



# TEXAS LOTTERY COMMISSION

2015 COMPREHENSIVE BUSINESS PLAN  
AND ANNUAL REPORT



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## TEXAS LOTTERY COMMISSION

### 2015 COMPREHENSIVE BUSINESS PLAN AND ANNUAL REPORT

### SECTION 1: ANNUAL REPORT





# OPENING LETTERS

## MESSAGES FROM THE CHAIRMAN & EXECUTIVE DIRECTOR

### Commissioners:

J. Winston Krause,  
Chairman

Jodie G. Baggett

John W. Townes, III

Mary Ann Williamson



## TEXAS LOTTERY COMMISSION

Gary Grief, Executive Director

Alfonso Royal, Charitable Bingo Operations Director



The Texas Lottery has enjoyed record-breaking sales and revenue results for the past several years. Having served as a member of the Texas Lottery Commission since 2009, I am proud of the agency's work in fulfilling its mission to generate revenue for public education, veterans' assistance and other worthy state causes. Beginning with the first ticket sold in 1992 through the end of the most recent fiscal year in 2013, the Texas Lottery has generated more than \$21 billion in revenue for the state of Texas.

As stated in a report from the Texas Sunset Advisory Commission in March 2012, "The Texas Lottery Commission walks a tightrope in balancing the

many contradictions in the State's attitudes about gaming.... The current Sunset review found that despite these challenges, the Commission successfully balances the various demands placed on it."

As a result of Sunset legislation, the size of the Lottery Commission was increased from three to five commissioners and a 10-member legislative review committee was authorized to study the impact of eliminating the lottery and the revenue impacts of doing so.

The Texas Lottery continues to set new standards of excellence in its mission to generate revenue for the state of Texas, and we are looking forward to continued success. This Comprehensive Business Plan and Annual Report will illustrate the record achievements attained over the past several years, but more importantly it details the business plan goals and key performance factors that are used to measure that success. The Texas Lottery's success story is not just in the numbers, but in the statewide impact to our retailers, prizewinners, vendors, employees and, most importantly, public education and veterans' assistance.

J. Winston Krause, Chairman



### Commissioners:

J. Winston Krause,  
Chairman

Jodie G. Baggett

John W. Townes, III

Mary Ann Williamson



## TEXAS LOTTERY COMMISSION

Gary Grief, Executive Director

Alfonso Royal, Charitable Bingo Operations Director



The staff of the Texas Lottery is pleased to present the Texas Lottery's Fiscal Year 2015 Comprehensive Business Plan and Annual Report. This report details the results of the Texas Lottery's most recent full fiscal year in 2013, but more importantly it communicates who we are, our role in the Texas economy, and the agency's business plan for executing its mission in the coming years.

Before you learn more about the Texas Lottery, we want to share with you a few key facts. We are excited to report that this is the 10<sup>th</sup> consecutive year that the Texas Lottery generated more than \$1 billion in contributions to the state of Texas. The Lottery continues to succeed in its mission to generate revenue for the state of Texas, primarily supporting two good causes dear to the hearts of many Texans: **Public education** and **Veterans' assistance**.

By any measure, fiscal year (FY) 2013 was the most successful year in the history of the Texas Lottery. The agency achieved record sales and revenue transfer levels. We reached these accomplishments through our ongoing commitment to our Core Values and by maintaining a laser focus on our mission to generate revenue for the state of Texas through the responsible management and sale of entertaining lottery products.

The agency was fiscally responsible in our expenditures and in structuring our contracts with outside vendors, achieving the lowest administrative expense as a percentage of sales (4.44 percent) in our history, a figure well below the 7 percent allowed by statute.

Both of our key product categories (scratch-off tickets and draw games) were up 4.4 percent in sales, reflecting our continued innovation and the effectiveness of our advertising. We also paid out record commissions and bonuses to our retailers along with record prizes to our players.

However, selling lottery tickets and generating revenue for good causes is only part of our mission. Encouraging the public to "Play Responsibly" is something we take seriously and the Texas Lottery proudly serves as a contributing member of the National Council on Problem Gambling. Likewise, we take pride in our ability to outsource to the private sector and effectively manage large contracts, and, in doing so, encouraging the use of Historically Underutilized Businesses (HUBs) in Texas. State service initiatives like the Amber, Silver and Blue Alert programs are also important to us and we continually look for new opportunities in these areas.

Nationally and globally, the Texas Lottery continues to take a leadership role as a member of the two largest multi-jurisdictional lottery organizations, the North American Association of State and Provincial Lotteries (NASPL) and the Multi-State Lottery Association (MUSL), filling the Presidency role for NASPL and focusing on product development for MUSL.

On behalf of the staff, I look forward to sharing more information with you about the Texas Lottery on the following pages and providing you with insight into the challenges ahead and our business planning strategy for ensuring future success.

Thank you for your interest and remember, **"When Texans Play, Texas Wins."**

Gary Grief, Executive Director



# TEXAS LOTTERY COMMISSION OVERVIEW

## Texas Lottery Commission History

The Texas Lottery was established through a vote of the Texas Legislature and Texas voters in 1991 and began sales operations on May 29, 1992, under the oversight of the Texas Comptroller of Public Accounts. On September 1, 1993, the Texas Lottery Commission was created as a standalone agency to administer the Texas Lottery. The Legislature also transferred regulatory authority for charitable bingo to the Texas Lottery Commission on April 1, 1994. The State Lottery Act gives both the commission and the executive director broad authority, together with the responsibility to exercise strict control and close supervision over all lottery games conducted in Texas to promote and ensure integrity, security, honesty, and fairness in the operation and administration of the lottery. The five-member Commission sets policy, adopts all rules for the agency, and performs all other duties required by law. The Governor appoints Commission members, with the advice and consent of the state Senate, to staggered six-year terms. One Commission member must have experience in the bingo industry.



# MEET THE COMMISSIONERS



J. Winston Krause, *Chairman*



Jodie G. Baggett



Mary Ann Williamson



John W. Townes, III

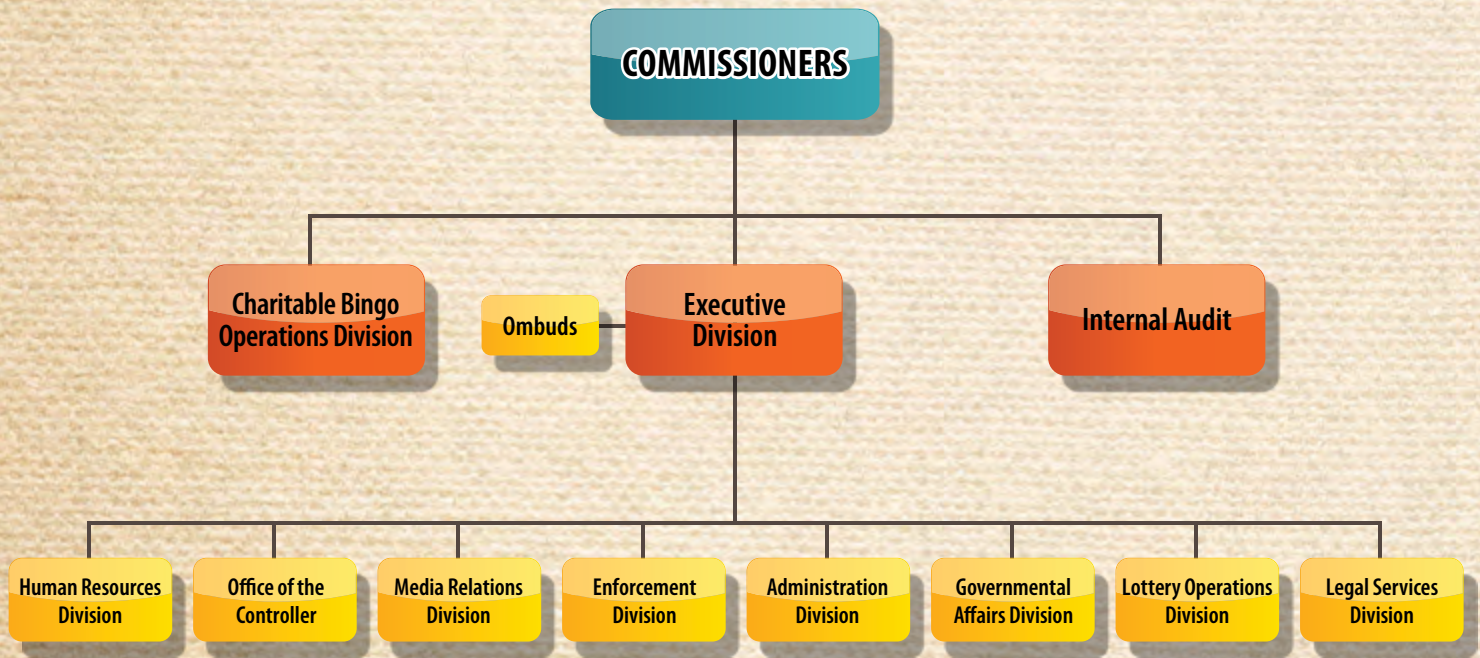


# TEXAS MODEL – IT WORKS FOR TEXAS!

## Management and Organizational Structure

The Texas Lottery is overseen by a five-member Commission that sets policy, adopts all rules necessary to administer the State Lottery Act, and performs all other duties required by law. The agency is comprised of 11 distinct operating areas, including 10 divisions (Administration, Charitable Bingo Operations, Enforcement, Executive, Governmental Affairs, Human Resources, Legal Services, Lottery Operations, Media Relations, and the Office of the Controller) and an externally sourced Internal Audit function. The agency’s organizational structure is depicted below.

**Texas Lottery Commission Organizational Chart**

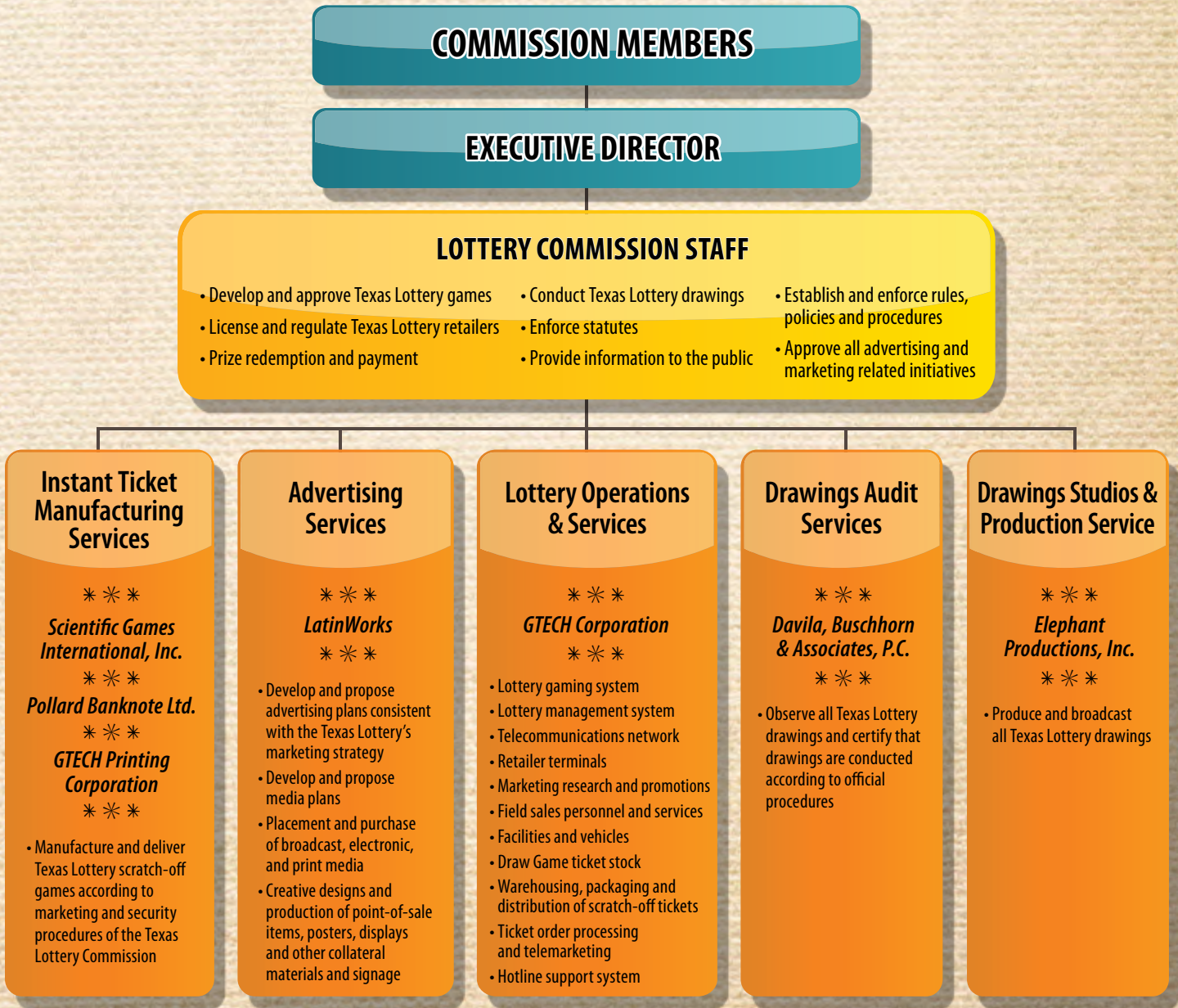


What sets the Texas Lottery Commission apart from other North American lotteries is the unique public/private structure of the agency. The members of the original Implementation Task Force of the Texas Lottery were the architects of what has become known within the lottery industry as the “Texas Model.” The agency maintains administrative, regulatory and management control over all critical functions, while utilizing private enterprises’ inherent efficiency and profit motive to optimize the Texas Lottery’s revenue potential. This organizational model maintains critical functions and broad oversight within the agency, while outsourcing those functions better performed by private industry. This approach shifts the burden of performance to the private sector while the state enforces performance standards

under parameters strictly defined by contract. The agency also enjoys economies of scale by contracting with vendor partners to provide—directly or through subcontractors—a wide range of services statewide. This alliance with private enterprise enables the Texas Lottery to realize several key operational benefits:

- Substantially reduced government capital investment necessary to operate the lottery
- Significantly reduced work force as compared to similarly sized lotteries (e.g., California and Florida)
- Incentivized sales organization
- Enhanced resource allocation capabilities associated with market change
- Greater flexibility in customer responsiveness

Using this public-private concept, the agency addresses a number of significant business functions through contractual arrangements with seven primary vendors. Each vendor provides a variety of services under the continuous supervision of Commission personnel. The Texas Model is illustrated in the chart below.





# EXECUTIVE SUMMARY

## Commitment to Texans

The Texas Lottery Commission is unique among other Texas state agencies in that its ongoing operations combine for-profit performance expectations with fiscal accountability and regulatory oversight of a government entity. Through its administration of Texas Lottery games, the Texas Lottery has a significant fiscal impact in our state.

Accordingly, the Commission is extremely respectful of its role and responsibilities as a vigilant steward of resources entrusted to it. It is also understood that the inherent challenges involved in sustaining its success necessitate more comprehensive planning than the state's standard five-year strategic planning process provides. This document is designed to complement that process and report on challenges and key performance factors that act as measures of the agency's performance.

It is also intended to address the *Sunset Advisory Commission, Final Report with Legislative Action for the Texas Lottery Commission—July 2013*.

More than 20 years after the first ticket was sold, millions of players continue to enjoy Texas Lottery games every day. In fact, the Texas Lottery is now the fourth largest lottery in North America. But the Texas Lottery is not just about fun and games. The most important function of the Texas Lottery is to generate revenue for public education, veterans' assistance and other causes and programs of the state of Texas.

