



Pennsylvania Lottery Profit Report

As Required by Act 201 of 2014

2016

FISCAL YEAR 2015-16 ANALYSIS

The Pennsylvania Lottery set a new sales record for fiscal year 2015-16 of \$4.13 billion, surpassing the \$3.82 billion record set in fiscal year 2014-15 by \$315 million, or 8.26 percent. This is the sixth year in a row that the Lottery has set a record in total sales.

The Lottery returned \$1.12 billion in profits for fiscal year 2015-16, marking a new record and the fifth consecutive year that profits have surpassed \$1.0 billion. Profits grew by \$60 million, or 5.70 percent, from fiscal year 2014-15 total profits of \$1.061 billion.

The Lottery paid a record \$2.63 billion in prizes to players, which was an increase of \$228.2 million over the prior fiscal year. A total of 86 players won prizes of \$1 million or more in 2015-16.

More than 9,000 licensed Lottery retailers statewide earned a record \$218.3 million in sales commissions, an increase of approximately \$15 million from the prior fiscal year.

The Lottery was able to reduce its operating costs to 1.89 percent from the prior fiscal year's 1.98 percent.

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 \$26.9 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.

LOTTERY PROFIT RETURN

Lottery ended the 2015-16 fiscal year with a net profit percentage of 27.12 percent, down from the 27.77 percent recorded in fiscal year 2014-15. By law (Act 201 of 2014), Lottery is required to return 25 percent in net profits for programs that benefit older Pennsylvanians. Using the reduction of the minimum rate of return, the Lottery was able to execute a marketing plan and product portfolio that resulted in increased sales and net revenues for senior programs.

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. Act 201 of 2014 set the minimum return percentage at 25 percent starting with the fiscal year 2014-15.

Product mix plays an important role in the overall rate of return. Product mix is influenced by many factors including the length of jackpot runs, as well as shifts in consumer preferences within the Lottery's game portfolio. Instant games return approximately half the amount of profit for the same dollar spent on terminal-based games. The trend of players gravitating toward instant games, and particularly higher price point instant games, continues in Pennsylvania and in the lottery industry as a whole.

The table below shows that as the percentage of sales continues to shift toward instant products, the overall profit margin continues to decline.

Instant Games and Profits as a Percentage of Sales (FYs 2006-07 Through 2015-16)

Last 10 Fiscal Years	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	FY12-13	FY13-14	FY14-15	FY15-16
Instants - as percent of sales	55.37%	55.25%	56.92%	57.04%	59.92%	61.32%	62.31%	64.35%	67.80%	67.53%
Profit - as percent of sales	30.85%	30.05%	29.48%	29.87%	29.95%	30.48%	28.85%	28.46%	27.77%	27.12%

As the profit margin as a percentage of sales declines, the Lottery continues to set new sales and profit records – returning a record \$1.12 billion in profits for fiscal year 2015-16. The lottery ended fiscal year 2015-16 with a net profit percentage of 27.12 percent, down from the 27.77 percent recorded in fiscal year 2014-15, largely due to the continuing trend toward higher payout instant products. Consumer preference will continue to trend toward higher payout games. Eventually, the Lottery will need full relief from the minimum return rate in order to continue to set new sales and profit records.

The Pennsylvania Lottery remains one of the best-performing lotteries of the 45 U.S. Lotteries, ranking sixth in population and sixth in profits in fiscal year 2014-15 (the most recent period for which national statistics are available). It should be noted that several lotteries ranking higher than Pennsylvania have the advantage of including profits from Video Lottery Terminals (VLT) and Keno, or both.

U.S. Lottery Profit Rankings (2014-15)

Profit Rank	Lottery	Profit (\$M)	
1	VLT, Keno	New York	\$3,110.6
2		Florida	\$1,496.4
3	Keno	California	\$1,364.5
4		Texas	\$1,242.7
5	VLT, Keno	Ohio	\$1,095.0
6		Pennsylvania	\$1,060.9

Source: La Fleur's 2016 World Almanac 24th Edition.

