9%
Quinto mid-day	3.6%

In-State Lottos: Cash 5, Match 6, Treasure Hunt

In-state lotto accounted for 7.2 percent of total sales in fiscal year 2011-12, down from 7.9 percent in fiscal year 2010-11. Cash 5 sales were down 7.2 percent while Match 6 sales were up 17.2 percent and Treasure Hunt sales were up 7.1 percent.

There is no doubt that in-state lotto players did some jackpot shopping in fiscal year 2011-12. As a result, considerable wagering shifted away from Cash 5 and toward Treasure Hunt and Match 6. Overall, the category was down \$1.1 million from fiscal year 2010-11.

The Lottery has the same concern for this category as it does for the numbers games. There is increased competition from big jackpots games and the instant product that is likely to erode this category further in the future. As with the lost revenue from sagging numbers games sales, new revenue sources will be required to replace potential lost revenues in the in-state lotto category.

Millionaire Raffle

The Lottery sold out both Millionaire Raffle games launched in fiscal year 2011-12. The Lottery plans to again offer Millionaire Raffle for New Year's and for the Fourth of July in fiscal year 2012-13. The Pennsylvania Lottery remains the only U.S. lottery to have sold out all its Raffle games on schedule.

PLANNING FISCAL YEAR 2012-13 AND BEYOND

The Lottery has established five key strategies for continued success that will be utilized to meet its fiscal commitments for fiscal year 2012-13 and beyond.

Key strategy #1 - Everybody Wins.

The Lottery returns approximately 30 cents of each dollar spent on ticket sales to programs benefiting older Pennsylvanians, every day. In fiscal year 2011-12 that amounted to a record \$1.061 billion 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 has and will continue to increase Lottery sales. The current campaign has increased awareness of the programs supported by Lottery funds. For fiscal year 2012-13, the Lottery plans to update the current mass media awareness campaign titled *Everybody Wins* featuring the slogan, "Millions Won. Millions Win.," which launched during fiscal year 2011-12. The updated campaign will begin during the first quarter of fiscal year 2012-13.

This benefit awareness campaign will include the use of television, billboards, social media, Lottery's newly launched YouTube channel, digital point-of-sale displays and "winners circles" at Lottery's seven area offices, among various other tactics.

Key strategy #2 - Increased Interactive Presence.

The Pennsylvania Lottery continues to build its interactive presence in order to engage players on-the-go and, most importantly, at the point of sale. Digital mediums compliment traditional marketing efforts and further extend Lottery's reach, thus keeping the Lottery brand top-of-mind with current players and potential new players. To meet consumer expectations, the Lottery has established a strategy to increase engagement with its players and potential players through an increased interactive presence. The Lottery plans to build

upon established interactive platforms currently being used by the Lottery, including social media (Facebook, Twitter and YouTube), palottery.com, mobile, VIP Players Club and digital point-of-sale monitors.

The interactive initiatives for fiscal year 2012-13 will include the launch of a redesigned palottery.com that is tablet- and mobile-friendly, development of a mobile application, the use of quick response (QR) codes at point-of-sale, and mobile-optimized second-chance drawing microsites. Additionally, the Lottery will continue to grow membership of its VIP Players Club and add value for the club's 200,000+ members by allowing members to further personalize their experiences, participate in surveys and receive exclusive coupons.

The Lottery also will enhance the use of digital displays to promote winner and benefit messaging by localizing the messaging. Additionally, Lottery will pursue growing social media participation through promotions, connecting with retailer partners, and exploring other social media networks.

Key strategy #3 - Terminal-Based Growth.

The Lottery plans to carefully manage the established terminal-based game portfolio while exploring new tactics that have the potential to reach beyond the current player base. For fiscal year 2012-13, the Lottery plans to utilize a successful instant product tactic, second-chance drawings, for the terminal-based games. The Lottery is also developing options for a new in-state lotto game beginning with focus group testing in the beginning of the fiscal year. The Lottery is also exploring opportunities for web-based lottery games and potential add-on games for the current numbers game offerings.

Key strategy #4 - Additional Instant Growth.

The Lottery recognizes that consumer demand for instant products will continue to grow and plans several initiatives to strengthen the base products, maximize growth and add value for players. For fiscal year 2012-13, the Lottery plans to keep the instant product fresh and exciting by reducing the number of active games in the market, shortening the average time in market, focusing on payouts and continuing to offer licensed properties.

The Lottery's licensed property games give players the opportunity to win unique non-cash prizes above and beyond the millions of dollars in instant-win prizes. The 2012 Harley-Davidson® game offers players the opportunity to win a 2012 Harley-Davidson® Softail® Deluxe motorcycle with up to \$10,000 in winner-selected custom-build options. The Lottery's upcoming The Price Is Right® second-chance drawings offer players a chance to win a trip to Las Vegas to play condensed versions of six popular TV game shows with a chance to win up to \$1 million.

As mentioned above, second-chance drawings are very popular with instant players who recognize the added value the drawings provide. In fiscal year 2012-13 the Lottery will offer web-based second-chance drawings associated with the Halloween games, winter holiday games and St. Patrick's Day games.

In order to leverage the affinity between Lottery purchases and food and beverage purchases, Lottery will develop a coffee scented game that will be used in cooperative promotions with convenience stores.

Key strategy #5 - Partnerships.

The Lottery exclusively sells its products through a retail network of 9,000+ licensees. Growth in Lottery sales and profits is positively correlated with growth in the size of the retailer and equipment network. Fiscal year 2011-12 continued a three-year trend of positive retailer growth. 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 9,380 retailers by June 30, 2013. That would be an increase of 300 retailers or 3.3 percent in fiscal year 2012-13.

In addition to planning to grow the Lottery's valuable network of business partners for fiscal year 2012-13, the Lottery will employ a retail-centric business approach that will include corporate partner outreach, meetings with retail partners and retailer roundtable sessions. The Lottery will also explore a retail co-op program for fiscal year 2012-13.

Conclusion

Despite a highly competitive environment for the entertainment dollar, the Lottery had a record sales year in fiscal year 2011-12 posting \$3.48 billion in total sales. Older Pennsylvanians are the real lottery winners as the Pennsylvania Lottery set a profit record of \$1.061 billion which exceeded the program funding goals for fiscal year 2011-12.

Although the Lottery had record sales and profits last fiscal year, the Lottery is focused on the future and providing the funding necessary to meet program goals for fiscal year 2012-13 and beyond. By executing the key strategies outlined above 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.

The Lottery is projecting another strong year of sales growth in fiscal year 2012-13. Total sales are projected to grow to \$3.6 billion, an increase of \$110 million or 3.2 percent over fiscal year 2011-12.