Through FY 2013, the *Games of Texas* remain extremely popular with Texas Lottery players. However, as a mature lottery, the agency must remain vigilant and responsive to industry trends and players' interests if it is to continue its high level of support for Texas education, Texas veterans and other good causes in the coming years. Concurrently, the agency is respectful of and sensitive to the viewpoints of the approximate one-third of Texans who are not in favor of gaming. Therefore, this document highlights FY 2013 results and lays out initiatives carefully designed to ensure continued maximum revenue generation for the state of Texas in FY 2015, while being mindful of all viewpoints.

## VISION

To be the preeminent Lottery and Charitable Bingo agency through innovative leadership.

## MISSION

The Texas Lottery is committed to generating revenue for the state of Texas through the responsible management and sale of entertaining lottery products. The Texas Lottery will incorporate the highest standards of security and integrity, set and achieve challenging goals, provide quality customer service and utilize a TEAM approach.

## CORE VALUES

- **Integrity and Responsibility** - The Commission works hard to maintain the public trust by protecting and ensuring the security of our lottery games, systems, drawings and operational facilities. We value and require ethical behavior by our employees, licensees and vendors. We promote the integrity of charitable bingo in Texas for the benefit of charitable organizations.
- **Innovation** - We strive to incorporate innovation into our products to provide the citizens of Texas with the best entertainment experience available through our products. We pursue the use of technology that enhances the services that we provide to our customers and reduces our operating expenses.
- **Fiscal Accountability** - We emphasize fiscal accountability by ensuring that all expenditures directly or indirectly generate revenue, enhance security, fulfill regulatory requirements, improve customer service and/or boost productivity. We recognize our responsibility in generating revenue for the state of Texas without unduly influencing players to participate in our games. We maximize benefits to charities through the continual examination and review of charitable bingo operations.
- **Customer Responsiveness** - The Commission takes pride in providing exemplary service to the people of Texas through the courteous dissemination of clear and accurate information about our products, services and regulatory functions. We seek and respond to feedback expressed by our employees, retailers, licensees and the playing and non-playing public. We apply this feedback in the development of our products and in the services that we provide.
- **Teamwork** - We are committed to creating an environment of mutual respect where open, honest communication is our cornerstone. We embrace the diversity of our team and individual perspectives in working together to achieve our common goals.
- **Excellence** - We strive for excellence by taking a position of leadership on issues that impact the Commission and achieve challenging goals by focusing on our core values.



# INSTANT PRODUCT AND DRAW PRODUCT HIGHLIGHTS





**Powerball® and Mega Millions®**

Powerball and Mega Millions are the two multi-jurisdictional, rolling jackpot games played across the nation. Each game has its own add-on multiplier feature that allows players to increase their non-jackpot prizes – Power Play® and Megaplier®. Due to the design of each base game, both Powerball and Mega Millions have the ability to generate jackpots in the hundreds of millions of dollars, which garner national media attention and player interest while having a dramatic impact

on sales. FY 2013 was a successful one for Powerball sales due to three large jackpot rolls—the highest being the record-breaking \$590.5 million jackpot. Mega Millions did not experience large jackpot rolls in FY 2013, resulting in a sales decline over the prior year. Player research was conducted to gauge reaction to Mega Millions game changes that would create faster growing, larger jackpots, a more appealing 2<sup>nd</sup> tier prize and better overall odds in addition to modifications to the Megaplier feature. These changes were implemented in October 2013.

**Lotto Texas®**

Lotto Texas was the first draw game introduced in Texas in November 1992. It is Texas’ original in-state rolling jackpot game with jackpots now starting at \$5 million, due to game modifications that were implemented this past fiscal year and included a new add-on feature, called Extra! Lotto Texas is a mature game that has experienced sales declines over time, but the game maintains a relatively loyal following. With the large jackpots often generated by the multi-jurisdictional games, smaller in-state rolling jackpot games like Lotto Texas often struggle to compete and be relevant. However, Lotto Texas still achieved \$146.6 million in sales during FY 2013, outselling Mega Millions.

**Texas Two Step®**

Texas Two Step is also an in-state rolling jackpot-style game similar to Lotto Texas but on a smaller scale, with jackpots starting at \$200,000. Texas Two Step has a loyal player base and experiences consistent sales at lower-level jackpots. Like other jackpot games, as the jackpot climbs, sales increase. Texas Two Step’s \$5.3 million sales decrease in FY 2013 was a result of lower jackpots than in FY 2012.

**DRAW GAME OVERVIEW**

**SUMMARY OF TLC DRAW GAME PORTFOLIO**



**Cash Five™**

Cash Five is the agency’s five-digit daily game with a roll-down feature. When there is not a top-prize ticket sold for a drawing, the prize funds allocated to the top-prize tier “roll-down” to the second prize tier and that prize amount increases accordingly. Cash Five was originally introduced in 1995 and was modified in 2002. It is also a mature game that has been experiencing sales declines. The agency is evaluating this game for possible modification and/or replacement. However, other new game introductions and national draw game initiatives have taken precedence based on their revenue potential. Game alternatives will be pursued when appropriate based on individual draw game and portfolio performance.

**All or Nothing™**

All or Nothing is the Texas Lottery’s newest draw game, introduced in September 2012. All or Nothing, with its unique hourglass payout design that offers two ways to win the \$250,000 Top Prize, is an innovative draw game and different from the traditional draw games in the Texas portfolio. All or Nothing features the best overall odds (1 in 4.5) of any Texas draw game and 10 ways to win a prize. Players embraced the game and it generated \$63.6 million in sales in its first year. The game was also recognized as the Best New Draw Game at the North American Association of State and Provincial Lotteries (NASPL) 2013 annual conference.

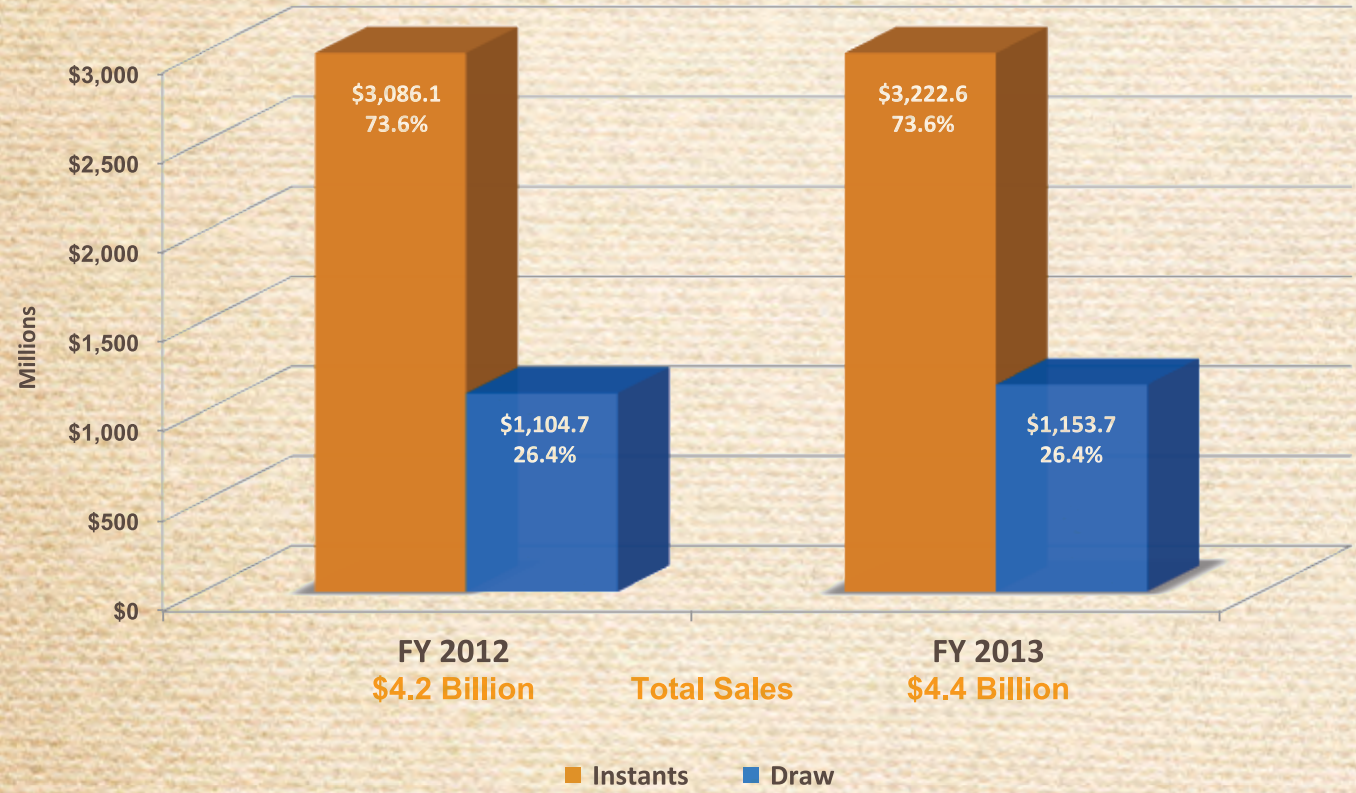
**Pick 3™ and Daily 4™**

Pick 3 and Daily 4 are the Texas Lottery’s three- and four-digit daily numbers games. Pick 3 has consistently been the best-selling draw game, even outselling the multi-jurisdictional games, until this fiscal year when Powerball sales surpassed it. Pick 3’s sales success, \$269 million this past year, illustrates that non-jackpot style games are well-received by players and are a critical component of the portfolio for reaching sales and revenue goals. Daily 4 has experienced sales growth every year since its introduction in 2007.

While sales of the Daily 4 game have increased, there have been slight annual declines in Pick 3 sales performance. It is believed that Pick 3 players are migrating to Daily 4, apparently a trend being experienced in other lottery jurisdictions around the country. However, sales and revenue for the category continue to show an upward trend year-over-year. Both games have an add-on feature, Sum It Up®, which provides players with a chance to win even if they don’t win on the base game. A new rule was adopted in FY 2013 to increase the number of Pick 3 and Daily 4 drawings from twice to four times daily, Monday through Saturday, beginning in September 2013.



**Texas Lottery FY 2013  
Sales Comparison**  
(in Millions)

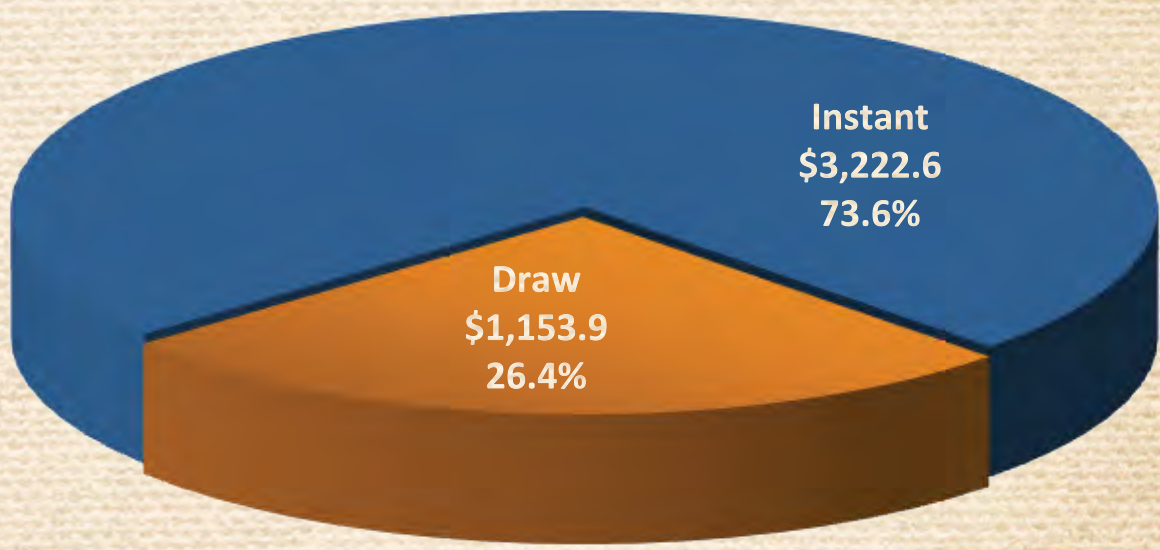


**Sales Comparison**

For FY 2013, the Texas Lottery recorded \$3.22 billion in instant (scratch-off) ticket sales, an increase of more than \$130 million and a new sales record that marked the best year of instant ticket sales in the history of the agency. Draw sales concluded the fiscal year with \$1.15 billion in total sales. The \$2 *Powerball* game, *Pick 3*, *Daily 4* and the new *All or Nothing* game contributed to the draw game sales increase of \$49 million.

Combined product sales for FY 2013 were approximately \$4.38 billion, which is an increase of \$185 million over the prior fiscal year, representing an all-time sales record for the agency.

**Texas Lottery FY 2013  
Sales Game**  
(in Millions)



Fiscal Year Sales: \$4.38 Billion

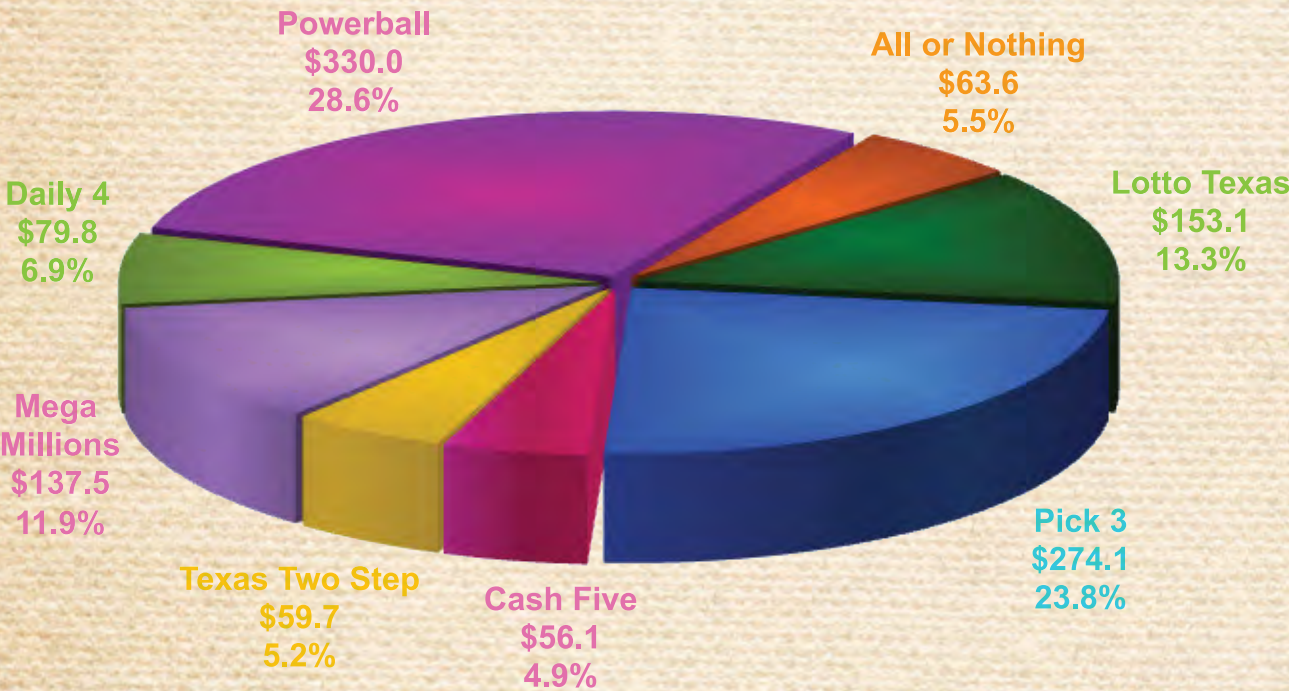
**Sales by Game**

In FY 2013, instant games represented approximately 74 percent of total sales and draw games represented approximately 26 percent of total sales. This product mix is typical for Texas where instant games have accounted for the majority of total sales for many years. Instant games have many qualities that aid in marketing them to potential players including, but not limited to, a variety of price points, game themes, and play styles.