STATE OF THE LOTTERY GAME PORTFOLIO

The Lottery maintains a diverse products portfolio, providing lottery games that meet an equally diverse consumer population. The Lottery's 8.26 percent sales growth was driven by a 7.76 percent growth in the instant games category as well as a 9.32 percent growth in terminal-based games. Fiscal year 2015-16 marks the sixth year in a row that instant sales have grown by 6 percent or more.

Instant Games

The instant games category accounted for 67.5 percent of total sales in fiscal year 2015-16.

For the sixth year in a row, the Lottery set a new instant games sales record. Instant sales of \$2.79 billion surpassed the record of \$2.59 billion set in fiscal year 2014-15. The growth in instant sales amounted to an increase of \$201 million, or 7.76 percent. An impressive 23 of the top 40 instant

game sales weeks in the entire 44-year history of the Lottery occurred in fiscal year 2015-16.

As with most lotteries, the instants sales mix is shifting toward the higher-price-point instant tickets, which generally have higher prize payouts - as shown in the chart below.

Payout of Instant Games By Price Points

Price Point	\$1	\$2	\$3	\$5	\$10	\$20	\$30
FY15-16 Payout	62.13%	65.20%	63.98%	70.10%	72.02%	74.15%	75.29%

There has been a steady increase in sales migration toward the higher-price-point instant games over the last five fiscal years. As a result, the average selling price has risen as well.

Instant Games - Percentage of Sales By Price Points

Instants	\$1 Inst	\$2 Inst	\$3 Inst	\$5 Inst	\$10 Inst	\$20 Inst	\$30 Inst	Avg. Selling Price
FY15-16	3.9%	7.2%	5.7%	32.6%	21.1%	22.1%	7.4%	\$5.15
FY14-15	4.1%	7.5%	6.3%	30.5%	20.0%	24.7%	6.8%	\$5.12
FY13-14	4.5%	8.7%	7.0%	29.8%	19.7%	25.9%	4.5%	\$4.87
FY12-13	5.0%	9.9%	7.0%	30.6%	19.3%	28.2%	0.0%	\$4.59
FY11-12	6.0%	11.6%	6.7%	32.2%	18.7%	24.8%	0.0%	\$4.24

Multi-State Lotto: Powerball[®], Mega Millions[®] and Cash4Life[®]

The multi-state lotto category accounted for 12.0 percent of total sales in fiscal year 2015-16.

The multi-state lotto category saw an incredible 30.3 percent increase in fiscal year 2015-16, largely due to the January 2016 Powerball[®] jackpot run that ended in an advertised \$1.6 billion jackpot. Mega Millions[®] ended the fiscal year on a jackpot run of its own, with an advertised jackpot climbing to \$415 million by the end of the fiscal year. As a result, Mega Millions[®] recovered from being down over \$30 million in early May compared to the same time in the prior year, to down only \$18.5 million by fiscal year’s end.

In April 2015, Pennsylvania joined the regional multi-state game Cash4Life[®]. The game accounted for over \$32 million in sales in fiscal year 2015-16. Currently, the Cash4Life[®] group is considering research and marketing options designed to strengthen the game.

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

The in-state lotto game category was up 0.2 percent in fiscal year 2015-16 over the prior fiscal year. All three games within the category experienced relatively flat growth in fiscal year 2015-16.

Cash 5 sales were up 0.6 percent.

Treasure Hunt sales were up 1.8 percent.

Match 6 sales were down 1.2 percent.

Numbers Games: Pick 2, Pick 3, Pick 4, Pick 5

Numbers games accounted for 14.1 percent of total sales in fiscal year 2015-16.

Numbers games ended fiscal year 2015-16 down 2.6 percent as compared to the prior year. That decline mirrors a similar decline over the last several years. Although numbers games have a loyal following, industry-wide trends show that these games have a shrinking player base.

Although declining, numbers games still account for a significant portion of sales and an even larger portion of profits. The Lottery introduced a new two-digit game (PICK 2) in January 2015 and at the same time re-branded all games in this category under the "PICK" moniker. In September 2016, the Lottery will be launching a new add-on for the PICK family of games called Wild Ball. Players will be able to purchase the Wild Ball add-on in order to give themselves additional chances to win prizes.