### Texas Lottery FY 2013 Draw Sales Game

(in Millions)



Fiscal Year Draw Sales: \$1.15 Billion

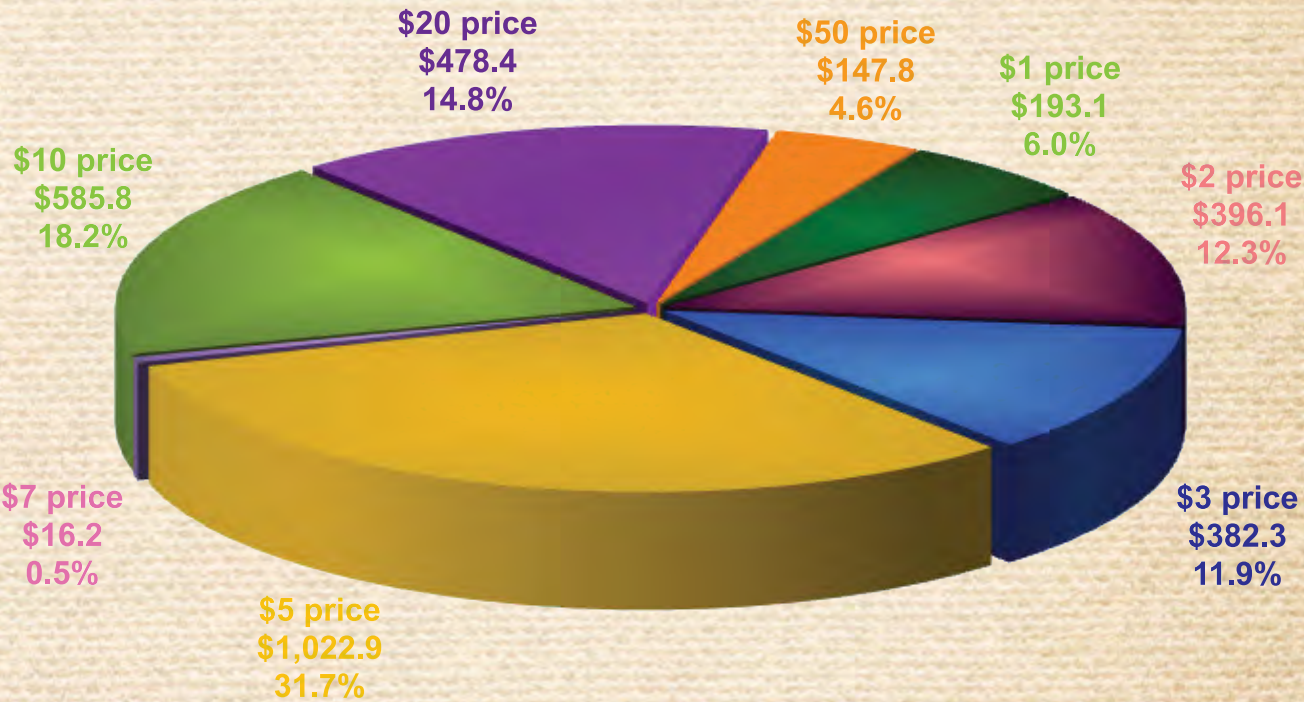
*Note: add-on game sales are grouped with the sales for the base games.*

#### Draw Sales by Game

For FY 2013, *Powerball* was the best-selling draw game followed by *Pick 3*. *Lotto Texas*, the agency's oldest draw game, was the third highest-selling draw game slightly ahead of *Mega Millions*. This can be attributed to a lack of large *Mega Millions* jackpots. While sales of *Lotto Texas* have declined, it still remains an important part of the overall game portfolio. The *All or Nothing* game delivered \$63 million in sales during its first year in the draw game portfolio.

### Texas Lottery FY 2013 Instant Sales by Price Point

(in Millions)



Fiscal Year Instant Sales: \$3.22 Billion

*Note: The \$7 price point has been discontinued and the agency is no longer producing or selling \$7 games.*

#### Instant Sales by Price Point

The Texas Lottery realized \$3.22 billion in instant game sales during FY 2013. The \$5 price point continues to be the best-selling price point totaling over \$1 billion in sales. The \$10 and \$20 price points were the next best-selling price points, respectively. Both of these price points include Spotlight games, which feature larger print runs and a large quantity of top prizes available. Spotlight game offerings helped contribute to the sales success realized at these two price points.



# BENEFITING TEXANS

MORE THAN \$1 BILLION TO GOOD TEXAS CAUSES FOR 10 CONSECUTIVE YEARS.

Since 1992, the Texas Lottery has generated more than \$21 billion in revenue for good causes in the state of Texas, including education, veterans' services and other important state programs. Through strict adherence to our vision, mission and core values, the Texas Lottery is dedicated to ensuring that these benefits continue.

**The Texas Lottery supports Texas education.** Since 1997\*, the vast majority of Texas Lottery proceeds—totaling more than \$16 billion—have been transferred for benefiting of the Foundation School Fund supporting public education in Texas. In FY 2013, the Texas Lottery transferred \$1.149 billion to the Foundation School Fund.

**The Texas Lottery supports Texas Veterans.** Legislation was passed in 2009 directing the Texas Lottery to create and offer an instant scratch-off game for the benefit of the Fund for Veterans' Assistance administered by the Texas Veterans Commission. The Fund awards reimbursement grants to eligible charitable organizations, local government agencies, and Veterans Service Organizations that provide direct services to Texas Veterans and their families. Approximately 90 percent of the revenue contributed to the Fund is derived from the sales of the Texas Lottery veterans' games. The first game was introduced in FY 2010 and since that time 12 additional games have been launched with the proceeds supporting the fund. Through FY 2013, the Texas Lottery has transferred \$27.5 million in proceeds for the benefit of Texas Veterans and their families.

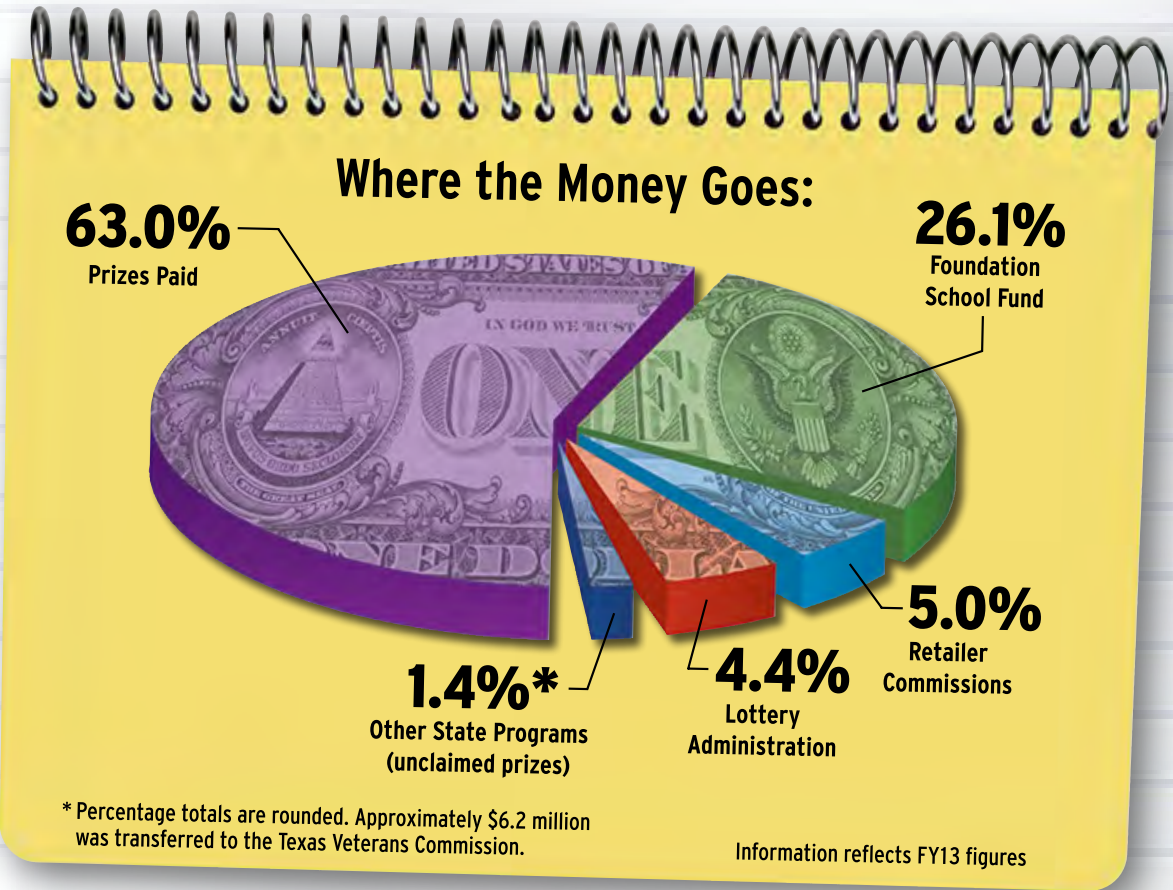
**The Texas Lottery supports Other State Programs.** Other Texas Lottery funds, such as unclaimed prizes, contribute to other causes and programs as authorized by the Texas Legislature.

The chart to the right provides a breakdown of an average dollar spent on lottery games and illustrates "Where the Money Goes," based on FY 2013 financial results.

\*Prior to 1997, the proceeds were allocated to the General Revenue Fund and were applied to the benefit of all state programs.

\$16 BILLION  
IN 16 YEARS

THAT'S A WINNING STORY FOR TEXAS EDUCATION.



When Texans Play, Texas Wins!



## PLAYERS

The Texas Lottery strives to consistently deliver on its core value of Innovation in offering new and entertaining lottery products to its players. We offer our players a wide selection and diversity of products. Whether it is a new draw game or the latest instant (scratch-off) game, we want our players to have fun when they choose to play the *Games of Texas*. We strive to provide exemplary service to the people of Texas and we seek feedback that we use in the development of our products. Players embraced the games offered by the Texas Lottery and participated at record levels in FY 2013. They experienced the excitement of playing and the joy of winning and they won like never before, as the lottery paid out \$2.77 billion in prizes in FY 2013!





## RETAILERS

The Texas Lottery had 17,103 licensed retailers statewide offering lottery products at the end of FY 2013. The dedicated lottery retailer community is the critical bridge between the lottery and its players. Lottery retailers work tirelessly to manage inventory, merchandise and sell games, pay prizes and educate the public on how to play the *Games of Texas*.

The Texas Lottery reached record sales and revenue levels in FY 2013 through the hard work of its licensed retailers. Lottery retailers reaped the benefits of their efforts by earning record-breaking commissions of \$218.89 million. Retailers also earned an additional \$15.41 million in sales performance incentive payments and \$2.52 million in bonuses during the year. All told, retailers earned approximately \$236.83 million in FY 2013.





# SOCIAL RESPONSIBILITY

The Texas Lottery's mission is to generate revenue for the state of Texas through the responsible management and sale of entertaining lottery products. This must be achieved while maintaining public confidence and trust that the agency's games are conducted fairly and securely with a constant focus on Integrity and Responsibility. This core value of the agency is supported by several key initiatives designed to protect and enhance the security of lottery games, systems, drawings and operational facilities. The goal is to provide optimum protection for lottery players and ensure retailers comply with agency rules related to the sale and validation of lottery tickets.

The agency accomplishes this through a number of regulatory and educational activities serving the social responsibility standards of the agency and its customers. Specific areas of emphasis include vendor and licensee compliance, consumer protection, jurisdictional complaint monitoring/hotline support, retailer surveys and inspections, security and integrity of lottery drawings and ticket validations, and implementation of the agency's Play Responsibly initiative.

Enhanced consumer protection strategies include the deployment of more than 16,000 devices which provide lottery players with the ability to check the winning status of instant and draw game tickets prior to validation by a retailer. These devices include counter-top Check-a-Ticket terminals as well as self-service lottery vending machines. Additionally, customer displays and distinct audible tones at sales terminals provide player verification of the prize-winning status of tickets validated by retailers. The agency

is focused on creating an environment where players can participate in the games, independently verify the winning/non-winning status of their tickets and the value of prizes won.

The "Security Spotlight" page on the Texas Lottery website features consumer protection tips and information on how to avoid lottery-related scams. Information is also available regarding resources for reporting or researching suspicious activity.



As a member of the National Council on Problem Gambling, the Texas Lottery helps bring awareness to this issue by encouraging consumers to play responsibly. Since 2004, the Texas Lottery has

participated in the annual Problem Gambling Awareness Month campaign, a grassroots public awareness and outreach campaign presented by the National Council on Problem Gambling. The goal of this campaign is to educate the general public and health care professionals about problem gambling and raise awareness about the help that is available both locally and nationally.

The Texas Lottery's Play Responsibly public information initiative reminds consumers that the Texas Lottery Commission encourages conscientious participation in its games. The initiative was launched in August 2003 and continues today with the Play Responsibly

message positioned in public communications, including how-to-play brochures, retailer and player publications, point-of-sale materials, instant and draw game tickets, and news releases. The initiative features the agency's Play Responsibly web page where players can find links to outside problem gambling resources.

The Texas Lottery is committed to these various initiatives to ensure a socially responsible playing environment for lottery players. The agency continues to identify and implement evolving strategies for consumer protection. With advancements in technology and new tools and reporting available through its gaming system, the Texas Lottery has added, and continues to develop, a significant level of security for consumers and for retailer licensees who sell Texas Lottery games.





# TEXAS LOTTERY COMMISSION

## 2015 COMPREHENSIVE BUSINESS PLAN AND ANNUAL REPORT

### SECTION 2: BUSINESS PLAN KEY BUSINESS PERFORMANCE FACTORS

## OPENING NARRATIVE

The Texas Lottery's Comprehensive Business Plan and Annual Report for FY 2015 was prepared by the agency's management team and approved by the Texas Lottery Commission. The agency originated its formal business planning process in response to Sunset Staff recommendations in 2004. Over the last decade, the business plan has become a key driver of the Texas Lottery's operational and strategic planning. During the agency's most recent Sunset Review Process, Sunset Staff recommended additional enhancements to the agency's business planning process detailed in the "Sunset Advisory Commission Staff Report with Decision Materials," issued in May 2012. Those recommendations, in part, are detailed below:

### **3.1 Require the Lottery Commission to develop a comprehensive business plan including specific evaluations of, and goals tied to, efficiency and performance.**

*This recommendation would build upon the agency's current business plan and a previous Sunset recommendation aimed at evaluating, and ultimately improving, the agency's performance and cost-effectiveness. The agency should develop and update the plan according to an internally developed schedule approved by the Commission, and should provide information and updates regarding the plan's progress to the Commission in a public meeting at least annually. The recommendation would require the plan to set specific goals, evaluate the agency's overall performance, effectiveness of specific programs and initiatives, and ongoing efficiency of operations.*

The Texas Lottery has been successful in producing more than \$1 billion in revenue for the state of Texas each year for the last 10 years, with the primary beneficiary being the Foundation School Fund. However, not unlike other lottery jurisdictions around the country with mature product portfolios and limited opportunities for portfolio expansion, the Texas Lottery faces ongoing challenges to maintain and increase future revenue for the state. Numerous factors can affect lottery performance, such as the mix and design of games offered, number and quality of lottery retailers, and agency administrative efficiency. While the recent Sunset review determined that the Texas Lottery is generally high performing when compared to other states, the agency recognizes that there are challenges ahead in continuing to meet the high expectations based on past performance.

With a focus on improved accountability and performance measurement, this report continues the best of the Texas Lottery's past business planning practices while incorporating new performance measurement tools to ensure that progress is being made in achieving critical agency goals and to allow opportunities for improvement to be quickly identified. The following section of the report walks through 10 key performance factors and associated goals for FY 2015, all of which will drive significant program decisions and major initiatives for the agency. Management believes that these key performance factors are major determinants of the Texas Lottery's future success.



## PERCENTAGE OF RETAILERS SATISFIED WITH THE TEXAS LOTTERY

### Background

The Texas Lottery has a unique relationship with its licensed retailers. Selling lottery products is a licensed, regulated activity and lottery licensees must meet strict standards of conduct both personally and in the sale of lottery products to meet and maintain compliance with the agency's licensing requirements. At the same time, lottery retailers act as the distribution channel in selling the state's lottery products to the consumer and are critical to the ultimate success of the Texas Lottery. Retailer satisfaction with the Texas Lottery lies at the heart of retail support for the lottery and its products.

Retailer satisfaction begins with the agency's regulatory responsibilities which encompass a thorough licensing review of every retailer to ensure only qualified businesses receive licenses. The agency must be efficient in completing these review processes to allow businesses to complete and/or continue licensure and be in a position to offer lottery products at a time consistent with their business needs. The agency also focuses heavily on retailer education to ensure that licensees fully understand the responsibilities and business impact of being a lottery retailer. A variety of training initiatives and collateral materials focus on licensee rules and requirements, financial and accounting procedures, lottery products and equipment operation.

The Texas Lottery dedicates extensive resources to support licensed retailers in their day-to-day relationship with the agency and consumers. This begins with licensure and continues throughout a retailer's history with the agency. In addition to the agency's retailer training program, each new licensee receives a comprehensive welcome packet by mail providing basic information on the agency's processes. The agency provides ongoing support for its retailers via two toll-free hotlines. The first is a technical support hotline, specified under contract with the lottery operator, providing retailers with support for equipment operational issues 24 hours a day, seven days a week. The lottery operator hotline staff also support retailers with time-sensitive needs such as reporting ticket theft or damage and ordering scratch-off tickets.

The agency's second hotline supports all aspects of the agency's regulatory functions related to retailer licensing and accounting matters and is available during business hours Monday through Friday. Hotline team members enter and update retailer information, coordinate ownership transfers and lottery terminal moves, process license terminations, perform retailer records maintenance, and respond to all licensee account questions. This includes routine interactions with retailers on Electronic Funds Transfers (EFTs), sweep amounts, account adjustments, account reconciliations and final balances due. The agency also works closely with retailers to ensure prompt payment following a non-sufficient fund EFT bank account sweep.

The agency has also consistently invested significant time and resources in the area of technological support for its retail licensees. In recent years, several initiatives have been implemented to provide enhanced customer service to licensed retailers through ongoing improvements to the web-based Retailer Services Center (RSC), available to retailers at [txlottery.org/rsc](http://txlottery.org/rsc). The RSC provides retailers with continuous access to online license renewals and numerous reports for managing inventory and financial matters related to the lottery.

Player ticket self-check (Check-A-Ticket) technology was introduced in 2008, reducing retailer labor and transaction time in processing ticket inquiries and validations by minimizing player questions on the prize amount of potential winning tickets. Additionally, Texas Lottery and lottery operator personnel continue to reach out to retailers in group settings called Retailer Links meetings each year, reaching retailers in more than 75 cities and towns across the state since the inception of the program in 2006. Links meetings provide retailers the most current information on Texas Lottery policies and game initiatives while offering an open forum for soliciting feedback and addressing retailer concerns. Retailers view these meetings as a positive means of furthering communication among the Texas Lottery, the lottery operator and lottery retailers.

With the award of a new lottery operator contract in December 2010, all retailers received new sales terminals in 2011, which provided improved transaction times, thus reducing retailer labor costs. The contract also included new play stations, designed with space for player Check-a-Ticket devices reducing the space requirements for lottery at the retail location. Retailers were furnished electronic monitors for displaying player transactions, lottery marketing messaging and other important lottery and non-lottery messaging (e.g., Amber and Silver Alerts, etc.). Electronically updated jackpot signage was introduced at licensed locations, offering retailers the convenience of providing their customers with the most current information with no additional retailer time or labor investment.

Regardless of the issue being addressed, the agency's focus remains squarely on our core value of Customer Responsiveness in providing exemplary service. To ensure that the agency is delivering on its commitment, the agency surveys its retailer base to determine the level of satisfaction with the services being provided. The agency historically set a target of 93 percent satisfaction levels (measured as satisfaction scores of "good" or "excellent"). However, the agency has recently increased its satisfaction standard to 95 percent. In the three most recent full fiscal years (FY 2011-2013), the agency has exceeded this target and achieved satisfaction level scores exceeding 96 percent.





Challenges and Opportunities

The Texas Lottery has been very successful over time in achieving a high level of success in its retailer satisfaction measure. The agency’s continued positive relationship with its retailers is maintained through consistent, rigorously applied licensure standards for all retailers and a continued focus on exceptional customer service. However, the retail business environment is dynamic and ever-changing and so too must be the service that the agency delivers to its retailers. Success is ensured by communicating regularly with the diverse lottery retail base and understanding their challenges and needs effectively. With this base of knowledge, the lottery must address current needs and also anticipate future retailer requirements and expectations for lottery business continuity, efficiency and growth.

Key Initiatives and Goals

The Texas Lottery recognizes that the success of its retailer licensees is inextricably tied to the agency’s achievement of its mission to generate revenue for the state through the responsible management and sale of entertaining lottery products. Timely, effective support and exceptional service are necessary to ensure retail success and the staff is committed to delivering against these standards. Additionally, the staff is working on a new web-based retailer interface called the Lottery Services Portal which will replace the existing Retailer Services Center. The Lottery Services Portal will provide additional reporting tools and significantly enhanced opportunities for licensees to conduct their business with the lottery via the Internet, including the ability to submit license applications online. A second web-based module, the Lottery Learning Link, will provide retailers quick access to refresher training on specific lottery topics from terminal functionality to game features. Through our Customer Responsiveness commitment, the staff is intent on continuing to exceed our goal of a 95 percent retailer satisfaction level.

PERCENTAGE OF LICENSEES WITH NO RECENT VIOLATIONS

Background

The Texas Lottery is committed to maintaining the public trust by protecting and ensuring the security of lottery games. This performance metric reports the ratio (by percentage) of currently licensed and active lottery retailer locations that have not incurred a violation within the current fiscal year to the total number of licensed and active lottery retailer locations at the end of the reporting period. A violation is defined as any violation of the State Lottery Act or Lottery Rules by a lottery retailer that results in the suspension or revocation of the retailer’s license. This metric is an indicator of licensed retailer adherence

to state laws and administrative guidelines. This metric reflects (1) how effectively the Texas Lottery is in communicating with retailers regarding statutes and rules, and (2) how effective the agency’s activities are in deterring these violations.

Lottery retailers are the primary point of interaction for lottery customers for both lottery purchases and the validation and payment of lottery prizes. These lottery transactional activities, by their nature and volume, represent several potential risks in the area of consumer protection and also represent numerous opportunities for misunderstandings between lottery players and retailers. The agency has developed numerous tools and programs to monitor these transactions, limit opportunities for misunderstandings and investigate potential wrongdoing on the part of its licensees.

Ensuring a low number of licensees with recent violations is a function of strict standards for licensure, and effective licensee support functions including strong education programs stressing ethical standards and the consequences of rule violations. Also, the agency’s initiatives for reducing violations include the deployment of best-in-class transactional support technology, rigorous compliance monitoring and focused enforcement efforts in circumstances involving unethical or inappropriate licensee behavior.

The agency has embarked on numerous consumer protection initiatives to provide additional protection for lottery consumers and ensure retailers comply with rules related to prize validations. The centerpiece of these efforts was initiated by the agency in 2004 with the introduction of the Compliance Activity Monitoring Process (CAMP) hotline. The hotline provides consumers with a mechanism to notify the Texas Lottery Commission of jurisdictional concerns. CAMP staff monitor complaints and violations of the State Lottery Act (and Bingo Enabling Act) and administrative rules. An automated system provides the ability to track all complaints and violations from initial intake or discovery to final disposition, which facilitates trend analysis and reporting. The program is publicized via the agency website and signage in retailer locations.

Several of the agency’s other consumer protection-related initiatives that have already been implemented are listed below.

- Dual validation receipt (one for players and one for retailers)
- Split/floating validation numbers (VIRN)
- Removing validation codes
- “Sign Your Ticket” campaign
- PDF 417 barcode on scratch-off tickets for self-check equipment
- Player-activated terminals for self-checking winning status of tickets
- Self-check terminal locator on website
- Terminal inquiry/validation tones
- Transaction display devices for terminals
- Security spotlight on web page





- Purchase day, date and time printed on draw game tickets
- Monitoring of validation activity at retail
- Secure Shield, one-step validation barcode on scratch-off tickets

The agency has established a progressive disciplinary process for retailer violations of the State Lottery Act and rules. Every effort is made to ensure timely and consistent application of progressive disciplinary remedies up to and including the revocation of sales licenses. The agency recognizes the need to protect consumers while simultaneously not inconveniencing or disrupting the daily business activities of honest retailers. As the vast majority of retailers serve their customers in an ethical and forthright manner, it is critical for the agency to balance consumer protection with retailer motivation to sell lottery tickets. The agency's mission to generate revenue for the state of Texas is supported by making every effort to ensure fun, positive lottery player experiences.

The agency has set a target of 98 percent for the percentage of licensees with no recent violations and has consistently seen compliance exceed this goal.

### **Challenges and Opportunities**

Without confidence in the security and integrity of lottery games, consumers might choose not to play and retailers might not fully support the agency's sales, marketing and merchandising initiatives. The Texas Lottery is focused on creating a culture of compliance and trust among its retailers and players. This requires that the agency remain ever vigilant in all areas of its operations as there are individuals who would exploit gaps or weaknesses if they existed in the agency's operational security.

### **Key Initiatives and Goals**

The agency has been able to leverage advancements in technology to refine and enhance the level of sophistication of its resources and tools for monitoring and supporting transactions at retail. The agency's new lottery gaming system offers an expansive data warehouse of information on all aspects of lottery transactions and system activities that can be leveraged by the agency through enhanced reporting tools to ensure secure operations. The Security Department and Enforcement Division are at the forefront of leading the agency in these initiatives.

These same technological advancements have led to a number of the initiatives listed above. The agency will closely monitor these advancements to identify new opportunities that will further enhance the security of the lottery playing experience.

The Texas Lottery will also continue to alert consumers about security issues via its Security Spotlight section on the agency's website. The agency is confident that through vigilant attention to all aspects of licensee support, monitoring and continued transactional enhancement that the Texas Lottery will continue to achieve a goal of 98 percent of the licensee base having no recent violations.

## **PERCENTAGE OF BAD DEBT TO LOTTERY SALES**

### **Background**

The Texas Lottery must deliver secure and entertaining lottery products to its players to generate sales and ultimately revenue for the state of Texas. However, it is equally important to revenue generation that the agency effectively collect sales proceeds from its retail licensees. A retailer licensee's accounting relationship with the Texas Lottery involves a weekly collection process for the prior week's sales of draw game tickets and settlements of instant ticket packs. Retailers must deposit funds associated with these sales transactions (net of retailer commissions) to their bank account to be electronically swept and collected.

The Texas Lottery provides a substantial level of support regarding a retailer's financial commitments to ensure retailer success. Retailers have numerous reports available on their sales terminals and on the agency's web-based Retailer Services Center that provide information about all of their transactional activity and balances due. The agency also interacts daily with retailers on Electronic Funds Transfers (EFTs), sweep amounts, account adjustments, account reconciliations and final balances due. The Retailer Services Department works with retailers who have experienced a non-sufficient fund EFT bank account sweep to ensure prompt payment. The department tracks and manages delinquent retailer accounts using various collection methods—including bank account freezes, levies, property liens and cash seizures—and, where appropriate, the department may seek suspension or revocation of a retailer's sales agent license in accordance with the State Lottery Act or agency rule.

The Texas Lottery utilizes a performance metric to evaluate collection effort performance. The metric provides an indication of the effectiveness of the agency's systems and procedures for collecting the proceeds from the sale of lottery tickets. The measure also provides an indication of the effectiveness of the collection and enforcement tools used by the agency to collect on delinquent accounts. This measure is important because it reflects the agency's performance as it attempts to minimize bad debt related to retailer balances.

The metric specifically calculates the ratio (by percentage) of the Certified Bad Debt (CBD) to total lottery sales at the end of each fiscal year. CBD includes accounts that have been delinquent or in bankruptcy for at least 12 months at the end of the fiscal year and accounts that have an outstanding debt of \$10,000 or more that have been delinquent for up to 180 days.

The agency has established a target goal for CBD to not exceed .02 percent of gross sales as a ratio. This is a target that the agency has consistently outperformed during the last three full fiscal years as illustrated in the chart on the following page.



	FY 2011	FY 2012	FY 2013
Total Sales	\$3,811,270,135	\$4,190,815,913	\$4,376,286,456
Bad Debt Expense	\$317,378	\$361,399	\$289,311
Bad Debt Expense as a % of Sales	0.0083%	0.0086%	0.0066%

Source: Texas Lottery Performance Measures

The combined three-year collection rate translates to collecting 99.22 cents on every dollar of gross lottery sales over this period. This is a collection rate and bad debt expense ratio that even the most efficient of S&P 500 corporations could only dream of. A collection rate this high is made possible through dedicated staff committed to all aspects of the agency’s collection efforts.

Challenges and Opportunities

The Texas Lottery has a robust collections program that leverages all tools authorized by the State Lottery Act to ensure that it collects proceeds from lottery sales. However, there are factors outside of the agency’s control that can impact sales collections. These include poor economic conditions that can impact lottery retailers, leading to increases in non-sufficient fund EFT bank account sweeps and bankruptcy filings. Similarly, a large retail chain might file for bankruptcy, potentially resulting in significant unpaid balances related to lottery transactions. The agency takes certain actions to mitigate the effects of large non-sufficient-funds bank account sweeps and retailer bankruptcies, including working closely with the Office of the Attorney General, as appropriate. In addition to these measures, the agency conducts an analysis during the initial license application review process of business owners’ financial history with the lottery or credit history to determine potential financial risk. High-risk applicants are required to post CDs in the agency’s name to protect the state against financial loss.

Key Initiatives and Goals

The Texas Lottery has established an exemplary sales collection program in support of its revenue generation efforts, and the agency is committed to the continued success of this program. In 2012, the agency completed a thorough review and analysis of its CD program to ensure best practices are being used to establish requirements for certain licensees to place CDs on deposit in the agency’s name to protect against loss. The results of the analysis validated the agency’s methods to manage the CD requirement process. The agency is committed to a target goal for Certified Bad Debt to Gross Lottery Sales ratio not to exceed .02 percent.

DOLLARS COLLECTED VIA THE DEBT SET-OFF PROGRAM

Background

Consistent with provisions of the State Lottery Act, the Texas Lottery assists the state by collecting monies from persons who have been finally determined to be delinquent in the payment of any money owed to or collected by other state agencies. The Debt Set-off Program helps collect debts owed to the state of Texas by withholding those amounts prior to the awarding of prize payments to lottery winners. These collections represent substantial annual amounts due to the state that might otherwise go uncollected.

The Texas Lottery’s role in this performance metric is to manage the Fiscal Accountability of the program, ensuring all payments collected consistent with the State Lottery Act are sent in a timely fashion to the appropriate state agency.

The program has seen substantial increases in amounts collected during the three most recent full fiscal years. Over this period, Debt Set-Off collections have increased by 139.05 percent, representing an average increase of just over \$1.12 million in collections per year. Total monies collected for the period were \$8.18 million.