Millionaire Raffle

The Lottery sold out all Millionaire Raffle offerings up to and including the game's 19th offering, drawn in January 2015, but failed to sell out Raffles 20, 21, 22, 23 and 24. In fiscal year 2015-16, the Lottery launched two new Raffles (Halloween and St. Patrick's Day). These offerings also fell short of selling all 500,000 available tickets.

Millionaire Raffle Sell-Through Rates

Raffle	Theme	Sell Rate
Raffles #1 through #18		100.0%
Raffle #19	New Year's	100.0%
Raffle #20	Independence Day	92.4%
Raffle #21 (New)	Halloween	71.4%
Raffle #22	New Year's	94.9%
Raffle #23 (New)	St. Patrick's Day	61.9%
Raffle #24	Independence Day	77.5%

In response to this changing trend, the Lottery conducted research in May 2016 in an attempt to understand exactly why Raffle sales have declined. One conclusion drawn from the research is that there are only enough core players to support two Raffles per year. Furthermore, respondents were clear that waiting several weeks for the drawing is a negative attribute of the game. In response to this feedback, for the New Year's Millionaire Raffle, the Lottery will increase the prize payout from roughly 50 percent to 60 percent in the form of six weekly early-bird drawings. The early-bird concept tested significantly better when compared to five other models that provided the same additional 10 percent payout increase. The Lottery will evaluate the success of the revamped Millionaire Raffle sales model following the conclusion of the New Year's drawing.

New Terminal-based Game in 2017

The Lottery tested several terminal-based game concepts in 2015. Based on the results of that testing the Lottery plans to launch a new terminal-based game in early 2017 that is projected to add approximately \$1 million in sales per week.

PLANNING FISCAL YEAR 2016-17 AND BEYOND

To meet its commitment in fiscal year 2016-17 and beyond, the Lottery has set the following specific strategies and goals:

- Continuing to aggressively manage its product portfolio. This includes:
 - Launching two new terminal-based games (Wild Ball, an add-on to the PICK family of games, in September 2016 and a new game sold through Lottery terminals, in early 2017).
 - Launching at least 70 instant games.
- Continuing to engage the Lottery player base. This includes:
 - Adding value to Lottery games and increasing player engagement through second-chance drawings, promotions and tie-ins with interactive games.
- Expanding points of distribution. This includes:
 - Partnering with the PA Liquor Control Board (as permitted under Act 39 of 2016) to sell Lottery games in more than 300 state Fine Wine and Good Spirits stores.
- Continuing to optimize presence at retail. This includes:
 - The Lottery's sales makeover initiative designed to generate incremental sales at existing retail locations by increasing game displays, signage and winner awareness.
- Finally, measuring product performance and marketing effectiveness to optimize Lottery sales and profits.

CONCLUSION

The Lottery achieved record sales and profits in fiscal year 2015-16 with \$4.13 billion in sales and \$1.12 billion in total profits. The Lottery is projecting another strong year of sales growth in fiscal year 2016-17. Currently, total sales are projected to grow to \$4.181 billion, an increase of \$59 million or 1.11 percent over fiscal year 2015-16.

The Lottery projects relatively flat growth in profit. Total profits are projected to be \$1.117 billion, a slight decrease of \$4 million or 0.38 percent over fiscal year 2015-16, with a projected rate of return of 26.72 percent. These projections are based on the Lottery's expectations of a decline in Powerball sales compared to 2015-16, which was an exceptional year because of the record jackpot. Instant games, which pay out more in prizes and therefore are less profitable, are expected to continue to grow and make up most of that difference in sales. Eventually, the Lottery will need full relief from the minimum return rate in order to continue to set new sales and profit records.

The Lottery remains committed to achieving and, if possible, exceeding established profit goals by quickly responding to changing market conditions and consumer demand in order to provide the greatest benefit as possible to older Pennsylvanians.