Dollars Collected via the Debt Set-Off Program



Source: Texas Lottery Performance Measures



Challenges and Opportunities

The Texas Lottery has seen impressive growth in its collections of debts on behalf of the state over the last three years. While there has been growth in these collections over time, the numbers reflected over the last three years are unique in the magnitude of growth that has occurred. While these results are significant, it is important to note that the funds collected are a function of the number of prizewinners owing monies to the state who claim prizes at claim centers. There are a number of variables that the agency does not influence or control that impact this metric. The metric may be influenced by the volume of people owing monies to the state and the amounts that those individuals owe. Economic events may be contributors to these variables. It is likely, however, that the success that the agency has experienced in gross sales growth in recent years is a contributing factor to the growth of these collections. Lottery sales increases translate into greater participation and an increase in the overall number of prizewinners who claim prizes at claim centers.

Key Initiatives and Goals

As noted, the Texas Lottery does not directly influence this performance factor. The agency’s focus on its sales and revenue goals has an indirect impact that may influence collection performance. The pattern of growth in this metric is unique in the near term. When accounting for this and historical collections and growth, the agency has established a target of \$2,500,000 for collections in FY 2015.

The agency also remains committed to ensuring that its systems and mechanisms for receiving debt information from other state agencies remain thorough and robust to ensure that all opportunities for debt collection are pursued.

RETAIL DISTRIBUTION CHANNEL EXPANSION

Background

Lottery retailers represent the key delivery channel through which the agency sells tickets to generate revenue for the state. To achieve the agency’s mission of generating revenue to support education and other good causes, it is critical that lottery products are conveniently and widely available at a variety of locations frequented by a broad diversity of consumers.

The lottery retailer base represents a dynamic business environment where frequent business sales and acquisitions are a part of the normal operating environment. The economic climate of the state can

also have a significant impact on the retailer base. The agency works to support existing retailers and to recruit new retailers to ensure a stable, but growing, product distribution channel.

Although the base contains a variety of trade styles, convenience and grocery stores are the dominant trade-style segments. Together, these two trade styles comprise 89 percent of retailers and 96 percent of Texas Lottery sales. Convenience and grocery stores are considered to be “traditional” lottery trade styles. Other common retail trade styles—such as general merchandise, pharmacy and big box (e.g., Wal-Mart, Target, Home Depot, etc.)—are typically categorized as “non-traditional” lottery trade styles, as they have not broadly adopted the lottery category as a standard product offering.

In spite of a dynamically changing business environment, the agency has been able to maintain a relatively stable retailer base over its history. However, during the period from FY 2000 to FY 2007, there was a slow decline in the agency’s retailer base from a peak of 16,767 to 16,211 retailers. Beginning in 2008, the agency placed renewed emphasis on retail distribution channel expansion efforts in coordination with the lottery operator, GTECH, which is primarily responsible for licensee recruitment activities under its contract with the agency. This emphasis continues in the current Lottery Operations and Services contract which began September 1, 2011. Since FY 2008, the retailer base has grown each year, surpassing 17,100 retailers in FY 2013.

The lottery operator is required to provide key infrastructure and support for future recruitment success. Key among these is a fully refreshed equipment platform for retailers featuring state-of-the-art, play-er-activated, self-service equipment; dedicated personnel focused on individual and small chain business recruitment opportunities; GTECH support for route sales licensing models to reduce business overhead expenses related to retailer lottery participation; and new systems that provide Texas Lottery retailers with terminal- and web-based accounting and sales information detail far beyond past capabilities.

These cumulative efforts resulted in expansion of the distribution channel from 16,211 retailers at the end of FY 2007 to 17,103 retailers at the end of FY 2013.

Challenges and Opportunities

The Texas Lottery must continue to work to maintain its effective relationship with retailers within traditional lottery trade styles, while actively pursuing opportunities to expand into non-traditional lottery trade styles.

There are several challenges to expanding lottery distribution channels. Independently owned retailer establishments are often focused on offering higher profit margin products that can be more easily correlated to bottom-line revenue. As lottery products typically produce lower profit margins than many other retail products, prospective retailers’ interest in adding the lottery category can be limited. Also, the instant product category can present operational concerns associated with inventory control/shrinkage and the potentially labor-intensive nature of servicing lottery products. These concerns can serve as a barrier to interest in licensure.



Recruiting chain establishments in non-traditional lottery trade styles presents other challenges. The Texas Lottery, lottery operator and lottery members of the North American Association of State and Provincial Lotteries (NASPL) have consistently identified the following barriers to recruiting national corporations representing new trade styles: the consistent ability to offer self-service and route sales models, lack of standardized licensing and accounting processes across all jurisdictions, and the availability of new technologies providing back-office accounting and real-time connectivity to sales information. Additionally, some retailers perceive that selling lottery products may not align with their business models.

Often, prospective retail trade styles may be best suited for player-controlled, self-service sales due to consumer traffic patterns and trade-style business models. These different sales methods require specialized equipment and support that are outside the prevalent and historic lottery industry sales model of clerk-assisted transactions.

### Key Initiatives and Goals

The key strategies for licensing new Texas Lottery retailers will continue to focus on soliciting the traditional trade styles of convenience and grocery for both independent and chain locations. In addition to expanding the traditional retailer base, there will be equal emphasis on soliciting and licensing key non-traditional trade styles. In order to successfully pursue broader distribution channels for its products, the Texas Lottery must continue to meet the needs and concerns of both traditional and non-traditional trade styles by providing innovation and services such as those included in the Lottery Operations and Services contract.

The agency and the lottery operator will continue to work together to enhance retailer recruitment efforts to increase the Texas Lottery's overall presence in a broader array of trade styles while continuing to recruit new businesses in core traditional lottery trade styles. In recent years, these efforts have shown promise as some non-traditional trade styles have engaged in pilot sales programs and discussions are ongoing with other businesses previously hesitant to embrace the lottery category.

Regardless of the trade style category, the Texas Lottery is invested in growing the licensed retailer base through sustained and strategic recruitment allowing for better product accessibility for the public while potentially increasing revenue to the State. From FY 2010 to FY 2013, the retailer base grew by an average of 115 retailers annually. In coordination with the lottery operator, the agency has set a goal of again achieving this level of growth in FY 2014 and 2015.

## RETAILER INCENTIVE PROGRAM

### Background

The Texas Lottery received authorization and funding from the legislature, via a rider, for an additional one-half (0.5) percent allocation of gross sales for sales performance commissions or similar sales performance incentive programs beginning with the FY 2010-11 biennium. This budgetary allocation is over and above the standard 5 percent sales commission that is paid to retailers.

In determining the optimal structure for this program, the Texas Lottery engaged in a study of other lottery retailer incentive programs and evaluated standards across the retail industry for sales performance-based programs. Following this study, the agency worked to develop a same-store sales growth program that incentivized retailers based exclusively on performance. The program has undergone modifications over the years to optimize the revenue benefit to the state. The current retailer incentive program uses a two-phase approach to reward retailers who meet and exceed their sales goal:

- Phase I: Eligible retailers are required to meet a specific sales goal in order to qualify for an incentive payment. Retailers can receive additional payments for achieving incremental sales milestones beyond their goal.
- Phase II: Retailers who reach their goal in Phase I are automatically qualified to receive an entry into a random drawing for additional cash prizes. Retailers continue to receive additional entries as they reach incremental sales milestones.

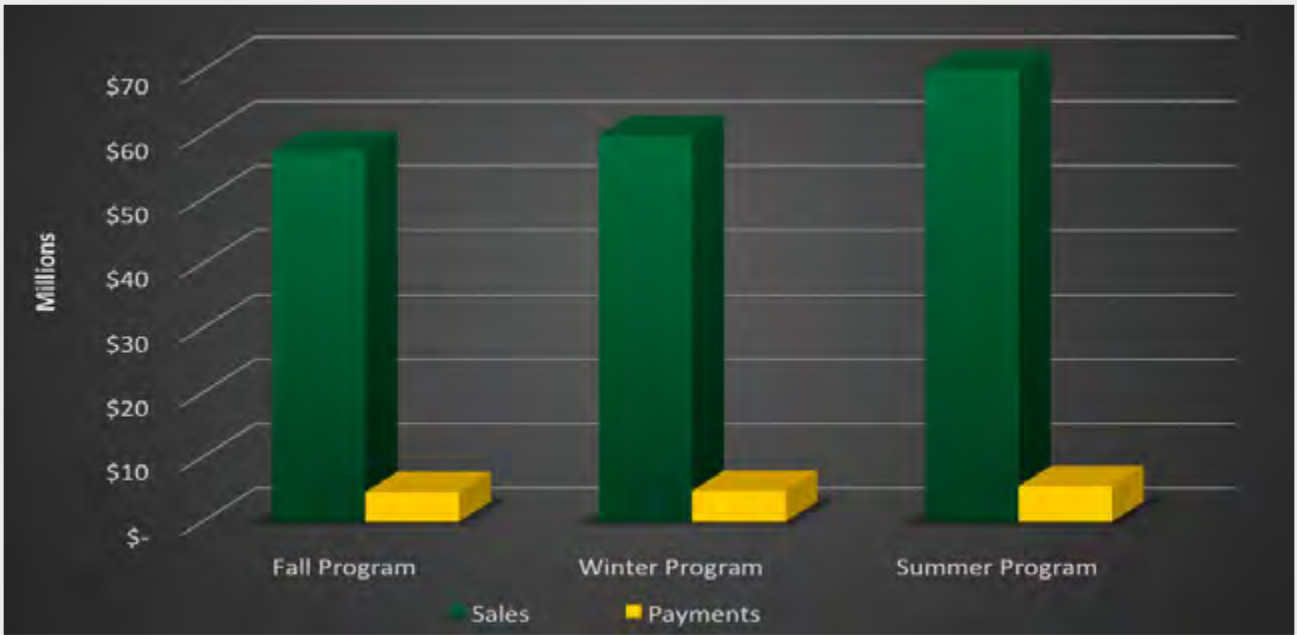
At the end of FY 2013, the agency had completed 11 individual retailer incentive periods since the program began in September 2009. Qualifying retailers have generated more than \$714 million in additional sales, yielding more than \$127 million in incremental revenues for the state. These retailers received more than \$54 million in incentive payments based on their sales performance.

The chart on the following page depicts the three incentive program periods during FY 2013, illustrating the retailer payments made and the related sales impact of each program.





## FY 2013 Retailer Incentive Program Payments and Sales Impact



### Challenges and Opportunities

The Texas Lottery is the only lottery in the industry that incentivizes retailers based on true same-store sales performance. As an industry leader in this area, the agency must continually evaluate its incentive program to ensure the design of the program remains appealing to retailers, resulting in high levels of retailer participation and yielding maximum sales and revenue growth. The retailer participation rate has grown from 6 percent for the first incentive program, to an average 37 percent for the three-program period in FY 2013. While retailer participation is important, the agency must also ensure that each program period establishes challenging goals for retailers that will optimize revenue to the state.

### Key Initiatives and Goals

The agency has designed the program to significantly mitigate risk to the state by focusing on same-store sales growth. Retail licensees only receive incentive payments under the program if they meet their sales goals and produce incremental sales and revenue results for the state. In addition, each individual program has a budget limitation or cap on the total amount of incentive payments that can be made. If the total projected payments exceed the cap, all payments will be reduced by an equal percentage in order to not exceed the allocated program budget. This ensures the agency does not exceed its appropriation for this program. Drawing prizes and entries are not impacted by the budget limitations.

With this risk-averting program structure in place, the ongoing goal of the agency is to optimize retailer participation and set challenging sales goals to maximize the programs benefits. The agency will continue to accomplish these balanced priorities by conducting program analysis, establishing effective sales projections and maintaining close communication with and understanding of its retailer base, both directly and through the lottery operator’s sales force.

The agency is committed to achieving this goal by identifying opportunities to modify program parameters based on the results of past programs and new business environment variables identified during its reviews, which may impact future performance. The staff will report annually, or more frequently as directed by the Commission, on attainment of these ongoing retailer incentive program goals.

## ADVERTISING EXPENDITURES AND EFFICIENCY

### Background

The Texas Lottery engages in advertising to communicate with the public about the numerous products offered by the agency each year. The agency makes considerable efforts to appropriately and effectively allocate its advertising dollars to reach the public and enhance awareness of Texas Lottery games. The Texas Lottery’s advertising is allocated among 20 designated market areas (DMAs) throughout the state. Texas has the largest number of DMAs of any state in the country. This means that in order to reach and communicate with all adult Texans, advertising must be placed in all 20 market areas. The Texas Lottery uses a combination of mass media (television, radio, newspaper, out-of-home billboards, digital, social media) advertising and point-of-sale materials (flyers, brochures, posters, etc.) to achieve this goal.

Research performed by the Texas A&M Mays School of Business was conducted in 2014 to determine the impact of advertising on lottery sales in the state of Texas. The research models in the Texas A&M report suggest that advertising has a positive and significant effect on lottery sales. More specifically, the results suggest that a 10 percent decrease in advertising (expenditures) would result in a 17 percent decrease in lottery sales. Total advertising budgeted across all media in FY 2013 was \$36.26 million. Against this scenario in FY 2013, a 10 percent decrease (increase) of \$3.63 million in the advertising budget would reduce (increase) sales by \$74.40 million. This decrease (increase), in turn, would translate to a loss (gain) of \$19.57 million for the state of Texas. The Texas A&M modeling further concluded that if the long-term impact of advertising were to be considered, the potential impact to sales and revenue for the state would be even greater.



Challenges and Opportunities

The purchasing power and reach of the Texas Lottery’s advertising budget has declined significantly over the nearly 22 years of the agency’s existence. The Texas Lottery’s appropriated advertising budget has diminished in nominal dollars from \$40 million in 1993 to \$32 million in 2013. However, the effects of inflation are even more pronounced. An advertising budget of \$40 million in 1993 dollars would equate to \$64.4 million in 2013 dollars, adjusted for inflation.

Add to that a greatly expanded product mix, and it becomes apparent that the agency faces significant challenges in advertising and communicating with the public about all of its products. In 1993, lottery products consisted of one draw game (*Lotto Texas*) and two instant games. Today, the Texas Lottery offers eight different draw games with four unique add-on features and approximately 85 to 90 instant games each year.

Furthermore, in 1993, players were easier to reach frequently via network television and radio advertising. Since then, dramatic change has come to the advertising industry including the proliferation of new media choices for consumers. A few examples of new media include the continuing growth of the Internet, social media and mobile. Cable channels and streaming media have also played a significant role in the increasingly fragmented media landscape. This market dilution means it has become more difficult to reach large groups of consumers with the same level of media expenditures.

Since 1993, the population of Texans over the age of 18 has increased by 51 percent from 12,812,537 to 19,406,207 in 2013. Additionally, the population of Texas has become more ethnically diverse, reaching minority-majority status in recent years. The increased population and decreased appropriated advertising budget have combined to lower per capita advertising expenditures over this period by 52 percent from \$3.17 to \$1.65. By focusing with its advertising vendor on the efficiency of its advertising and developing an annual advertising execution strategy, the Texas Lottery continues to be one of the top-selling lottery jurisdictions in the nation, while operating with one of the lowest per capita advertising budgets in the industry. According to the LaFleur’s 2013 World Lottery Almanac, Texas ranks 34<sup>th</sup> of 44 state lotteries in advertising budget per capita and 8<sup>th</sup> among the top 10 performing lotteries (ranked by sales per capita).

Advertising Budget Per Capita



Source: La Fleur’s 2013 World Lottery Almanac

The following table summarizes and compares the major challenges impacting the Texas Lottery’s advertising over time. (Table continues on the following page.)

	FISCAL YEAR 1993	FISCAL YEAR 2013
Impact of Inflation	\$40 million base appropriated advertising budget	\$32 million base appropriated advertising budget \$40 million in 1993 dollars equates to \$64.4 million in 2013 Adjusted for inflation, \$32 million in 2013 equates to \$19.9 million 1993 dollars
	12.6 million Texans 18 or older	19.4 million Texans 18 or older
	\$3.17 ad spend per capita	\$1.65 ad spend per capita \$3.17 ad spend per capita in 1993 dollars equates to \$5.10 in 2013 Adjusted for inflation, \$1.65 in 2013 equates to \$1.02 in 1993 dollars
Increase in Products	Two products: <i>Lotto Texas</i> Scratch-off games (2)	Nine products + 4 unique add-on features: <i>Pick 3 with Sum it up</i> <i>Cash Five</i> <i>Daily 4 with Sum it up</i> <i>All or Nothing</i> <i>Lotto Texas with Extra</i> <i>Texas Two Step</i> <i>Mega Millions with Megaplier</i> <i>Powerball with Power Play</i> Scratch-off games (approx. 80-90 launched annually)



	FISCAL YEAR 1993	FISCAL YEAR 2013
<b>Product Life Cycle</b>	Lottery product was brand new, generating immense excitement and interest.	Lottery products are mature, meaning that advertising dollars must work harder to create player excitement and interest in the games. New games, game changes and add-on features continue to be introduced, all requiring additional advertising support.
<b>Free Media Exposure</b>	Extensive free coverage of winners, new games and ball drawings by all media types due to newness of games.	Media coverage of winners and large jackpots, but the reach of traditional media is significantly downsized. Almost no coverage of live drawings or new game launches. Social media platforms increasingly structured so that they necessitate paid advertising.
<b>Texas Ethnicity</b>	Population was made up of a significant majority of Caucasians.	Population is much more diverse with a minority-majority population. Texas is the second most populous state in the nation and the third fastest-growing, with the majority of the growth being driven by Hispanics, followed by African-American and Asian communities. By 2016, the multicultural population of Texas is forecasted to account for 61 percent of the total 18-49 year old population, further solidifying its current minority-majority status in the years to come.
<b>Media Proliferation</b>	Players were easy to reach frequently via network TV and radio advertising.	The advertising industry has encountered dramatic challenges with the proliferation of new media choices for consumers, including exponential cable channel expansion, streaming radio, the role of the Internet and social media, all factors that limit advertising exposure. Additionally, the rapid adoption of tablets and continued expansion of smartphones, DVR usage and content-streaming create even greater opportunities for consumers to time-shift programming, potentially affecting advertising exposure. This market dilution means it has become more difficult to reach large groups of consumers for the same level of media expenditures.
<b>Pay at the Pump</b>	Because pay-at-the-pump technology was new and limited, most people went into the store to pay for gas, allowing for exposure to lottery products.	Most stores have pay-at-the-pump technology, and about 64 percent of consumers use it, requiring advertising to work harder to drive players into the store for lottery products.

### Statutory Limitations on Types of Advertising

Statutory provisions also affect the type of messaging the agency can use in its advertising. Section 466.110 of the Texas Government Code states that advertisements or promotions sponsored by the Texas Lottery must not be of a nature that unduly influences any person to purchase a lottery ticket or number. This general restriction can be broadly interpreted and significantly limits both the types of advertising messages and the media placement strategies employed in the agency’s messaging. The agency is very respectful of and sensitive to the viewpoints of the approximate one-third of Texans who are not in favor of gaming in any form.

### Key Initiatives and Goals

With statutory restrictions on the Texas Lottery’s advertising and limitations on the agency’s appropriated advertising budget, advertising efficiency is the most critical tool at the agency’s disposal to maintain its ability to reach consumers and communicate about new and existing lottery products. The agency remains committed to the goal of enhancing the efficiency of its advertising. This includes efforts to internally review and challenge past advertising strategies and efforts to engage third-party unbiased resources to evaluate the efficiency of the agency’s advertising efforts. This includes the recent 2014 analysis of “The Impact of Advertising on Lottery Sales in the State of Texas,” performed by the Texas A&M Mays School of Business. Additionally, the agency has procured vendor services in FY 2014 to complete an advertising media audit of the advertising services vendor’s purchase and placement of advertising media to evaluate the efficiency of these expenditures. The Texas Lottery will apply any media efficiency opportunities identified to future media purchases.

The Texas Lottery must also engage in creative strategies to optimize its appropriated advertising expenditures. The following are a few key areas that the agency is leveraging to optimize expenditures and efficiency in reaching consumers.

### Tiered-Media Markets

The Texas Lottery continues to evaluate the effectiveness of its advertising media placement strategies. Due to budgetary constraints, several years ago the agency implemented a tiered ranking process to make discrete choices in the weighting of its advertising in the different advertising markets in Texas. This means that the agency’s advertising presence in some markets is “underweighted,” but ultimately results in the most efficient allocation of resources to reach the broadest population of consumers. The Texas Lottery continues to work with its advertising vendor to refine its tiered-media market strategy and media weight allocations by market to optimize advertising efficiency. The agency utilizes a formal annual advertising media plan approval process to achieve this goal.



### Social Media

The Texas Lottery must work to reach new consumers using non-traditional advertising and communication vehicles. Social media is at the forefront of these efforts and has become an increasingly important component of the Texas Lottery's efforts to reach and communicate with adult Texans. The agency currently communicates

with consumers about its products through social media resources including Facebook, Twitter, YouTube and Instagram. The Texas Lottery social media platforms were developed in compliance with the Texas Department of Information Resources social media policy and guidelines. The agency continually monitors the social media landscape for appropriate opportunities to advertise via these platforms and to reach and communicate with adult Texans about lottery products.

### Consumer Electronic Communications and Applications

The Texas Lottery also engages its players directly through an opt-in e-mail or text messaging program that provides winning numbers, current estimated jackpot alerts, instant game information, and general news and alerts. The Texas Lottery will soon begin work in FY 2015 with the lottery operator to develop smartphone applications that will deliver similar information and other features to consumers on a new convenient platform.



### General Background

There are 47 jurisdictions in the United States conducting government-run lotteries, including 44 states, plus the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Some lotteries are structured as corporations, while the majority, including the Texas Lottery, are structured as traditional state agencies. The Texas Lottery is situated in a mature market where it competes primarily for the discretionary entertainment dollars of adult Texans age 18 and older. It is within this general environment that the Texas Lottery must tailor its products to appeal to its customers.

The Texas Lottery strives to provide the citizens of Texas with the best entertainment experience available through its products. New games and game enhancements are continually being developed to keep Texas Lottery games innovative and exciting for Texas players. The agency uses market research to help ensure that any changes made to the current game mix will effectively meet the needs of Texas players, as well as serve the agency's mission of generating revenue to support public education.

Historically, the Texas Lottery has consistently ranked among the top-selling lotteries in the United States, most recently ranking fifth and exceeded only by New York, Massachusetts, Florida and California.<sup>1</sup>

The *Games of Texas* are the body of products that the Texas Lottery makes available to the playing public. These include instant games and draw games. The agency currently offers eight draw games, including four unique add-on features offered on five of its draw games, and approximately 90 instant games annually constituting the current game portfolio.

## INSTANT TICKET GAMES

### Background

Also referred to as "scratch-off" or "scratch" games, instant ticket games are preprinted tickets with symbols hidden under a latex covering. The player scratches off the latex and determines "instantly" whether or not the ticket is a winner. Instant tickets include a variety of themes, play styles, and prize structures in order to offer an attractive game mix to players. Popular game themes include gaming, money, numbers, seasonal, annuity and extended play.

<sup>1</sup> *La Fleur's 2013 World Lottery Almanac*. 2013. 21st edition. Edited by Teresa La Fleur, Byron La Fleur, and Bruce La Fleur. Rockville, Maryland: TLF Publications, Inc. P. 325.



Play styles include matching dollar amounts or symbols, tic-tac-toe, key number or symbol matches, your score beats theirs, and add-up games. Additional game features include “doubler,” “automatic win” and “win all” symbols, providing added entertainment value. Players enjoy multiple chances and multiple ways to win on each ticket.

Licensed property games capitalize on well-known, branded concepts, such as *World Poker Tour*®, *The Price Is Right*®, *Monopoly*®, the *Houston Texans* and the *Dallas Cowboys*, which appeal to members of the public who might not typically purchase a lottery ticket. The agency has also developed “core” or base games, including *Break the Bank* and *Weekly Grand*, which are always available for sale because of their long-term, ongoing popularity with players.

Prizes for current instant games range from \$1 to \$7.5 million. The majority of \$1 tickets typically offer a top prize of \$3,000 – \$5,000 or less, while \$2, \$3, \$5, \$10, \$20 and \$50 games offer higher top prizes. The \$20 price point games offer top prizes of \$1 million to \$2.5 million, whereas the \$50 price point offers top prizes up to \$7.5 million. There are also games that provide annuity prizes that are paid out over time. Annuity-style instant games are offered at the \$1, \$2, \$5 and \$10 price points.

While draw games have a set number of drawings scheduled each week, instant ticket games offer the possibility of immediate winning experiences with cash and non-cash prizes. Most instant ticket purchases are impulse buys. Therefore, it is important to create games that are attractive to players, provide frequent opportunities to win, and offer a variety of prizes per game. In evaluating industry best practices related to scratch-off game marketing initiatives, the Texas Lottery has added “call-outs” to the face of certain tickets. These “call-outs” communicate to consumers specific prize amounts and the number of prizes in a game.

### Challenges and Opportunities

Printed instant products have been available in the industry for decades and there has been limited vendor innovation with regard to the style and features of instant products over time. The Texas Lottery’s efforts to keep instant products fresh and interesting for the consumer must now focus on unique opportunities to tweak existing game designs, while developing new and innovative product positioning and marketing strategies. These efforts are critical to reach new players, maintain player interest and ensure existing sales and revenue levels for this product category.

### Key Initiatives and Goals

In order to be responsive to the changing tastes and preferences of consumers, the Texas Lottery must actively explore new instant game opportunities and unique product enhancements that hold the most promise for generating incremental revenue for the state.



### Game Launch Schedule and Plan-o-Gram Implementation

While the Texas Lottery has experienced tremendous success with its instant product category, the agency is exploring new ways to enhance sales based on product marketing and distribution recommendations made by the lottery operator. After carefully reviewing the product portfolio, it was determined that core games such as *Crossword*, *Weekly Grand*, *Break The Bank* and *Bingo*, while successful, may not be selling to their full potential due to the large number of non-base games available.

Core games at all price points are very popular among players. However, these games face heavy competition for retailer display space week after week from non-base games. It is also difficult for new non-core games to gain loyalty among players as the games tend to be over-shadowed by “the next new game.” Based on recommendations of the lottery operator, a new instant product management strategy is being explored that includes:

- Reducing the frequency of new game introductions,
- Increasing the focus on base-game and game suite placement in dispensers, and
- Allowing for consistent merchandising of existing base games and new non-base games.

Previously, the Texas Lottery launched new games once every two weeks. In January 2014, new game launches were reduced to every three weeks, and in March 2014, introductions changed to every four weeks. This change only affects new game launches. Retailers still continue to receive automatic inventory replenishment orders every two weeks or upon request.

The goal of a reduction in the frequency of game introductions is to allow the agency and the lottery operator’s sales force to take a more tactical approach to product merchandising and display at retail. In support of the revised launch schedule and the effort to maximize and advance core game sales, instant game plan-o-grams have been developed and distributed to lottery sales representatives so they can assist retailers with arranging their instant game dispensers with the right mix of core and new games to optimize sales. This initiative is in its early stages and the Texas Lottery will continue to closely evaluate this program and make modifications as needed.

### Spotlight Game Offerings

In FY 2009, the agency introduced its first \$20 “Spotlight” or “Mega” instant game, *\$500,000,000 Blockbuster*. A Spotlight or Mega game is known in the industry as a game that typically has a larger than normal print run with an increased prize payout. In Texas, \$20 games were typically produced at a 3 million print quantity and a 72-percent payout. Utilizing industry best practices, *\$500,000,000 Blockbuster* was produced with a 33 million print-run and a slightly elevated prize payout percentage. The larger quantity and increased payout allowed for the creation of many “call-out” features on the front of the ticket that were appealing to players such as:

- “More than \$500,000,000 in prizes”
- “Win up to \$2.5 million instantly”
- “More than 75 percent payout”
- “50 cash prizes from \$1 million to \$2.5 million”



This game was very successful for the agency in terms of sales and revenue generation, resulting in sales of \$420,597,540 and revenue of \$61,605,387 during the first full year of sales. Capitalizing on the success of \$500,000,000 *Blockbuster*, the agency introduced \$500 Million *Frenzy* in March 2011 and \$500,000,000 *Extreme Cash Blast* in August 2012. These games were equally well received by both retailers and consumers.

Based on the success of the \$20 Spotlight games, the Texas Lottery expanded the concept to the \$10 price point, launching the \$200 Million *Cash Spectacular* game in February 2012. The game was a huge success for the Texas Lottery and its primary beneficiary, the Foundation School Fund. Sixteen weeks after the introduction of the game, the Texas Lottery's instant ticket sales reflected a year-over-year increase of \$161.3 million or 7.36 percent over the previous fiscal year. The \$200 Million *Cash Spectacular* game contributed \$14.1 million in revenue to the Foundation School Fund and paid out an estimated \$56.1 million in prizes to winners during that same period. The game also assisted the agency in reaching record-breaking overall instant product sales levels in FY 2012.

Due to these stellar sales and revenue results, 10X *Mega Money*, the agency's second \$10 Spotlight game, was launched a year later in January 2013. The introduction of 10X *Mega Money* and its supporting advertising campaign proved very successful. The 10X *Mega Money* game generated outstanding sales as compared to past \$10 instant ticket games, including its predecessor, the \$200 Million *Cash Spectacular* game. For the first 26 weeks, it generated \$142 million in sales as compared to an average of \$44.7 million for traditional \$10 instant ticket games and \$112.8 million for the \$200 Million *Cash Spectacular* game.

Based on the sales and revenue results from past and current Spotlight games, the agency will continue to develop and place full advertising support behind these game launch initiatives. In the summer of 2014, the next \$10 Spotlight game, \$200 Million *Cash Blowout*, will be introduced, and a new \$20 Spotlight game is being planned for FY 2015.

### Growth of Core Instant Product Offerings

Core (or base) games are games that are always available for sale because of their long-term, ongoing popularity with players. Core games are important within the Texas Lottery's portfolio as anchors at various price points, mitigating the need to identify and produce additional offerings at a particular price point. Examples of current core games are \$2 *Weekly Grand*, \$2 *Break the Bank*, \$3 *Bingo*, \$3 *Cashword*, \$3 *Loteria*, \$5 *Cashword*, \$5 *Bonus Break the Bank* and \$10 *Bingo*. The Texas Lottery strives to identify unique products that both resonate with players and offer the potential to become core offerings. The Texas Lottery will continue to identify games that it believes can achieve this level of player loyalty.

To further this effort, the Texas Lottery is working to capitalize on the strength of the *Weekly Grand* brand by creating a "family" or suite of games using the *Weekly Grand* brand. The \$2 *Weekly Grand* has been a top-selling game since its launch in the early 1990's. In September 2013, a *Weekly Grand* suite was introduced—\$1 *Weekly Half Grand*, \$2 *Weekly Grand*, \$5 *Bonus Weekly Grand* and \$10 *Super Weekly*

*Grand*. The Texas Lottery's goal is for these games to become core offerings. Sales results and the ability to sustain acceptable sales levels will be analyzed and reviewed to determine the longevity of this suite.

### Game Suites

In addition to *Weekly Grand*, the Texas Lottery introduced another suite of games, called the multiplier suite, in early 2014. These games received full advertising support including TV, radio, outdoor and full in-store POS. This suite offered five different games at the \$1, \$2, \$5, \$10 and \$20 price points—5X *The Cash* (\$1), 10X *The Cash* (\$2), 20X *The Cash* (\$5), 50X *The Cash* (\$10) and 100X *The Cash* (\$20). The games have performed well and all have been reprinted in order to keep up with player demand. The Texas Lottery is already planning a new suite of games to replace the multiplier suite in early 2015.

### Play Books

Play books are a proprietary instant game product produced by one of the Texas Lottery's instant game manufacturers, Pollard Banknote Limited. Just as its name suggests, a play book is a book of instant games. A play book typically sells for \$20 and contains multiple games packaged together that provide a value proposition to the player. Play books have been successfully launched in other jurisdictions, and the Texas Lottery is planning to introduce the first-ever play book in Texas for the 2014 holiday season. Sales results will be evaluated to determine if future play book concepts should be developed and introduced. Other jurisdictions have launched play books containing extended play games like *Crossword* or *Bingo*, or have created game books with all games in the book containing a consistent theme like 7's, gems, or casino-style games.

### Products Geared to Appeal to New Players

As a mature, 22-year-old lottery, the Texas Lottery recognizes that in order to remain relevant and continue to grow, it must attract new players. The Texas Lottery must also achieve this goal within the framework of its traditional lottery (instant and draw) game offerings. Offering licensed/branded instant games and instant games that feature unique prizes represents a significant portion of the agency's strategy to reach new audiences.

### Licensed/Branded Products

As noted above, the Texas Lottery must create products that will engage new consumers. Well recognized brands and licensed properties that have strong consumer affinity can be leveraged to appeal to consumers who may have lapsed in their lottery participation or who have not considered a lottery product trial in the past. The Texas Lottery considers these offerings to be an important part of its product portfolio and works to identify brands that would be well received by consumers. Recent licensed property games include KISS®, Star Trek™, Dallas Cowboys, Houston Texans and Texas Dream Home (a game branded with The Home Depot® logo and offering The Home Depot gift cards and a chance to win a D.R. Horton® Dream Home as promotional second chance prizes).



### Luck Zone Player Internet Site

Product innovation is not always limited to the attributes and qualities of the product itself. Innovation can occur in extensions of the product such as offering promotional second chance drawings for merchandise and experiential prizes. The Texas Lottery continues to identify and develop games that include unique merchandise/experiential prizes that appeal to particular player segments. The Texas Lottery Luck Zone site allows players to create an account and quickly and conveniently enter non-winning scratch-off game tickets in promotional second chance drawings.

### Market Testing of Unique Production Features for Instant Games

While many of the game design changes made by instant ticket manufacturers have been subtle, new production methods are being developed that can be marketed to consumers. One example that the agency has leveraged successfully is where the latex overprint on the ticket is scented and emits a fragrance (e.g., peppermint or chocolate) when scratched. This scent can be combined with the theme of the game to make the product unique for the player.

Another recently introduced production method is to print play areas on the front and back of tickets. This offers players more play action without increasing the size of the ticket. While continuing its focus on keeping administrative expenses in check, the agency will evaluate these and other added-value features that may increase player enthusiasm and, in turn, produce additional game sales and revenue.

## DRAW GAMES

### Background

Most draw games require the player to select from a pool of numbers. For example, when the pool consists of 37 numbers and a player selects five numbers from the pool, the game is described as having a 5-of-37 matrix. In order to claim the top prize, the player's ticket must correctly match all five numbers drawn. Other prizes may be paid for matching fewer than all of the numbers selected. Players may select their own numbers or have them selected by the retailer sales terminal by choosing the Quick Pick option. The Texas Lottery conducts drawings independent of the lottery operator's central computer or gaming system to determine a set of winning numbers for these types of games. Lottery drawings are supervised by lottery security, witnessed by an independent certified public accountant, and open to the public.

The Texas Lottery's current draw game offerings include *Powerball*® with the add-on feature *Power Play*®, *Mega Millions* with the add-on feature *Megaplier*®, *Lotto Texas*® with the add-on feature *Extra!*, *Pick 3*™ with the add-on feature *Sum It Up*®, *Daily 4*™ with the add-on feature *Sum It Up*®, *Cash Five*®, *Texas Two Step*® and *All or Nothing*™.

*Lotto Texas*, *Powerball* and *Mega Millions* are multimillion-dollar rolling jackpot-style games. *Lotto Texas* was the first draw game introduced in Texas in November 1992 and has undergone three game or matrix changes since its introduction. The starting jackpot for *Lotto Texas* is currently \$5 million and the numbers are drawn twice per week. In October 2003, Texas joined the multistate game *Mega Millions* and sales began on December 3, 2003. The *Mega Millions* game matrix changed in the summer of 2005 as a result of the California Lottery joining the game and again in October 2013 to address a lack of large, attention-getting jackpots. Currently, the *Mega Millions* starting jackpot is \$15 million and numbers are drawn twice per week. For an extra \$1 wager, the *Megaplier* feature allows players the chance to increase their non-grand/jackpot prize winnings. Players can win up to \$5 million with the *Megaplier* feature.

Until January 2010, *Mega Millions* was comprised of Texas and 11 other member states including California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Virginia and Washington. In October 2009, a historic cross-selling agreement was reached between the *Mega Millions* member states and the Multi-State Lottery Association (MUSL), which operates *Powerball*, to allow *Mega Millions* states to sell *Powerball*, and *Powerball* states to sell *Mega Millions*. Starting January 31, 2010, *Mega Millions* and MUSL member states could begin offering both games. The Texas Lottery Commission adopted the *Powerball* game rule at the January 6, 2010, Commission meeting, authorizing the executive director to sign the necessary agreements for Texas to begin selling *Powerball* on January 31, 2010. Offering both multi-jurisdictional jackpot games with large population bases has created the opportunity for longer jackpot rolls and record-breaking jackpots, resulting in increased revenue to the Foundation School Fund.

Currently, the *Powerball* starting jackpot is \$40 million and numbers are drawn twice per week. Like *Mega Millions*, *Powerball* also has a multiplier feature, called *Power Play*. For an extra \$1 per play, players can increase their non-grand/jackpot prizes by two, three, four or five times. The Match 5 prize (2<sup>nd</sup>-tier prize) with *Power Play* is \$2 million; all other prize tiers are multiplied by the *Power Play* number that is drawn. In January 2012, the price of a *Powerball* ticket increased from \$1 to \$2. This was a major initiative for the lottery industry to increase the price point on a well-known and strongly recognized jackpot-style draw game brand.

*Pick 3* is a daily non-jackpot game that has typically realized consistent year-over-year sales growth since its inception in October 1993. The game experienced its first sales decrease in FY 2008, due to the addition of the *Daily 4* game. Even with this anticipated cannibalization caused by *Daily 4*, *Pick 3* continues to be one of the agency's best-selling draw games, illustrating that non-jackpot style games can be effective in reaching sales and revenue goals. *Sum It Up* is an add-on game concept first introduced with the *Daily 4* game and then added to *Pick 3* in November 2007. For an additional wager, players can win if the sum of their three numbers matches the sum of the three numbers drawn in the applicable drawing. This provides





players a chance to win even if they do not win on the base game. Starting in September 2013, *Pick 3* drawings increased from two daily drawings to four times daily, six days a week.

*Cash Five* is a roll-down style game that began in October 1995 and remained unchanged until July 2002. In *Cash Five*, when there is not a top-prize ticket sold for a drawing, the prize funds allocated to the top-prize tier “roll-down” to the second-prize tier and that prize amount increases accordingly. A matrix change in 2002 improved the overall odds of winning from 1 in 100 to 1 in 8, changing the game from one of the most difficult five-digit games to win in the country to one of the easiest. *Cash Five* is drawn six days a week.



*Texas Two Step* is a rolling jackpot-style game similar to *Lotto Texas*, but on a smaller scale, with jackpots starting at \$200,000. *Texas Two Step* began in May 2001 and was originally drawn twice per week, on Tuesdays and Fridays. However, after Texas joined *Mega Millions*, *Texas Two Step* draw days were changed to Mondays and Thursdays to avoid direct competition with *Mega Millions*, which had the same Tuesday/Friday draw schedule. *Texas Two Step* has a loyal player base and experiences consistent sales at lower-level jackpots; however, it does respond like any other jackpot game in that, as the jackpot climbs, sales increase.



*Daily 4* is similar in play style to *Pick 3*; however, it also offers an additional play style, Pair Play, which allows players to wager on the first two, middle two or last two numbers drawn. Pair Play is not currently offered on *Pick 3* and this assists in differentiating the *Daily 4* and *Pick 3* games. The *Sum It Up* add-on game feature is also available on *Daily 4*. If the sum of the player’s numbers matches the sum of the four numbers drawn, the player wins *Sum It Up*. This provides players a chance to win even if they don’t win on the base game. Initially, *Sum It Up* was only available on the *Daily 4* game, but later was added to the *Pick 3* game. *Daily 4* follows the same drawing schedule as *Pick 3* and is currently drawn four times daily, six days a week. The *Daily 4* drawing schedule was increased at the same time the *Pick 3* drawing change was implemented.



The *All or Nothing* game originated from the Texas Lottery’s desire to introduce a new, innovative game to the Texas market that was outside of the conventional draw game box. *All or Nothing* was a unique and different draw game because it offered two ways to win the top prize: by matching all of the numbers drawn or by matching none of the numbers drawn. Players can become disappointed by not matching any numbers when they play lottery draw games. In *All or Nothing*, not matching any numbers wins \$250,000! The *All or Nothing* game also allowed the Texas Lottery to introduce two new drawing times (10 a.m. and 6 p.m.). It was also the first Texas game to offer players the opportunity to play and win up to four times per day. The *All or Nothing* draw game also provides the best overall odds of winning out of all the games in the Texas draw game portfolio—1 in 4.5. In addition to the \$250,000 top prize, *All or Nothing* also offers lower-tier prizes of \$2, \$10, \$50, and \$500, depending on how many numbers the player does



or does not match in the drawing. Tickets for *All or Nothing* are \$2 per play and the game has a 12-of-24 matrix. *All or Nothing* became the second \$2 game in the Texas Lottery’s draw game portfolio (joining *Powerball*) and the first \$2 daily game. Designing and introducing draw games at higher price points—a very successful strategy in the instant product portfolio—is a primary goal of the agency. The successful launch of *All or Nothing* was an important milestone. The unique attributes of *All or Nothing* and its price point positioning resulted in the game being recognized in 2013 by the North American Association of State and Provincial Lotteries (NASPL), as the Best New Draw Game introduced in the industry.

### Challenges and Opportunities

One of the most significant differences between the instant and draw game playing experiences is the time that elapses between buying the ticket and finding out if the ticket is a winner. For example, a player who purchases a *Lotto Texas* ticket on a Sunday morning must wait until the *Lotto Texas* drawing on Wednesday night to determine if a prize has been won. In contrast, as soon as an instant ticket is scratched, the player immediately knows if the ticket is a winner. Most instant ticket prizes can be paid immediately at a retail location, creating an opportunity for a subsequent ticket purchase.

Draw games, industry-wide, have relied primarily on jackpot levels to drive sales and revenue generation. Most lotteries are attempting to increase draw game sales by exploring the introduction of higher price points. However, lotteries have struggled in these efforts, as players have become accustomed to playing for multi-million dollar jackpots for a \$1 wager. The *Powerball* price point increase was implemented with a game change that created a value proposition for players and has been a positive step toward expanding price points in the draw game category. This strategy has been very successful with instant tickets and additional draw game initiatives are underway within the industry.

As noted above, lotteries nationally have collaborated to expand the offering of multi-jurisdictional jackpot games (*Mega Millions* and *Powerball*) across significantly larger population bases. This expansion of the jackpot draw game offerings in Texas plus new game concepts that are currently under development require the continued monitoring of jackpot and daily (non-jackpot) game performance for possible modifications and adjustments to the overall draw game portfolio.

Multi-jurisdictional games like *Mega Millions* and *Powerball* are capable of generating jackpots upwards of \$600 million, creating excitement for players and retailers alike, and also driving sales. While the agency enjoys the benefits of these large jackpots and the strong sales associated with them, they can create a phenomenon known in the lottery industry as “jackpot fatigue.” This phenomenon causes players to become desensitized to smaller jackpot amounts, and ever-larger jackpots are required to garner attention and excitement. Lotteries, including Texas, have relied on jackpot-style games to generate large jackpots in an effort to increase sales. However, due to jackpot fatigue, sales and revenue for this type of draw game have generally decreased over time.



New draw games and game changes may require administrative rulemaking and extensive system software development prior to introduction. Additionally, there may be costly advertising expenditures to communicate to the public about the new product or changes to an existing product. Draw games differ from instant tickets, as the instant game serves as its own communication vehicle due to its visible placement at retail. The additional requirements for draw games present challenges limiting the agency's ability to frequently introduce new games or make rapid changes to existing games.

Lastly, there are certain draw games offered in other lottery jurisdictions that are not being pursued in Texas as they would require specific legislation; for example, Keno, which is traditionally sold in bars and restaurants, and sales terminal-generated raffle games.

### Key Initiatives and Goals

#### Price Point Expansion

While challenging, it is important to continue efforts to expand the price point offerings for draw game products. This has been a key driver in growing instant ticket product sales and revenue in Texas. Lotteries have worked collaboratively to redesign the *Powerball* game and reposition it at a \$2 price point. *Powerball* now features significantly higher starting jackpots—\$40 million—than any other jackpot game available in the industry.

The Texas Lottery has conducted research on other new \$2 draw game concepts that would also be positioned at the \$2 price point along with *Powerball* and *All or Nothing*. The agency is preparing to introduce *Texas Triple Chance*. The game features a \$2 price point that gives players three chances or sets of numbers and provides three ways to win in each play. The Commission approved the new game rule in February 2014, but directed staff not to begin sales or expend agency funds to implement *Texas Triple Chance* pending the issuance of a Texas Attorney General opinion reviewing the game (pursuant to Request No. 1185-GA).

Another industry-wide initiative currently in final development would create a \$5 draw game. Known as the National Premium Game, this game concept incorporates numerous promotional game features in addition to the base game matrix and introduces a strong licensed property brand into the draw game portfolio. The use of licensed property games has been successful with instant tickets. The National Premium Game leverages the *Monopoly*® brand to create new play experiences and offers added value through promotional second chance drawings where players enter for an opportunity to be selected to join a studio audience for a chance to compete for prizes during a nationally televised game show. This unique promotional draw game feature offers players an exciting new game element. This game is tentatively scheduled to launch in the fall of 2014 with the game show beginning in early 2015. Agency staff is working to bring the proposed game rule before the Commission in summer 2014 to consider Texas' participation in this new game.

#### Evaluation of Jackpot Game Portfolio

With the planned introduction of the new \$5 National Premium Game, the Texas Lottery will need to closely monitor sales performance among all of its jackpot games to determine the need for any modifications or adjustments.

#### Add-on Features

Add-on features, such as *Megaplier*, *Power Play* and *Extra!*, have been successful in generating incremental sales and revenue, and the Texas Lottery will continue to explore additional add-on concepts that may offer incremental sales and revenue potential for the draw game portfolio.

#### Draw Game Cross Promotion

The Texas Lottery has been very successful in designing instant games that feature or highlight games from its draw game portfolio. A prize in these instant games is a free play in the associated draw game. These games have performed well and introduced instant game players to the Texas Lottery's draw game product offerings. The agency is launching an *All or Nothing*-themed instant game in the summer of 2014. The agency will continue to identify opportunities to cross-promote instant and draw games.

#### Cash Five Game Modification Research

*Cash Five* is a mature game that has experienced sales declines over time. The Texas Lottery plans to explore options to modify or replace the current *Cash Five* game. Due to several recent national game initiatives and other in-state draw game opportunities offering greater revenue potential, there has not been an appropriate time in the game software development cycle or adequate advertising support dollars available to pursue this initiative. The agency expects to conduct this evaluation within the next two fiscal years and, if appropriate, proceed with a game modification or replacement.

#### Packaged Draw Game Play

The Texas Lottery also plans to explore packaging or bundling draw games for ease of purchase by players. This initiative will allow the agency to promote lesser played games and to potentially expand draw game product trial. This initiative also requires a significant software development effort and implementation will be coordinated with other draw game initiatives.



# GROSS SALES

## Background

Gross sales are critical to the Texas Lottery’s mission of generating revenue for public education, veterans’ assistance and other worthy causes.

The Texas Lottery achieved annual sales growth in consecutive fiscal years from 1999 to 2006 following the removal of limits on the agency’s prize payout percentage. These gains were achieved through restoration of past payout percentages along with innovations in the agency’s instant and draw product categories. However, the effects of being a mature lottery began to show as sales plateaued, fluctuating between \$3.6 billion and \$3.7 billion from FY 2006 to 2008.

Since FY 2009, the Texas Lottery has experienced significant sales growth. Several different strategic sales initiatives contributed to this achievement, including an enhanced focus on retail distribution channel expansion, implementation of a performance-based retailer incentive program, and continued product innovation, including new in-state and national draw game introductions. In addition, the agency’s current lottery operations and services contract with GTECH included enhancements to the sales organization along with new equipment platforms and marketing support for lottery retailers. The table below illustrates the growth in sales over the three most recent full fiscal years.

	SALES ACTUAL FY 2011 (IN MILLIONS)	SALES ACTUAL FY 2012 (IN MILLIONS)	SALES ACTUAL FY 2013 (IN MILLIONS)
Total Sales	\$3,811.27	\$4,190.82	\$4,376.29

Total sales for the three-year period grew 14.8 percent, culminating in record sales of \$4.38 billion in FY 2013.

The Texas Lottery was equally successful when compared to its peers within the United States lottery market. Among the Top 10 states in gross lottery sales over the most recent five full-year period (2008-2012, where data is available), Texas significantly exceeded the average sales growth of the group, with sales up 14.15 percent in Texas versus an average 12.22 percent for the other top-selling lottery jurisdictions, as illustrated on the following page.

## Texas vs. Average Growth Rate of Top Selling Lotteries (FY 2008 - FY 2012)

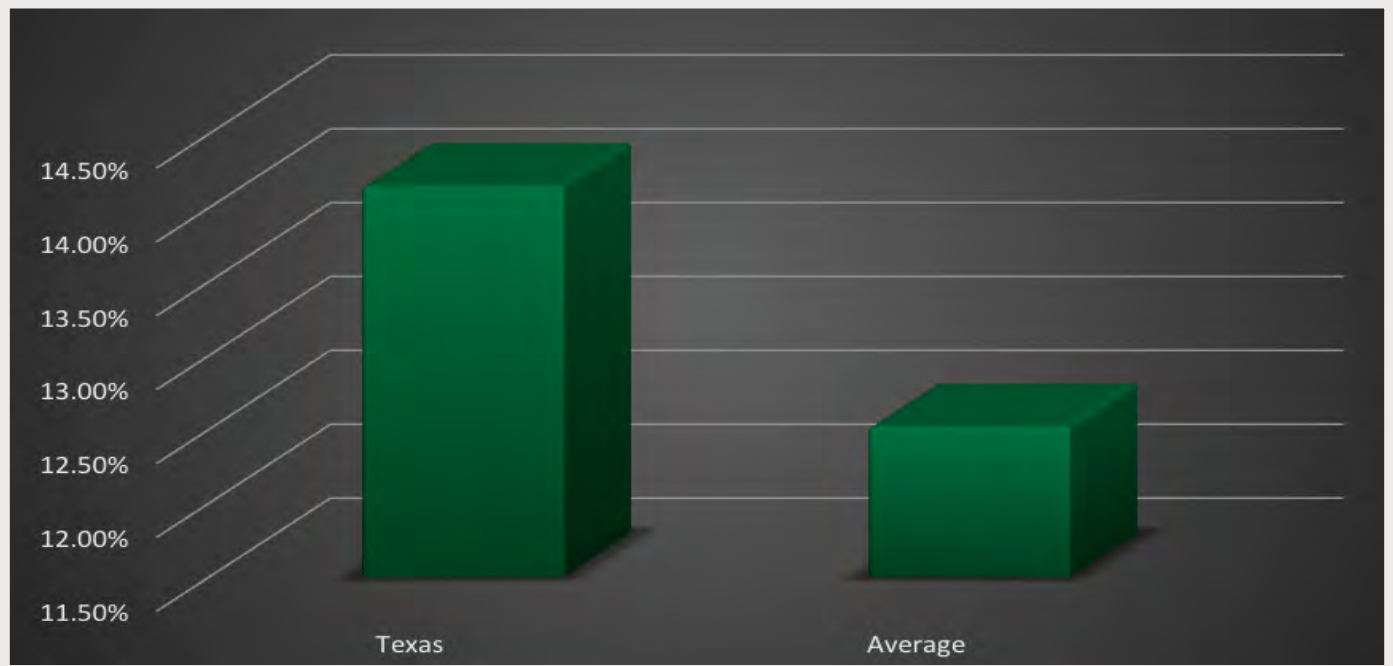


Chart Data Pulled from La Fleur’s 2013 World Lottery Almanac

There are a number of controllable and uncontrollable variables that impact lottery sales. Examples of variables outside the agency’s control include general economic conditions in the state, weather conditions, and the level of jackpots on certain draw product offerings (jackpot “rolls”). The focus of the business plan is the establishment and monitoring of goals associated with key factors tied to agency performance, with an emphasis on controllable variables that influence the outcome of these performance factors. Arguably, every performance factor tracked and monitored in this plan contributes to the agency’s gross sales and, ultimately, net revenue for the state. However, there are certain factors and key operational functions that are more obvious in their direct impact on efforts to grow sales.

These include the following:

- Distribution Channel Expansion - The number and quality of lottery retail locations.
- Retailer Incentive Program - Same-store sales growth.
- Advertising Expenditures and Efficiency - Amount and effectiveness of advertising.
- Product Mix and Game Portfolio Management - Lottery product mix, game design (product diversity, game odds and payout design) and product differentiation.

Each of these performance factors has been addressed in detail in the business plan.



Challenges and Opportunities

The Texas Lottery has enjoyed great success through several effective programs that have driven sales performance. While proud of those results, the agency recognizes these sales levels may not be sustainable and that future results may be flat or slightly decline. The Texas Lottery faces competition from other gaming activities, both legal and illegal, in Texas and in surrounding states.

The Texas Lottery also must compete with other forms of entertainment as adult Texans make discrete choices with their discretionary income. The Texas Lottery is a mature lottery offering a full suite of instant games with price points ranging from \$1 – \$50 and eight different draw games, including a wide selection of daily draw games and in-state and multi-jurisdiction jackpot games. There are limited traditional lottery game concepts available that Texas does not currently offer, creating a lack of opportunity for new product offerings.

These realities loom in opposition to continued sales growth. Additionally, limitations on the agency’s advertising budget restrict the agency’s ability to effectively reach Texans across all media markets and cause the agency to limit advertising to only a small portion of its product offerings to the exclusion of other advertising opportunities. Several draw games have received little or no advertising support for many years due to limits on the advertising budget. One example is *Cash Five*, which has sustained sales declines in all but two fiscal years dating back to FY 1997. Market research data collected by the agency also reflects a significant lack of public awareness of many of the agency’s lottery products.

The agency continues to strive to overcome these challenges by pursuing the opportunities outlined in this business plan with a particular emphasis on the four performance factors above, as they relate to gross sales.

Key Initiatives and Goals

Texas Lottery gross sales have benefited from a number of large scale initiatives that the agency has implemented in recent years, including changes in the lottery operator contract, the new Retailer Incentive Program and several product initiatives that have helped to fill out and supplement the product portfolio. It is realistic to note that the most significant sales benefits of these initiatives have been achieved. Future sales benefits from these efforts are likely to be smaller and more muted in their impact.

At the time of this writing, the agency anticipates FY 2014 sales comparable to the record-breaking sales achieved in FY 2013. The agency has seen a softening of sales in recent months. With this flattening of sales and recognition that future growth will occur through execution at more of a tactical level related to the performance factors in this plan, it is anticipated that the agency will see a slight retrenchment in overall gross sales performance in FY 2015 as detailed in the chart on the following page.

	SALES ACTUAL FY 2013 (IN MILLIONS)	SALES PROJECTION FY 2014 (IN MILLIONS)	SALES GOAL FY 2015 (IN MILLIONS)
Instant Product	\$3,222.59	\$3,258.20	\$3,274.49
Draw Product	\$1,153.69	\$1,131.95	\$1,090.33
Total Sales	\$4,376.29	\$4,390.15	\$4,364.82

These projections reflect a slight increase in overall sales for the instant product portfolio in FY 2015 sales. However, the draw product portfolio is anticipated to experience a decline. As noted in the Product Mix and Game Portfolio Management section of this plan, the agency has identified potential opportunities for new and modified draw game offerings that would support sales (e.g., the National Premium Game, *Texas Triple Chance*). However, the sales impact of these initiatives have not been included in the agency’s gross sales projections for FY 2015, pending the Commission’s consideration for adoption of the National Premium Game rule and the Attorney General’s opinion on *Texas Triple Chance*.

NET REVENUE

Background

The Texas Lottery’s mission is to generate revenue for the state of Texas through the responsible management and sale of entertaining lottery products. To achieve this mission, the Texas Lottery incorporates the highest standards of security and integrity, sets and achieves challenging goals, provides quality customer service and utilizes a TEAM approach.

The Texas Lottery’s primary performance factor related to its mission is the generation of net revenue for the state. Every agency program, performance factor and initiative is designed with net revenue in mind. The agency also has a significant regulatory responsibility to protect the interests of the citizens of Texas. The agency is committed to providing products that are fun and entertaining while ensuring all games are delivered in a safe and secure manner and that the integrity of the games is above reproach. The agency must invest in the systems, equipment and personnel necessary to ensure public trust in the *Games of Texas*.



The Texas Lottery was launched in 1992 under the public-private Texas Model, placing emphasis on outsourcing functions more efficiently performed through private sector contracting, while maintaining the critical contract oversight and administrative responsibilities important to the state. The Texas Lottery continues to emphasize Fiscal Accountability to support a foundation of Customer Responsiveness and secure lottery operations while focusing on administrative efficiencies that will optimize net revenue for the state both now and in the future.

While the agency pursues a number of program initiatives to support gross sales, the agency is equally committed to administrative efficiency. This includes careful monitoring and ongoing evaluation of the primary contributors to administrative overhead:

- Negotiated rates for outsourced (contracted) services
- Retailer compensation and incentive programs
- Standard agency overhead costs including key lottery programs (e.g., security, drawings, claim centers, etc.)

Under the State Lottery Act, the agency is authorized to pay costs incurred in the operation and administration of the lottery, including any fees received by a lottery operator, provided that the costs incurred in a fiscal biennium do not exceed an amount equal to 12 percent of the gross revenue accruing from the sale of tickets in that biennium. A minimum of 5 percent of this amount is to be allocated as compensation paid to sales agents (licensed retailers). The base retailer commission has remained at 5 percent since the inception of the lottery, leaving the remaining 7 percent available for other administrative expenses, subject to legislative appropriation. The Texas Lottery has consistently kept administrative expenses well below 7 percent of gross revenue (sales).

In the area of retailer compensation, the agency has focused on its retailer incentive program as a supplement to the existing 5 percent retailer commission in the State Lottery Act. This program is performance-based and rewards retailers based on same-store incremental sales results. For more information on this program, see the Retailer Incentive section of the business plan.

The agency contracts for a number of third-party services in operating the lottery. The lottery operations and services, advertising and instant ticket manufacturing contracts are the Texas Lottery's three largest contracts in dollar terms, but there are numerous other services that the agency must procure. The agency aggressively negotiates all contracts to ensure the state receives best value and routinely reviews existing contracts to identify efficiencies that can be achieved in future procurements. The recent lottery operations and services contract is the best example of the agency's efforts in this regard. Through this procurement and the contract negotiations that followed, the agency was able to obtain significantly expanded services including:

- State-of-the-art technology and retailer/player equipment with faster, easier to use terminals and a more reliable telecommunications network, including new player communication displays
- Increased levels of security and redundancy along with expanded capacity to handle extremely high transaction volumes generated daily by the Texas Lottery
- New lottery game management system featuring enhanced levels of service and efficiency to support lottery players and retailers
- New system tools allowing the Texas Lottery to bring exciting new lottery games and promotions to market more quickly in response to consumer demand

Additionally, the agency was able to achieve significantly reduced pricing under the new contract. Under the prior contract, the lottery operator compensation rate was 2.6999 percent of sales. Under the new contract, this was reduced to 2.2099 percent of sales. This reduction is anticipated to result in savings to the state of over \$18 million annually beginning September 1, 2011, and more than \$160 million over the nine-year base term of the contract, based on ticket sales levels at the time of contract award. As ticket sales have grown since the new contract started, these savings are likewise expected to increase.

The agency has a keen focus on its own day-to-day administrative expenses, and this focus continues to yield efficiencies over time. For example, the agency has restructured its operations on multiple occasions, including the consolidation several years ago of the Marketing and Lottery Operations divisions of the agency into one operating unit. This restructuring yielded salary savings and allowed the agency to streamline its strategic execution in support of lottery revenue. The agency has also reduced the number of claim centers from 24 to 16, while maintaining the agency's commitment to Customer Responsiveness. The agency's comprehensive efforts resulted in administrative expenses of less than 4.4 percent of total sales, inclusive of vendor contract expenses, in FY 2013.

The agency's continued focus on its performance factors culminated in a record revenue year in FY 2013, with total transfers to the state exceeding \$1.2 billion, marking the 10<sup>th</sup> consecutive year the Texas Lottery has generated more than \$1 billion in contributions to the state of Texas. In FY 2013, \$1.149 billion went to the Foundation School Fund. The Fund for Veterans' Assistance, administered by the Texas Veterans Commission, and other programs as determined by the Legislature also benefit from lottery proceeds. Over the last three years, lottery net revenue transfers have grown 4.75 percent annually, representing overall growth of 18.59 percent during that time.



## Total Transfers to State



Source: Texas Lottery Audited Financial Statement

## Challenges and Limitations

The Texas Lottery is committed to continuing to achieve its primary mission of generating revenue for the state. Sales growth and administrative efficiency are key drivers in revenue generation. However, as detailed in the prior section, continuing to grow lottery sales in the current environment will be challenging.

Further opportunities to enhance administrative efficiency will be limited. As a mature 20+ year old organization, the Texas Lottery has had the opportunity to extensively evaluate all aspects of its operations to identify and implement internal administrative efficiencies, such as those previously identified. In addition, the agency has had tremendous success in negotiating favorable pricing and services with its vendors. Although the agency has strenuously emphasized Fiscal Accountability, limited opportunities exist in the near term for significant cost reductions that might yield further administrative efficiencies.

Base lottery retailer compensation in Texas is among the lowest in the United States lottery industry. The agency has supplemented these low rates through its retailer incentive program and successfully leveraged this program to generate incremental revenue. The agency continues to evaluate and modify the retailer incentive program, as necessary, to drive retailer interest in supporting lottery sales. However, program changes at this point in the life of the program are more incremental than substantial.

## Key Initiatives and Goals

The agency is confident in its ability to continue to generate significant revenue for the Foundation School Fund and other state programs. However, the agency foresees the potential for a slight decline in net revenue contributions to the state in FY 2014 and 2015 from the record levels attained in FY 2013, as detailed in the chart below.

	REVENUE ACTUAL FY 2013 (IN MILLIONS)	REVENUE PROJECTION FY 2014 (IN MILLIONS)	REVENUE GOAL FY 2015 (IN MILLIONS)
Total Revenue	\$1,214.10	\$1,192.38	\$1,175.27

This projected net revenue performance in FY 2014 and 2015 would result in the third- and fourth-highest revenue transfers to the state in the history of the lottery.